

National Bank of the Republic of Macedonia



**Quarterly Report
November 2018**



Contents

Introduction	3
I. Macroeconomic developments.....	6
1.1. International economic surrounding	6
1.2. Domestic supply	11
1.3. Aggregate demand.....	15
1.3.1. Private consumption	15
1.3.2. Public consumption	16
1.3.3. Investment consumption	17
1.3.4. Net external demand	18
1.4. Employment and wages	18
1.5. Inflation	21
1.5.1. Current inflation	21
1.5.2. Inflation expectations	24
1.6. Balance of payments.....	24
1.6.1. Current account.....	25
Box 1: Foreign trade of goods and movement of the Nominal and the Real Effective Exchange Rate (NEER and REER).....	26
1.6.2. Financial account.....	30
1.6.3. International investment position and gross external debt.....	31
II. Monetary policy.....	34
2.1. Bank liquidity	37
III. Financial market developments.....	38
3.1. Unsecured interbank deposit market.....	39
3.2. Government securities market.....	39
IV. Monetary and credit aggregates.....	43
4.1. Monetary aggregates	43
4.2. Lending activity.....	46
V. Public finance.....	49
VI. Macroeconomic forecasts and risks	52
6.1. Underlying assumptions in the external environment forecast	53
6.2. Forecast and effects on monetary policy	55
6.3. Comparison with the previous forecast	61



Introduction

During the third quarter of 2018, the NBRM eased the monetary policy, thus reducing the policy rate from 3% to 2.75%¹. The decision to cut the NBRM policy rate, for the second time since the beginning of the year, was made in conditions of sound economic fundamentals and absence of imbalances, as seen through the continuous favorable movements on the foreign exchange market, the solid external position and the stable expectations of economic agents. In the third quarter of 2018, the NBRM intervened on the foreign exchange market by purchasing foreign currency, the foreign currency position of the banks was maintained at a solid level, and the foreign reserves increased and were kept in a safe zone. Favorable shifts were registered in the deposit base and the lending activity of banks, which is also a signal of stabilization of the expectations of economic agents. Observing risks, during this quarter, risks of external environment in the short and the medium run were assessed as less favorable, and mainly associated with the increase in protectionism in trade, tightening of the global financial conditions, as well as geopolitical tensions and uncertainties, including those that arise from the Brexit negotiations.

The latest October cycle of macroeconomic forecasts for the current and the next two years indicates certain changes compared to the April forecast. They mainly arise from the performance in the first half of 2018 when the economy registered lower growth than expected, which is mainly reflection of the drop in investments, amid decelerated performance of public infrastructure investments. However, the contribution of net export demand was positive and more favorable than expected. **Such developments in domestic demand, assessed as temporary, have conditioned downward revision of the expected economic growth for 2018. On the other hand, the estimates for the stability of domestic fundamentals and the features of the external environment remain relatively solid.** Hence, the October macroeconomic scenario for 2019 and 2020 preserves the forecasts for relatively solid economic and credit growth, absence of significant price pressures and balance of payments position that provides adequate level of foreign reserves. Such forecasts imply a stable domestic political environment and in particular a continuation of the policy of supporting the overall investment activity in the economy.

Changes also occurred in the expected movements of the key indicators of external environment in the period between both projections. Forecasts for the growth of **foreign effective demand** have been moderately revised downwards for 2018 and 2019 in relation to the April expectations, largely as a result of the expectations for slower economic growth in Germany. Observing dynamics, the period 2018-2020 expects gradual moderate acceleration of foreign demand, with a growth of around 2%. In contrast, **foreign effective inflation** has been revised upward in 2018 and 2019. Moreover, it is expected to accelerate in 2020, with a stable movement amounting to slightly below 2%. Forecasts for annual changes in **primary commodities prices** on the world markets for 2018 were mainly revised upwards in relation to the April forecasts, whereas for 2019, most prices were revised downwards, except the oil prices. Thus, the level of primary commodities prices will still be higher, compared to the previous forecasts. Dynamically, after the growth in 2018, in 2019 and 2020 most price categories are expected to increase, or to be downwardly adjusted. Exceptions are the prices of primary food commodities that are expected to increase over the two years.

The latest projections, same as the April forecasts, show stable growth trend of the domestic economy. However, the expected growth rate for 2018 was revised downwards from 3.2% to 2.3%. The downward correction of the expected economic growth for 2018 reflects the performance in the first half of the year, when the growth was significantly lower than expected in the April forecast (1.6% versus the expected 3.3%). This deviation was mostly due to the weaker investment activity. However, such unfavorable investment trends are considered to be temporary, thus expecting a revitalization of the investment activity already in the second half of the year, partly related to the start of the temporary delayed public infrastructure projects. **The estimate for economic growth of 3.5% was maintained for 2019, while in 2020 a moderate acceleration of the economic growth is**

¹The decision was taken at the meeting of the Operational Monetary Policy Committee held on 14.8.2018.



expected, which according to the current estimates would reach 3.8%. For this forecast period, the growth assumptions remain the same, mainly driven by exports and investments, despite the somewhat less favorable external environment and the increased exogenous risks compared to previous perceptions. The main growth factors, as in the previous forecast cycle, continue to include the activity of new export foreign owned companies, the estimates for a further solid inflow of new foreign investments, public investments in road infrastructure, which are expected to accelerate from the second half of 2018, as well as the growth in disposable income and stable household expectations. Taking into account the above, the growth structure remains similar to the expectations in the April forecasting round. Observed the GDP spending components, exports of goods and services are expected to have the highest positive contribution to growth in 2019 and 2020. Such assessments are based on the expectations for further increase in activity of foreign owned companies, inflow of new foreign investments, favorable global environment and recovery of some of the traditional export sectors. In addition to exports, growth in the next two years will also be supported through investment activity, amid stable environment, further growth of foreign investments and continuation of the cycle of public capital investments. The favorable economic environment is expected to stimulate further growth of private consumption by increasing wages and employment in the private sector, and additional impact is expected from the credit support of the banks. The growth of domestic demand and export components is expected to increase imports, but it is estimated that the increase in imports will be in line with the fundamentals and will not distort external balance. In the longer run, in 2021, the Macedonian economy is expected to grow at a rate of around 4%.

Credit activity of the banking sector would still be a major supportive factor for the economic growth. In the first 10 months of 2018, amid accelerated growth pace of deposits, as a main source of financing to credit activity, as well as stabilization of the expectations of economic agents, the credit activity grew, at a faster pace than expected. Thus, for 2018, in accordance with the performance since the beginning of the year, an upward correction was made in loans to private sector, with a credit growth forecast of 8.4%, versus 6.5% from the April forecast. Similar growth dynamics of the credit activity is expected in 2019 in the amount of 8.5% (7.7% in the April forecast), which will continue in the coming period (2020-2021). The estimates for acceleration of the credit growth rely on the assumptions for stable expectations, growth of the deposit base and favorable capital and liquidity position of the banks. In accordance with the estimates for stable environment and intensification of the economic activity, and given the dynamics of the deposit base in the first nine months of the year, for 2018, total deposits are expected to increase by 10.2% (6.4% in the previous forecast), while for 2019 they are expected to equal 7.7% (6.5% in the April forecast). In the following period as of 2021, amid estimates for economic growth and further increase in the propensity for saving in banks, a deposit growth of 8.6% on average is expected.

Regarding the future price trajectory in the domestic economy, the latest forecasts point to environment of stable prices, without major inflationary pressures. The inflation forecast for 2018 was corrected downwards, i.e. the inflation rate was revised to 1.6% (as opposed to 2% in the April forecasts) mainly due to the current lower performances. The inflation rate in 2019 is expected to equal 2%, as in the previous forecast cycle, while the growth dynamics of domestic prices of around 2% is expected to continue in the following period (2020-2021). These estimates reflect the lower price movements in the previous period, as well as the expected upward movement of import prices of food and energy and foreign effective inflation. Moderate pressures on inflation are also expected from the domestic demand, in conditions when the output gap is being estimated as slightly positive during the entire forecast horizon.

The latest October forecasts of the external sector dynamics in the period 2018-2021 still point to moderate current account deficit, of around 1.3% of GDP (on the average for the period), which will be entirely covered with the financial account flows, which will enable further growth of the foreign reserves and their maintenance at an appropriate level. These estimates on the average meant a slightly lower current account deficit as opposed to the expectations in April (1.6% of GDP, for the aforementioned period on the average). Such change, is largely due to the better balance of primary income, while the higher energy prices resulted in higher trade deficit compared to the April forecast. Observing the annual dynamics, **the October forecasts in 2018 expect a tightening of the**



current account deficit by 0.5 percentage points of GDP compared to 2017, amounting to 0.5% of GDP. The improved balance in current transactions were mostly due to further improvement of the trade deficit, mainly due to the higher surplus in services. **In 2019 and 2020, the current account deficit is expected to slightly deepen to 1.5% and 1.7% of GDP, respectively.** Furthermore, in 2021, a stabilization of the current account deficit is expected at around 1.6% of GDP. The balance of goods and services is expected to improve in 2019, with a slightly lower deficit which will remain at the same level in 2020. The strong utilization of the capacities of the new foreign companies is expected to further support the trade balance, coupled with positive performances of part of the traditional export sectors and the increased surplus in services. The primary income deficit is expected to moderately increase in the period 2019-2020, due to the increase in the foreign investors' income in the economy. At the same time, the secondary income surplus is expected to further decline gradually and moderately, in the absence of shocks which would affect its dynamics. As a whole, the current path of the current account deficit and its structure indicate favorable external position and absence of imbalances in the economy. **Analyzing the financial account, the current account in the aforementioned period 2018-2021 is expected to be funded through non-debt and debt flows i.e. foreign direct investment and borrowing of the public and private sector abroad.** In the period 2018-2021, the current account deficit is expected to be fully covered by financial flows, which will ensure additional increase in the foreign reserves. The foreign reserves adequacy indicators show that they were in the safe zone during the forecast horizon.

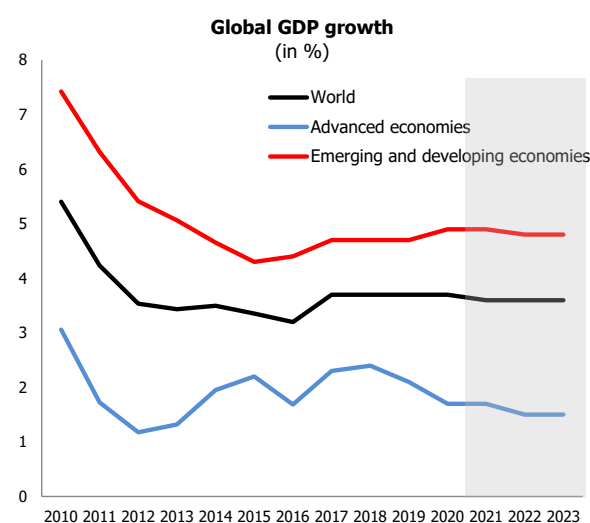
Generally speaking, the latest macroeconomic forecasts point to safe and sound fundamentals of the domestic economy, with potential for solid growth supported by the banks' lending activity, amid absence of inflationary pressures and maintenance of favorable external position. This scenario assumes a stable and predictable domestic environment, further inflow of foreign investments, strengthening of the public infrastructure cycle, and relatively favorable external environment. Any lack of materialization of the embedded assumptions or pronounced adverse risks may cause deviations from the forecast path of the key indicators. Positive risk, which is not embedded in this forecast cycle, is the opportunity to accelerate the Euro-Atlantic integration process, which can certainly have beneficial effects on the economy. In the period ahead, the NBRM will closely monitor the trends and changes in the domestic and external environment, in light of the monetary policy conduct.



I. Macroeconomic developments

1.1. International economic surrounding²

The global economy was marked with favorable performances in the second quarter of 2018, with solid economic growth rates in both developed and developing countries. Thus, despite the slight deceleration compared to the previous quarter, the euro area registered an increase of 2.1% on an annual basis, while the US economy continued the trend of accelerating economic activity, mainly driven by the fiscal stimulus. The expectations indicate that the favorable global economic performances will further continue, with an economic slowdown in the medium term, thus the growth is expected to reach the rates of potential growth, especially in developed economies. The latest projections of the International Monetary Fund indicate global economic growth of 3.7% in 2018 and 2019 respectively, and 3.6% in 2020-2023 on average. The increase in protectionism in trade, tightening of the global financial conditions, as well as the geopolitical tensions and uncertainties, including the Brexit negotiations, are considered as risks that could have adverse effects on the world economy. In the second quarter, there was certain global deceleration of inflation compared to the first quarter, with lower inflation rates being registered in both developed and developing countries. However, as a result of the mostly higher primary commodities prices in the last period, higher inflation rates are expected in both groups of countries for 2018. The assessments for greater global utilization of production facilities are still expected to gradually accelerate inflation.



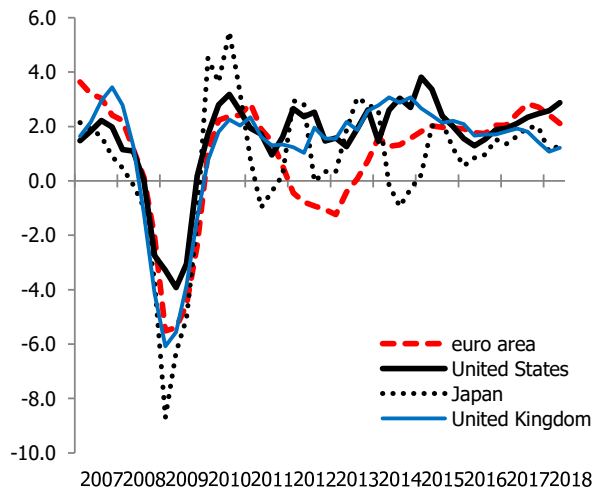
Source: IMF, WEO October 2018.

The favorable global economic developments continued in the second quarter of 2018. In addition, the positive economic performances were largely dispersed by country, with solid growth rates in both developed and developing countries. The economic growth rate in the Euro area in the second quarter amounted to 2.1% annually, which is a solid performance although it is a slight deceleration compared to the first quarter. The growth in the Euro area is mostly due to the strong personal consumption and investments, amid favorable movements on the labor market. In the US, due to the fiscal stimulus of tax reforms, the record low level of unemployment and positive effects on the personal consumption and investments, the economic activity registered a growth rate of 2.9% on an annual basis, which is an acceleration compared to the previous quarter. The UK registered an insignificant acceleration in economy, despite the high political insecurity which arises from the Brexit negotiations. Slight economic acceleration driven by the stimulating monetary policy was registered in the Japanese economy. When it comes to fast-growing countries, the Brazilian economy further decelerated, due to domestic political turmoil. On the other hand, China and India registered solid economic growth rates in the second quarter (6.7% and 8% on an

²The analysis is based on the IMF's *World Economic Outlook* of October 2018; the ECB's *Economic Bulletin*, the announcements of *Markit Economics*, the World Bank's *Global Economic Prospects*, the reports of *Bloomberg*, *Capital Economics*, *Reuters* and *Trading Economics*, the monthly reports of the International Energy Agency and the weekly reports of the National Bank of Greece.

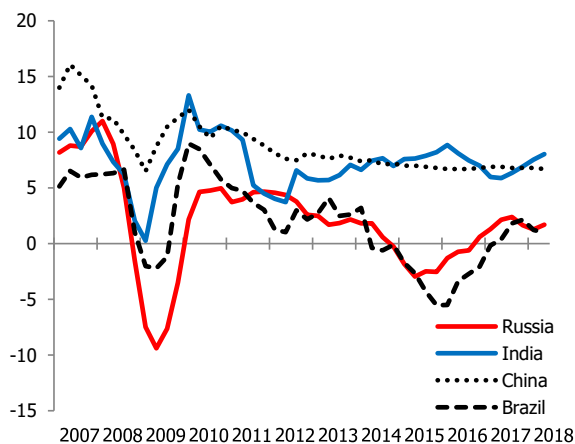


Real GDP growth in advanced economies (year-on-year percentage changes; quarterly data)



Source: OECD.

Real GDP growth in emerging economies (year-on-year percentage changes; quarterly data)



Source: OECD and IMF.

annual basis, respectfully), with a certain acceleration in the economic activity registered in Russia.

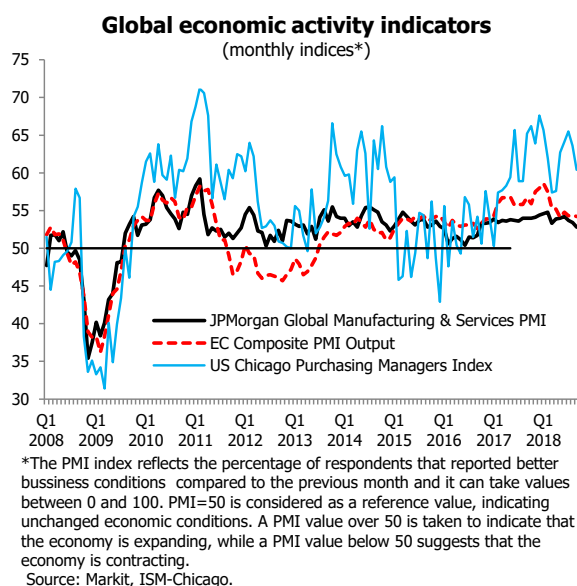
The high frequency survey indicators - PMI in the third quarter are slightly below the average value in the second quarter. The average of the PMI index in the period July - September equals 53.3 (54 in the second quarter), which probably points to moderate acceleration of the global economic activity in this period.

According to the October projections of the IMF, the global economic growth rate is expected to equal 3.7% in 2018 and 2019 respectively, and 3.6% in 2020-2023 on average.³ In the short term, in conditions of stimulating monetary policy in developed countries and the effect of the fiscal stimulus in the US economy, the solid economic growth rates are expected to continue. However, the current trade tensions and the decrease in trade can have serious adverse effects on the global economy. In the medium run, the expectations point to deceleration of the global economic growth, expecting most of the developed countries to grow at rates similar to their prospective ones.

The recent period registered increase in certain risks that could adversely affect the economic activity worldwide. Thus, the main risks include the growing protectionism in trade, especially the trade tensions between the US and China, further tightening of financial conditions, which particularly affects the emerging economies, the reforms in China and geopolitical tensions in the world, including the uncertainty related to Brexit in early 2019.

The second quarter of 2018 registered certain slowdown in the global inflation compared to the first quarter. Moreover, the slowdown in inflation was also recorded in both, developed and developing countries. Thus the average inflation rate in the period April-June in developed countries amounted to 1.5% (2.3% in the first quarter), while in the emerging economies it equaled 2.3% (against 3.4% in the first quarter). However, the expectations for 2018 acted towards higher inflation rates in both groups of countries, mostly due to the increase in the prices of primary commodities in recent period. Gradual decrease in the oil prices that would affect the decline in inflation is expected in the medium run, but on the

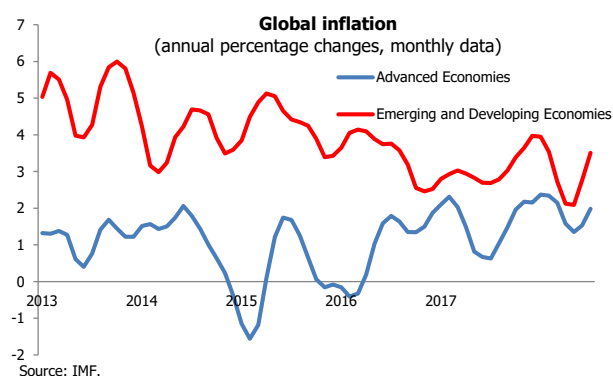
³ In October the IMF revised the April forecasts for 2018 and 2019, estimating that the global real GDP growth will be 3.9%, respectively.



other hand, the growing utilization of production facilities will have an opposite effect on the global inflation rate.

Despite the slight slowdown in the first quarter, the Euro area registered a solid annual economic growth rate in the second quarter of 2018. In the second quarter, the real GDP growth rate amounted to 2.1% (2.4% in the first quarter) annually, while the quarterly growth rate equaled 0.4%, same as in the first quarter. The synchronicity and the relatively wide dispersion by country feature the economic performances in the Euro area. The strong private consumption amid favorable conditions on the labor market, the wage growth, as well as the ECB's stimulation monetary policy are considered to be the reasons for such performances. Furthermore, the investments which are stimulated by the favorable financing conditions and the increase in the companies' profitability positively affected the economic results in the Euro area. The latest ECB forecasts from September indicate increase in the real GDP in the Euro area of 2% in 2018, 1.8% in 2019 and 1.7% in 2020⁴, thus expecting further positive contribution of the solid global demand to the exports in the Euro area.

The third quarter of 2018 registered accelerated inflation in the Euro area compared to the second quarter. The average annual inflation rate in this period amounted to 2.1%, which is higher compared to the average rate of 1.7% calculated in the second quarter. The main reason for inflation acceleration is the growth in energy prices, which is generally driven by the increase in oil prices in the past period. Moreover, accelerated inflation occurred amid high level of utilization of facilities and favorable conditions on the labor market which result in wage growth. The latest ECB forecasts from September remained unchanged relative to those in June and indicate that the inflation rate in the Euro area is expected to equal 1.7% in 2018, 2019 and 2020, respectively.

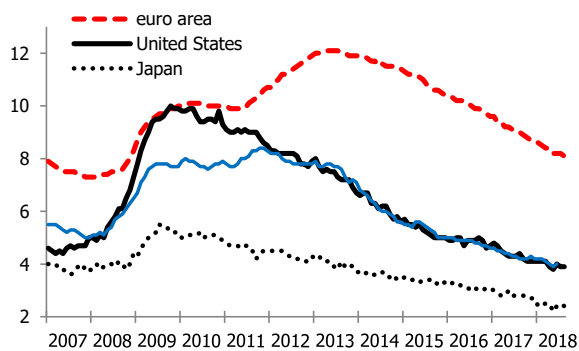


⁴ In September, the ECB revised the June forecasts for 2018 and 2019, estimating that the Euro area real GDP growth will be 2.1% and 1.9%, respectively.



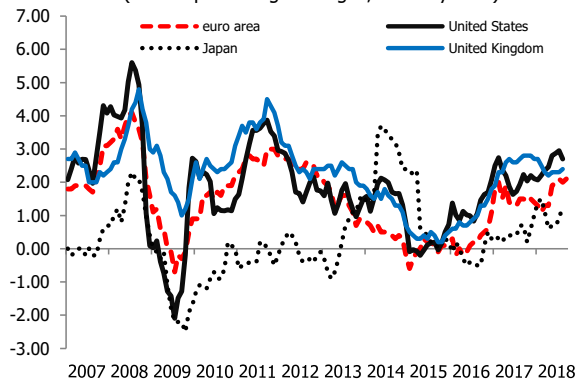
Unemployment in advanced economies

(in percent; seasonally adjusted monthly data)



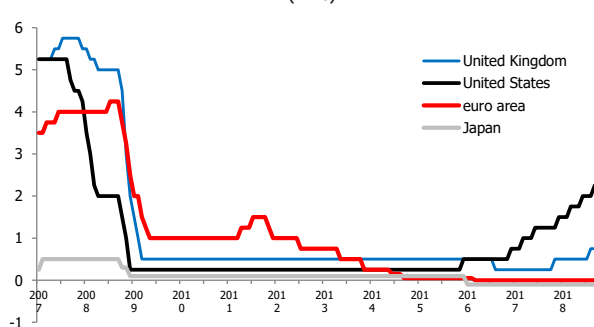
Inflation in advanced economies

(annual percentage changes; monthly data)



Policy rates in advanced economies

(in %)



The divergent monetary policy setup of the central banks in the developed countries was evident in the third quarter of 2018. Thus, FED made changes aimed at tightening, which is in line with market expectations and previous announcements for gradual change in the US monetary setup. At the regular meeting in September, FED made a decision on new increase in the target range of the policy rate by 25 basis points and it equaled 2% - 2.25%. The increase in the interest rate was largely due to the solid economic performance, as well as the FED's estimations for improved labor market conditions⁵ and moderate growth of the economy in the medium term. At the regular meeting in September, the ECB decided to keep the interest rate, at the same time extending the quantitative easing program, yet to a lesser extent, by the end of 2018⁶. In its regular meeting in September, the Bank of England raised the policy rate by 25 basis points to 0.75%. The main purpose of the increase

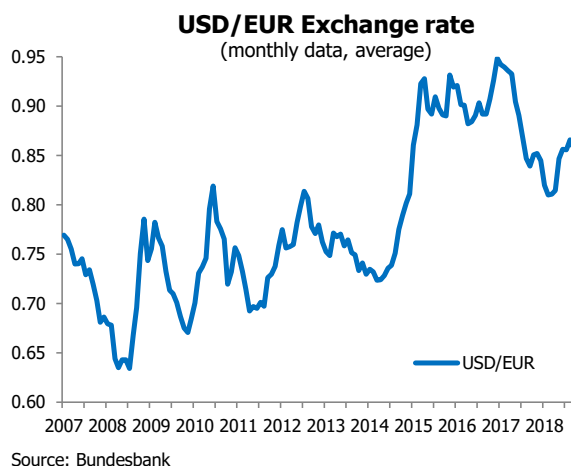
⁵ In August 2018, the unemployment rate in the US was 3.9%, which is the lowest unemployment rate since April 2000.

⁶ At the ECB's regular meeting in September 2018, the European Central Bank decided to keep the current policy rate, while extending the quantitative easing program, but with lower intensity by the end of 2018, so it will equal Euro 30 billion by September 2018 and Euro 15 billion from October to the end of 2018.

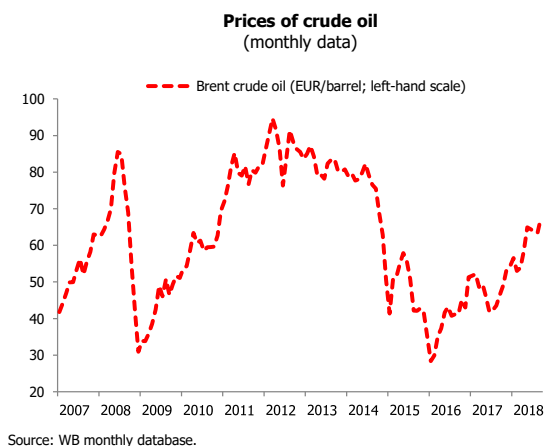


in the interest rate was to reduce the pressures from external shocks (the growth of energy prices and depreciation of the UK pound) on inflation. On the other hand, the Bank of Japan made no changes to the monetary policy setup.

In the third quarter of 2018, the appreciation of the US currency against the euro was registered at 2.5%, on average, compared to the second quarter of 2018. Annually, in the third quarter, the US dollar against the euro grew by 1%, thus in September 2018 one US dollar was exchanged for 0.86 euros on average. Despite the solid performances of the US economy and tightening of the monetary policy by the FED, the depreciation of the euro against the US dollar was also driven by the investors' concern about the Italian economy and the reduced inflation pressures in the Euro area which they view as a signal for possible slowdown in the economic growth.



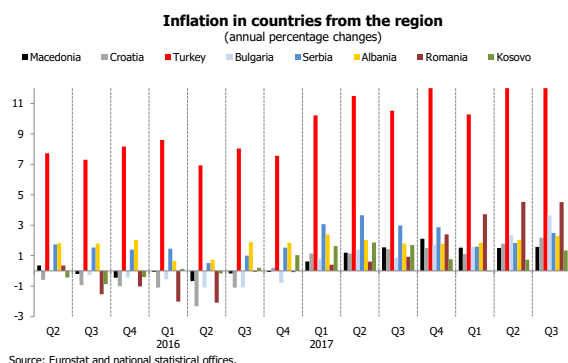
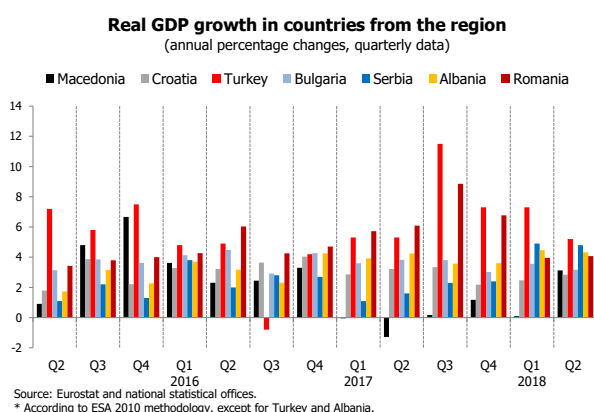
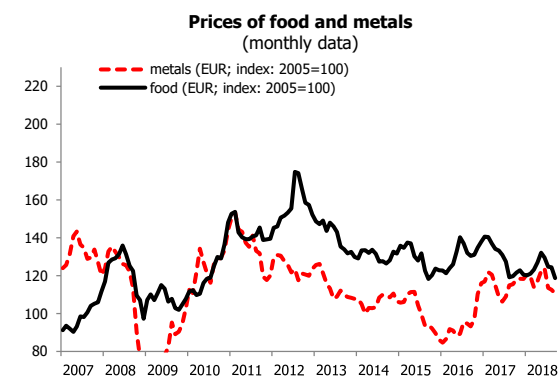
In the third quarter of 2018, the oil price increased relative to the price in the second quarter of 2018. Thus, in this period, the average oil price in euros equaled Euro 64.9 per barrel, which is an increase of 3.7% on a quarterly basis, i.e. 47.4% annually. The increase in the oil price, amid relatively stable demand, is mainly due to geopolitical tensions between the US and Iran⁷, which are expected to contribute to the deficit in the global supply of this fuel.



In the third quarter of 2018, the prices of non-energy primary commodities declined, compared to the second quarter of 2018. Moreover, the decline in the prices of these products amounted to 4.9% compared to the second quarter of 2018. Analyzed by groups of products, the decline reflects the decrease in metal and food prices, which equaled 7.3% and 5.3%, respectively compared to the second quarter of 2018, mostly due to the dominance of the international trade tensions. On the other hand, observed annually, the prices of primary non-energy products in euros registered insignificant growth of 0.2%, while the prices in US dollars slightly declined by 0.8%. These differences arise due to the changes in the euro/US dollar exchange rate.

The trend of positive economic performance in the region continued in the third quarter of 2018. Thus, the Turkish economy recorded the

⁷ On 6 July 2018, the US President made a decision to impose additional sanctions on Iran (after those imposed on 8 May 2018) which will mainly hit the oil sector. According to the latest statements of the President Trump's administration, the sanctions will come into force on 4 November 2018.



highest increase in the region in this quarter (5.2%), mostly driven by private consumption and exports. The other countries in the region also registered solid growth rates, as follows: Serbia (4.8%), Albania (4.3%), Romania (4.1%), Bulgaria (3.2%) and Croatia (2.8%). The growth in Serbia and Bulgaria mostly reflected the increase in private consumption and investments, while the growth in Albania, Romania, Bulgaria and Croatia was mostly driven by private consumption and exports.

In the third quarter of 2018, all countries in the region registered further acceleration of the annual inflation rate. Observed by country, the largest acceleration of the annual inflation rate was registered in Turkey, while the acceleration in the other countries was relatively smaller. Such movements in consumer prices in most of the countries mainly reflected higher food prices, while in Romania the increase was mostly due to the growth in energy component.

1.2. Domestic supply

After the minimal growth in the first quarter of 2018 of 0.1%, the domestic economy in the second quarter registered a solid annual rate of real economic growth, which equaled 3.1% according to the estimated data of the SSO. The main driver of such positive movements is the group of activities "trade, transport and catering", with a positive contribution from industry as well. On the other hand, the value added in construction in this period made a negative contribution to the growth, yet its adverse impact is significantly weaker compared to the impact in the first quarter. Regarding the developments in the third quarter of 2018, most of the available data for certain economic



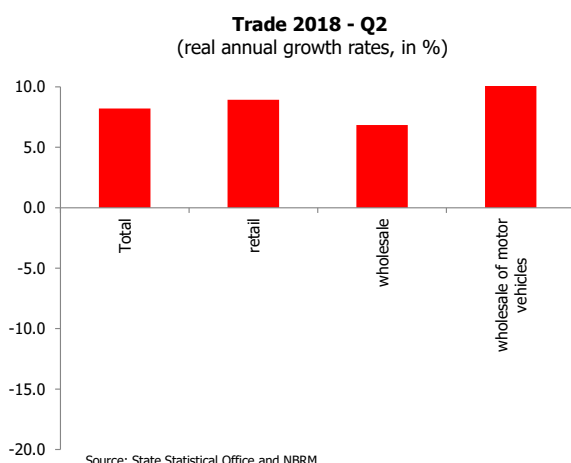
sectors for the period July-August point to favorable movements compared with the second quarter.

In the second quarter of 2018, the domestic economy strengthened, whereby the gross domestic product grew by 2% on a quarterly basis (seasonally adjusted) and by 3.1% on annual basis. Observed by activity, the higher value added was registered in number of activities, with trade, transport and catering being the main drivers of the GDP growth. Further significant positive contribution to the growth in the second quarter was made by industry and other services. On the other hand, during the second quarter the value added in construction decreased, at a significantly slower pace compared to the decline in the first quarter⁸.

	annual growth rates, in %							contribution in GDP growth, in p.p.						
	2013	2014	2015	2016	2017	Q1 2018	Q2 2018	2013	2014	2015	2016	2017	Q1 2018	Q2 2018
Agriculture	8.6	3.1	1.9	2.8	4.1	6.6	0.3	0.8	0.3	0.2	0.3	0.4	0.5	0.0
Industry	3.7	11.5	4.9	1.4	-2.5	1.4	4.4	0.6	1.7	0.8	0.2	-0.4	0.2	0.7
Manufacturing	9.6	21.5	5.0	4.1	-4.0	5.5	5.8	1.0	2.1	0.5	0.5	-0.5	0.6	0.7
Construction	12.8	5.1	8.0	11.9	-13.7	-37.2	-12.9	0.7	0.4	0.6	0.8	-1.0	-2.8	-0.7
Trade and transport	11.1	3.1	1.4	4.2	9.0	10.5	12.7	1.9	0.6	0.3	0.8	1.7	2.0	2.7
Information and communication	4.8	3.4	13.4	6.5	2.6	-6.9	-9.5	0.2	0.1	0.4	0.2	0.1	-0.2	-0.3
Financial and insurance activities	-1.4	13.5	8.7	0.9	-1.8	-0.8	-1.8	0.0	0.4	0.3	0.0	-0.1	0.0	-0.1
Real estate activities	-1.3	0.0	2.7	-0.5	-0.6	-0.2	0.6	-0.2	0.0	0.3	-0.1	-0.1	0.0	0.1
Professional, scientific and technical activities	9.6	6.3	5.9	7.7	-3.3	8.5	4.5	0.3	0.2	0.2	0.2	-0.1	0.3	0.1
Public administration	-7.5	3.2	6.5	1.5	-2.3	-1.6	-1.6	-1.1	0.4	0.8	0.2	-0.3	-0.2	-0.2
Other service activities	12.7	11.5	4.5	0.0	-7.4	12.1	13.9	0.3	0.3	0.1	0.0	-0.2	0.3	0.3
Gross Domestic Product	2.9	3.6	3.9	2.9	0.0	0.1	3.1	2.9	3.6	3.8	2.8	0.2	0.1	3.1

*From the release for GDP of 06.09.2018

Source: State Statistical Office and NBRM calculations.



Source: State Statistical Office and NBRM.

The GDP growth in the second quarter was mostly driven by the growth in the value added in trade, transport and catering, which was a structural feature for several consecutive quarters. Observed by the high frequency data⁹ the second quarter of the year registered a faster growth of total trade, given higher turnover registered in all types (wholesale trade, retail trade and trade in motor vehicles). The growth in total trade turnover continued in the period July-August 2018 amid increase in wholesale and retail trade, which indicates a possible growth of activities in the sector in the third quarter of the year. Observing the expectations for the third quarter of the year the perceptions of the corporate managers in retail trade are more favorable in terms of the number of

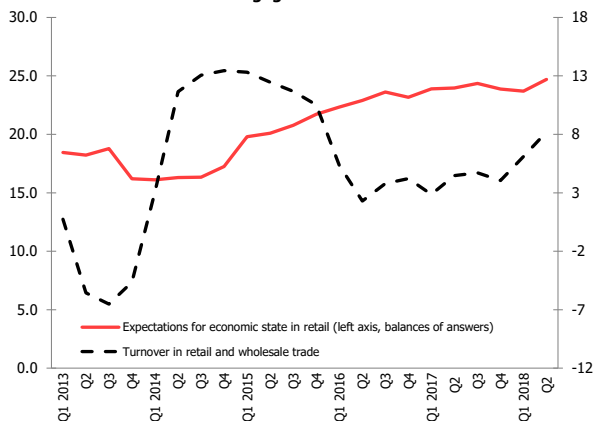
⁸Besides the construction sector, a decline in value added in the second quarter was also registered in the activities: "information and communication", "public administration and defense, compulsory social insurance, education and health and social care activities" and in "financial activities and insurance".

⁹The analysis of trends in trade uses data on the trade turnover.

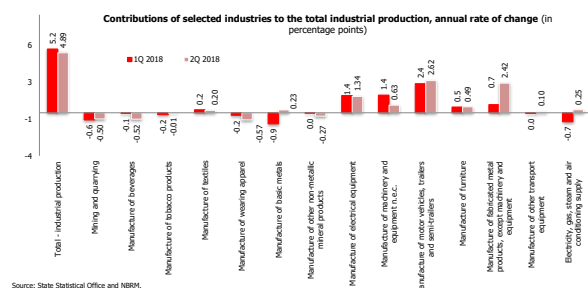


employees, orders, sales prices and business conditions¹⁰.

Trade and expectations of managers of business entities engaged in retail

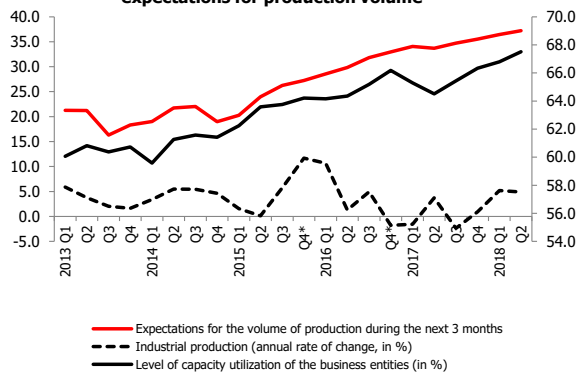


Source: State Statistical Office and NBRM.



Source: State Statistical Office and NBRM.

Industry, capacity utilization and managers' expectations for production volume

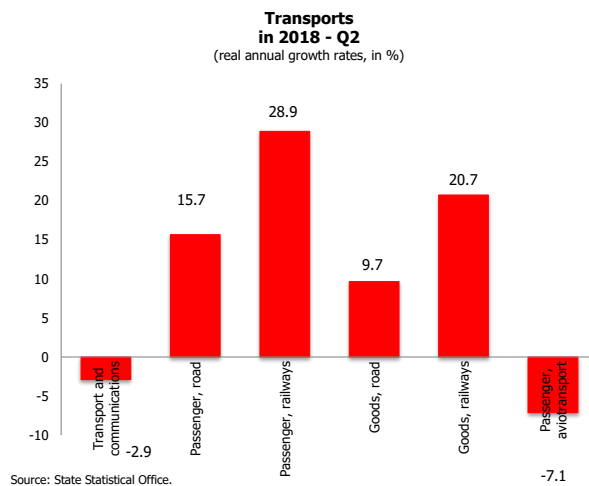
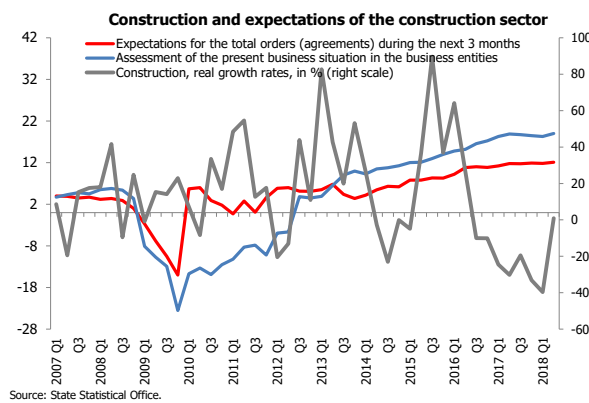
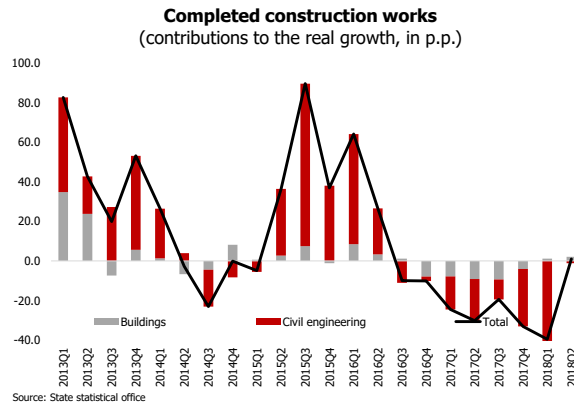


Source: State Statistical Office.

The industry also made a positive contribution to the growth in the second quarter. The favorable movements that started in late 2017 continued in the second quarter of 2018, with an increase in the average utilization of the business agents' capacity and higher industrial output by 4.9% annually. Moreover, such increase in the industrial output was primarily due to the increase in the production in the manufacturing industry, and the growth of the production in the energy sector also made a positive, but more moderate contribution, while the production in mining continued to fall. Within the manufacturing industry, the growth, as before, is mainly explained by the production in the activities in which the major foreign export capacities (motor vehicles, electrical equipment, machinery and devices) are present, as well as in "manufacture of fabricated metal products, except machinery and equipment". A moderate positive contribution in this quarter was also made by the manufacture of furniture and textile, as well as the manufacture of metals. However, some of the other traditional activities still registered unfavorable movements (production of food, beverages and clothes). In the third quarter, the growth in industry is expected to continue, according to the favorable expectations of the managers in this sector for production, prices and employment. Also, data for the period July-August 2018 indicate an increase in the industrial output, at slightly faster pace of annual growth. The growth entirely reflects the further positive developments in manufacturing industry, while production in mining and energy sectors went down.

On the other hand, in the second quarter of 2018, the value added in construction decreased, at a significantly slower pace compared to the decline in the previous quarter. Such slowdown in the decline can partly be explained by the low comparison base of the previous year, which relates to the discontinuation of the planned public infrastructure investments. The slowdown in the decline of the value added in construction is evident through the high-frequency indicators of construction activity. The completed construction works registered a minor real annual growth, for the first time after almost a two-year period of continuous decrease. Such positive

¹⁰The expectations of the corporate managers in construction, retail trade and manufacturing Industry for the third quarter are taken from Business Tendencies Surveys for the respective sector conducted in the second quarter of 2018.



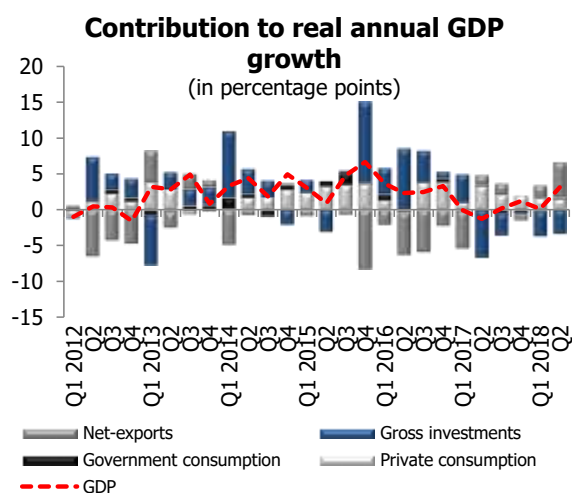
movements are due to the growth in building construction, while the civil engineering slightly declined by 1.7%, which is a significantly less intensive fall (decline of 65.2% in the previous quarter). Such shifts can be partially explained by the start of part of the planned public infrastructure projects which were interrupted in the past period. However, after the minor growth in the second quarter, in July 2018, construction works declined again, due to the high base effect of the previous year. The decline in the value of completed construction works in July was due to the simultaneous decline in both building construction and civil engineering. On the other hand, the expectations of the corporate managers in construction for the third quarter of 2018 in terms of orders and employees are mainly favorable.

The positive developments in transport were maintained in the second quarter of 2018. Thus, the high frequency data show positive movements in the second quarter in most types of transport except the urban-suburban passenger traffic and freight traffic (road and air)



1.3. Aggregate demand

Observed by the aspect of the demand, the solid annual GDP growth of 3.1% in the second quarter of 2018 is driven by the positive contribution of net exports, amid prolonged decline in domestic demand. Observing individual components, the export continued to register significant increase and the highest contribution, mainly related to the activity of foreign export industrial facilities. The private consumption further grew, driven by the increase in disposable income and lending, with a growth in public consumption as well. However, their positive contribution to domestic demand was entirely neutralized by the decline in gross investments, due to weaker realization of public infrastructure projects. The second quarter also registered an increase in import demand, yet at a more moderate pace, compared to the annual dynamics in the previous two quarters.



Source: State Statistical Office and NBRM calculations.

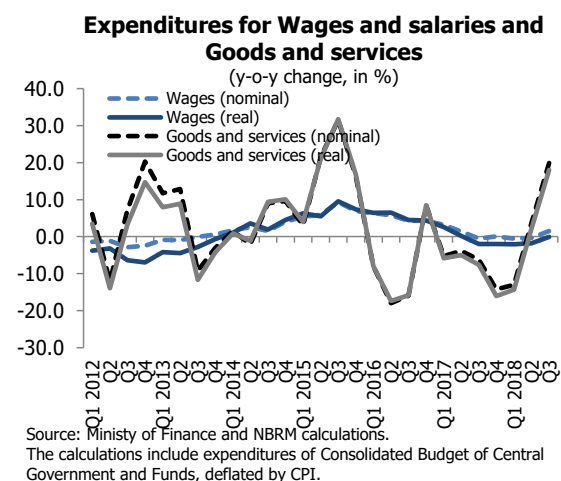
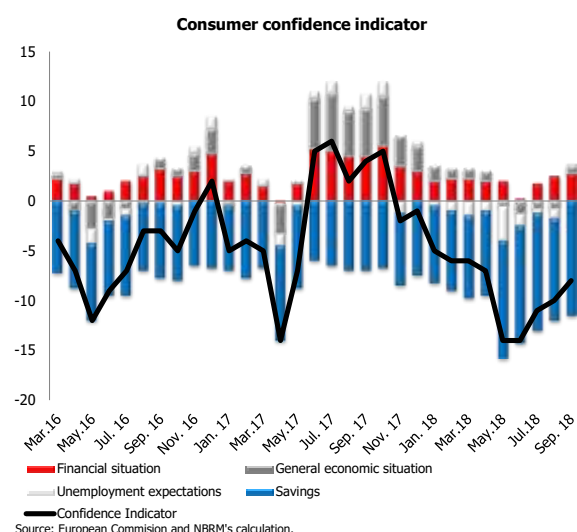
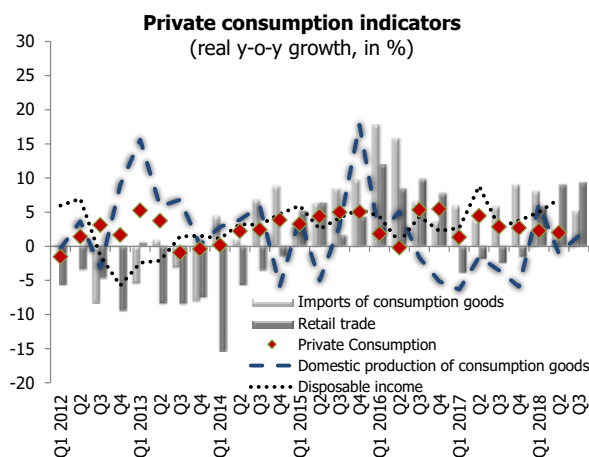
In the second quarter of 2018, the structural analysis shows that the export remains the dominant component with the highest individual positive contribution to the growth of the economy, which has long been a structural feature of the domestic economic growth. Observing the domestic demand components, the private consumption continued to increase, and the public consumption also recovered after the decline in the previous three quarters. Gross investments continued with the steep decline. These movements partially correspond to the changes in the construction activity, which declined, yet with a lower intensity, mainly due to the weaker realization of part of the infrastructure projects. The unfavorable investment movements led to negative contribution of domestic demand to the growth in the second quarter.

	Real annual growth rates (%)											Contributions to real annual growth (in p.p.)										
	2013	2014	2015	2016	2017	2017-Q1	2017-Q2	2017-Q3	2017-Q4	2018-Q1	2018-Q2	2013	2014	2015	2016	2017	2017-Q1	2017-Q2	2017-Q3	2017-Q4	2018-Q1	2018-Q2
Private consumption	1.9	2.2	4.4	3.1	2.9	1.3	4.4	2.9	2.7	2.3	2.0	1.4	1.6	3.1	2.1	1.9	0.9	2.9	1.9	1.8	1.5	1.3
Government consumption	0.5	3.0	3.9	1.9	-1.5	-0.8	0.4	-3.6	-2.1	-1.4	1.0	0.1	0.5	0.7	0.3	-0.2	-0.2	0.1	-0.5	-0.3	-0.2	0.1
Exports of goods and services	6.1	16.5	8.5	8.1	9.2	8.3	11.0	5.5	12.1	10.6	13.7	2.8	7.2	4.0	3.9	4.6	4.0	5.4	2.9	6.0	5.4	7.6
Imports of goods and services	2.2	14.1	9.9	11.6	7.3	13.4	5.6	2.1	9.0	5.1	4.0	-1.4	-8.7	-6.5	-7.5	-4.7	-8.4	-3.6	-1.3	-5.8	-3.4	-2.8
Gross capital formation	0.5	10.7	8.3	13.3	-4.5	11.4	-18.6	-9.4	-1.0	-9.0	-11.3	0.1	3.1	2.5	4.0	-1.5	3.6	-6.1	-2.7	-0.5	-3.1	-3.2
Domestic demand	1.3	4.4	5.4	5.7	0.2	4.0	-2.7	-1.3	0.9	-1.7	-1.4	1.6	5.2	6.3	6.5	0.2	4.4	-3.1	-1.3	0.9	-1.9	-1.7
Net exports*	-6.9	8.0	14.1	21.0	2.9	26.4	-5.9	-8.9	2.7	-7.1	-20.5	1.3	-1.5	-2.4	-3.6	-0.2	-4.4	1.8	1.5	0.2	2.0	4.8
Statistical discrepancy												0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
GDP	2.9	3.6	3.9	2.9	0.0	0.0	-1.3	0.2	1.2	0.1	3.1	2.9	3.6	3.9	2.9	0.0	0.0	-1.3	0.2	1.2	0.1	3.1

*decrease represents lower deficit
Source: SSO and NBRM calculations.

1.3.1. Private consumption

In the second quarter of 2018, the private consumption further grew, yet at a slower annual pace. Compared to the same quarter in the previous year, the consumption grew by 2% (1.7% on a quarterly basis), mainly driven by the positive performances in all disposable income components. Thereby, in the second quarter,



besides the accelerated growth of wages and pensions, higher inflows were registered on the basis of private transfers. At the same time, the household lending by the banks accelerated in this period. The slower growth pace in private consumption can be partially explained by the perceptions from the consumer trust surveys¹¹, which in the second quarter also indicate unfavorable consumer perceptions, amid further unfavorable expectations related to the overall economic situation, the possibilities for reduced unemployment and increased savings.

The signals of the available high frequency mostly indicate prolonged growth of private consumption in the third quarter of 2018.

Thus, in the period July-August, increase was registered in retail trade, real wages and pensions, with a solid growth in the household lending as well, which corresponds partly with the results of the Lending Survey, which indicate easing of the total lending conditions, as well as net decrease in the households demand for loans in this period. In the same period, increase was registered in both the domestic production of consumer goods and the import of consumer goods, while in July net private transfers moved upward as well. At the same time, the signals from consumer surveys on consumer confidence conducted in the third quarter point to increased consumer optimism with more favorable expectations regarding the overall economic situation, as well as the possibility of reducing unemployment.

1.3.2. Public consumption

In the second quarter of 2018, the public consumption grew quarterly by 1.5% and 1.0%, respectively, following the annual decline in the previous three quarters. The increase in public consumption is mainly a result of the higher expenditures for goods and services, as well as higher health care transfers¹².

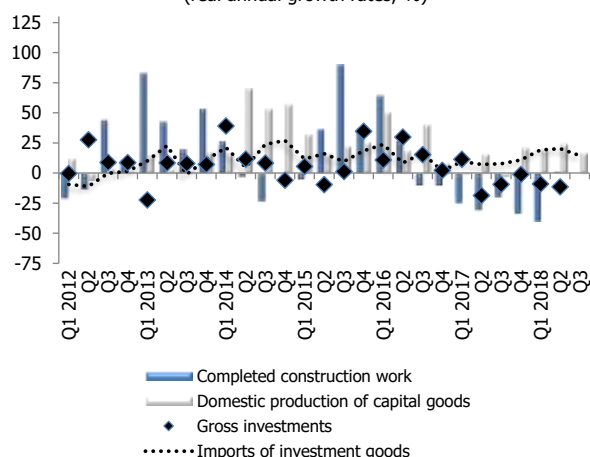
The data on July and August 2018 show annual increase in the public consumption, mainly as a result of the higher expenses for goods, services and health transfers.

¹¹ European Commission's Consumer Survey as of September 2018. The chart shows the consumer confidence index as a net percentage of responses. This index is an integral component of the total index of economic confidence.

¹² Most of these assets relate to expenditures on goods and services of the Health Insurance Fund.

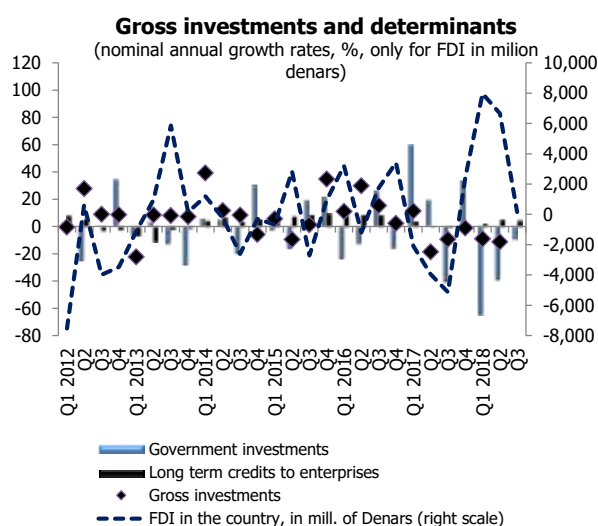
1.3.3. Investment consumption

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



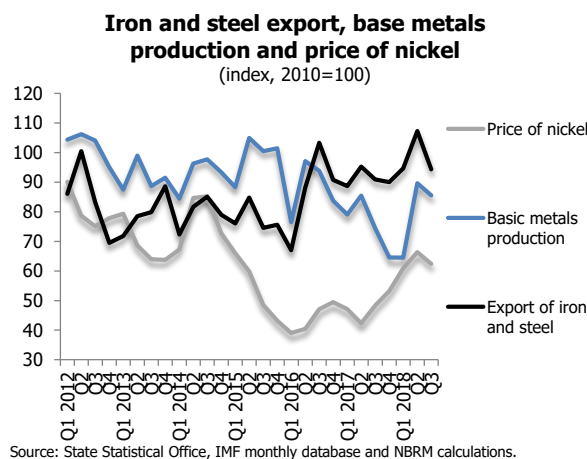
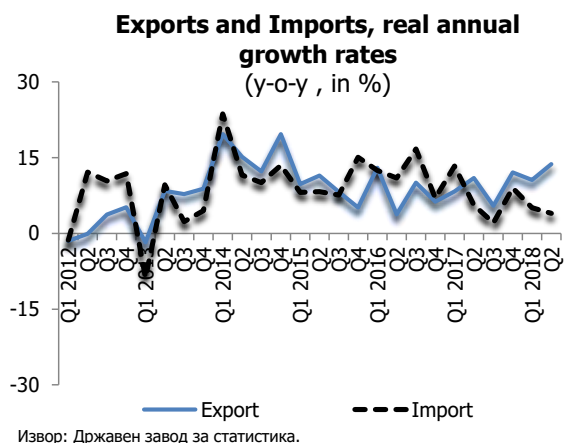
Source: State Statistical Office, Ministry of Finance and NBRM calculations.

The unfavorable performances in gross investments continued in the second quarter of 2018 as well, with a stronger quarterly and annual decline of 15.4% and 11.3%, respectively. Although the value added to construction activity is with a significantly weaker intensity, the decline in gross investments continued at a similar pace. This is partially related to the weaker realization of part of the public infrastructure projects. The other high frequency indicators for gross investments are mainly favorable (growth of the import of products for investments and domestic production of capital goods), with an additional growth of foreign direct investments and long-term lending to enterprises by domestic banks also being registered.



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

In terms of the movement of investments in the third quarter of 2018, part of the high-frequency data indicate favorable movements. Namely, out of the short-term investments indicators, annual growth has been registered by the domestic production of capital goods, the import of investment products, as well as for foreign direct investments. At the same time, corporate lending for the period July-August continues to grow, with stable loan demand and net easing of credit conditions in this period, in accordance with the results of the bank's surveys. On the other hand, data on government capital investments still indicate their annual decrease, yet at a slower pace compared to the previous quarter. Moreover, despite the mostly favorable perception of the managers in the construction sector for the situation in the sector during the third quarter, in July the construction activity noted a significant annual decline, which in addition to the reduced construction works also reflects the high base effect from the previous year, when the construction sector registered the highest performance.



1.3.4. Net external demand

The positive contribution of net exports continued to increase in the second quarter of 2018. Higher growth of export of goods and services than the import **for five consecutive quarters ensures** positive contribution of the net exports to the increase in domestic economy. Thus, the real export of goods and services registered quarterly and annual growth of 4.7% and 13.7%, respectively, as a result of which also in this quarter this component registers the highest positive contribution to the GDP growth. Analyzed according to the high frequency foreign trade statistics, the growth of the nominal export was mostly supported by the solid performances of the new export-oriented industrial capacities, but also from the export activity of the metal-processing industry. In the second quarter, the real import increased by 4.0%, yet at a slower pace compared to exports, while quarterly it declined by 2.9%

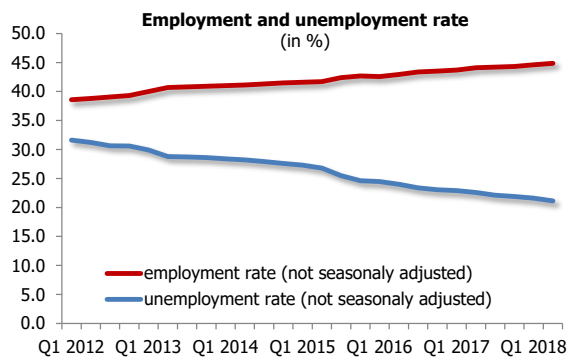
In the third quarter of 2018, the annual trade deficit is expected to slightly spread, as indicated by the nominal data on foreign trade for July and August 2018, in conditions of higher annual export growth than the import of goods.

1.4. Employment and wages

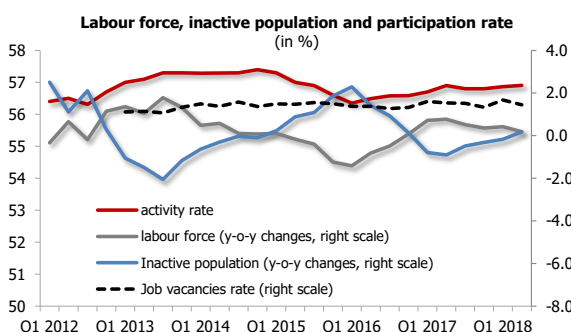
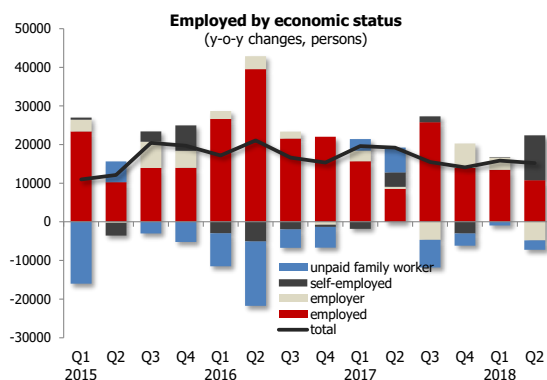
Given the solid economic performance, the labor market indicators in the second quarter of 2018 point to further improvements of this market segment. Thus, the number of employed persons increases, with similar intensity as in the previous quarter. At the same time, the unemployment rate reduced to 21.1%, which is a new historical minimum. The business tendency surveys point to increased optimism about employment for the next three months. On the supply side, the annual growth of the active population, which began in the last quarter of 2016, continued. However, the competitiveness indicators still point to unfavorable shifts, which although more moderate, further indicate reduced labor productivity and increased unit labor costs.

The employment growth continued in the second quarter of 2018, with similar intensity as in the previous quarter. Thus, the number of employees increased by 2.1%, annually, while quarterly, increase of 0.6% was registered¹³. Observed by activity, movements are divergent. The largest contribution to the increase in the number of employees was made by the construction, the professional, scientific and technical activities, the manufacturing industry and

¹³ The analysis of quarterly dynamics of employment, unemployment and total economically active population was made using seasonally adjusted data.



Source: State Statistical Office, Labour Force Survey.



Source: State Statistical Office,.

the accommodation facilities and catering services. On the other hand, one third of the activities registered a decrease in employment, while activities with a steeper decline in employment are financial activities and insurance, transport and storage, wholesale and retail trade, repair of motor vehicles and motor-cycles and information and communication. Regarding the economic status¹⁴, the largest increase is registered in the "employed" category.

In the second quarter of 2018, the employment rate amounted to 44.9%, which is an annual growth of 0.8 percentage points. Simultaneously, **the aggregated signals from business tendency surveys¹⁵ suggest increased optimism** among managers of business entities regarding the employment for the next three months. In the second quarter **the job vacancy rate¹⁶ equals 1.4%** (1.5% in the same quarter of 2017). Analyzed on a longer-term basis, the job vacancy rate is relatively stable, which, in conditions of decrease in the unemployment rate, points to possible improvement of the connection process of the supply with the demand for skills in the labor market. Observed by comparison, by sectors of activity, the highest job vacancy rate was registered at accommodation and food service facilities (2.6%), other service activities, as well as administrative and auxiliary services activities (2.3%).

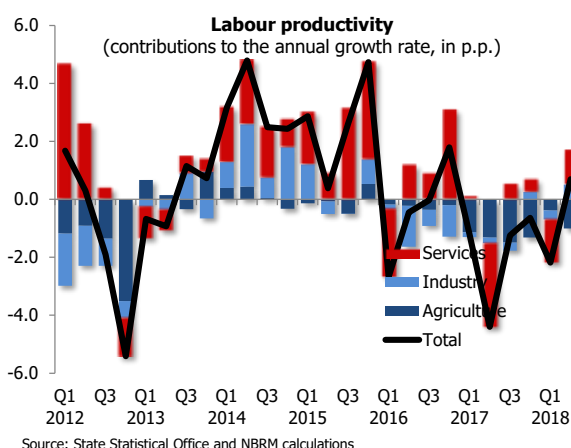
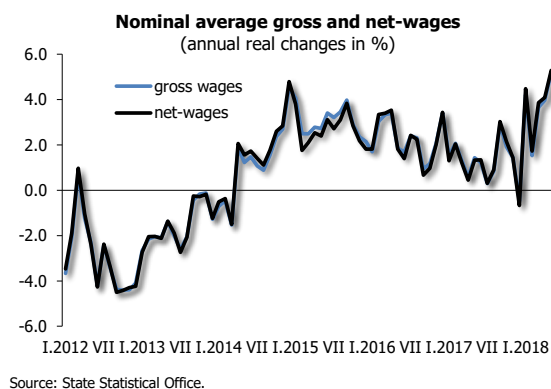
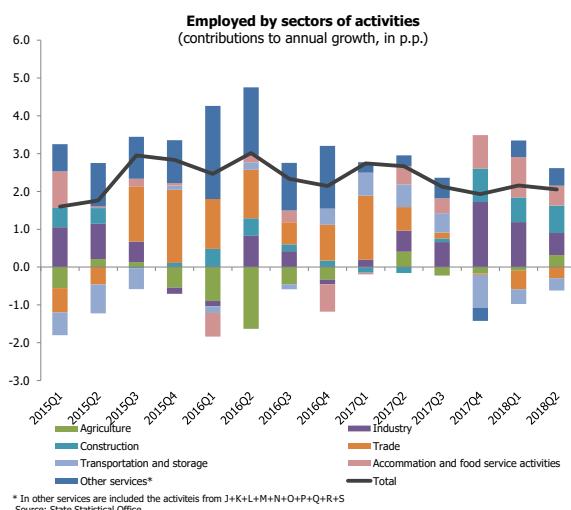
As for the movements on the side of labor supply, the growth trend observed since the last quarter of 2016, continued in the second quarter, as well. Thus in the second quarter, the total labor force increased by 0.2% annually, while the activity rate equaled 56.9%.

The stronger rise in the demand relative to supply of labor force in the second quarter of the year resulted in further fall in unemployment. The number of unemployed in the second quarter decreased by 6.2% on an

¹⁴ The classification by economic status applies to the following groups: **employers** - persons who operate their own business entity or engages independently in their own shop, or farm owners who hire other employees; **employees** - persons who work in government institutions, business entities in public, mixed, cooperative and undefined ownership or for private employer; **own-account workers** - persons who operate their own business entity, company, engage independently in their own business and work on a farm in order to generate income, while not hiring other employees; **unpaid family workers** - persons who work without pay in a business entity, shop or farm (owned by a family member).

¹⁵ Source: State Statistical Office, business tendency surveys in manufacturing industry (July and August 2018), construction (second quarter of 2018) and trade (second quarter of 2018).

¹⁶ The job vacancy rate is defined as the ratio between the number of job vacancies and the total number of jobs. Usually, the job vacancy rate is considered along with the unemployment rate (a relationship known as the Beveridge Curve). The value of these two indicators provides labor market information about any skill mismatch. In particular, if both indicators are moving simultaneously, they are temporary, cyclical fluctuations, while in the case of the unemployment rate decreasing, with a stable vacancy rate, these are structural changes that is, improving the efficiency of the labor market.



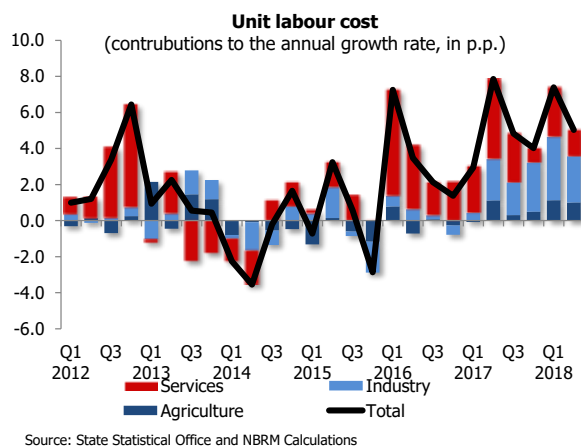
annual basis, which is a slight intensification compared to the previous quarter, while the unemployment rate reduced to the level of 21.1% (annual and quarterly fall of 1.5 percentage points and 0.5 percentage points, respectively).

The average net and gross wages paid in the second quarter registered and annual growth of 6.3% and 6.2%, respectively, which is an acceleration of the annual increase, partially reflecting the increase in legally prescribed minimum net wage from September last year¹⁷. Wage growth was registered in most of the economic activities, among which according to the amount of the increase, the following activities are distinguished: mining, facilities for lodging and service activities, manufacturing industry, information and communication administrative and support service activities. On a quarterly basis, nominal net and gross wages registered an increase of 2.5%, which is an accelerated growth compared to the previous three-month period. **In the second quarter, given the growth of consumer prices of 1.5%, the real annual growth of net and gross wages was 4.7% and 4.6%, respectively.**

The unfavorable trend in labor productivity initiated in 2017, continued in the second quarter of 2018, yet with a significantly moderate movements. In conditions of a solid increase in value added, and further unemployment growth, the labor productivity¹⁸ reduced by 0.3%, which is a significant slowdown in the decline, given the annual fall of 4.4% in the first quarter of 2018. Observed by sector, the improved prospects on the labor market, observed through the significant deceleration of the labor productivity decline, is mostly due to the significantly lower decline in the services sector. **The wage increase, amid weaker decline in productivity, contributed to less intensive unit labor costs of 6.1%** (as opposed to the 9.9% in the first quarter of 2018). The decrease in the unit labor costs is mainly explained by the lower unit labor costs in industry and services sector, amid moderate contribution of the agriculture sector.

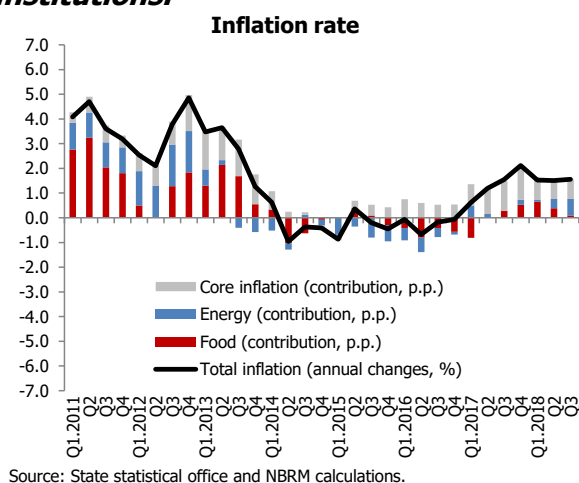
¹⁷ On 19 September 2017, the Assembly of the Republic of Macedonia adopted the amendments to the Law on the Minimum Wage of the Republic of Macedonia. According to the amendments, the minimum wage in the Republic of Macedonia, starting with the payment of the wage for September 2017, was determined for all sectors in the economy at a gross amount of Denar17.130 or Denar12.000, net.

¹⁸ Total productivity is a weighted sum of productivity of each sector. Sector productivity is the ratio of the sector's value added to the number of employees.



1.5. Inflation

In the third quarter of the year, domestic prices continued to grow annually, at a similar pace to the previous two quarters of 2018. Observing structure, this quarter registered accelerated annual increase in energy prices, according to the movements in the price of oil and oil derivatives on the world market, while the increase in food prices decelerated. The core inflation also made a positive and stable contribution to the growth of domestic prices. The indicators of the future short-term dynamics of consumer prices generally do not point to significant upward pressures on the price level, except on the labor costs, whose increase continued in the second quarter of this year, yet at a slower pace. In terms of the expectations for the inflation rate in the next two-year period, according to the NBRM Survey, economic analysts expect that it will be moderate and around 2%, similar to the NBRM forecast and the forecasts of part of the international institutions.



1.5.1. Current inflation

In the third quarter of 2018, domestic consumer prices increased at a similar pace as in the previous quarter (annual inflation rate of 1.6%)¹⁹. This period registered an acceleration in the annual growth of energy prices, retained core inflation growth, and a deceleration in the growth of food prices, compared to the growth of the previous quarter.

The core inflation rate in the third quarter amounted to 1.6% (same as in the previous Quarter). Analyzing structure, the highest positive contribution to the core inflation growth was made by the prices of tobacco²⁰, the prices of transport and to a lesser extent the hotel and restaurant

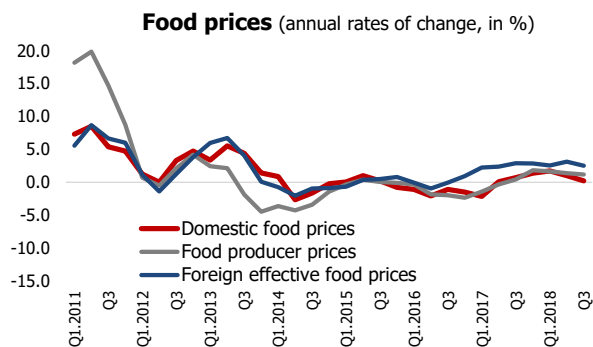
¹⁹ On a quarterly basis, consumer prices increased by 0.2%, while on a seasonally adjusted basis they increased by 0.5%.

²⁰ The annual growth of tobacco price in the third quarter reflects the increase in the prices of cigarettes in April, May and July, in the eve of the increase in excise duties on cigarettes at the beginning of July 2018. The increase in excise duties of 0.20 denars/a piece is envisaged for each year, until 1 July 2023.



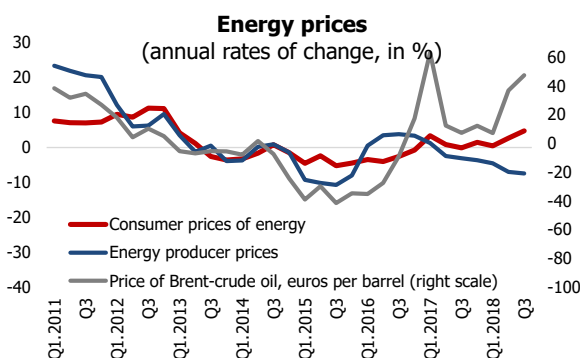
	(annual changes, in %)												(contribution to annual changes, in p.p.)											
	2017				2018				2017				2017				2017				2017			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Consumer price index - all items	0.6	1.2	1.5	2.1	1.4	1.5	1.5	1.6	0.6	1.2	1.5	2.1	1.4	1.5	1.5	1.6	0.7	1.4	1.5	1.6	0.7	1.4	1.5	1.6
Food	-2.1	0.1	0.7	1.4	0.8	1.7	1.8	1.8	-0.8	0.0	0.3	0.5	0.0	0.7	0.4	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Energy	3.4	0.8	-0.1	1.7	1.4	0.5	2.7	4.0	0.5	0.1	0.0	0.2	0.2	0.1	0.4	0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Electricity	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Fruit energy	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0
Fuel energy	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0
Fuels and lubricants	16.4	5.5	0.4	0.0	0.7	2.0	10.1	10.1	0.5	0.2	0.0	0.2	0.2	0.1	0.4	0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Food and energy (volatile prices)	-0.7	0.3	0.5	1.4	0.4	1.4	1.5	1.5	-0.3	0.1	0.3	0.7	0.2	0.7	0.4	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Core inflation calculated by the NBRM (total index - food and energy (categories 01.1, 04.5, 07.2, 2.0))	1.9	2.1	2.6	2.8	2.0	1.7	1.6	1.6	0.9	1.0	1.2	1.5	1.1	0.8	0.7	0.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall index excluding energy, liquid fuels and lubricants and unprocessed food (S50)	0.8	1.3	1.6	2.3	1.5	1.3	1.1	1.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall index excluding energy, liquid fuels and lubricants, unprocessed food, tobacco and alcoholic beverages (S50)	0.5	1.0	1.4	2.0	1.2	1.0	0.7	0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Source: State Statistical Office and NBRM calculations.



* 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.



Source: State statistical office and NBRM calculations.

services. The rest of the inflation sub-indexes increased as well, excluding the categories of variable prices. Thus, the total index, excluding energy²¹, liquid fuels and lubricants (for transport) and unprocessed food, has an annual growth of 1.1% (same as in the previous quarter), while the total index excluding energy, liquid fuels and lubricants (for transport), unprocessed food, tobacco and alcoholic beverages, indicates annual growth of 0.9% (0.7% in the previous quarter).

In the third quarter of the year, the annual growth of **food prices** further decelerated, reducing to only 0.2% (annual growth of 1% in the previous quarter), reflecting the decrease in fruit prices, as well as the decelerated increase in the prices of vegetables and meat. The slowdown in the annual growth of consumer food prices is consistent with the decelerated growth pace of foreign effective food prices, as well as with the downward movement of the prices of domestic producers of food. Unlike food prices, **energy prices** in the third quarter grew at a faster pace compared to the annual growth of the previous quarter, which is mainly explained by the movement of domestic prices of oil derivatives. This shift in domestic consumer energy prices is in line with the movement in the price of crude oil and derivatives on the world market, whose growth significantly accelerated during the third quarter.

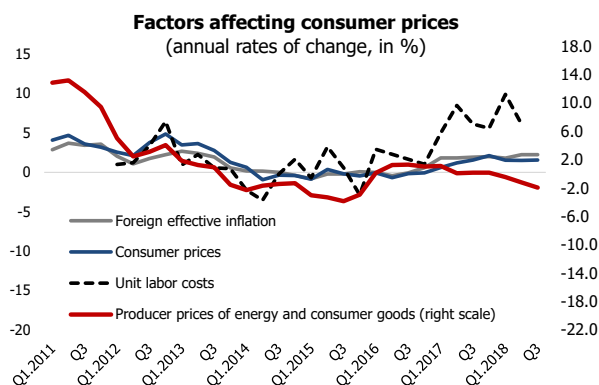
The prices of producers of industrial products on the domestic market, as one of the factors that influence the dynamics of consumer prices, register a small annual decline in the third quarter²². The total index decreased by 0.7% (in the previous quarter, the decrease amounted to 0.2%), while the producer prices of energy and consumer goods decreased by 1.9% (a decrease of 1.2% in the previous quarter).

Foreign effective inflation²³, as an indicator of imported inflation, in the third quarter of the year grew with the same dynamics compared to the previous quarter (annual growth of 2.2%). Despite the absence of potential pressures on domestic prices through the foreign prices and producer prices channel, **the unit labor costs** continue to increase (amid prolonged wage growth and decline

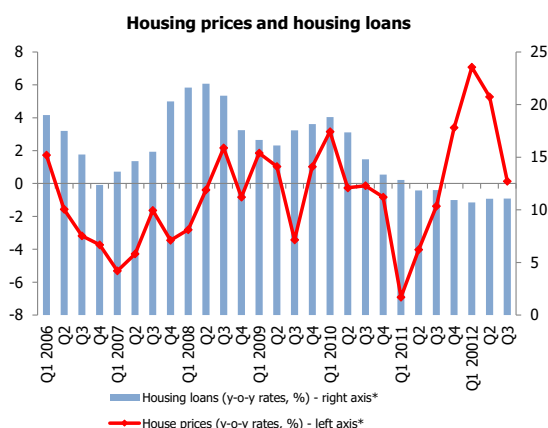
²¹ The category "energy" refers to electricity, gas, liquid and solid fuels for heating and central heating.

²² The analysis refers to the first two months of the quarter.

²³ The calculation of foreign effective inflation derives from the weighted sum of consumer price indices of the countries that are major partners of the Republic of Macedonia in the field of import of consumer goods. The weight structure is based on the normalized shares of nominal imports from each country in the total nominal imports in the period 2010-2012. The calculation of this indicator includes Bulgaria, Germany, Greece, France, Italy, Austria, Slovenia, Croatia and Serbia. The analysis refers to the first two months of the quarter.



Source: State statistical office and NBRM



Source: NBRM. Index of housing prices is calculated by the employees of the NBRM based on the data from the daily newspapers.

*Annual changes for 2009 are not calculated due to changes in methodology.



Source: State Statistical Office of RM and NBRM calculations

in productivity), yet at a slower pace compared to the previous quarter (6.1% versus 9.9% in the first quarter of 2018). Further growth in labor costs, amid estimates for slight positive gap²⁴, could create pressures on the prices of final products in the following period.

In the third quarter of the year, apartment prices, as measured by the Hedonic index²⁵, grew further, but at a significantly slower pace (minimal annual growth of 0.1%, as opposed to 5.3% in the previous quarter). On the supply side, the value of the constructed residential buildings in the second quarter of 2018 increased (for a third consecutive quarter), with an increase registered in the value of approvals issued for construction of residential buildings²⁶ after a long period of decrease). In terms of demand, also in the third²⁷ quarter of 2018, the solid rise in the housing loans continued.

²⁴The latest NBRM forecasts show that domestic production is above the potential level (positive output gap) in the second half of 2018.

²⁵ Hedonic index of housing prices, prepared by the NBRM on the basis of the notices of sale in the capital city, and published by the agencies dealing with trade in real estate. The apartment price is a function arising from the size of the apartment, the location, the floor, whether the apartment has central heating and whether the apartment is new.

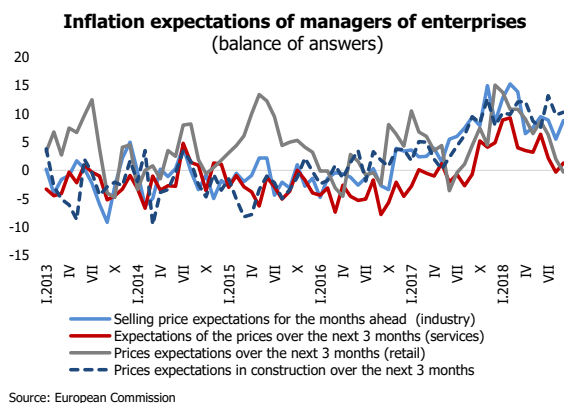
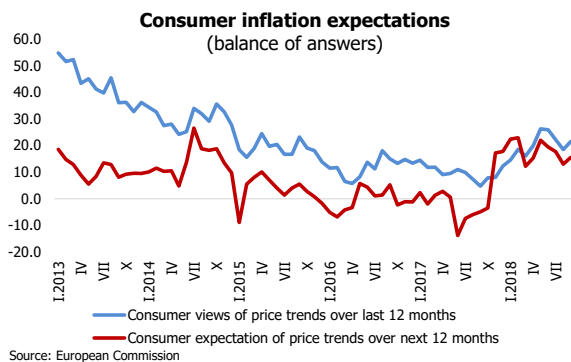
²⁶ The analysis refers to the first two months of the quarter.

²⁷ Available data for the first two months of the quarter.

Forecasts and expectations for the inflation rate

	2018	2019	2020
Economic analysts	1.8	2.0	2.1
IMF	1.8	2.0	2.0
Consensus Forecast	1.9	2.1	/
Ministry of Finance of the R. of Macedonia	1.7	2.0	2.0
National Bank of the R. of Macedonia	1.5	2.0	2.0

Source: Inflation and real GDP growth expectations survey, September 2018; IMF World Economic Outlook, October 2018; Consensus Forecast, September 2018; Ministry of Finance of the Republic of Macedonia, Fiscal strategy 2019-2021, May 2018; National Bank of the Republic of Macedonia, October 2018.



1.5.2. Inflation expectations

In the following period, no significant changes in the dynamics and the path of movement of the inflation rate are expected.

Economic analysts expect a moderate inflation that would follow a path of minimal acceleration in the next two-year period. According to the September research from the **Inflation and Real GDP Expectations Survey**²⁸, the expectations of the economic analysts for the average inflation rate have not changed compared to the previous research in June. In 2018, according to the economic analysts, the inflation rate will equal 1.8%, while during the next two years it will slightly increase to 2.0% and 2.1% in 2019 and 2020, respectively. Other institutions also predict similar dynamics of the prices in the domestic economy.

When it comes to the short-term expectations of consumers and corporate managers (period up to 12 months), in terms of the price movement, the surveys point to similar movements.

In the third quarter of 2018, the indicator **“consumers’ expectations for the price changes in the next 12 months”**²⁹ suggests retention of the expectations for price growth i.e. a larger number of persons still believe that prices will rise in the next 12-month period, relative to the number of respondents who expect unchanged or reduced prices.

As for the short-term expectations of the corporate sector³⁰, most of the executives of companies in industry, construction and services sector expect growth of their prices in the next few months, while the executives of retail trade companies expect lower prices.

1.6. Balance of payments³¹

In the second quarter of 2018, the current account of the balance of payments recorded a surplus, which is not a common movement for this time of year. Annually, positive

²⁸ Starting from October 2017, the NBRM changed the current Inflation Expectations Survey. The new Inflation and Real GDP Expectations Survey is conducted on a sample of economic analysts, extending the Survey subject in line with the practice of the European Central Bank (ECB).

²⁹ European Commission's Consumer Survey as of September 2018.

³⁰ European Commission's business tendency surveys in industry, retail trade, construction and services sector as of September 2018

³¹ Starting from the Quarterly Report, October 2014, the analysis of the movements in the balance of payments is based on data compiled under the *Manual on the Balance of Payments and International Investment Position, sixth edition (IMF, 2009) (IMF, 1993)*. For more information on the methodological changes, visit the NBRM website (http://nbrm.mk/WBStorage/Files/Statistika/Informacija_za_promenite_vo_platniot_bilans_megunarodnata_investiciska_pozicija_i_nadvoresniot_dolg_koisto_proizleguvaat_od_primenata_na_novite_megunarodni_statisticki_standardi.pdf).

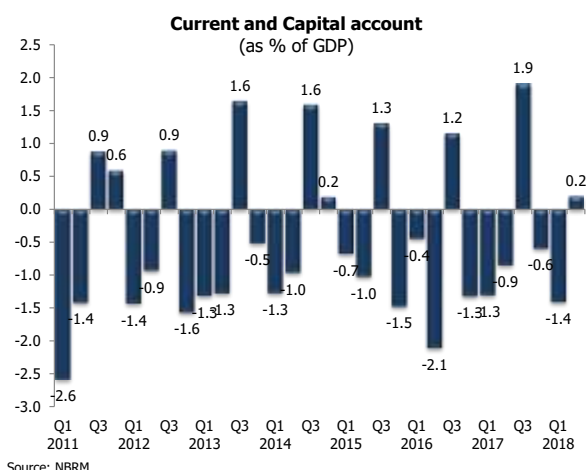


movements were registered in all current account component, with the largest contribution from the balance in foreign trade in goods and services. In the second quarter, the financial account registered net inflows that arise from the high net inflows with foreign direct investments and loan-based inflows. The other financial account categories registered moderate net outflows in the second quarter of the year, excluding the investment portfolio which does not show significant changes. The total performance of individual components of the balance of payments contributed to the growth of foreign reserves in the second quarter of 2018.

	2017			2018			2017			2018		
	Q1	Q2	I-VI	Q1	Q2	I-VI	Q1	Q2	I-VI	Q1	Q2	I-VI
	во милиони евра						% of GDP					
I. Current account	-135.4	-90.8	-226.2	-148.7	20.5	-128.2	-1.3	-0.9	-2.2	-1.4	0.2	-1.2
Goods and services	-364.1	-375.2	-739.3	-369.3	-298.2	-667.4	-3.6	-3.7	-7.3	-3.5	-2.8	-6.3
Credit	1250.7	1350.5	2601.2	1398.9	1549.2	2948.1	12.4	13.4	25.8	13.3	14.7	28.0
Debit	1614.8	1725.7	3340.5	1768.2	1847.3	3615.5	16.0	17.1	33.2	16.8	17.6	34.4
Goods	-462.0	-417.4	-879.4	-474.1	-414.3	-888.5	-4.6	-4.1	-8.7	-4.5	-3.9	-8.4
Services	97.9	42.2	140.1	104.9	116.2	221.0	1.0	0.4	1.4	1.0	1.1	2.1
Primary income	-98.5	-101.4	-199.8	-108.7	-106.1	-214.8	-1.0	-1.0	-2.0	-1.0	-1.0	-2.0
Secondary income	327.1	385.7	712.9	329.2	424.8	754.0	3.2	3.8	7.1	3.1	4.0	7.2
II. Capital account	4.0	5.2	9.2	0.3	0.2	0.6	0.0	0.1	0.1	0.0	0.0	0.0
Net lending (+) / net borrowing (-) (balance from current and capital account)	-131.4	-85.7	-217.1	-148.4	20.7	-127.7	-1.3	-0.9	-2.2	-1.4	0.2	-1.2
III. Financial account	-55.0	-36.2	-91.2	-419.0	-27.6	-446.6	-0.5	-0.4	-0.9	-4.0	-0.3	-4.2
Direct investment	-96.5	22.3	-74.2	-237.2	-87.4	-324.6	-1.0	0.2	-0.7	-2.3	-0.8	-3.1
Portfolio investment	-20.3	7.2	-13.1	-368.6	1.4	-367.2	-0.2	0.1	-0.1	-3.5	0.0	-3.5
Currency and deposits	34.4	19.6	54.0	80.5	72.9	153.4	0.3	0.2	0.5	0.8	0.7	1.5
Loans	29.1	-23.9	5.2	47.5	-58.1	-10.7	0.3	-0.2	0.1	0.5	-0.6	-0.1
Trade credit and advances	-1.8	-61.4	-63.1	58.9	44.3	103.2	0.0	-0.6	-0.6	0.6	0.4	1.0
Other accounts receivable/payable	0.0	-0.1	0.0	0.0	-0.6	-0.7	0.0	0.0	0.0	0.0	0.0	0.0
Special drawing rights (Net incurrence of liabilities)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
IV. Net errors and omissions	9.9	-12.2	-2.3	-14.0	12.7	-1.4	0.1	-0.1	0.0	-0.1	0.1	0.0
V. Reserve assets	-66.5	-61.3	-127.8	256.6	60.9	317.6	-0.7	-0.6	-1.3	2.4	0.6	3.0

Source: NBRM.

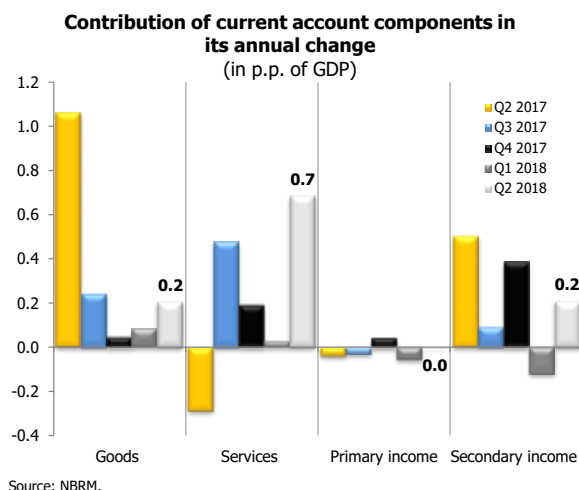
1.6.1. Current account



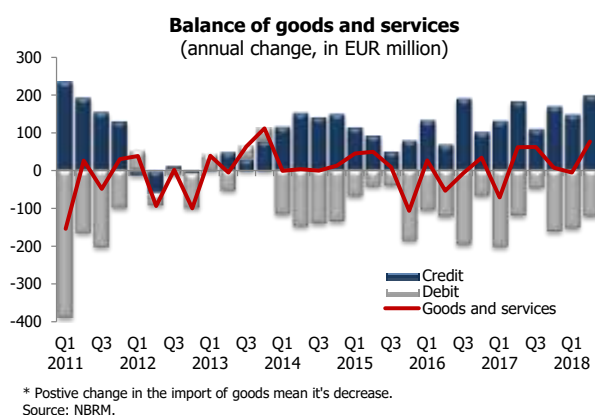
Source: NBRM.

In the second quarter of 2018, the balance of payments' current account registered a surplus of Euro 20.5 million, or 0.2% of GDP³². Such positive balance is atypical for this part of the year, when the current account usually notes deficit. Compared to the same period last year, favorable movements were registered in all current account components. Significant improvement was registered in the surplus in trade in services, while the positive performances in the rest of the components had a moderate effect. In terms of services, several categories registered favorable movements, primarily the processing services, services for the use of intellectual property, transport services, as well as other business services. As for the secondary income, the annual growth mostly arises from the stronger net inflows of private transfers (mainly from the

³² The calculations use the nominal GDP forecast (from October 2018).

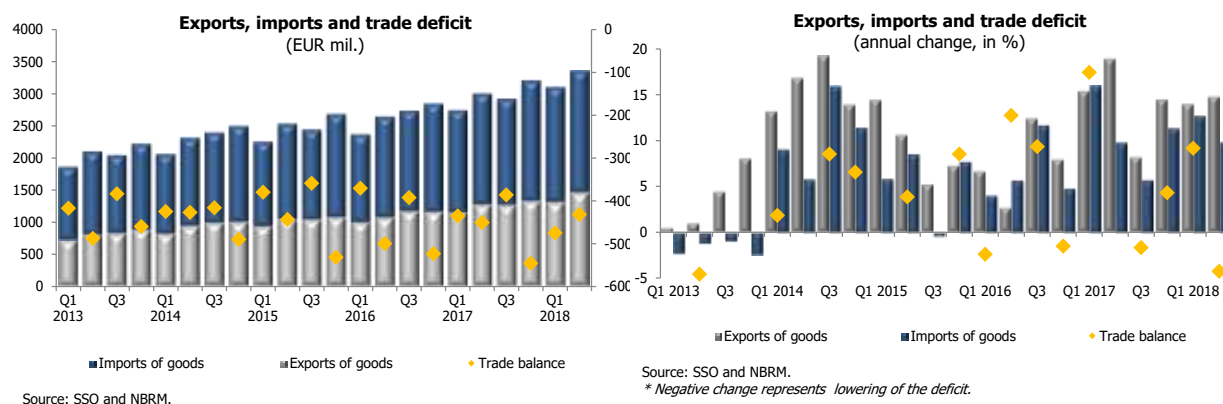


increase in purchased cash foreign currency on the currency exchange market, as an indicator of the cash private transfers), amid low and unchanged official transfers. At the same time, the intensive growth in imports moderately tightened the annual deficit in goods, while the primary income remained almost unchanged compared to the second quarter of 2017.



Box 1: Foreign trade of goods and movement of the Nominal and the Real Effective Exchange Rate (NEER and REER)³³

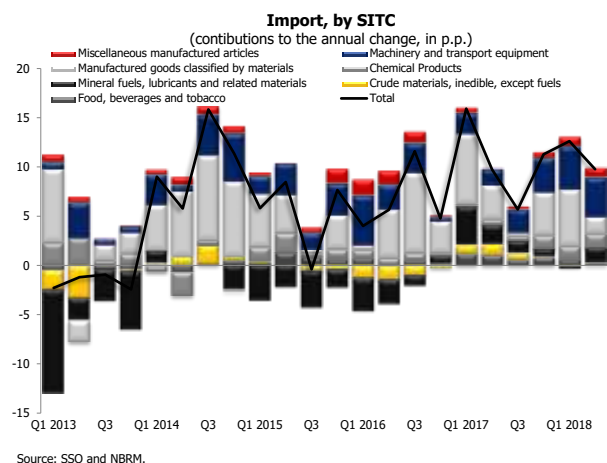
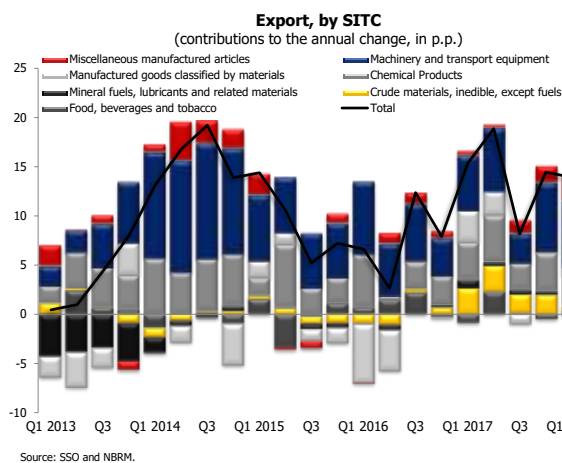
In the second quarter of 2018, the foreign trade amounted to Euro 3,348.1 million, i.e. 31.8% of GDP, which is an annual growth of 11.9% (i.e. 2.1 percentage points of GDP). The annual growth in total trade stems from the growth of its two components.



³³ According to the Foreign Trade Methodology, data on export of goods are published on an f.o.b. basis, and on import of goods, on a c.i.f. basis.

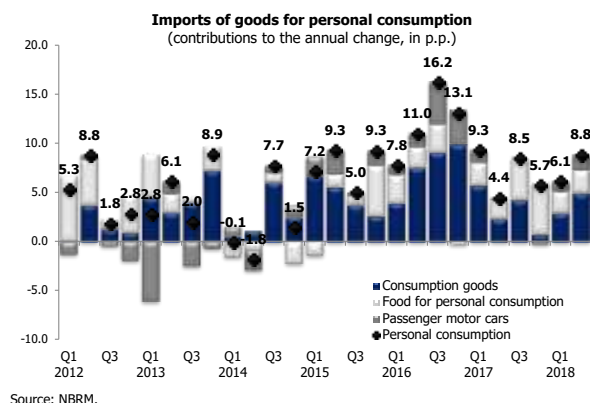
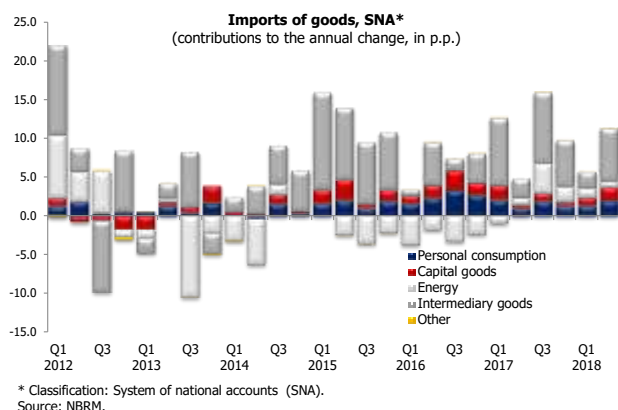


In the second quarter of 2018, the export of goods continued to increase at a solid growth rate of 14.7% annually (13.9% in the previous quarter). The new export-oriented industrial facilities still have the largest contribution to the increase in total exports. Structurally, this is mostly observed through the growing export of machinery and transport equipment, and less through the higher export of furniture. Part of the traditional export branches provided a significant positive impetus to the export growth in this quarter. The export of metal processing industry registered a solid growth, after three consecutive quarters of negative annual changes. The higher export of iron and steel is a combined effect of the increased exported quantities and higher prices. **The import of goods in the second quarter registered a slight slowdown in the annual growth of 9.8%, against the growth of 12.6% in the previous quarter.** The raw material imports for the new facilities is the driver of the annual growth in imports, primarily reflecting the increased import within machinery and transport equipment. Additional upward pressures were made by energy imports, i.e. the imports of oil derivatives. Moreover, the annual growth of the imports of oil derivatives almost entirely reflects the price effect, in line with the increase in the price of oil on world markets, amid slight increase in imported quantities. The other import categories made a modest contribution to the annual import growth in the second quarter. **The annual changes in both foreign trade components reduced the trade deficit by 4.3%.** This change reflects the lower deficit in non-energy component, amid worsening of the energy deficit.



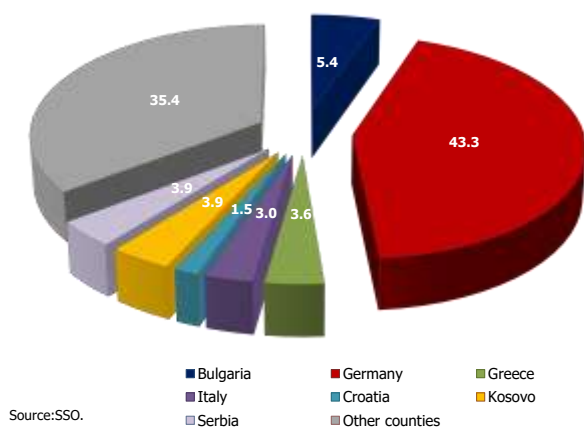
The analysis of the import of goods under the System of National Accounts (SNA) indicates that in the second quarter of 2018 the import of intermediate products made the dominant contribution to the annual growth of total imports. In terms of imports for private consumption, the annual growth of this component reflects the higher imports of consumer goods, amid slight positive contribution of the import of passenger of and food vehicles. In general, the growth of imports for personal consumption in the second quarter of 2018 was moderate and decelerating, which does not indicate pressures on the imports from the growth of private consumption.

The latest available data on foreign trade during July and August 2018 indicate stronger annual growth of the imports compared with the import activity. The export of goods increased by 9.3% annually, which largely reflects the favorable export performances in the new production facilities. In terms of traditional export branches, the higher export of metal industry also contributed to the annual growth, as opposed to the decline in the exports of tobacco processing sector. The import of goods grew annually by 13.9%, due to the increase in the imports of equipment and machinery, as well as to the higher import of energy, while the import of metals registered an annual decline.

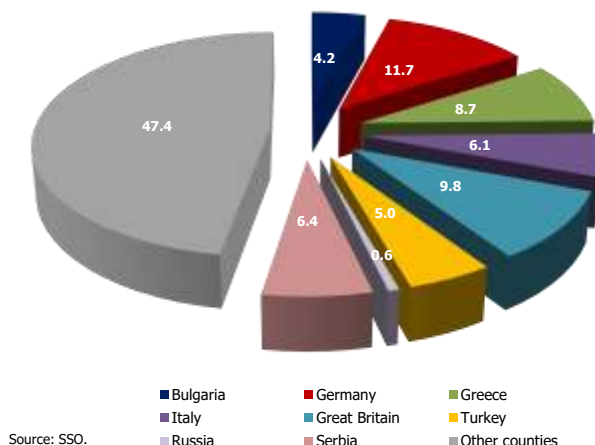


The foreign trade analysis, by trading partner, shows that in the second quarter of 2018, the European Union was the major trading partner of the domestic economy, making up 71.7% of total foreign trade of goods. Observed by country on the exports side, high annual growth was registered in the exports of machinery and equipment to Germany, reflecting the intensified exports of new foreign-owned companies. Part of the exports of new industrial facilities is oriented towards other European market, which led to higher placement in Austria, Great Britain and Belgium. The reduced exports in iron and steel to China acted in opposite direction. In terms of imports, the largest individual contribution to the annual increase in the second quarter was made by the higher imports of oil derivatives from Greece. Moreover, the imports from Germany and Great Britain increased, due to the raw material imports for the needs of the new industrial facilities. Annual growth was also registered in the imports of iron and steel from Ukraine, amid decline in the import demand for these products from Russia. Analyzing balances, the tightening of the trade deficit mostly affected the increase in the trade surplus with Belgium, Austria³⁴ and Germany, as well as the tightening of the trade deficit with Russia. At the same time, the deepening of the negative trade balance with Greece, China and Ukraine acted in opposite direction.

Export of goods, by countries in the second quarter of 2018
(share, in %)

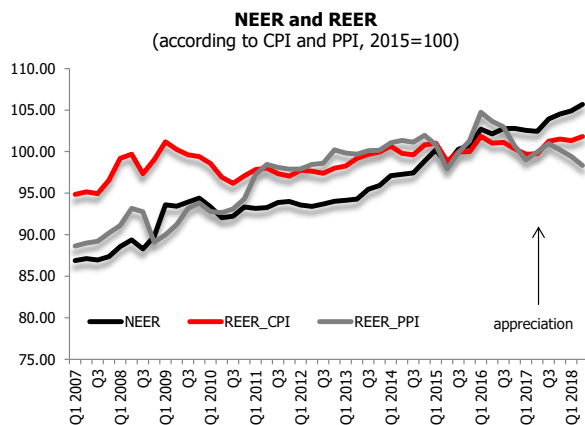


Import of goods, by countries in the second quarter of 2018
(share, in %)

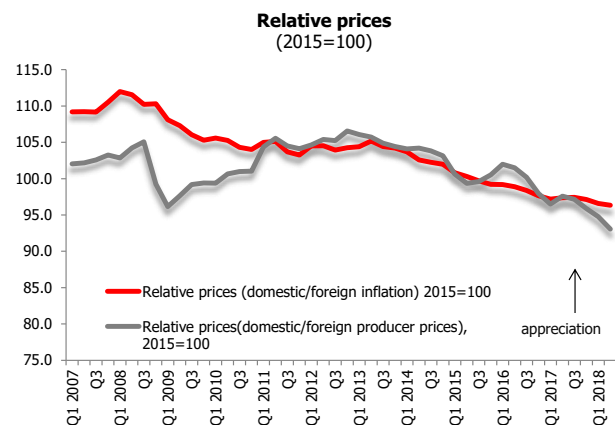


In the second quarter of 2018, price competitiveness indicators of the Macedonian economy registered divergent movements. Namely, the REER deflated by consumer prices appreciated by 2.1%, while the REER deflated by producer prices depreciated by 1.6%. Moreover, the upward pressures result from the NEER, which registered an annual appreciation of 3.2%, caused by the appreciation of the denar against the Turkish lira and the Russian ruble. In terms of the relative prices, the relative consumer prices declined by 1%, while the decline in the relative producer prices was sharper and amounted to 4.6% on an annual basis.

³⁴ In the second quarter of 2018, historically, the trade with Austria registered a small surplus for the first time.

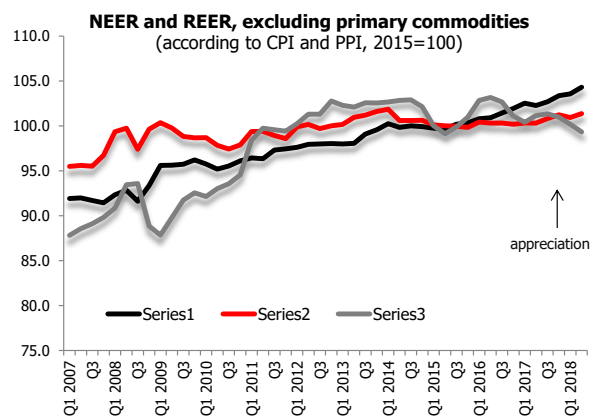


Source:NBRM.

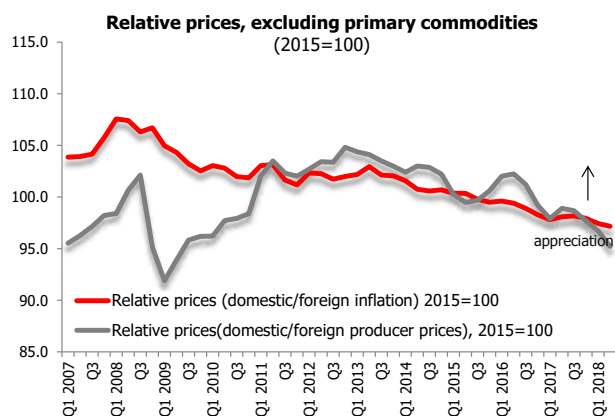


Source:NBRM.

The analysis of REER indices, as measured using weights based on the foreign trade without primary commodities, also indicates divergent changes³⁵. The REER deflated by consumer prices moderately appreciated by 1%, while the REER deflated by producer prices depreciated by 1.8% on an annual basis. The NEER index appreciated by 2% on an annual basis, unlike the decline in the relative consumer prices and the relative producer prices (of 0.9% and 3.7%, respectively).



Source:NBRM.



Source:NBRM.

The latest data on price competitiveness for the period July-August 2018 indicate divergent movements of the REER as measured using weights of the total trade in goods. In circumstances of appreciation of the NEER, the REER deflated by consumer prices appreciated by 1.2%, while the REER deflated by producer prices depreciated by 4.3%. From the viewpoint of REER with weights based on the foreign trade without primary products, the REER calculated according to consumer prices appreciated by 1.3%, and the REER deflated by producer prices depreciated by 3.2%.

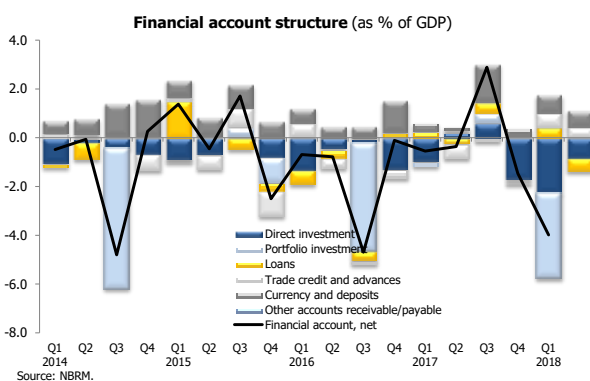
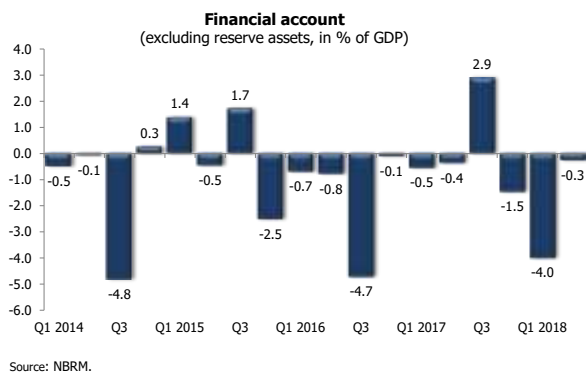
In the second quarter of 2018, the analysis of REER indices calculated according to the unit labor costs³⁶ indicates deterioration in the price competitiveness of the domestic economy. The REER index calculated by weights based on total foreign trade appreciated by 4.3%. The relative labor costs registered an annual growth of 1.2%, while the NEER appreciated by 3.1%. Annual appreciation was registered in the REER index calculated by using weights based on the foreign trade without primary products (by 2.5%), determined by the appreciation of the NEER (by 2%) and the growth of the relative labor costs (by 0.5%).

³⁵ Primary products not included in the calculation are: oil and oil derivatives, iron and steel, ores and imported raw materials for the new industrial facilities. For more detailed information on the methodology for calculating the real effective exchange rate visit: http://nbrm.mk/WBStorage/Files/Statistika_REDK_Informacija_za_promenite_na_metodologijata_za_presmetuvanje_na_realniot_efektiven_devizen_kurs_na_denarot_mak.pdf

³⁶ The REER indices based on the unit labor costs indices are NBRM internal calculations and do not represent a formal statistical survey. The calculation uses data on the unit labor costs indices for the entire economy, published by the ECB and the Bureau of Labor Statistics for the United States. Data based on internal calculations are exceptions, such as the data for Switzerland, as well as for Turkey and Serbia, whereby the calculated indices refer only to the industrial sector.



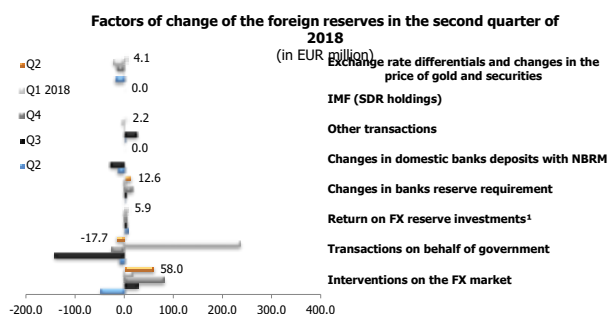
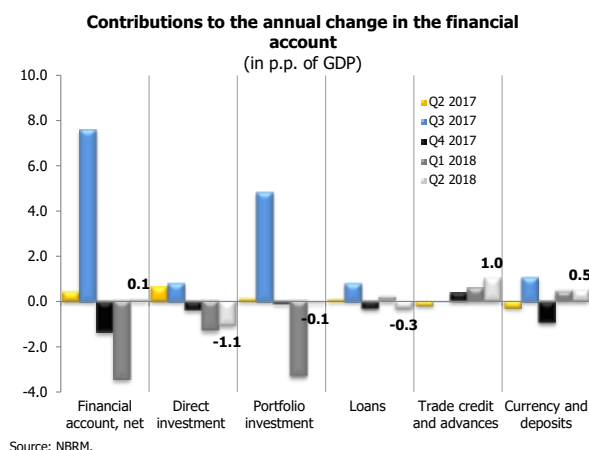
1.6.2. Financial account



In the second quarter of 2018, the financial account of the balance of payments registered net inflows in the amount of Euro 27.6 million or 0.3% of GDP. In this period, foreign direct investments were the main source of financing, mostly arising from high reinvested profits, with a solid contribution from foreign direct investments based on debt instruments (intercompany lending) and equity. Loans also registered positive movements, which almost entirely stem from the long-term component, mainly due to net borrowing of other sectors in the economy. On the other hand, currencies and deposits are the most significant outflow category, reflecting the outflows in other sectors, while net outflows in trade loans acted in the same direction but at a slower pace. The portfolio investments did not significantly affect the financial account balance.

In the second quarter of 2018, the net inflows in the financial account were lower compared to the performances in the same period of the previous year. The unfavorable movements in this period were mostly due to the other sectors' deleveraging based on trade loans (net inflows based on trade loans were registered in the second quarter of 2017), as well as to the higher net outflows in currencies and deposits (mostly due to low net outflows in banks in the second quarter of 2018, against the high net inflows in this category in the same period of the last year). On the other hand, the performances in other financial account categories improved annually, except the investments portfolio which did not register major changes in the performances.

At the end of the second quarter of 2018, the gross foreign reserves amounted to Euro 2,642.2 million, which is a quarterly growth of Euro 65.1



million. The increase in the foreign reserves mainly arises from the NBRM interventions on the foreign exchange market. The remaining flows had a moderate impact on the changes in foreign reserves in the analyzed period.

As of 30.9.2018, gross foreign reserves stood at Euro 2,709.2 million, which is an increase of Euro 66.9 million compared to the end of the second quarter of 2018. The increase in the foreign reserves mainly arises from the NBRM purchase of foreign currency on the foreign exchange market. On the other hand, the decrease in foreign reserves mainly results from the NBRM's transactions on behalf of the government, primarily the regular external debt servicing, and less the price and exchange rate differentials. The remaining flows had a moderate impact on the shifts in foreign reserves in the analyzed period.

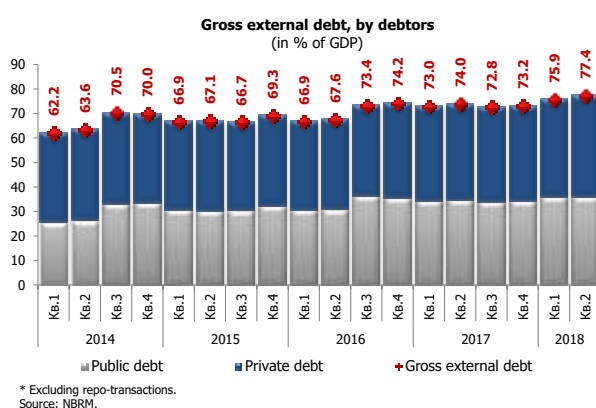
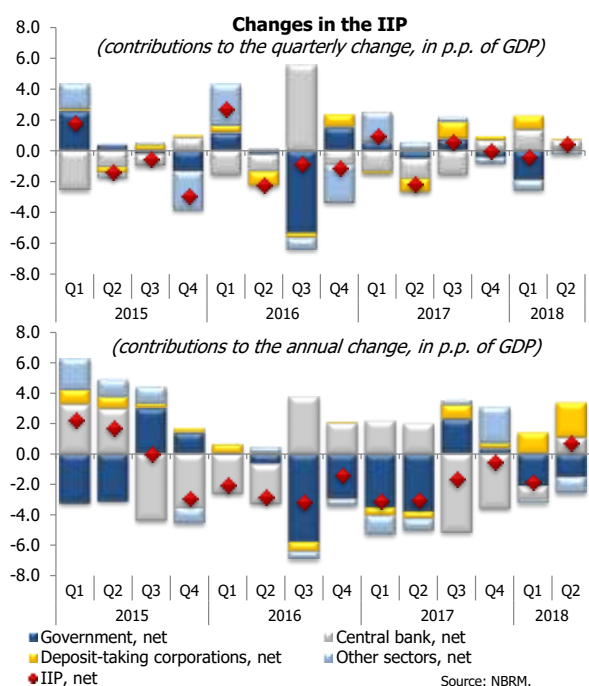
1.6.3. International investment position and gross external debt



At the end of the second quarter of 2018, the negative IIP³⁷ of the Republic of Macedonia equaled Euro 6,070.7 million, or 57.7% of GDP. The quarterly analysis shows decrease in the negative international investment position by 0.5 percentage points of GDP, in conditions of higher growth of international assets relative to the growth of international liabilities. Sector-by-sector analysis shows that the quarterly shift mostly arises from the higher positive net position of the central bank, due to the increase in foreign reserves. On the other hand, the net position of other sectors³⁸ acted in the opposite direction, amid growth in the net liabilities based on foreign direct investments.

³⁷ In the second quarter of 2011, the NBRM began concluding repo and reverse repo transactions. These transactions represent an investment opportunity to use portfolio securities to provide additional income. Conclusion of repo transactions incurs liabilities. At the same time, claims created from reverse repo agreements tend to increase gross claims. The NBRM simultaneously carries out matched repo and reverse repo agreements in nearly identical amounts. In general, as they are concluded concurrently, these transactions have a neutral net effect, i.e. they appear in almost identical amount on both liabilities and assets side, and therefore do not affect the total net IIP nor the total net external debt.

³⁸ Refers to other financial institutions, non-financial corporations, households, and NPISHs.



The net position of government and depository institutions registered no significant changes compared to the previous quarter.

On an annual basis, the negative IIP has decreased by 0.8 percentage points of GDP, as a result of the larger increase in the international assets compared to that of the international liabilities³⁹. Sector-by-sector analysis shows that such change is mostly due to the shifts in both, net position of depository institutions and the central bank. Changes in the government net position acted in the opposite direction, due to higher net liabilities based on debt securities (based on the Eurobond, issued in the first quarter of the year). Increase in net liabilities on an annual basis was registered also in other sectors, based on direct investments and long-term loans.

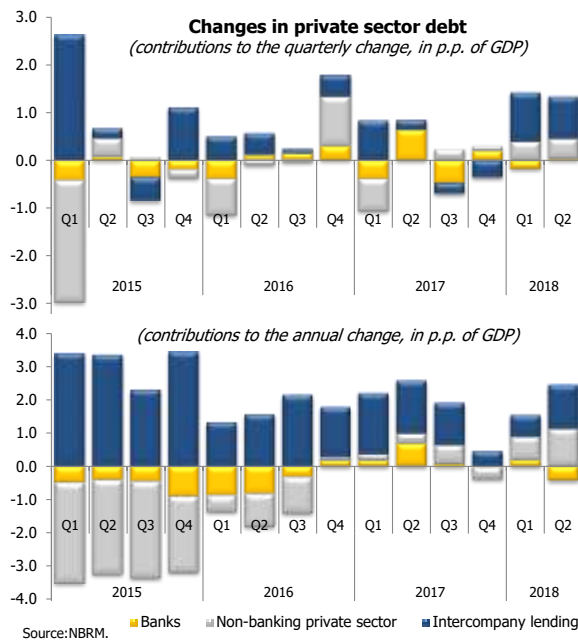
At the end of the second quarter of 2018, the gross external debt stood at Euro 8,432.9 million, or 80.2% of GDP, which is an increase of 1.6 percentage points of GDP, compared to the previous quarter. If we exclude the effect of the repo transactions of the NBRM⁴⁰, the gross external debt stands at 77.4% of GDP and is higher by 1.6 percentage points of GDP, on a quarterly basis. The higher gross external debt mainly arises from the quarterly increase in private debt, while less from the increase in public debt. Within the private debt, the increase is driven by the increase in intercompany lending, as well as the higher long-term liabilities of the non-banking private sector. Regarding the public debt, the change was mostly due to the higher long-term liabilities based on loans with public companies.

On an annual basis, the gross external debt increased by 3.4 percentage points of GDP, amid growth of both the private and the public debt (of 2 and 1.3 percentage points, respectively). The increase in the private sector debt is due to the growth in intercompany debt, as well as to the higher liabilities of the non-banking private sector, in the long and medium term. Analyzing the debt position of the public sector, the growth was driven by the increase in government liabilities on the debt securities and the higher long-term liabilities of public companies.

At the end of the second quarter of 2018, the net external debt stood at Euro 2,993.5 million, or 28.5% of GDP, which is a quarterly decrease of 0.8 percentage points of GDP. The lower net external

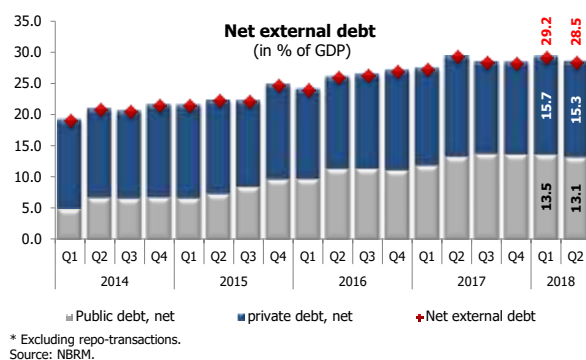
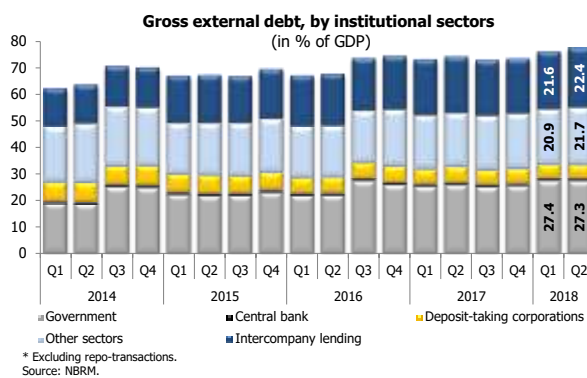
³⁹In absolute amounts, IIP worsened by 3.1% annually.

⁴⁰ The overall analysis below relates to gross external debt without the central bank liabilities based on repo transactions.



debt is due to the decrease in both private and public net debt.

External indebtedness indicators of the national economy shows no significant changes, still indicating that the gross external debt is in the safe zone. The only indicator that classifies the economy in the group of highly indebted countries is the gross external debt to GDP ratio, while other indicators show low indebtedness. Dynamic analysis of the external debt points to favorable annual shifts in some of the solvency and liquidity indicators, i.e. the indicator for the share of gross debt in the export of goods and services and other inflows, the indicator for the interest repayment in the export of goods and services and other inflows, as well as the indicator for the coverage of short-term debt liabilities with residual maturity with foreign reserves. The other indicators registered moderate worsening on an annual basis.





Indicators for external indebtedness	Solvency				Liquidity		
	Interest payments/ Export of goods and services and other inflows	Gross debt/ Export of goods and services and other inflows	Gross debt/ GDP	Debt servicing/ Export of goods and services and other inflows	Foreign reserves/ Short-term debt	Foreign reserves/ Short-term debt, with residual maturity**	Short-term debt/ Overall debt
	in %				ratio	ratio	in %
31.12.2004	2.41	129.3	47.3	12.4	1.14	0.89	30.3
31.12.2005	2.66	147.0	54.2	11.1	1.67	1.04	26.7
31.12.2006	3.44	131.3	49.8	21.7	1.95	1.34	29.0
31.12.2007	2.78	119.3	51.3	19.4	1.35	1.08	39.8
31.12.2008	2.66	116.9	54.1	10.2	1.29	0.95	35.2
31.12.2009	2.43	131.0	57.8	11.8	1.29	0.94	32.9
31.12.2010	3.22	140.4	59.7	13.9	1.49	0.99	27.9
31.12.2011	3.12	148.4	64.6	16.8	1.78	1.18	25.2
31.12.2012	2.92	142.1	67.6	13.1	1.64	1.03	26.7
31.12.2013	2.51	137.3	67.3	15.8	1.64	1.08	23.3
31.12.2014	3.01	149.1	74.0	17.2	1.82	1.13	22.3
31.03.2015	2.69	138.8	70.6	20.0	1.66	1.09	23.4
30.06.2015	2.69	139.3	70.9	20.0	1.56	1.03	23.8
30.09.2015	2.69	138.4	70.4	20.0	1.57	1.03	23.1
31.12.2015	2.69	143.9	73.2	20.0	1.69	1.13	21.3
31.03.2016	2.37	134.76	71.38	14.89	1.51	1.05	23.05
30.06.2016	2.37	136.09	72.09	14.89	1.41	0.98	23.24
30.09.2016	2.37	147.73	78.25	14.89	1.74	1.16	21.72
31.12.2016	2.37	149.39	79.13	14.89	1.65	1.16	21.93
31.03.2017	2.69	138.64	76.36	12.72	1.47	1.00	23.53
30.06.2017	2.69	140.65	77.47	12.72	1.33	0.88	24.19
30.09.2017	2.69	138.20	76.12	12.72	1.26	0.86	24.57
31.12.2017	2.69	139.14	76.63	12.72	1.32	0.89	23.94
31.03.2018	2.51	136.33	78.96	14.57	1.29	0.92	25.01
30.06.2018	2.51	139.13	80.58	14.57	1.27	0.96	25.50
Moderate indebtedness criterion*	12 - 20%	165 - 275%	30 - 50%	18 - 30%	1.00		

*The moderate indebtedness criterion is according to the World bank's methodology of calculating indebtedness indicators, which implies 3-year moving averages of GDP and exports of goods and services in the calculation of the indicators.

In compliance with "External debt statistics: Guide for compilers and users," published by the IMF.

*According

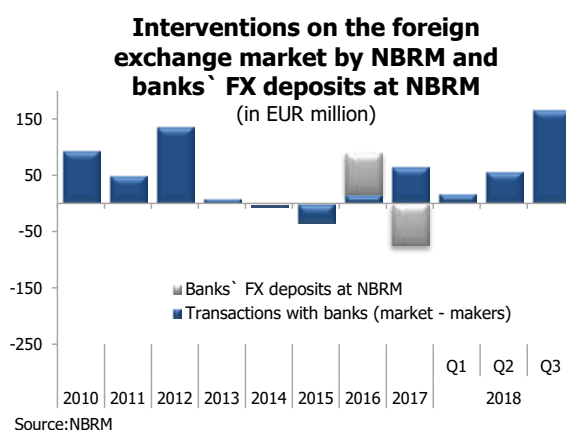
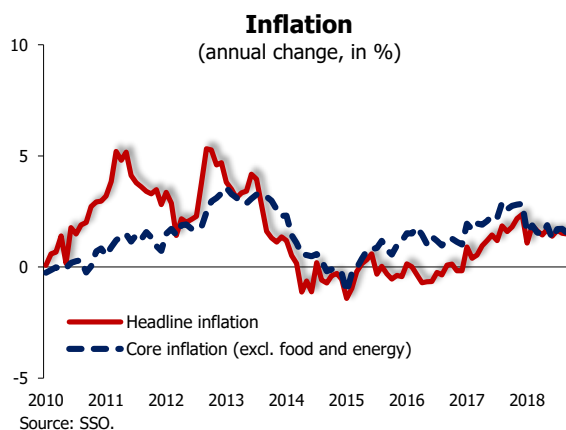
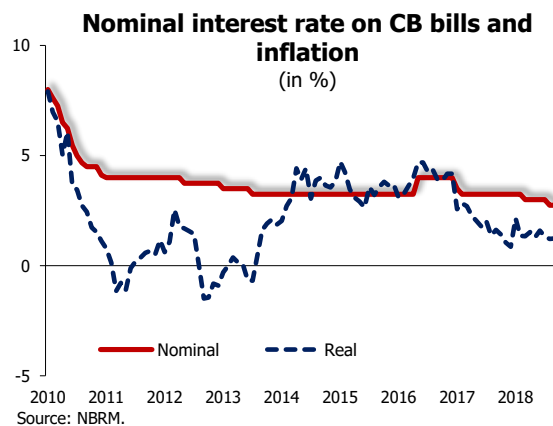
to the "Greenspan-Guidotti rule", a country should maintain full coverage of short-term debt at remaining maturity with gross foreign reserves.

Short-term debt at remaining maturity is calculated by addition of the long-term external debt (original maturity), with final contractually scheduled payment of less than a year, to the short-term debt (original maturity).

Source: NBRM.

II. Monetary policy

During the third quarter of 2018, the NBRM eased the monetary policy by cutting the policy rate from 3.00% to 2.75%. The decision to cut the NBRM policy rate by 0.25 percentage points, for the second time since the beginning of the year was made amid existing favorable foreign exchange market developments, solid external position and stable expectations of the economic agents. Having an improved foreign exchange position of the corporate sector, as well as favorable currency exchange market developments, in the third quarter, the National Bank purchased foreign currency on the foreign exchange market, thus increasing the foreign reserves. All adequacy indicators are still maintained in the safe zone. Further gradual stabilization of the expectations of economic agents was also evident through the banks' deposit base, i.e. positive shifts in household deposits, which further grew. In general, during the quarter, the estimate that the economy is based on healthy economic fundamentals, without imbalances, remained. The NBRM will continue to monitor closely the situation for the timely and appropriate adjustment of monetary policy.

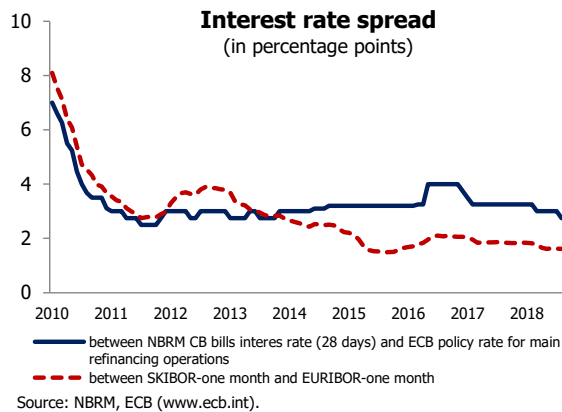


During the third quarter⁴¹ of 2018, the NBRM eased the monetary policy by cutting the policy rate from 3.00% to 2.75%. The decision to cut the policy rate by 0.25 percentage points for the second time since the beginning of the year⁴², was made in the monthly OMPC meeting on 14 August, where it was assessed that the current economic and financial indicators confirm the sound economic fundamentals and the absence of imbalances, while the perceptions of the monetary policy environment are somewhat more favorable. The assessment of both the domestic and the external environment showed continuous presence of risks. Thus, in the period ahead, the NBRM will continue to monitor the situation closely and adjust the monetary policy as appropriate.

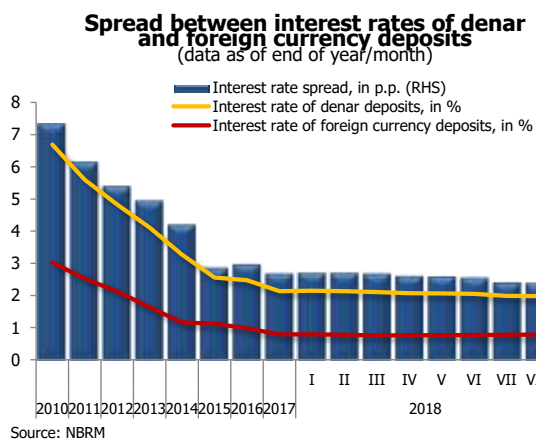
The comparison of the main macroeconomic indicators with their forecast dynamics in the April forecasts did indicated certain deviations in the individual segments of the economy. Inflation growth in the period July-August was moderate and averaged 1.6% on an annual basis. Given the upward correction of import prices and lower inflation than forecast, risks surrounding the inflation forecast of 2% for 2018 were assessed as balanced. The uncertainty around the projected movement of the world prices of primary commodities, primarily oil prices were further referred to as the main risk to the inflation forecast. According to the GDP data for the second quarter, the economy registered solid growth of 3.1%. This performance is slightly lower compared to the forecast and is mainly explained by the continuing fall in gross investments, versus the expectations for their growth during the second quarter of the year, amid a more favorable contribution of net export demand. The foreign reserves in the third quarter of the year increased, largely driven by NBRM interventions with net purchase on the foreign currency market. Foreign reserves adequacy ratios have shown that their level is appropriate and maintained in the safe zone. The growth of banks' deposit base and lending activity continued in the third quarter, signaling stable expectations and increased confidence. Credit market developments matched the results of the Lending Survey in the second quarter, where the banks expressed their expectations for further easing of the overall credit standards and growth in the demand for loans by both sectors for the third quarter of the year. Total deposits and loans at the end of August were higher than the expected at the end of the third quarter of 2018.

⁴¹ It refers to the decisions of the Operational Monetary Policy Committee (OMPC) passed in the July- September.

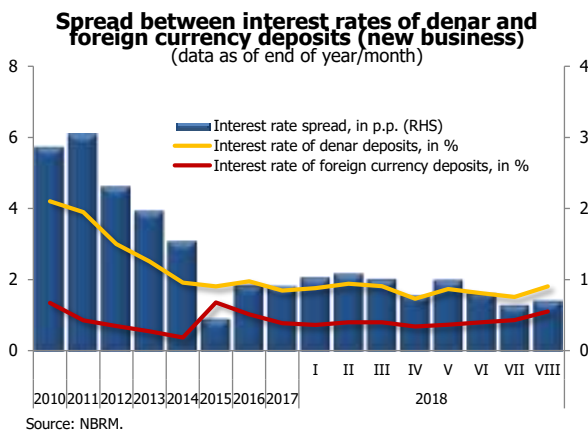
⁴² In March, the NBRM reduced the policy rate from 3.25% to 3.00%.



In September, the European Central Bank announced a decrease in the amount of Assets Purchase Program (from 30 to 15 billion euros a month), as of October 2018, thus keeping the interest rate at their current level, at least by the end of the summer 2019. Given the NBRM policy rate cut and the unchanged ECB rate⁴³ in the third quarter of 2018, the spread between these interest rates moderately tightened. Regarding the indicative market interest rates, amid moderate reduction of the one-month SKIBOR, the spread between the interest rates in the Republic of Macedonia and in the euro area (the one-month SKIBOR and the one-month EURIBOR) slightly narrowed.



In the domestic economy, in August, the total received deposits reduced the interest rates on denar deposits by 0.1 percentage points, relative to June, which amid unchanged interest rate on foreign currency deposits, narrowed the interest spread to 1.2 percentage points (1.3 percentage points in June). The newly received deposits registered moderate increase of interest rates on denar and foreign currency deposits by 0.2 and 0.3 percentage points, respectively⁴⁴, compared to June, thus the interest spread at the end of August amounted to 0.7 percentage points (0.8 percentage points in June).



⁴³ Main refinancing operations rate

⁴⁴ The interest rates on newly received deposits are marked by volatility, which can result in frequent and temporary adjustments of the interest spread.



2.1. Bank liquidity

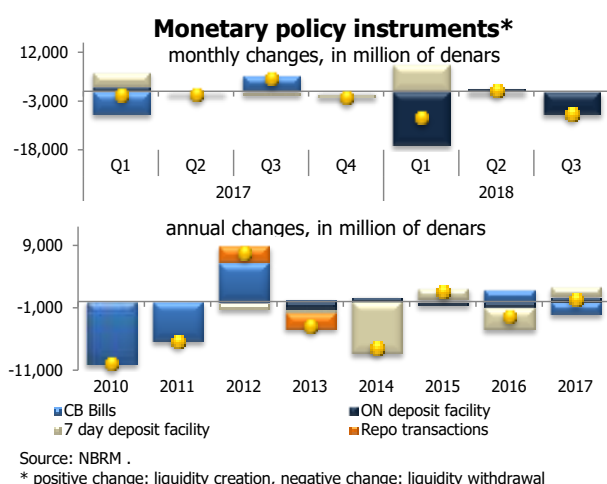
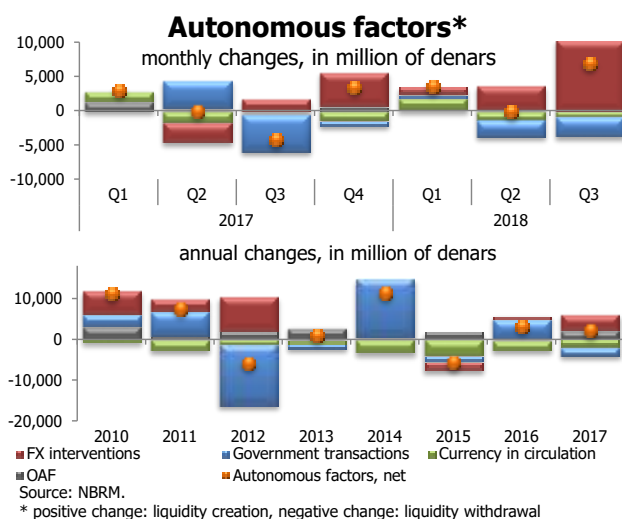
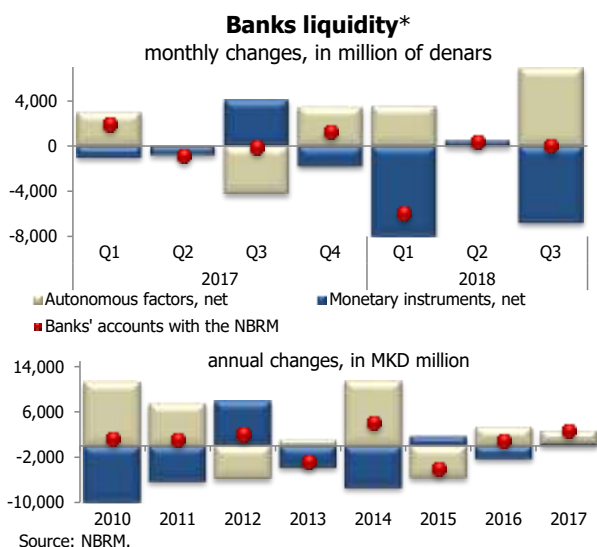
In the third quarter of 2018, the banks' liquid assets⁴⁵ on the accounts with the NBRM slightly grew (Denar 40 million).

The growth of banks' liquidity in the third quarter of the year reflects the effect of the autonomous factors. These factors created net liquidity in the amount of Denar 6,949 million. According to the analysis of the individual autonomous factors, the foreign exchange interventions of the NBRM (purchase of foreign currency on the foreign exchange market) were the dominant factor for creating liquid assets in the banking system. On the other hand, the government transaction and currency in circulation acted towards liquidity withdrawal from the system.

Liquid assets from the banking system in the amount of Denar 6,803 million were withdrawn through the NBRM's monetary instruments, net, in the third quarter. The change in total monetary instruments in the third quarter fully stems from the increase in the stocks of banks' short-term deposits placed with the NBRM (overnight), while the stock of the NBRM CB bills remained at Denar 25,000 million⁴⁶.

In the third quarter of 2018, the amount of liquid assets on the banks' accounts with the NBRM which exceeds the level of reserve requirement was almost identical to the one in the previous quarter. The stock of banks' liquid assets on the accounts with the NBRM in the third quarter was higher by 9.0% on average than the determined amount of the reserve requirement.

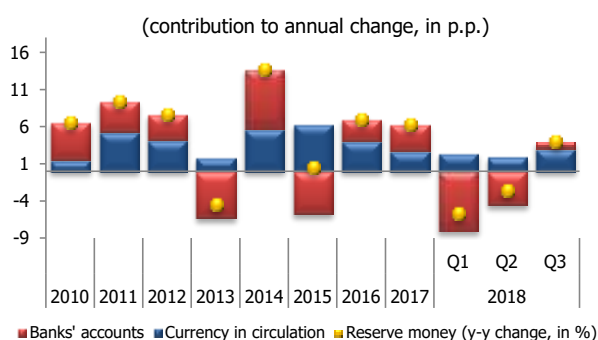
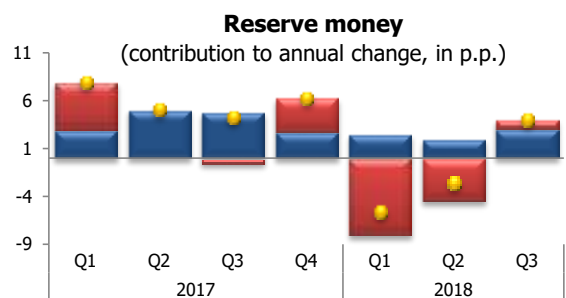
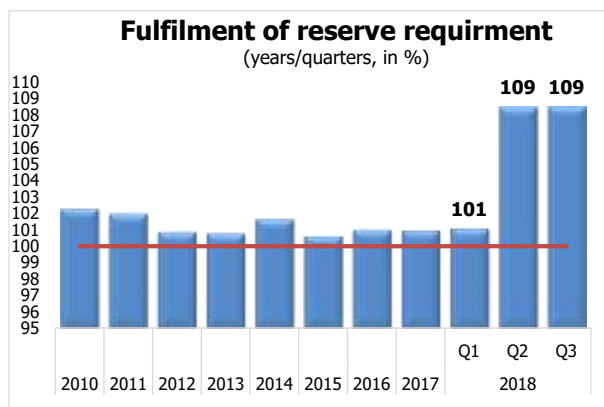
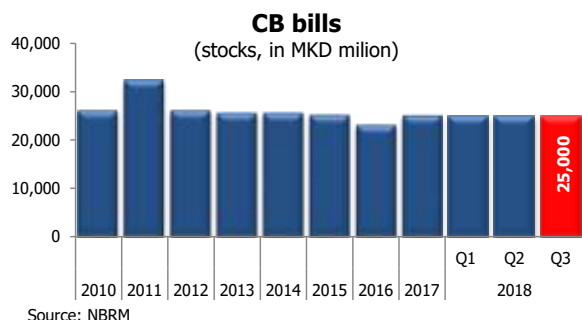
In the third quarter of the year, primary money⁴⁷ increased by 4.1% on annual basis despite the annual decline of 2.5% in the previous quarter.



⁴⁵ Refers to changes in banks' account balances with the NBRM.

⁴⁶ Three CB bill auctions were held in the third quarter of 2018, at which CB bills in the amount of Denar 25,000 million were offered and sold.

⁴⁷ Includes reserve requirement in foreign currency. Data are as of August



Source: NBRM.

III. Financial market developments

In the third quarter of 2018, the indicative SKIBOR rates moved downwards, in line with the cut of the NBRM policy rate, while the short-term deposit market interest rates (MBKS and MKDONIA) remained stable. On the primary government securities market, the tendency to redirect the due short-term securities to longer maturities and the preference for issuance of securities in domestic currency (without currency clause), at lower interest rates, continued. The secondary securities market reported

trade in government securities, thus the executed transactions (including repo transactions) were with lower interest rates. On the capital market, the value of the Macedonian stock exchange index MBI-10 further increased, while the changes in the regional stock exchange indexes were in different direction. On the international financial markets, the financial conditions indexes remained relatively low, indicating stable financial conditions. Macedonian Eurobond yields decreased, thus tightening part of the spreads compared to the yields on the German government bonds.

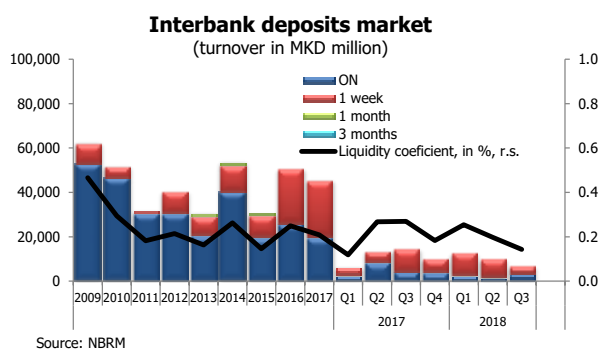
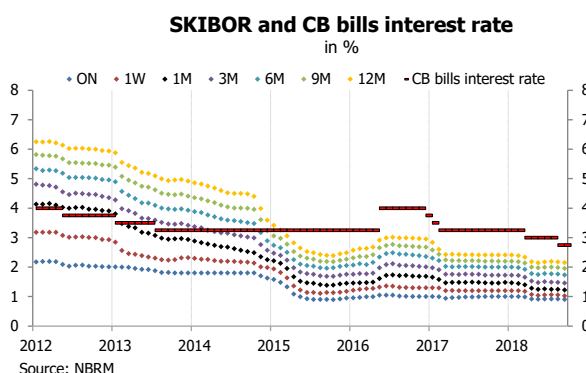
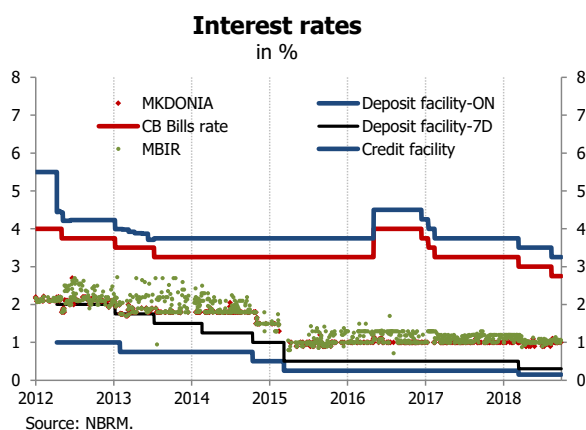
3.1. Unsecured interbank deposit market

In accordance with the cut of the NBRM policy rate in August by 0.25 percentage points, SKIBOR quotations⁴⁸ moved slightly downward, while the interbank money market interest rates remained stable. SKIBOR quotations in the third quarter were lower on the average compared to the previous quarter, with the largest downward movement registered in the last month of the quarter, after the NBRM cut the policy rate in August. In the third quarter, the interbank rate of all transactions (MBKS) equaled 1.0% and remained stable compared to the previous quarter, with the interbank overnight transactions (MKDONIA) registering no changes as well.

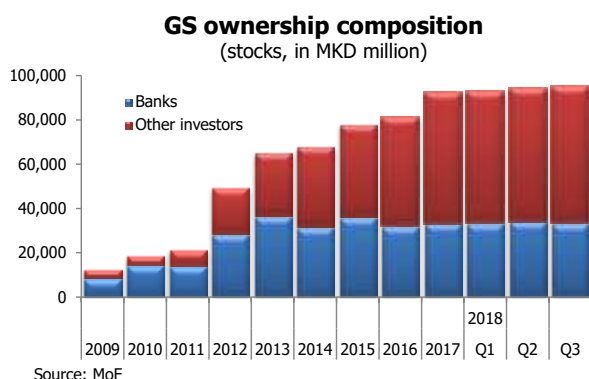
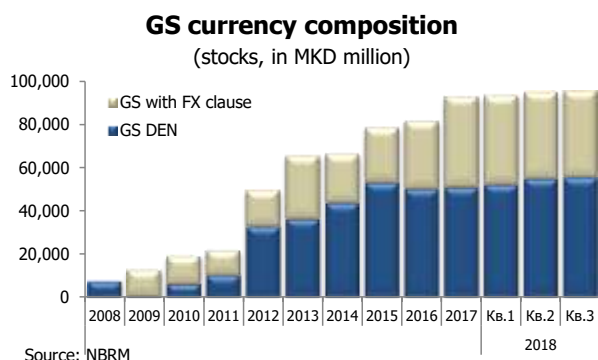
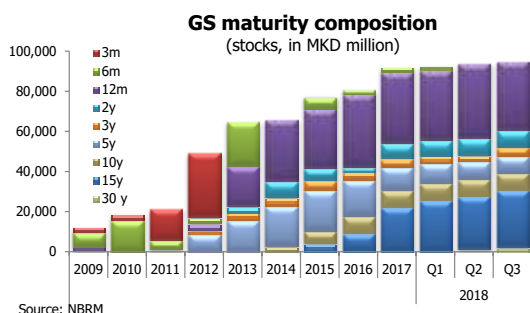
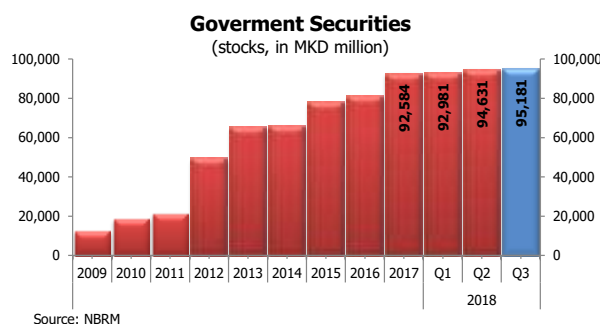
The interbank market of unsecured deposits registered lower trade activity compared to the previous quarter. The total turnover of this market segment in the third quarter of the year amounted to Denar 7,866 million, which was by 24.6% lower on a quarterly basis. As for the turnover, most of the transactions on the interbank market were overnight (42%) and with residual maturity up to 7 days (51%), with trading in maturity segment of 1 month as well.

3.2. Government securities market

On the primary government securities market, the tendency of redirection of the due short-term securities to longer maturities, continued. In the third quarter, the stock of government securities moderately increased, which is entirely due to the growth of the stock of government bonds, while the stock of treasury bills decreased. Observed by maturity categories, significant growth was registered in the three-year, fifteen-year and thirty-year government bonds, while reduction in treasury bills, in terms of both maturity segments (six-month and the twelve-month treasury bills). Such changes contributed to further increase in the share of the fifteen-year government bonds (from 28.2% to



⁴⁸Indicative interest rates for selling Denar deposits on the interbank market, with overnight maturities, 1 week, 1, 3, 6, 9 and 12 months, calculated from the quotations of reference banks.



29.7%) in the total amount of government securities, amid simultaneous reduction of the share of the twelve-month treasury bills (from 39.5% to 36.1%).

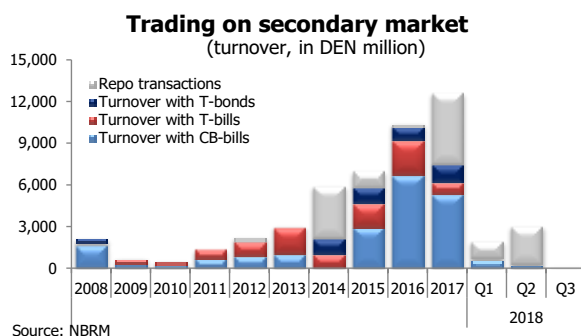
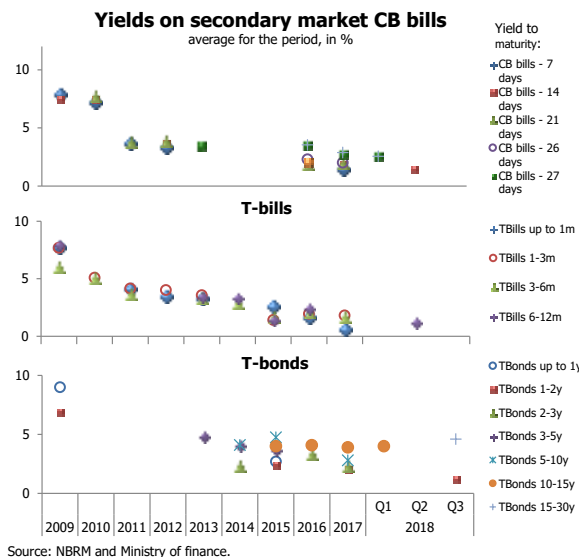
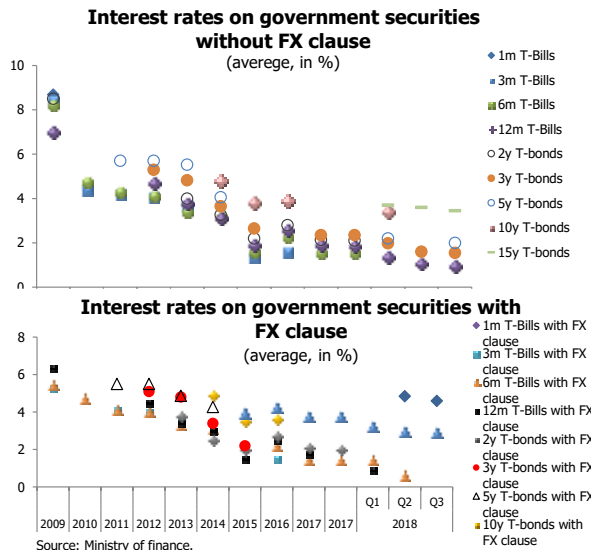
Further positive shifts were registered in the currency structure of government securities. In the third quarter of the year, all issues of government securities, offered and executed, were in denar (without currency clause), as opposed to the combined currency structure of government securities that fell due. As a result, denar securities (without currency component) increased quarterly, while their share in total amount of government securities reached 58.2% (57.9% at the end of the second quarter).

In the third quarter of 2018, the ownership structure of government securities registered no significant change. The majority of the total issued government securities at the end of the third quarter of the year remained in the ownership of other investors (64.8%, compared to 64% in the second quarter), primarily pension funds, while 35.2% are in bank ownership (36% in the previous quarter). On the primary market, in the third quarter of the year, the Ministry of Finance reduced the interest rates on government securities⁴⁹ in certain maturity segments adjusting them along the yield curve.

The secondary securities market registered trade in government bonds. The turnover of the secondary securities market in the third quarter of the year amounted to Denar 181 million and was lower compared to the previous quarter. The structure of turnover almost equally included the outright government bonds transactions (51%) and repo transactions (49%). In the third quarter, the yields for the securities transactions on the secondary market were lower compared to the previous quarter. The yields on the transactions in government bonds, with residual maturity of 1-2 years decreased by 1.2% (previously 2.1%), amid trading with government bonds with residual maturity of 15-30 years, with a yield of 4.6%.

On the Macedonian stock market, the value of the MBI-10 index increased, while the trading decreased quarterly. The value of the MBI-10 in the third quarter increased by 5.0%, which is more moderate compared to the previous quarter (20.5%). The growth of the MBI-10 (from 3,333 to 3,530) is associated with the increase in almost all shares that make up MBI-10 index. The turnover of the

⁴⁹ In August, the Ministry of Finance reduced the interest rates in three-year government bonds without FX clause from 1.80% to 1.60%. In September, interest rates on twelve-month treasury bills without FX clause were reduced from 1.00% to 0.90%, the three-year government bonds without FX clause from 1.60% to 1.50%, the 15-year government bonds without FX clause from 3.50% to 3.40% and the fifteen-year government bonds with FX clause from 3.00 to 2.90%.



Macedonian stock market in the third quarter amounted to Denar 1,865 million and was lower compared to the previous quarter, mostly due to the lower trading in shares. Trading in shares dominated the turnover, with several block transactions conducted as well⁵⁰. In the third quarter, the bond index (OMB) registered no significant changes and reached 129.5 at the end of the third quarter (129.3 at the end of the second quarter).

The stock exchange indices on the regional stock exchanges moved in various directions. The Macedonian stock exchange index MBI-10 continued to move upwards, with a growth, but less intense registered in stock markets indexes in Sarajevo, Ljubljana and Warsaw. On the other hand, the Budapest stock exchange index, which registered pronounced upward dynamics in the past period, declined, for third quarter in a row. Downward shift was also registered in the stock exchange indexes in Bucharest, Sofia, Belgrade and Zagreb.

Volatility indexes on bond and equity markets during third quarter pointed to stable financial conditions. The MOVE and VIX indexes⁵¹, despite the volatile movement during the quarter, remained at a lower level on average compared to the previous quarter.

The yields on long-term government bonds in the United States and the Euro area registered no significant change. The yields on US 10-year government bonds⁵² during the third quarter remained stable, in the average of around 2.9% and despite the further normalization of the monetary policy by the FED by increasing the target level of the interest rate spread by 0.25 percentage points⁵³. On the other hand, yields on 10-year government securities in the Euro area, equaled 0.55% on the average and were lower compared to the previous quarter (0.63%)⁵⁴.

The Macedonian Eurobond yields⁵⁵ decreased, thus tightening part of the spreads compared to the German government bonds. The spread between yields on Macedonian Eurobonds issued in July 2014 and December 2015 and the yields on German

⁵⁰ In the third quarter of 2018, block transaction were registered with shares of four domestic companies, within which the largest transaction was conducted with the shares of Strmos AD Non-metal Mines Probistip.

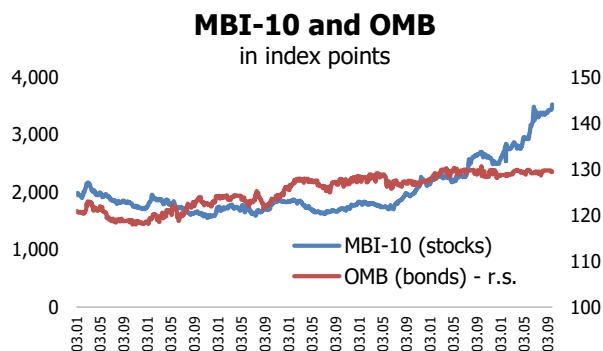
⁵¹ The MOVE index (Merrill Lynch Option Volatility Estimate) shows the volatility of the US government bond markets. The VIX index (Volatility Index) is constructed based on the implied volatility of S&P500 index options. Investors use both indexes as indicators of the conditions and expectations for the financial markets volatility. Downward path in indexes indicates a decrease in volatility.

⁵² Those are generic yields derived from the yield curve of government bonds of the United States.

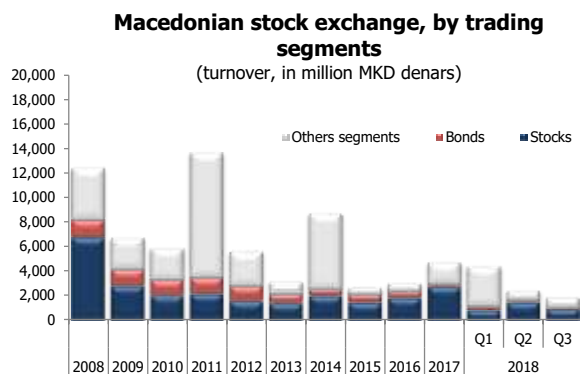
⁵³ Since December 2015, the FED has increased the market interest rate target seven times (from 0.00% -0.25% to 1.75% -2.00%), i.e. by 1.75 percentage points in total.

⁵⁴ Those are generic government bonds derived from the yield curves of government bonds of Germany and France.

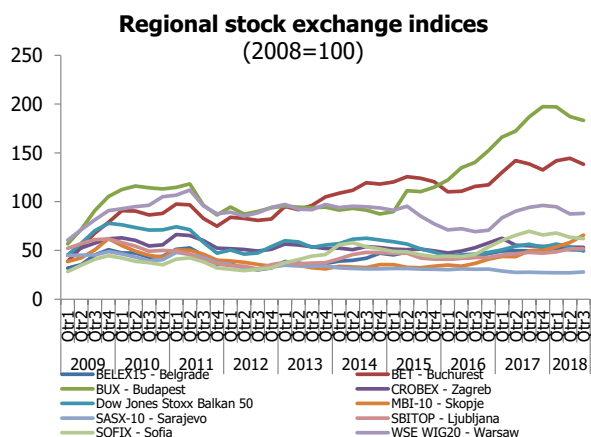
⁵⁵ It refers to the Macedonian Eurobonds issued in July 2014, December 2015, July 2016 and in January 2018. The Eurobonds were issued in the nominal amount of Euro 500 million, Euro 270 million, Euro 450 million, and Euro 500 million, respectively, with a maturity of 7, 5, 7 and 7 years, respectively, and annual interest rates of 3.975%, 4.875%, 5.625% and 2.75%, respectively.



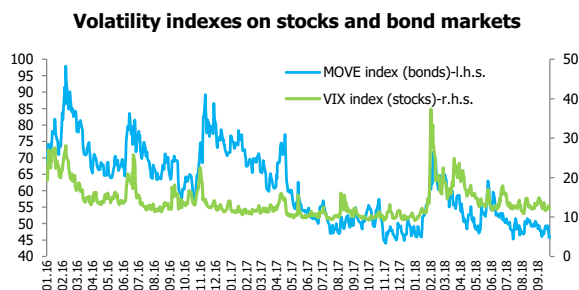
Source: Macedonian Stock Exchange



Source: Macedonian Stock Exchange

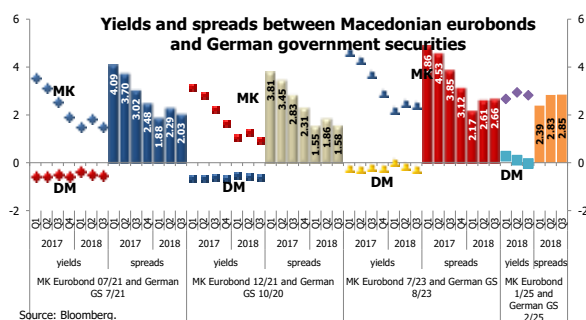
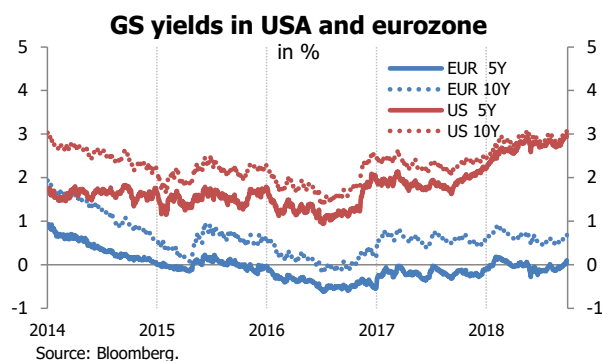


Source: Macedonian Stock Exchange and national stock exchanges.



Source: Chicago Board Options Exchange (CBOE)

government bonds narrowed and equaled 2.03 and 1.58 percentage points on the average for the third quarter (2.29 and 1.86 percentage points in the second quarter), respectively. In the same period, the spread between Macedonian Eurobonds issued in July 2016 and January 2018 and German government bonds remained at a relatively stable level and averaged 2.66 and 2.85 percentage points for the third quarter. (2.61 and 2.83 percentage points in the second quarter), respectively.



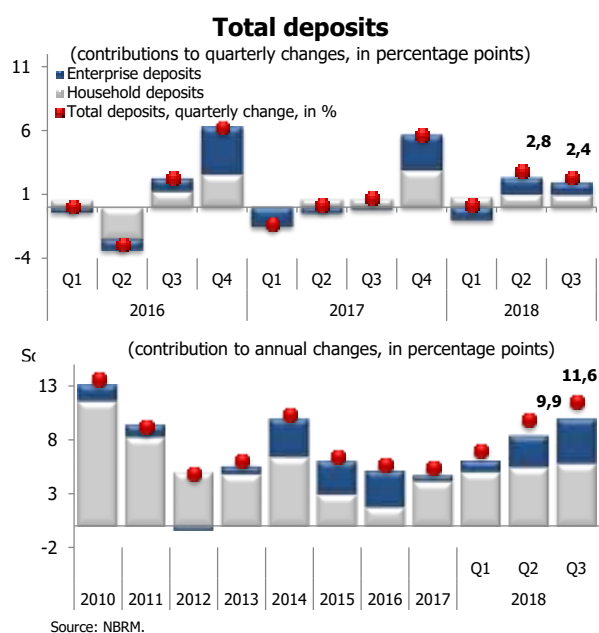
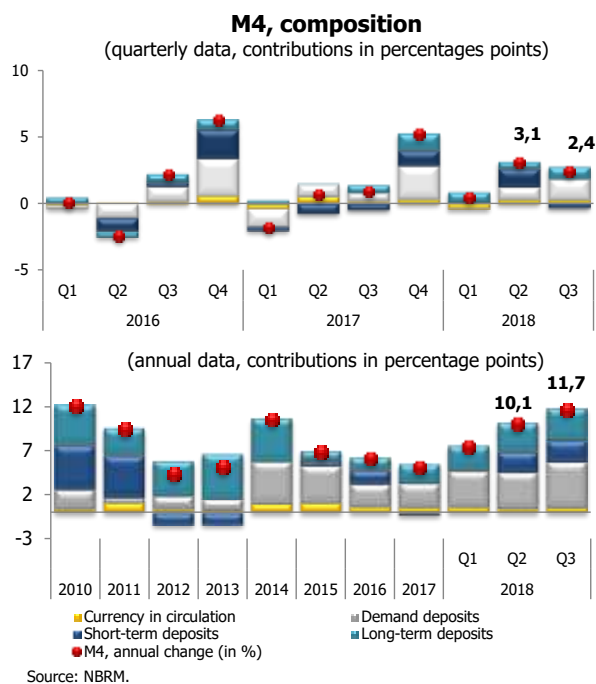
IV. Monetary and credit aggregates

In the third quarter of 2018 monetary and credit aggregates continued to grow, yet at a slower pace compared to the previous quarter. Structurally, money growth in the third quarter was driven by the most liquid component, with positive yet lower contribution of savings. In terms of savings, the analysis of deposit maturity points to further positive contribution of long-term deposits in the growth of money supply, at a moderately faster pace compared to the previous quarter, while short-term deposits declined. Similar developments were registered in the credit market. The credit activity in the third quarter decelerated, due to the moderate household and corporate lending, as opposed to the more intensive growth in the previous period. Such performance is partly underpinned by the results of the Lending Survey for the third quarter, which indicate a net decrease in the demand for household loans, amid significantly decelerated growth in the demand for corporate loans, in conditions of further net-easing of the total credit standards in both sectors.

4.1. Monetary aggregates

The broad money M4 in the third quarter of 2018 registered a quarterly growth of 2.4%, which was moderately lower compared to the previous quarter (3.1% growth). Structurally observed, the growth was mainly due to the most liquid component (cash in circulation and demand deposits) with contribution of 1.9 percentage points, prevailed by the contribution of the demand deposit⁵⁶ (1.6 percentage points), with lower positive contribution of savings (0.6 percentage points). In terms of savings, the analysis of deposit maturity points to further positive contribution of long-term deposits in the

⁵⁶The third quarter of 2018 registered more intensive payments from the Budget of the RM based on tax refund liabilities.



growth of money supply, moderately higher compared to the previous quarter, while short-term deposits declined. These structural shifts point to further gradual stabilization of expectations among economic agents. Observing currency, increase was registered in both currency components, with a significant decrease in the contribution of the foreign currency relative to denar component (denar deposits, excluding demand deposits). At the end of the third quarter, the share of foreign currency deposits in M4 (36.8%) was lower compared to the end of the previous quarter (37.6%). **Annually**, the growth of broad money accelerated, reaching 11.7% in September, as opposed to 10.1% at the end of the second quarter.

The total banks' deposit potential in the third quarter continued to increase, but at a moderately slower pace compared to the previous quarter (from 2.8% in June, to 2.4% in September). The analysis of the sectoral structure points to an almost equal contribution of household and corporate deposits to the quarterly growth of total deposits. In terms of dynamics, moderate slowdown was registered in the quarterly increase of corporate deposits. The moderate increase in deposits of other financial institutions also made positive contribution to the quarterly growth of total of deposits⁵⁷. The analysis of the currency structure points to further quarterly growth of denar deposits (with demand deposits), which mostly derives from the contribution of demand deposits. Foreign currency deposits continued to increase quarterly at a significantly slower pace compared to the previous period. Consequently, there was a decrease in the contribution of foreign currency deposits to total deposit growth. Analyzing the maturity structure, the growth was entirely due to the higher long-term deposits, amid fall in short-term deposits. **Annually**, the growth of total banks' deposits accelerated, reaching 11.6% in September (9.9% at the end of the second quarter).

Total household deposits in the third quarter further grew, at the same pace as in the previous period (of 1.4%). The increase in household deposits was due to the higher foreign currency deposits, amid solid growth of denar deposits, primarily demand deposits. The third quarter registered a stronger positive contribution of long-term deposits to the total quarterly growth compared to the increase in short-term deposits.

⁵⁷ Other financial institutions include: investment funds, pension funds, insurance companies, investment funds management companies and pension funds management companies, financial companies and finance leasing companies.



Total deposits

	2017				2018		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
	quarterly change, in %						
Total deposits	-1.29	0.2	0.8	5.7	0.2	2.8	2.4
	contributions to quarterly growth, p.p.						
Deposit money	-1.3	1.0	0.7	3.0	-0.7	0.7	1.7
Denar deposits	0.0	-0.4	0.0	0.9	0.5	0.7	0.6
FX deposits	0.0	-0.4	0.2	1.9	0.5	1.4	0.1
Short-term deposits	-0.3	-0.8	-0.5	1.3	0.1	1.6	-0.4
Long-term deposits	0.3	0.1	0.7	1.4	0.9	0.6	1.0
Households	0.0	0.6	0.6	2.9	0.8	1.0	0.9
Enterprises	-1.5	-0.5	-0.2	2.8	-1.0	1.3	1.0

Source: NBRM.

Household deposits

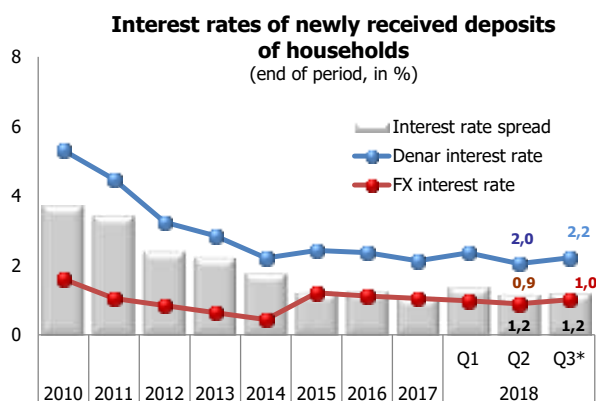
	2017				2018		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
	quarterly change, in %						
Total household deposits	0.1	0.9	0.9	4.1	1.2	1.4	1.4
	contribution to quarterly change of total deposits, in p.p.						
Deposit money	-0.5	1.4	-0.1	2.5	-0.1	0.3	0.4
Denar deposits	0.1	-0.4	0.2	0.5	0.5	0.1	0.2
FX deposits	0.5	-0.1	0.9	1.1	0.8	1.1	0.8
Short-term deposits	0.2	-0.7	0.6	0.6	0.5	0.7	0.2
Long-term deposits	0.4	0.2	0.5	1.0	0.8	0.5	0.8

Source: NBRM.

Enterprise deposits

	2017				2018		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
	quarterly change, in %						
Total household deposits	-5.7	-1.9	-0.7	11.1	-3.9	5.3	3.9
	contribution to quarterly change of total deposits, in p.p.						
Deposit money	-3.6	-0.2	2.3	5.8	-2.7	1.7	5.6
Denar deposits	-0.8	-1.0	-1.2	0.7	-1.2	1.2	0.0
FX deposits	-1.3	-0.6	-1.8	4.6	0.0	2.3	-1.7
Short-term deposits	-2.1	-1.9	-3.3	3.9	-1.4	3.7	-2.0
Long-term deposits	-0.1	0.2	0.3	1.4	0.2	-0.1	0.2

Source: NBRM.



*end of August
Source: NBRM.

On an annual basis, the growth of total household deposits accelerated in September, reaching 8.4%, against 7.9% at the end of June 2018.

The total corporate deposits in the third quarter continued to increase at a moderately slower pace compared to the previous period (from 5.3% at the end of June, to 3.9% at the end of September).

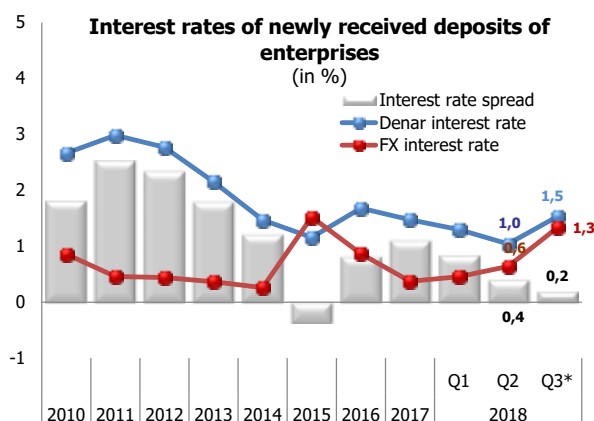
Observing the currency structure, the increase is fully due to demand deposits, amid decline in foreign currency deposits. Analyzing the maturity structure, the growth in the third quarter is entirely due to long-term deposits, amid negative contribution of short-term deposits. **On an annual basis**, corporate deposits increased by 16.8% at the end of September, which is an acceleration in relation to the annual growth compared to the end of June (11.6% growth).

The increase in deposit base was registered amid increase in the yields⁵⁸ on new savings in both sectors. Thus, in August, interest rates on newly received denar and foreign currency household deposits (2.2% and 1%, respectively) were higher by 0.2 and 0.1 percentage points, respectively compared to June. In such conditions, the interest rate spread between the new denar and foreign currency savings of households in August remained at the same level as in the previous quarter (of 1.2 percentage points). **Interest rates on newly accepted denar and foreign currency corporate deposits increased** by 0.5 and 0.7 percentage points, respectively compared to June, thus amounting to 1.5% and 1.3%, respectively. At simultaneous growth of both interest rates, the interest rate spread between the newly accepted denar and foreign currency corporate deposits in August decreased from 0.4 percentage points in June to 0.2 percentage points in August. As for the total accepted deposits, the interest rates on (denar and foreign currency) corporate and household deposits in August registered no changes compared to June and amounted to 1.6% and 1.4%, respectively.

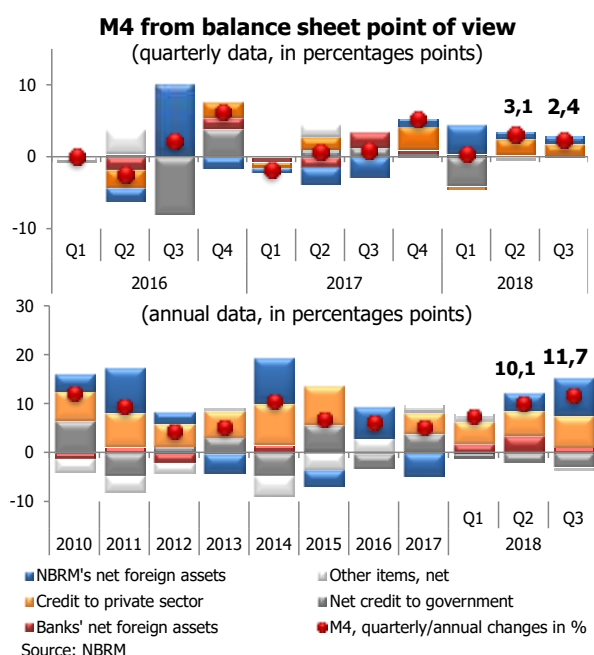
Observing the money supply structure, in terms of balance, the quarterly increase in money supply in the third quarter of the year was mostly a result of the loans to the private sector, as well as net foreign assets of the NBRM and less

⁵⁸ Data on interest rates are in accordance with the methodological changes of the NBRM from June 2018. For more information on the methodological changes visit:

http://www.nbrm.mk/monetarna_statistika_i_statistika_na_kamatni_stapki.nspix.



*end of August
Source: NBRM.



to the government net loans. Net foreign assets of banks acted in opposite direction.

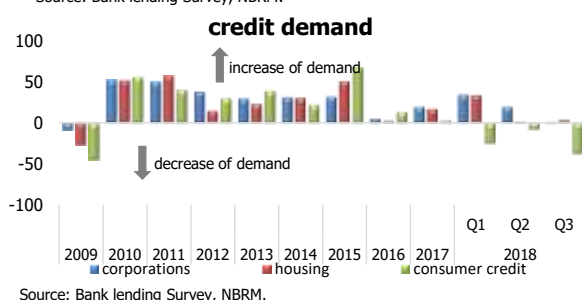
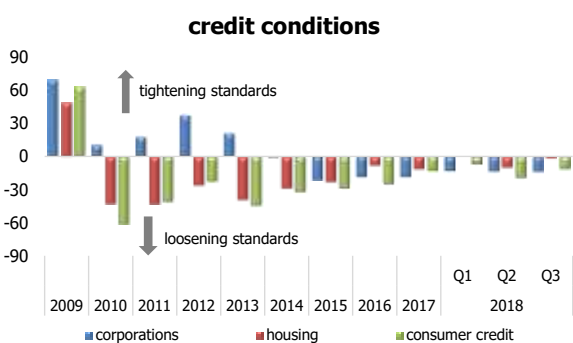
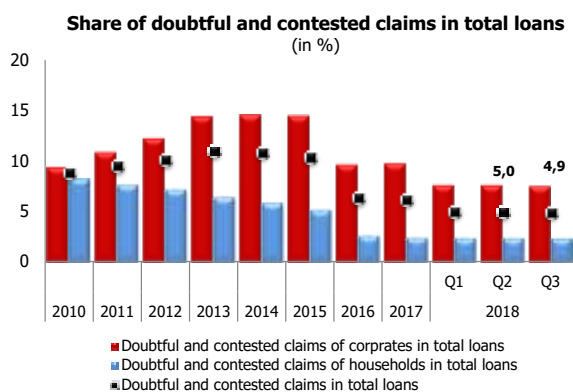
4.2. Lending activity

The Lending activity in the third quarter continued to increase, but at a moderately slower pace compared to the previous quarter (from 2.7% to 1.8%). The slower growth is mostly a result of the performances in the first two months of the quarter, with positive movements in September, primarily in corporate loans. Such performance is partly underpinned by the results of the Bank Lending Survey⁵⁹ for the third quarter, which show net reduction in household credit demand, amid decelerated increase in demand for corporate loans, in conditions of further net easing of total credit standards. In the fourth quarter of 2018, banks expected a net increase in total demand for loans

Total credits of private sector							
	2017				2018		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
quarterly change, in %							
Total credits of private sector	-1.0	2.2	0.2	3.9	-0.7	2.7	1.8
Contribution in quarterly change of total credits (in p.p)							
Denar credits	-0.9	1.7	1.4	3.1	-0.6	1.6	1.1
Foreign currency credits	0.0	0.5	-1.1	0.8	-0.2	1.1	0.7
Short-term credits	-1.4	0.5	-0.6	2.1	-0.8	0.6	0.0
Long-term credits	0.8	1.1	0.9	2.0	1.3	2.0	1.7
Households	1.0	1.4	1.0	0.8	1.1	1.6	1.2
Corporations	-1.9	0.8	-0.8	3.1	-1.8	1.1	0.6

Source: NBRM.

⁵⁹ For more information, also see Bank Lending Survey at <http://nbrm.mk/?ItemID=F7AC78DEE498764FBAF39049F726CE3C>.



Total credits of households	2017				2018		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
quarterly change, in %							
Total credits of households	2.1	3.0	2.1	1.6	2.308	3.3	2.5
Contribution in quarterly change of household credits (in p.p)							
Denar credits	1.0	2.1	1.5	0.7	1.38	2.4	1.7
Foreign currency credits	1.1	0.9	0.7	1.0	0.9	0.9	0.8
Short-term credits	0.3	0.1	0.1	-0.4	0.3	0.3	0.2
Long-term credits	1.8	2.8	1.8	2.3	2.0	2.9	2.3

Source: NBRM.

by both sectors, amid further easing of total credit standards.

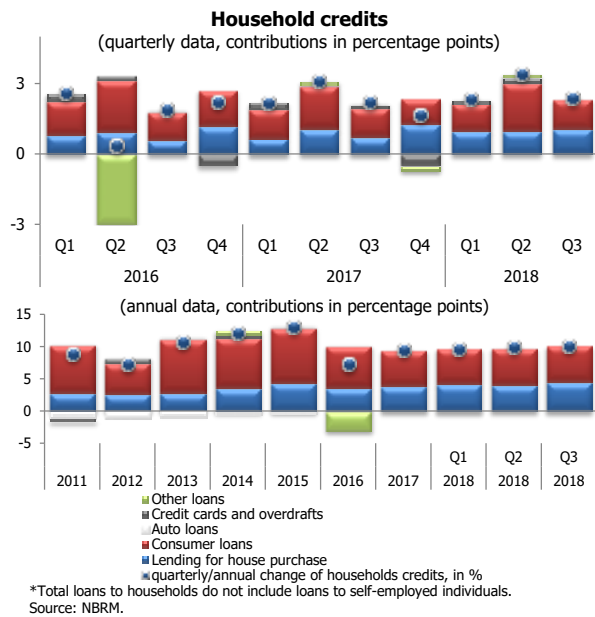
Analyzed by sector, the slower quarterly lending to private sector was mainly explained by the reduced credit support to the corporate sector. Consequently, there was a decrease in the share of corporate loans in total loans. Household loans registered decelerated growth in the third quarter, still dominating the growth in total loans. In terms of **currency structure**, the growth of total loans to the private sector in the third quarter was mostly due to the growth of denar loans, amid solid growth of foreign currency loans⁶⁰. The analysis of **maturity structure** shows that the quarterly increase in total loans was primarily due to the higher long-term loans, amid slight increase in short-term loans. The share of doubtful and contested claims in total loans was almost unchanged at the end of September compared to the previous quarter and amounted to 4.9% (5% in June).

Annually, in September total loans registered an increase of 7.9%, which was higher compared June (6.2%). During the third quarter, amid increase in deposit base and lending activity, the loan-to-deposit ratio remained at a stable level of around 85%.

The slowdown in the quarterly growth of household loans in the third quarter of 2018 (from 3.3% to 2.5%) is a result of the slower quarterly growth of consumer loans, amid stable and positive contribution of housing loans. According to the Lending Survey, the third quarter registered slight net increase in housing loans, amid further net decrease in consumer loans, but at a faster pace compared to the previous quarter. Analyzing the currency structure, the growth of household loans predominantly resulted from denar loans, amid increase in foreign currency loans. Analyzing the maturity structure, the growth is mostly due to the higher long-term loans, amid a moderate positive contribution of short-term loans. **On an annual basis**, total household loans increased by 10.1% at the end of September, which is moderately higher compared to the end of June (9.7%).

Total loans to corporate sector during the third quarter of 2018 registered a quarterly growth, which was more moderate compared to the previous quarter (1.1% versus 2.1%). Such performance was also

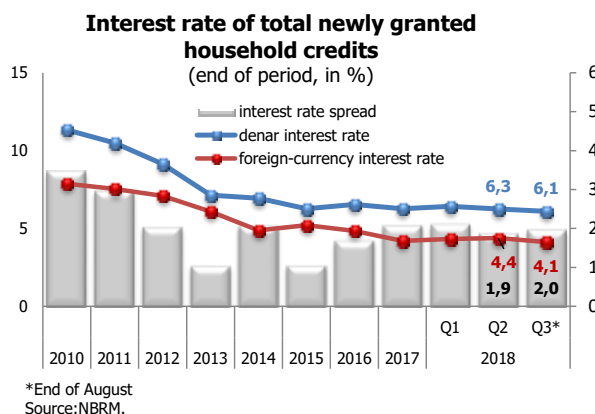
⁶⁰ According to the new Methodology, foreign currency loans also include denar loans with currency clause.



Total credits of corporations

	2017				2018		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
quarterly change, in %							
Total credits of corporations	-3.6	1.5	-1.5	6.1	-3.5	2.1	1.1
Contribution in quarterly change of corporation credits (in p.p)							
Denar credits	-2.6	1.4	1.2	5.4	-2.4	0.9	0.5
Foreign currency credits	-1.0	0.1	-2.8	0.7	-1.1	1.2	0.6
Short-term credits	-2.8	0.9	-1.3	4.4	-1.8	0.8	-0.1
Long-term credits	-0.1	-0.4	0.1	1.8	0.7	1.1	1.2

Source: NBRM.

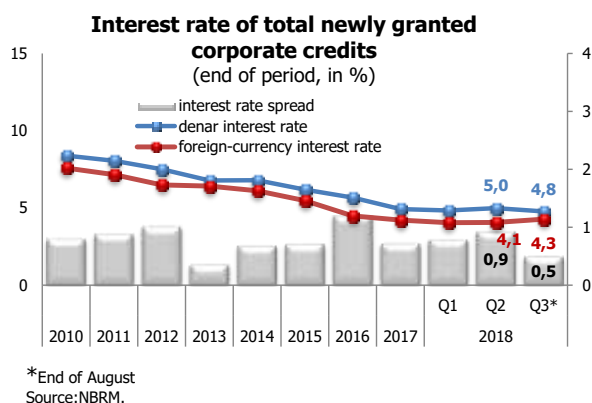


underpinned by the results of the Bank Lending Survey for the third quarter, which indicated a net decrease in the demand for loans by small and medium-sized enterprises amid slowdown in the growth of demand for loans by large enterprises. According to the currency structure, the increase in corporate loans in the third quarter equally arises from the increase in denar and foreign currency loans. Analyzing the maturity, the growth of corporate loans was entirely due to the higher long-term loans, amid quarterly fall in short-term loans. **On an annual basis**, total corporate loans increased by 5.7% at the end of September, which is higher compared with the end of June (2.9%).

According to the data⁶¹ on interest rates on new loans⁶², in August, the interest rates on denar and foreign currency loans to households dropped by 0.2 and 0.3 percentage points, respectively compared to June and amounted to 6.1% and 4.1%, respectively. In such circumstances, the interest rate spread between the new denar and foreign currency loans slightly widened (from 1.9 to 2 percentage points). Interest rate on new denar loans to the corporate sector was 4.8% which was a decrease of 0.2 percentage points compared June, while the interest rate on new foreign currency loans increased by 0.2 percentage points at 4.3%. In such circumstances, the interest rate spread narrowed (from 0.9 percentage points to 0.5 percentage points). The interest rates on the total household and corporate loans (both denar and foreign currency) at the end of August decreased intangibly compared to June and equaled 6.2% and 4.8%, respectively.

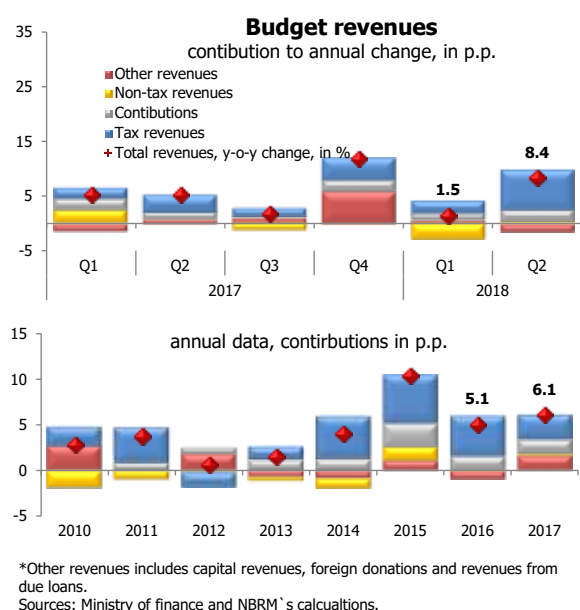
⁶¹ Data on interest rates are in accordance with the methodological changes of the NBRM from June 2018. For more information on the methodological changes visit: http://www.nbrm.mk/monetarna_statistika_i_statistika_na_kamatni_stapki.nspix.

⁶²Note that the interest rates on newly approved loans are volatile. Volatility of interest rate on newly approved loans results from the fact that they are driven by the volume of newly approved loans (which can vary from month to month) and their interest rate.



V. Public finance

In the second quarter of 2018, budget revenues and expenditures increased on an annual basis. The increase in budget revenues mostly reflects the improved performances in taxes, primarily revenues from value added tax and income tax. Moderate positive contribution to the growth in total revenues was made from revenues based on contributions. Regarding budget expenditures, the growth is a result of the current expenditures, while the contribution of the capital expenditures is negative. In the second quarter, the budget deficit equaled 0.2% of GDP, which is lower performance compared to the same quarter last year (0.8% of GDP). In the period January–August, the budget deficit was 1.1% of GDP (1.7% in the same period of 2017), accounting for 37.5% of the budget deficit forecast for 2018. In this period, the budget deficit was financed mostly by part of the inflows from the Eurobond of the Republic of Macedonia issued in January 2018, and to a small extent through a new issue of government securities on the domestic financial markets. At the end of the second quarter of 2018, total public debt equaled 48.8% of GDP, which is by 0.5 percentage points more compared to the previous quarter.



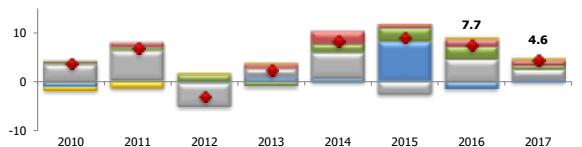
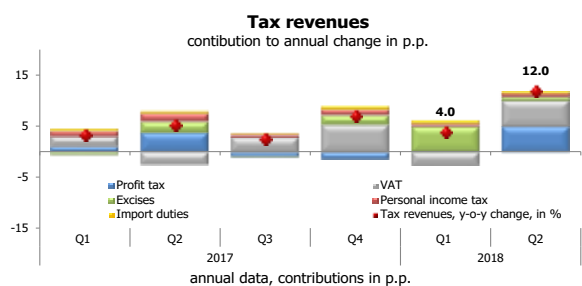
In the second quarter of 2018, the total revenues in the Budget of the Republic of Macedonia⁶³ increased by 8.4%, on an annual basis. Higher performances, observed structurally, mostly reflect the increase in taxes (contribution of 7.3 percentage points), and less the contributions of non-tax revenues, with contributions to the annual growth of 2.1 and 0.4 percentage points, respectively. Other revenues⁶⁴ made a negative contribution of 1.5 percentage points, entirely due to lower foreign donations.

In the second quarter of 2018, total tax revenues⁶⁵ were higher by 12.0% on an annual basis. The growth of tax revenues mainly arises from the higher performance of VAT and personal income tax, with a contribution of 5.0 and 4.8 percentage points, respectively. The personal income tax, excises and import duties made a small

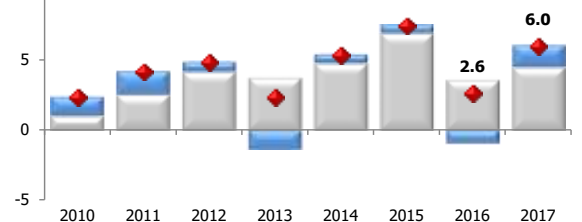
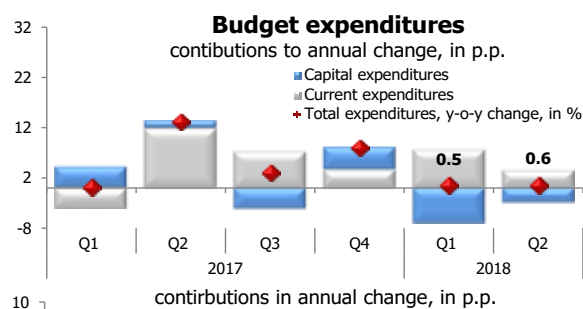
⁶³ Central budget and budgets of funds.

⁶⁴ Other revenues include capital revenues, foreign donations and revenues from recovered loans.

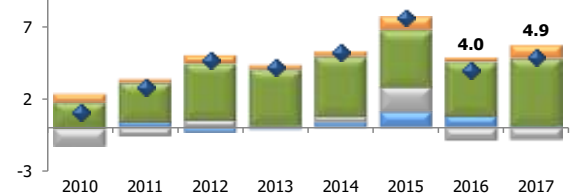
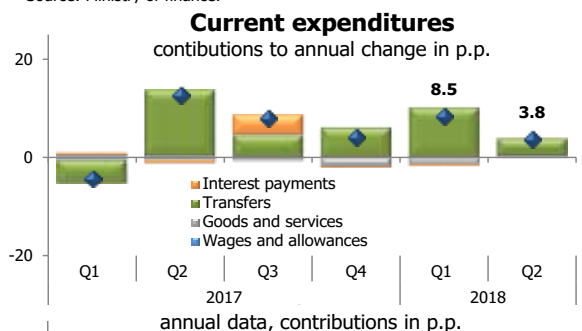
⁶⁵ It also includes own revenue accounts (SSP).



Source: Ministry of finance and NBRM's calculations



Source: Ministry of finance.



Source: Ministry of finance and NBRM's calculations.

negative contribution of 0.7, 0.7 and 0.4 percentage points, respectively.

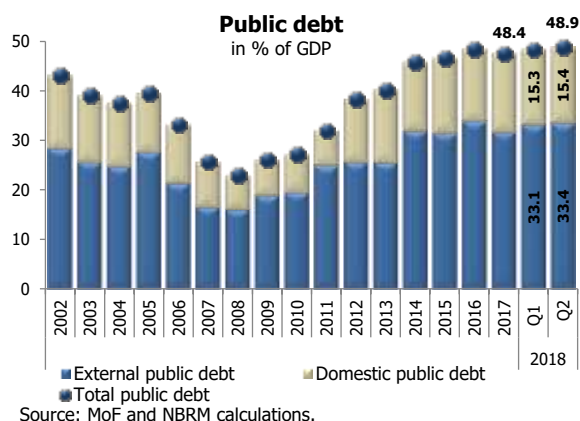
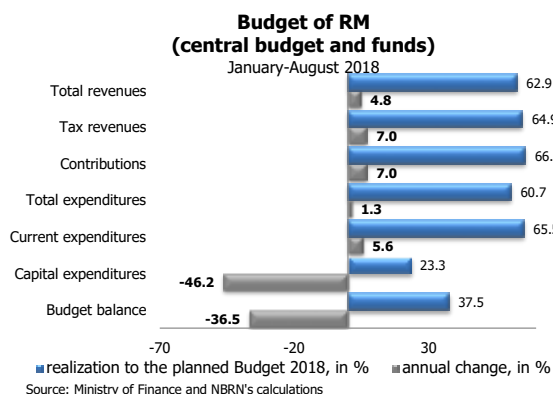
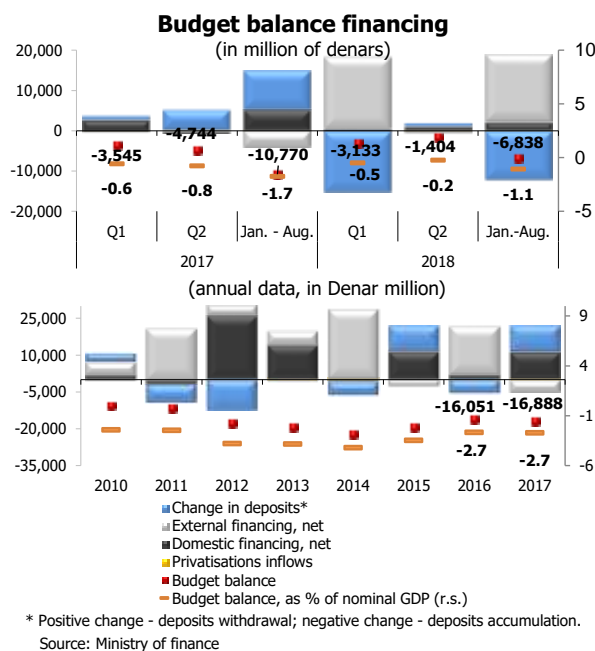
In the second quarter of 2018, total expenditures in the Budget of the Republic of Macedonia grew by 0.6% annually. Therefore, the increase in current expenditures accounted for 3.5 percentage points, which was mostly offset by the negative contribution of capital expenditures of 2.9 percentage points. The annual growth of current expenditures was 3.8% annually and mostly derives from the category of transfers. In terms of other budget expenditures, the categories "goods and services", and "interest payments" made slight positive contribution to the annual increase in current expenditures (of 0.3 and 0.1 percentage points, respectively), while "wages and allowances" made a negative contribution of 0.1 percentage points.

In the second quarter of 2018, the Budget of the Republic of Macedonia registered a deficit of Denar 1,404 million, or 0.2% of GDP, which is lower compared to the same period last year (0.8% of GDP). The deficit was mostly financed by government borrowing on the domestic financial market, and to a lesser extent by using government deposits with the National Bank.

In the period January-August 2018, total budget revenues were higher by 4.8% compared to the same period last year. The growth of budget revenues was mostly affected by the higher performances of taxes and contributions, with a contribution of 4.1 and 2.1 percentage points, respectively. On the other hand, **budget expenditures were higher by 1.3% compared to the same period last year.** Analyzed by category, the growth of budget expenditures entirely derived from the higher current expenditures, with a contribution of 5.1 percentage points, while the contribution of capital expenditures was negative (3.8 percentage points).

In the period January - August 2018, the budget deficit was Denar 6,838 million, which is 1.1% of GDP, or 37.5% of the deficit forecast for 2018. **Budget deficit** in this period was mostly financed by external sources, through the issuance of a Eurobond⁶⁶, with one part of the inflows being retained as a deposit on the government account with the NBRM. Smaller portion of the deficit was

⁶⁶ In January 2018, the sixth Macedonian Eurobond in the nominal amount of Euro 500 million, a maturity of 7 years and an annual interest rate of 2.75% was issued. Part of these foreign assets was used for early repayment of part of the external liabilities that fall due in 2020.



funded through the issue of government securities on the domestic financial markets.

At the end of the second quarter of 2018, total public debt⁶⁷ was 48.9% of GDP⁶⁸, which is a quarterly increase of 0.5 percentage points of GDP. Structurally, the increase was fully due to the higher external public debt (by 0.3 percentage points of GDP), amid slight increase in internal public debt (by 0.2 percentage points of GDP). With such performances, at the end of the second quarter, external public debt equaled 33.4% of GDP, while domestic public debt equaled 15.4% of GDP. Observing the sector structure, the total government debt⁶⁹ in the second quarter of 2018 increased by 0.3 percentage points of GDP and equaled 40.9% of GDP at the end of the quarter, while the debt of public companies⁷⁰ increased by 0.2 percentage point of GDP and made up 8.0% of GDP at the end of the second quarter of 2018. Annually, the total public debt at the end of the second quarter of 2018, increased by 2.1 percentage points of GDP compared to the same period of 2017.

⁶⁷ 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.

⁶⁸ The analysis uses the NBRM October forecast for the nominal GDP for 2018.

⁶⁹ Government debt is defined as a sum of debts of the central and the local government.

⁷⁰ Refers to guaranteed debt of public enterprises and joint stock companies owned by the state, according to the public debt definition under the Law on Public Debt (Official Gazette of the Republic of Macedonia No. 165/14).


BUDGET OF REPUBLIC OF MACEDONIA (Central budget and budgets of funds)

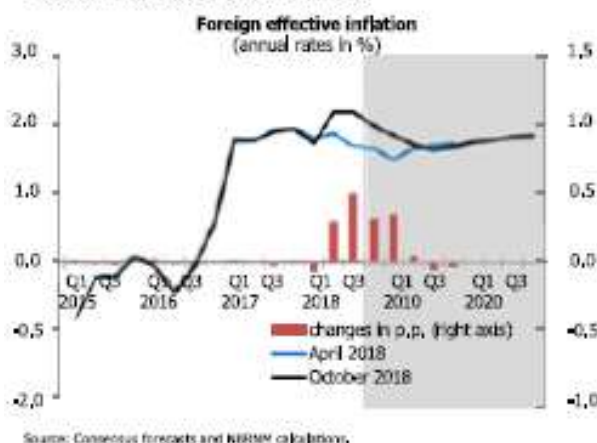
	Budget for 2018	Q1 2018	Q2 2018	Jan.-Aug.	Annual changes, period in 2018 over the same period in the previous year, in %	Contributions in annual changes, period in 2017 over the same period in the previous year, in %	Annual changes, period in 2018 over the same period in the previous year, in %	Contributions in annual changes, period in 2018 over the same period in the previous year, in %
	Realization, in mil. denars				Q1 2018	Q2 2018	Q1 2018	Q2 2018
							Jan.-Aug.	Jan.-Aug.
TOTAL REVENUES	193,512	43,369	47,280	121,634	1.5	8.4	1.5	8.4
Tax revenues and contributions	170,200	38,916	43,534	110,936	4.2	10.4	3.7	9.4
Taxes	112,828	25,529	29,146	73,197	3.8	11.9	2.2	7.1
Contributions	55,403	13,058	13,930	36,566	4.7	7.2	1.4	2.1
Non-tax revenues	17,201	3,197	2,744	7,866	-27.3	6.8	-2.8	0.4
Capital revenues	1,510	456	355	1,007	276.9	49.2	0.8	0.3
Foreign donations	4,201	788	632	1,791	-7.9	-51.6	-0.2	-1.5
Revenues from repayments of loans	400	12	15	34	0.0	-84.8	0.0	-0.2
TOTAL EXPENDITURES	211,745	46,502	48,684	128,472	0.5	0.6	0.5	0.6
Current expenditures	187,698	44,708	46,457	122,867	8.5	3.8	7.5	3.5
Capital expenditures	24,047	1,794	2,227	5,605	-64.5	-38.6	-7.0	-2.9
BUDGET DEFICIT/ SURPLUS	-18,233	-3,133	-1,404	-6,838	-11.6	-70.4		-36.5
Financing	18,233	3,133	1,404	6,838				
Inflow	40,897	21,709	4,858	30,467				
Privatisation receipts	0	0	107	152				
Foreign loans	34,839	30,462	628	31,111				
Deposits	-11,642	-15,032	774	-11,969				
Treasury bills	17,700	6,279	3,345	11,169				
Sale of shares	0	0	4	4				
Outflow	22,664	18,576	3,454	23,629				
Repayment of principal	22,664	18,576	3,454	23,629				
External debt	10,418	12,793	1,113	14,496				
Domestic debt	12,246	5,783	2,341	9,133				

Source: Ministry of Finance and NBRM calculations.

VI. Macroeconomic forecasts and risks

In the October forecasting round, the growth of the domestic economy for 2018 was revised downward from 3.2% to 2.3%. The downward revision reflects the dynamics in the first half of the year, when the growth was significantly lower than expected, mostly due to weaker investment activity. **The unfavorable investment trends are assessed as temporary, thus expecting certain revitalization of the investment activity already in the second half of 2018, partly related to the start of the temporary delayed public infrastructure projects. For 2019-2020, the growth assumptions remain the same, mainly driven by exports and investments, despite the somewhat less favorable external environment, slight downward revision of the expected growth of foreign effective demand and the increased exogenous risks compared to the April forecasts.** Hence, the estimate for economic growth of 3.5% was maintained for 2019, while in 2020 a moderate acceleration of the economic growth is expected, which according to the current estimates would reach 3.8%. Structurally observed, export demand remains the key factor of growth, which corresponds to the activity of new foreign capacities, the entry of new companies and the further growth of foreign effective demand. Within domestic demand, positive contribution from public infrastructure investments and further increase in foreign investments is expected in 2019 and 2020, thus gross investments would make a significant positive contribution to the growth. In a stable environment, the assessments for a stable growth of disposable income are maintained, as well as further credit support to the household sector, thus the private consumption will positively contribute to the growth of the economy as well. In the longer run, in 2021, the Macedonian economy is expected to grow at a rate of around 4%. **The inflation forecast for 2018 was corrected downwards, i.e. the inflation rate was revised to 1.6% (as opposed to 2% in the April projections) mainly due to the current lower performance.** The forecast for 2019 remained at 2%, a level at which the inflation is expected to gravitate until 2021, in the absence of larger shocks on the supply and demand side. **The estimates for the movement of balance of payment components in the forecasting round 2018-2021 still point to moderate current account deficit (of around 1.3% of GDP on average for the period).** In this period, the current account deficit is expected to be fully financed by the flows in the financial account, through foreign direct investments and external borrowing, which will enable further growth of the foreign reserves and their maintenance at the appropriate level.

6.1. Underlying assumptions in the external environment forecast⁷¹



In the latest estimates, foreign effective demand⁷² forecast for 2018 and 2019 was revised downwards compared to April forecasts. Thus, the growth of the foreign effective demand is currently expected to amount to 2.2% and 2% in 2018 and 2019, respectively, (versus 2.5% and 2.1% in April). The downward revision is almost solely due to the estimates for a lower growth of the German economy. Slight slowdown in the economic activity with our trading partners is expected in 2020, with a growth in foreign demand of 1.8%.

Compared to the April forecasts, the estimates for foreign effective inflation⁷³ for 2018 and 2019 were revised upward. The growth of foreign effective inflation in 2018 and 2019 is expected to equal 2.1% and 1.8%, despite the April forecast of 1.8% and 1.7%, respectively. Thus, the upward revision was largely due to expectations for higher imported inflation from Serbia, Germany and France. Relatively stable increase in the prices with our major trading partners is expected in 2020, with a projected foreign inflation of 1.9%.

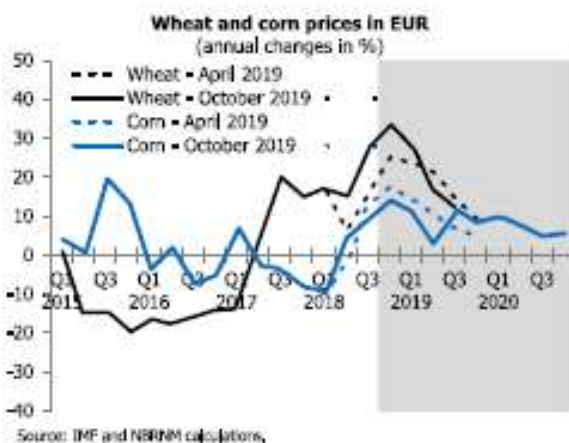
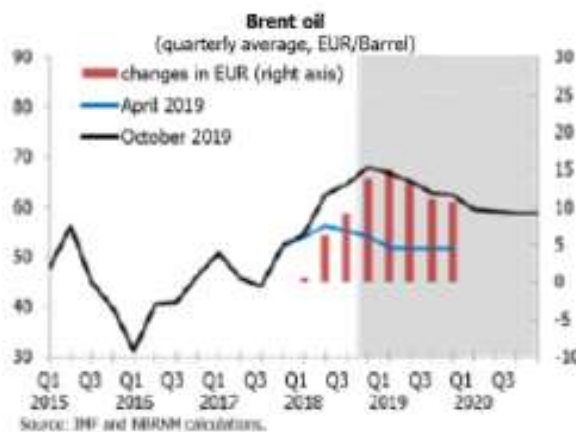
The latest forecasts on the euro/US dollar exchange rate for 2018 and 2019 registered an upward revision compared to April. Smaller depreciation of the US dollar of 4.9% is currently expected in 2018 (compared to 8.2% in April) and unchanged value in 2019, instead of its decrease. The upward revision was largely due to the growing concern of investors for the Italian economy and the reduced inflationary pressures in the Euro area, seen as a signal of a possible slowdown in the economic growth of the entire region. A decline in the value of the US dollar against the euro of 2.7% is expected in 2020.

The third quarter of 2018 registered significantly higher increase in the "Brent" oil price

⁷¹ Historical data on foreign demand, foreign inflation, exchange rate of the US dollar/euro and EURIBOR are sourced from Eurostat, while the World Bank statistics is a source of the data on prices of oil, food and metals. The forecasts of the foreign demand, foreign inflation, foreign exchange rate of the US dollar and EURIBOR are based on the Consensus Forecast, while the forecasts of the prices of oil, food and metals are based on the forecasts of market analysts. The analysis uses various reports of the IMF, the World Bank, ECB, FAO, OPEC and specialized economic portals.

⁷² Foreign effective demand is calculated as the weighted sum of GDP indices of the major trading partners of the Republic of Macedonia. The calculation of this index includes Germany, Greece, Italy, the Netherlands, Belgium, Spain, Serbia, Croatia, Slovenia and Bulgaria.

⁷³ The foreign effective inflation is calculated as the weighted sum of consumer price indices of the countries that are major partners of the Republic of Macedonia in the field of import of consumer goods. The calculation of this indicator includes Bulgaria, Germany, Greece, France, Italy, Austria, Slovenia, Croatia and Serbia. Inflation in Croatia and Serbia has been adjusted for the changes in the exchange rate.

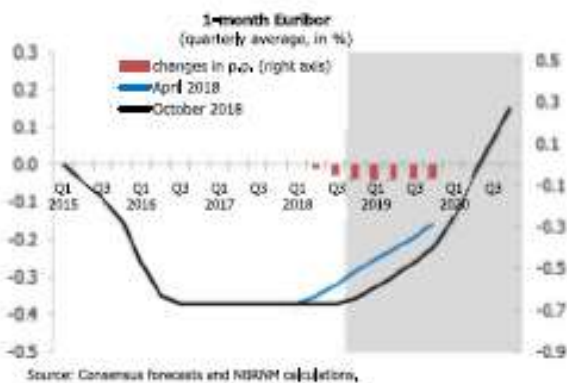


in euro, compared to the April forecast. **This trend is expected to continue in the fourth quarter, with a significant upward correction of the oil price for the entire 2018.** For 2019, oil price was also revised upwards, expecting a small growth rather than fall as expected in April. In conditions of relatively stable global demand, the upward revision of the oil price is mostly due to the expectations for foreign supply deficit, mainly as a result of the geopolitical tensions between the US and Iran⁷⁴. On the other hand, after the increase in 2018 and 2019, more pronounced decrease in the oil prices on world markets is expected in 2020.

In 2018, the metal prices were revised upwards compared to April. Thus, significantly higher increase is now expected in the price of nickel and steel compared to the April forecasts, with a slightly higher increase in the price of copper. The upward correction in the nickel price was mostly a result of the decrease in the world stocks of nickel and the expectations for increased demand from the electric vehicle industry, while the enhanced growth of the steel price reflected the political and trade tensions between the US and China. The upward revision in the copper price was mainly due to the expected changes in the euro/US dollar exchange rate. **On the other hand, a downward revision of the prices of all metals was made for 2019,** now expecting a slight decline in the nickel price, unlike the minor growth expected in April and a larger decline in the prices of copper and steel. The downward revision of metal prices in 2019 was mostly due to the expectations for weaker global demand, reflecting the risk of further escalation of trade tensions between the US and China. Despite the downward revisions of metal price changes in 2019, seen through price levels, more favorable conjuncture is expected compared to April, especially on nickel and steel markets. The prices of metals are expected to follow a downward path during 2020.

The expectations for the stock market prices of wheat for 2018 were significantly revised upward, while wheat kept the same price as in April. Thus, faster increase in the price of wheat is now expected while the growth in the corn price is still expected to be low. Such upward correction in the wheat price was mostly due to the expectations for reduced wheat production in Australia and Russia and high demand worldwide. On the other hand, in 2019 downward revision in the prices of these cereals

⁷⁴ On 6 July 2018, the US President made a decision to impose additional sanctions on Iran (after those imposed on 8 May 2018) which will mainly hit the oil sector. According to the latest statements of the President Trump's administration, the sanctions will come into force on 4 November 2018.



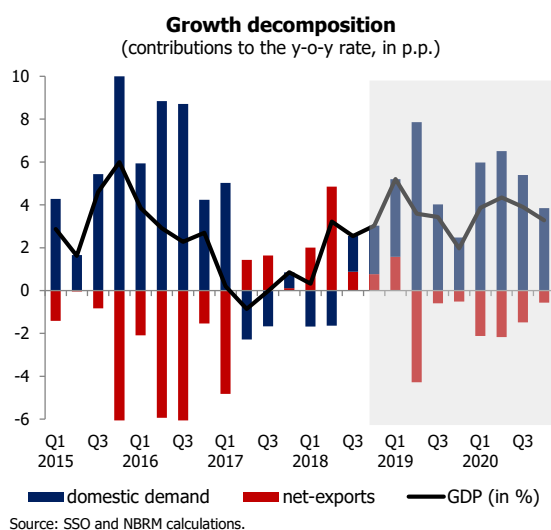
was registered, thus now the prices of wheat and corn are expected to slightly grow compared to April, mostly due to the expectations for increased level of global inventories. The prices of wheat and corn are expected to follow a moderate upward path during 2020.

The **one-month EURIBOR** for 2018 and 2019 registered a moderate downward correction, thus it is now expected to equal -0.37% and -0.28% in 2018 and 2019, respectively (-0.33% and -0.21% according to the April forecasts). The downward revision was mostly due to the ECB announcements to keep the current interest rates at least to the end of the summer 2019, while extending the quantitative easing program to the end of 2018⁷⁵. In 2020, the EURIBOR interest rate is expected to gradually leave the negative zone, and amount to 0% on average.

6.2. Forecast and effects on monetary policy

The latest scenario of the Macedonian economy points to unfavorable macroeconomic environment, especially in 2018, and more pronounced risks of the external environment compared to the April forecasts. Notwithstanding the above, the forecasts still indicate favorable external position of the economy and foreign reserves, which in the next period will be maintained at an appropriate level. External equilibrium will be maintained, despite the expectations for moderate strengthening of the economy in the following period and possible pressures on the import side due to high import intensity, which would not have the volume to cause larger imbalances. Hence, it is assumed that the current account deficit will be further moderate, with inflows based on direct investments and borrowings being its main sources of finance, in a volume that would enable further growth of foreign reserves and their continuous maintenance within the comfort zone for monetary purposes. **As concerns the foreign interest rate, as an important external factor for implementing domestic monetary policy, this forecast registered certain downward revisions for 2018 and 2019 compared to April.** Thus, the

⁷⁵At the ECB's regular meeting in September 2018, the European Central Bank decided to maintain the current policy rate, while extending the quantitative easing program by the end of 2018, but with slower intensity. Thus, it will amount to Euro 30 billion per month as of September 2018 and Euro 15 billion per month from October to the end of December 2018, after which the program is expected to be ceased, but depending on the data that needs to confirm the inflation prospects in the medium term.



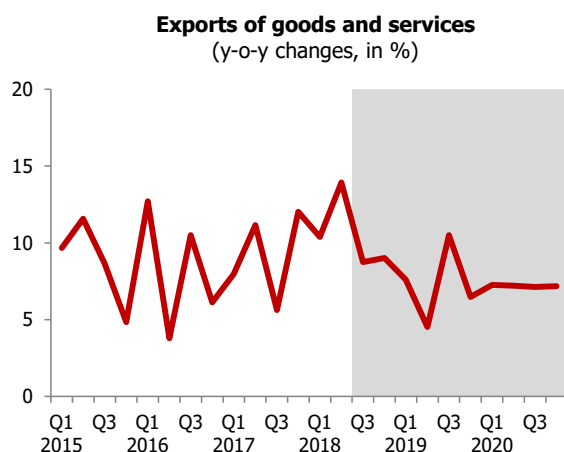
last estimates show that the one-month EURIBOR interest rate will be slightly more negative by the end of 2019, in accordance with the ECB announcements to keep the interest rate policy at least by the end of summer 2019, which will start entering the positive zone in 2020, following the normalization pace of the ECB monetary policy.

Risks to achieve the basic macroeconomic scenario in the external environment are assessed as somewhat less favorable compared to the April projection cycle.

On the other hand, same as in the April forecasts, the current basic forecasts do not embed the effects of possible NATO accession and the accession negotiations with the EU in 2019, which would have favorable implications on both, the economic growth and the risk premium of the domestic economy. At the same time, unlike in April, **external risks** associated with the global economic environment are assessed as unfavorable both in the short and the medium term, in conditions of increased global uncertainty⁷⁶. Part of the aforementioned risks, such as the rising trade barriers and capital outflows of emerging economies with weaker fundamentals, are now more pronounced or partially materialized. In the short term, the largest risks arise from possible escalation of the global trade tensions to a level which would make them a systemic risk to the global economy, as well as from the possible tightening of the global financial conditions, driven by the faster monetary tightening in the developed countries. On the other hand, the possible prolonged accumulation of financial vulnerabilities globally, the reduced global support for the prevailing economic policies and the implementation of unsustainable macroeconomic policies, as well as the geopolitical factors are considered to be medium-term negative risks.

In the first half of 2018 the growth of the economic activity was more intensive compared to the previous year. The growth in this period was fully driven by the positive contribution of net exports, amid further decline in domestic demand. Within net export demand, the real export continued to register high growth rates, which significantly exceeded the growth rates of real imports, amid increased export activity of the new foreign industrial capacities and the metal processing capacities. On the other hand, the decrease in domestic demand almost fully resulted from the significant decline in investment demand, due to the lag of the construction works in some of

⁷⁶ World Economic Outlook, IMF, October 2018.



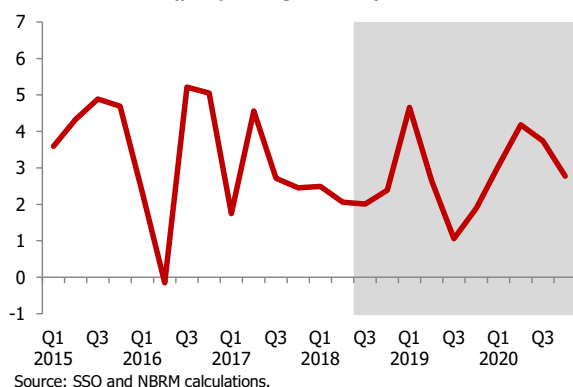
Source: SSO and NBRM calculations.

the larger infrastructure projects, the low realization of capital investments and probably the lowest private investments. At the same time, slight decline was registered in public consumption. In contrast, the private consumption continued to register solid growth rates as the unique components within domestic demand with positive contribution to the economic growth in this period. The available high-frequency data and estimates for the second half of 2018 indicate better performances compared to the first half, which would stem from the forecasts for recovery of the investment activity, as well as from the increase in private consumption and net exports. **Consequently, the GDP growth is expected to reach 2.3% on average for 2018 (after the rate of 0.2% in 2017), and to further accelerate to 3.5% and 3.8% in 2019 and 2020, respectively.** In addition, analyzing the growth structure, domestic demand is expected to remain the major generator of growth in the projection period, with the exception of 2018, when net exports will have a significant positive contribution, due to favorable export and import performance. In the longer run, the Macedonian economy is expected to grow, and reach a growth rate of 4% in 2021.

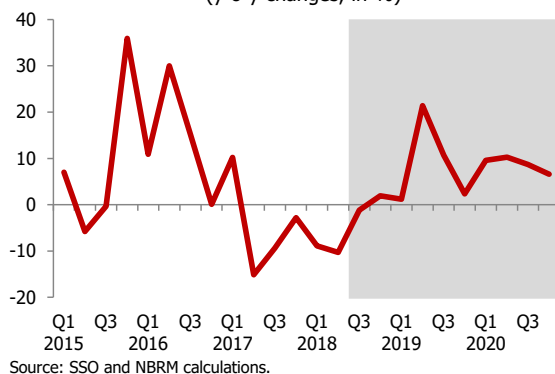
Analyzed by GDP component, the real export of goods and services is expected to be the main driver of the growth in the entire forecasting horizon. In terms of dynamics, the export component is expected to further accelerate in 2018, as a result of the higher performances in the first three quarters of the year and the estimate for positive movements in the last quarter of the year as well. Again, the main contribution to the growth in total exports stems from the increased export potential of foreign capacities, as well as of the dynamic activity of the rest of the domestic exporters, including the restart of the significant capacities which were temporary inactive. Furthermore, moderate deceleration of the growth of real imports in 2019 and stabilization of the growth in 2020 are expected, amid embedded assumptions for gradual maximum utilization of production facilities of new export-oriented companies and moderate activity in traditional export sector, in conditions of certain deceleration of demand on foreign markets and less favorable conjuncture in export prices of metals. Some uncertainty was caused by the EU trade barriers towards other countries which can have adverse effects on the export of the companies from the metal industry.



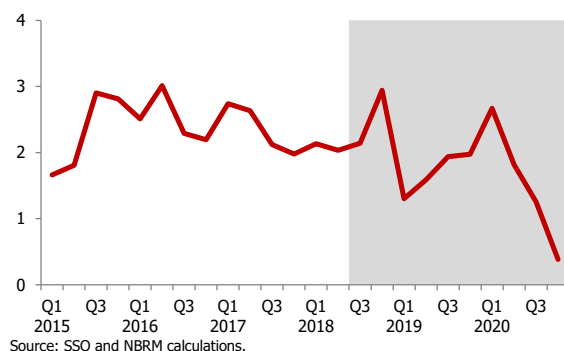
Private consumption
(y-o-y changes, in %)



Gross capital formation
(y-o-y changes, in %)



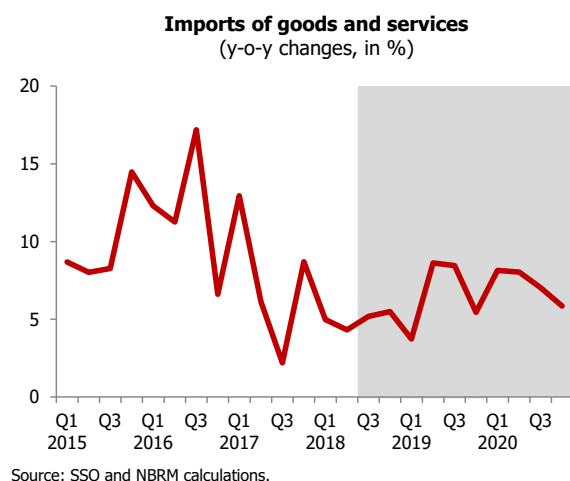
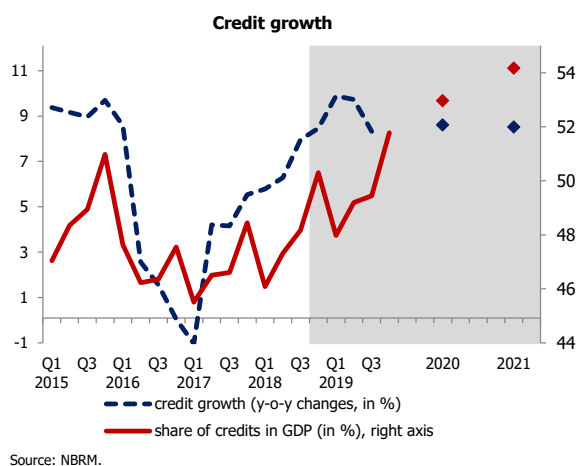
Employed persons
(y-o-y changes, in %)



According to the latest forecasts, in 2018 domestic demand is expected to record a slight positive contribution to the GDP growth, similar to the previous year. Observed by components, it is estimated that this year too, the **private consumption** will continue to make a positive contribution, which will be slightly lower compared to the previous year, in line with the lower performances in the first half of the year. **Public consumption** also made a minor positive contribution. On the other hand, **gross investments** registered further unfavorable trends, thus expecting their decline, with the same pace as in the previous year, mainly due to the postponement of part of the current investments in public infrastructure.

The forecasts for 2019 and 2020 show economic growth entirely driven by domestic demand, also expecting evident revival of the investment activity and accelerated growth of private consumption. After the decline in 2017 and 2018, higher growth rates are expected in the demand for investments, thus making it a domestic component with the highest positive contribution to the expected growth. Fundamentally, this estimate was mostly based on the expectations for extended and intensified construction works related to government investments in road infrastructure, after the temporary technical delay in the past period. At the same time, the expected improvement of the domestic environment, the increased confidence and the greater propensity for investments among private entities, partly driven by the legal framework for financial support of investments⁷⁷ and by favorable credit standards by banks, are expected to additionally stimulate the overall investment cycle. Moreover, solid capital inflows in a form of foreign direct investment are expected in the following period. This scenario does not assume new non-economic shocks with adverse effects on investment flows. Additional positive impulse to the economic growth in the next two years is expected from the higher **private consumption**. Further increase in consumption financing sources is expected, amid solid growth of real wages in economy, and favorable, yet more moderate movements on labor market. Pensions are also expected to grow, amid implementation of the legal adjustment with the increase in wages and prices, and further increase in the number of pensioners. At the same time, the increased inflows based on private transfers will additionally affect the greater propensity for consumption in

⁷⁷Law on Financial Support of Investments Official Gazette of the Republic of Macedonia No. 83 of 8.5.2018.



the forecasting period, also expecting further credit support to households by domestic banks. Regarding **public consumption**⁷⁸, its effect on the economic activity is estimated to be neutral cumulatively in the forecasting period.

The latest credit market assessments in the forecast horizon indicate increased credit activity in 2018 and solid growth rates for the next three years. The first half of 2018 registered solid credit growth, which is expected to continue until the end of the year and reach 8.4% (5.4% at the end of 2017). Furthermore, in the period 2019-2021 relatively stable movements in the credit growth are expected in the amount of 8.5%. Thus, amid sound solvency and liquid position of banks, with stable environment, enhanced competitiveness and sufficient level of available funding, banks are expected to provide sufficient credit support for both the households and the corporate sector. In accordance with the estimates for stable environment and intensification of the economic activity, and given the dynamics of the deposit base in the first nine months of the year, for 2018, total deposits are expected to increase by 10.2% (5% in 2017). The expectations for solid economic performances will ensure further deposit base growth, with projected interest rates of 7.7% in 2019 and 8.6% in 2020-2021.

In 2018, the import demand is expected to further grow, yet at a slower pace, primarily due to the effect of the reduced investment demand as well as to the weaker growth of private consumption. Hence, amid slower growth of imports and intensive export activity, the net export is expected to make a significant positive contribution to the growth this year. On the other hand, the next two years expect an accelerated growth of imports in goods and services, due to the expected investment recovery, the increase in foreign direct investments and further strengthening of private consumption, which will lead to growing need for investment and consumer goods import. Hence, the net export is forecast to make a negative contribution to the total growth in 2019 and 2020.

According to the latest estimates of the balance of payment, in 2018 narrowing of the current account deficit is expected compared to 2017, thus reducing from 1% in 2017 to 0.5% of GDP in 2018. The improved balance in current transactions were mostly due to

⁷⁸ Public spending forecasts are based on information from the Budget for 2018, as well as the fiscal strategy 2019-2021.

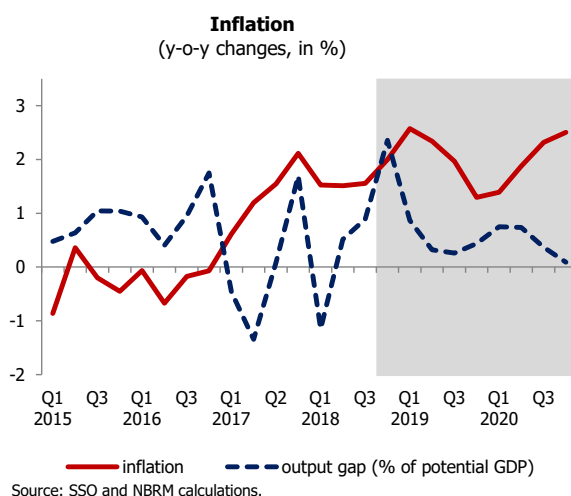


Balance of Payment forecast (% of GDP)

	2013	2014	2015	2016	2017	2018	2019	2020
Current account	-1.6	-0.5	-2.0	-2.8	-1.0	-0.5	-1.5	-1.7
Balance of goods & services	-18.3	-17.2	-16.2	-15.1	-14.0	-13.0	-12.9	-12.9
Goods, net	-22.9	-21.7	-20.1	-18.6	-17.8	-17.7	-17.7	-17.6
Services, net	4.6	4.5	3.8	3.5	3.7	4.8	4.8	4.7
Primary income, net	-2.4	-1.9	-3.2	-3.9	-3.9	-4.0	-4.5	-4.7
Secondary income, net	19.0	18.6	17.4	16.3	16.9	16.5	16.0	15.9
Private sector, net	18.1	17.3	16.9	15.3	15.8	16.1	15.5	15.3
Capital account	0.2	0.0	0.1	0.1	0.2	0.0	0.0	0.0
Financial account	-0.8	-5.1	0.1	-6.3	0.5	-4.0	-5.4	-2.2
FDI, net	-2.8	-2.3	-2.2	-3.3	-1.8	-3.8	-3.0	-3.2
Portfolio Investment, net	2.0	-5.6	-0.7	-4.4	0.2	-2.7	0.5	1.9
Other Investment, net	0.1	2.8	3.1	1.4	2.1	2.5	-2.9	-0.8

Source: NBRM.

further narrowing of the trade deficit, mainly due to the higher surplus in services. Despite the positive effect of the new export-oriented economic facilities, the trade deficit is expected to increase due to the worsening in the energy balance, amid higher energy prices on the world stock markets. At the same time, the primary income deficit slightly increased, while the secondary income surplus, as a share of GDP, gradually decreased. In 2018, the financing of the current account deficit is still expected to rely on net inflows from direct and portfolio investments and less on long-term loans. On the other hand, short-term flows and deleveraging of economic agents abroad will still create significant net outflows. **In 2019, moderate deepening of the current account deficit of 1 percentage point of GDP is expected, thus the deficit would amount to 1.5% of GDP, while the forecasts for the next 2020 show a slight additional worsening of the current transactions deficit of 1.7% of GDP and its stabilization in 2021 at 1.6% of GDP.** The balance of goods and services is expected to slightly improve in 2019 and to stabilize in 2020. The movements in trade deficit are conditioned by favorable movements in non-energy balance (combined effect of the increased net exports in new production facilities and expectations for improved export performances in part of the traditional export sectors) despite the higher energy balance. The primary income deficit is expected to moderately increase in the next period, due to the increase in the foreign investors' income in the economy. In the absence of shocks, the secondary income surplus is expected to stabilize during the forecast horizon, i.e. to slightly reduce. **Public sector debt, as well as inflows from foreign direct investment** are estimated as the main sources of financing the current account deficit, while their volume will enable additional growth of the foreign reserves and their maintenance at an adequate level.



For 2018, the inflation is expected to be 1.6%. All inflation components are expected to be in the zone of positive changes, mainly driven by the core inflation, which is however moderate and in line with the estimates for a slight positive production gap. **In 2019, the estimates are expected to further move upward, thus the inflation rate would reach the historical average of around 2% annually.** The increase in consumer prices is expected to mostly stem from the intensification of food inflation, in line with the forecast growth in world prices of primary food commodities. The core inflation will make positive contribution, amid improved domestic demand, as



well as energy component. However, the increase in energy prices will be slightly slower compared to 2018, in line with the expectations for stabilization of the oil price growth on the world stock market, after their significant growth in 2018. Amid further growth of the domestic economy and moderate rise in world prices, **in 2020, the inflation is projected to gravitate again around 2%, similar for 2021.** The main risk to the inflation forecast remains associated with the uncertainty regarding the future dynamics of the stock market prices of primary commodities, especially oil.

6.3. Comparison with the previous forecast

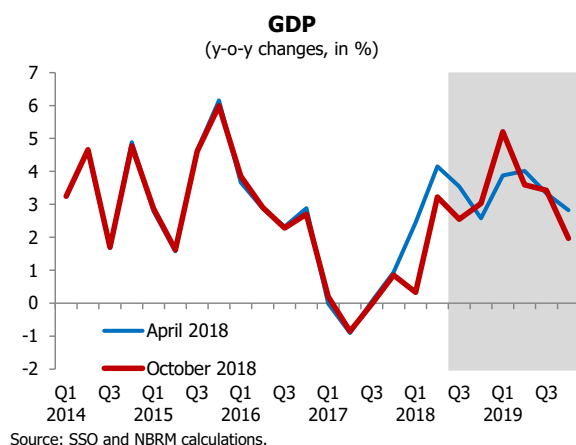
The latest October macroeconomic forecast points to certain changes relative to the April forecast, which mostly reflects the performances in 2018. The lower GDP growth in the first half of the year imposed the need for downward revision of the growth forecast for 2018, while for 2019, amid maintained assumptions, the projected growth rate is the same. The expected inflation rate also suffered downward revision for 2018. Changes have been made in the balance of payments forecast, namely, now a smaller average current account deficit is expected for 2018 - 2019, mainly due to the lower primary income deficit. The new forecasts expect lower net inflows in the financial account from financial transactions, cumulatively for the two years.

Forecast of selected macroeconomic variables

	2018 forecast		2019 forecast	
	Apr.	Oct.	Apr.	Oct.
GDP, %	3.2	2.3	3.5	3.5
Private consumption	2.8	2.2	2.5	2.5
Gross capital formation	5.2	-4.6	6.4	8.3
Public consumption	1.6	0.9	-1.1	0.2
Exports of goods and services	10.1	10.5	7.3	7.2
Imports of goods and services	7.7	5.0	5.3	6.5
Inflation	2.0	1.6	2.0	2.0
Current account deficit, % of GDP	-1.5	-0.5	-1.5	-1.5

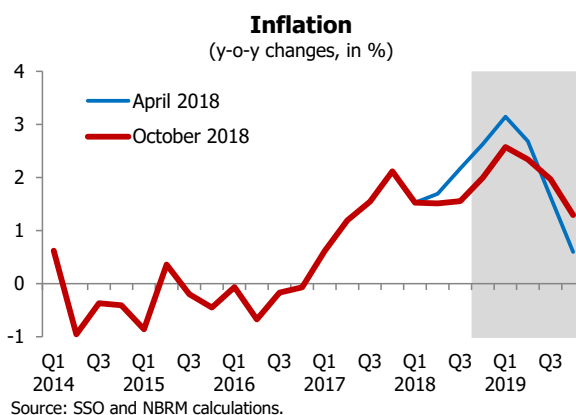
Source: NBRM.

The latest estimate for the GDP growth in 2018 was corrected downwards, by 2.3% as opposed to 3.2% in the April forecast, due to weaker performances in the first half of the year. The largest correction relative to April was made in gross investments. The April forecast assumed significant positive contribution of gross investments related to the increased private sector investments, as well as the recovery of the planned public infrastructure projects. However, risks around the materialization of this assumption was estimated as relatively high. Data on the first half of the year point to risk materialization, amid slower realization of planned public investments and decline in total gross investments. Given such realization, there are expectations for reduced investments in 2018 (against the expectations for their increase in April). The revisions in other domestic demand components were relatively small-scaled, with contributions to the projected growth for 2018 very similar to the April forecast. On the other hand, lower investments reflected the real imports, thus the contribution of net export

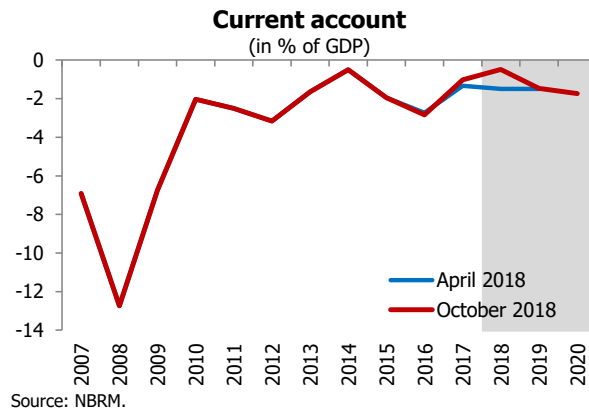


significantly improved (positive, instead of the previously expected negative contribution). **For 2019, the growth rate of GDP of 3.5% was maintained with a growth structure very close to the expected April forecasts.** Slight upward correction was made in both, investments and public consumption (amid weaker base from the previous year) which adequately reflected the import growth, which was projected to slightly grow compared to April. The export growth was maintained as in the April forecast. Such corrections in components make a stronger positive contribution of the domestic demand and slightly more negative contribution of net exports to the growth in 2019 compared to the April forecast.

The expected inflation rate for 2018 was reduced to 1.6% as opposed to the forecast of 2% in April. Thus, the correction was fully explained by lower performances in domestic food prices, while the energy component and core inflation were slightly higher compared to the expectations. **The April forecast was maintained for 2019, i.e. the inflation rate is anticipated to range around 2%, with a similar growth structure.**



According to the latest October forecasts, **lower average current account deficit is anticipated for both years unlike the April expectations (from 1.5% of GDP in April to 1% of GDP in the current forecast).** Such change was largely a result of the improved balance of primary income. The balance of goods and services slightly improved compared to the April forecasts, reflecting the improved expectations in trade in services, while the trade deficit was higher than expected. Compared to the previous forecasts, these shifts arise from the worsened energy balance (due to the higher energy prices on world's stock markets), amid unchanged average deficit in non-energy component. **Analyzing financial flows, slightly lower net inflows are expected for 2018 and 2019 cumulatively, compared to the April forecast.** Less favorable expectations arise from the higher than planned outflows in short-term flows, i.e. in currencies and deposits and trade credits, as well as lower than expected inflows in portfolio investments. On the other hand, higher inflows based on FDI were planned due to the improved performances of the projected amounts in April, while the expectations for external borrowing remained unchanged.



Comparison of GDP and inflation forecasts for Macedonia from various organisations

Organisation	Month of publication	Real GDP growth, %			Inflation (average rate, %)		
		2018	2019	2020	2018	2019	2020
IMF	October 2018	1.6	2.6	2.8	1.8	2.0	2.0
World Bank	October 2018	2.5	2.9	3.2	1.6	2.0	2.0
European Commission	May 2018	3.1	3.3	-	1.9	2.0	-
EBRD	May 2018	2.5	3.0	-	-	-	-
Consensus Forecast	October 2018	2.5	3.2	-	1.9	2.1	-
Ministry of Finance of the Rep. of Macedonia	May 2017	2.8*	3.5	4.0	1.7	2.0	2.0
National Bank of the Republic of Macedonia	October 2018	2.3	3.5	3.8	1.6	2.0	2.0

Source: IMF, World Economic Outlook, October 2018; World Bank, Western Balkans Regular Economic Report, Autumn 2018; European Commission European Economic Forecast, May 2018; EBRD Regional Economic Prospects, May 2017; Consensus Forecast, October 2018; Ministry of Finance of the Republic of Macedonia, Budget revision 2018 and Fiscal strategy 2019-2021, May 2018; and the National Bank of the Republic of Macedonia.

*Proposal to amend and supplement the Budget of the Republic of Macedonia for 2018, October 2018.