National Bank of the Republic of North Macedonia

Quarterly Report
November 2020

Contents

Introduction

The pandemic caused by the coronavirus and the measures taken to protect the public health negatively affected both global and domestic economy. Given the deteriorated epidemiological situation and the virus resurgence, which will probably continue in the first half of the following year, it is clear that the negative effects of the pandemic will be stronger than expected, while the economic recovery to the pre-crisis level will be slower. Although the new wave is expected to be followed by targeted and less restrictive measures than the ones introduced in dealing with the first pandemic wave, the further presence of the virus and the uncertainty will contribute to partial restraint by economic entities for a longer period. **A positive risk to the economic outlook would be the vaccine development earlier than initially expected,** given the intensified global efforts in this field. Hence, the macroeconomic forecasts in this cycle are subject to extremely high uncertainty related to the spread of the coronavirus, i.e. the prospects for dealing with it. The fast, timely and coordinated reaction of the monetary and fiscal policy in response to the crisis, has mitigated the initial strike on the real sector, with announcements of keeping the accommodative nature of policies longer than previously expected, until the overcoming of the crisis.

Amid solid level of foreign reserves and lack of financial pressures, in the third quarter, the monetary setup kept its accommodative nature. The decrease in interest rate on CB bills on three occasions during the first half of the year to the current level of 1.5%, as well as the significant decrease in the offered amount of CB bills on two occasions during the second quarter, increased the liquidity of the banking system and supported the credit flows in the economy. The regulatory amendments that provided greater flexibility of the banks and maintenance of the credit cycle were adopted for the same reason. Given the protracted effects of the COVID-19 crises, in accordance with the previously made regulatory amendments, towards the end of the third quarter, banks provided part of their clients with a second a favorable change in the contractual conditions for credit products. This support was aimed at those clients that were most affected by the pandemics. Also, in August, the European Central Bank (ECB), announced the approval of a repo line in the amount of Euro 400 million, upon request from the National Bank, for providing foreign currency liquidity for the financial institutions in the Republic of North Macedonia through the central bank. This instrument is especially important, because it provides access to liquidity in euros, amid high uncertainty and possible major disturbances on the international markets due to the shock from the COVID-19. The repo line will be available until the end of June 2021, with the possibility to be prolonged, if it is deemed necessary.

Certain changes occurred in the forecasts for the key indicators of the external economic environment in the period between the two forecasts. Thus, compared to April, the current perceptions of the foreign effective demand show larger drop in 2020 (of 6.3%, compared to the decrease estimates of 5% in April), and slight growth in 2021(of 4.6%, compared to expectations for growth of 4.9% in April). **Regarding the foreign effective inflation**, compared to the April forecasts, it noted a minimal downward revision for 2020 and minor upward correction for 2021, currently expecting a slowdown in inflation in 2020, reducing it to 0.5% and a moderate acceleration in 2021 to 1.4%. **The latest forecasts for the changes in prices of primary commodities in the world stock markets primarily indicate fall in prices for 2020 and synchronized rise in 2021 with mainly upward revisions compared to the April forecasts.** However, the movements in prices of primary commodities are extremely volatile, and under strong influence of the pandemic developments, which creates greater uncertainty about their future dynamics.

The October perceptions for decline in the Macedonian economy are unfavorable compared to the April estimates. This mainly reflects the weaker performances in the first half of the year, as well as the estimates for larger decline in the second half, due to the second wave of the virus and its presence in the first half of the next year, unlike the April estimates for faster normalization. **Thus,**

a 4.9% drop in GDP is forecasted for 2020, followed by a partial recovery i.e. growth of 3.9% in 2021 (April: fall of 3.5% and growth of 4.7%, respectively). Regarding the structure of activity for 2020, a large negative contribution compared to the April estimates is expected from domestic demand, with a slightly positive contribution of net exports. Within domestic demand, the largest negative contribution is still expected from investments, which is highly affected by the weak demand and high uncertainty. Negative contribution was also expected by the household consumption, reflecting further greater restraint, amid uncertainty around jobs and income. Regarding the market, the expected negative effects of the crisis will be mitigated with the announced and taken fiscal measures, which will keep the wage growth at a higher level and retain employment in 2020. Amid decline in foreign demand and temporary disrupted global production and logistic chains, the export will decline in 2020, but more moderately compared to the April expectations. Reduced export activity, amid decline in domestic demand, will decrease import of goods and services, which would also decrease imports, whereby net exports would make positive contribution to growth. The partial recovery of the economy in 2021 would be supported by all growth sources, expecting a positive contribution by domestic demand, while the net exports will make a negative contribution to the growth. **In the medium run, further economic recovery is expected, with a slightly moderate growth rate of 3.6% in 2022** (downward revision compared to the April growth estimates of 4%) **and 4% in 2023.** Pronounced downward risks to the forecasts taking into account that the recovery is largely conditioned on the pandemic duration, virus management measures, and the speed of restoring confidence and stabilizing expectations.

Regarding the future price trajectory in the domestic economy, the latest forecasts point to inflation of 1.1% in 2020, compared to the April expectations for inflation rate of about 0%. The outburst of the pandemic caused shifts on both the supply and demand side for certain market segments, factors which probably **contributed to higher inflation rate than the expected. Also, the increase in electricity prices, which was not embedded in the forecasts made certain contribution to the deviation. In 2021, the inflation rate is expected to moderately accelerate and reach 1.5%, approaching the level of around 2% in 2022-2023, which is in line with the April perceptions.** In the international markets there is still an exceptional volatility of the prices of primary commodities, and thus uncertainty about the future movements in import prices, especially in the long run.

Credit activity of the banking system is still considered a great supporter of economic growth. The latest credit market assessments in the forecast horizon indicate faster than expected credit activity in 2020 and solid growth rates for the next three years. In order to encourage lending activity, since the beginning of the crisis the National Bank has adopted a series of measures, creating conditions to reduce financing costs through loans from banks, as well as to provide additional liquidity for the banking system. Given the increased credit support in the first three quarters of 2020 and the expectations for its continuation by the end of the year, for 2020, the credit growth would be 5.3%[1] (3% in the April forecast). With gradual normalization of the situation and stabilization of expectations, lending is expected to gradually accelerate in the coming period. Thus credit growth for the period 2021-2022 would average 6.3% (6.5% in the April forecast) and would reach 7.6% in 2023. The estimates for such loan and deposit growth are based on the expectations for stabilization of the domestic economy by the end of 2021. Regarding the sources of financing, having in mind the solid growth of the total deposits in the first three quarters of 2020, it is expected that the growth for the whole 2020 will be 4.4%[2] (2.3% with the April forecast). Such changes with the deposit base partly reflect the greater restraint from spending / investing in conditions of uncertainty, as well as the economic measures to deal with the consequences of the health crisis, which provided additional funds for companies and households to improve their liquidity. In the next two years, amid assessment for faster economic growth and maintenance of high propensity to save in banks, an annual deposit growth is expected of about 6.9% on average (7.1% with the April forecast). In 2023, the deposit growth would reach 8.2%.

[1] If we include the stock of loans approved by the bankrupt bank, the loan growth in 2020 would equal 7%.
[2] If we include the data from the bank in bankruptcy, the deposit growth in 2020 would equal 5%.

The outburst of the pandemic led to interrupted global production chains and decline in the world trade. Such unfavorable environment, as well as the deteriorated expectations caused by the spread of the coronavirus moderately worsened the external position of the economy. The current account deficit of the balance of payments is expected to moderately increase in 2020 to 3.7% of GDP (3.2% in the April forecasts). Such expectations reflect the lower secondary income surplus, while other components are expected to slightly improve compared to the previous year. The containment measures to prevent the virus spread significantly reduced the international movement of passengers, which caused larger downward correction in foreign exchange inflows through informal remittances and adequate downward adjustment of net purchased cash foreign currency on the currency exchange market. This effect would be partly offset by larger foreign currency inflows through formal channels (personal transfers). A downward adjustment in both components of foreign trade is expected, amid negative pressures on exports by reduced foreign demand and temporary disrupted supply chains, as well as due to the adequate reduction of the import demand, coupled with lower import pressures of the decline in domestic demand. The decline in imports will be further accentuated by the expected decline in market prices of crude oil. Regarding the net effect, the projected movements of export and import of goods would narrow the trade deficit. The estimates for lower newly created value from foreign-owned companies will contribute to lower primary income deficit, with improved performance forecasts for the service balance as well, which reflects the pronounced downward adjustment in imports compared to the downward adjustment in exports of services (lower net-based outflows in other services and higher expected net export in manufacturing services). **The negative effects of the pandemic are expected to partly occur in 2021 as well, with a moderate current account deficit of 2.6% of GDP (as opposed to the expected 1.8% in April),** amid slower growth forecasts of secondary income net inflows, as well as worsened balance of goods and services, in conditions of faster increase in import demand compared to the expected increase in exports. **For the period 2022-2023, the current account deficit is expected to equal 1.6% of GDP, similar to the April expectations in the medium run. Analyzing the financial account, in the period 2020-2023 current transactions are expected to be largely financed through external government borrowings and foreign direct investment.** Foreign reserves adequacy ratios show that they remained in the safe zone over the forecast horizon.

In general, compared to April observations, the latest estimates for the period 2020-2023 indicate prolonged effects of the pandemic on the global economy, and thus on the performances in the domestic economy. As opposed to the April estimates for a temporary nature of the health crisis, the current estimates point to prolonged effects and offset of losses of economies in 2022. Hence, the domestic economy forecasts indicate a larger decline in 2020, more moderate recovery in 2021 and stabilization in 2022. Observing risk sources, they are still assessed as markedly downward and almost entirely related to the COVID-19 pandemic. Currently, the main downward risk is related to the potential reintroduction of restrictive measures to contain virus spread, in response to the current second wave of the pandemic, as well as any slower virus management than currently expected. The possible materialization of these risks would lead to re-disruption of production chains and demand and to a significant slowdown in the expected economic recovery, and thus to difficulties in the survival of companies and more pronounced labor market worsening. On the other hand, faster progress **in the coronavirus treatment and vaccine development are factors that instill optimism.** If the coronavirus threat is overcome faster than expected, enhanced confidence could significantly boost global economy. Also, our country's NATO membership and the possible start of EU accession negotiations are positive risks to the forecast, in the medium term. According to the October macroeconomic scenario, the inflation is expected to remain moderate. Moreover, larger imbalances in the balance of payments are not expected, given the dominance of the trade in goods in its structure, as well as partial change in the habits of our emigrants in sending remittances. In accordance with the forecasts for retaining favorable financial conditions globally, we expect normal access to capital markets. Consequently, foreign reserves will remain in the safe zone throughout the forecast horizon. The National Bank constantly monitors the current developments, including the potential surrounding risks and stands ready to adjust policies and take timely measures, in accordance with its mandate.

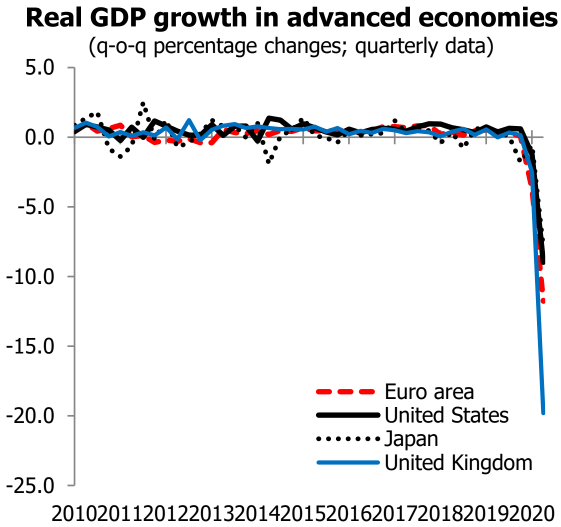
I. Macroeconomic developments

1.1. International economic surrounding

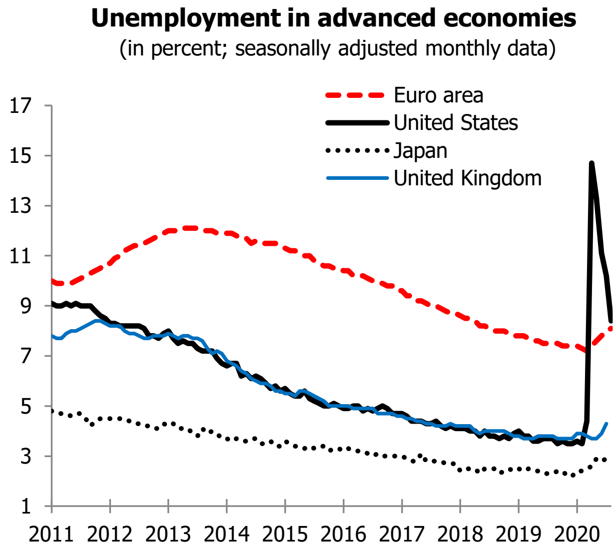
The new viral infection and the containment measures to prevent further virus spread had a strong unfavorable effect on the global economic activity in the second quarter of 2020, both in developed and developing countries. The euro area, as our most important trading partner, registered a real annual decline in economic activity of 14.7%. The latest perceptions of the world economy growth in the following period are affected by the weak performances in the first half of the year, and by the faster recovery in part of the economies in the third quarter, amid significantly high uncertainty around the further development of the new viral infection and its effects on the global economic activity and pronounced downward risks. The IMF October forecasts indicate a decline in the global economic activity in 2020 of 4.4%, which is a slight upward revision compared to the June forecasts, while 2021 expects a recovery and a global economic growth of 5.2%.

As a result of the negative effects of the COVID-19 pandemic, the global economic activity registered a significant decline in the second quarter of 2020, amid unfavorable economic performances in both developed and emerging economies. The United Kingdom, the euro area and the US registered significantly sharp decline in the real GDP in the second quarter of the year[3], which is among the historically sharpest decline in the real economic activity. In the second quarter, the economy of the United Kingdom decreased by 21.5% (decline of 2.1% in the first quarter), amid negative performances in all components of domestic demand, especially investments. The euro area registered a real annual decline of 14.7% in the second quarter (compared to the decline of 3.2% in the first quarter), mostly due to the negative performances in household consumption and investments. The Japanese economy in the second quarter registered a real annual decline of 10.1% (compared to the decline of 1.9% in the last quarter), amid significantly negative performances in private consumption and net exports, in conditions of weak external demand. In the second quarter of the year, the US economy registered a real annual decline of 9% (compared to the slight growth of 0.3% in the first quarter), mostly due to the decline in private consumption and investments, amid significantly deteriorated labor market, where the average unemployment rate in the second quarter amounted to 13%, which is in fact the highest unemployment rate in the US history[4].

[3]The United Kingdom and the euro area registered a decrease in the economic activity for two consecutive quarters, thus falling recession, while Japan fell in recession in the previous quarter.
[4]The data on the unemployment rate in the US as of January 1948 were taken into account.



Source: OECD.

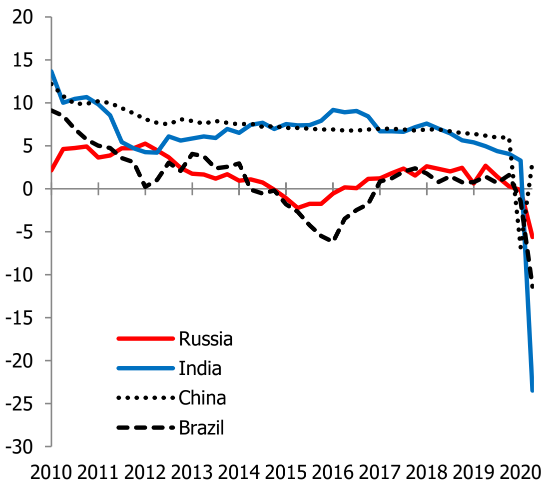


Source: Eurostat.

A sharp decline in the economic activity in the second quarter of the year was registered in most of the emerging economies, and the structure of the decline was generally similar to the one in the developed economies[5]. Thus, in the second quarter, the economy of India registered a real decline of 23.5% annually (compared to the growth of 3.3% in the previous quarter), after several decades of continuous growth in the economic activity. Brazil's economy registered a real annual decline of 11.4% (compared to the decline of 1.4% in the first quarter), due to the unfavorable performances in private consumption and investments, amid increase in unemployment. The economy of Russia noted a moderate decline of 5.6% compared to the other economies (a decline of 0.1% in the previous quarter), while the unfavorable performances are mostly due to the decline in oil prices, weak investment activity and household consumption, amid significant decline in real household income. Unlike these economies, Chine gradually recovered, thus registering a real annual growth of 3.2% in the second quarter (compared to the decline of 6.8% in the previous quarter), amid intensive investment activity and net exports, supported by the stimulating fiscal and monetary policy.

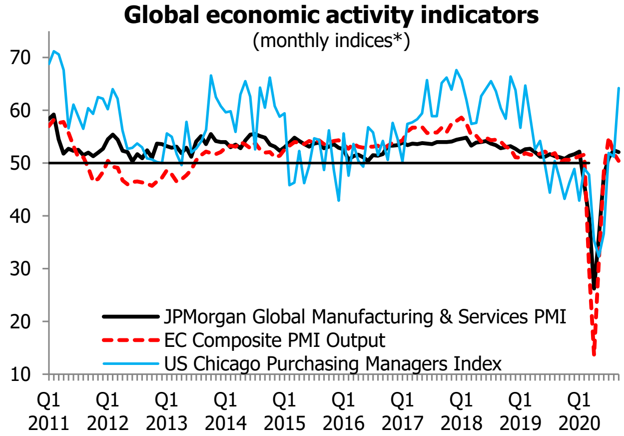
[5]For two quarters in a row, Brazil and Russia registered a decrease in the economic activity compared to the previous quarter, therefore fell in recession.

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



Source: OECD.

Global economic activity indicators
(monthly indices*)



*The PMI index reflects the percentage of respondents that reported better bussiness conditions compared to the previous month and it can take values between 0 and 100. PMI=50 is considered as a reference value, indicating unchanged economic conditions. A PMI value over 50 is taken to indicate that the economy is expanding, while a PMI value below 50 suggests that the economy is contracting.

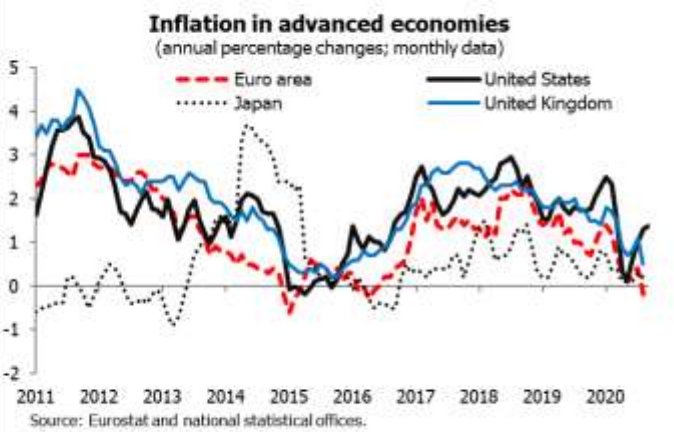
Source: Markit, ISM-Chicago.

Regarding the growth estimates in the third quarter, the latest high-frequency survey indicators point to significant improvement compared to the second quarter. Thus, the average value of the PMI index in the third quarter of the year equaled 51.8 (a significant improvement compared to the 36.8 in the second quarter), mostly reflecting the gradual economic recovery in the third quarter amid relaxed containment measures to globally deal with the pandemic.

The IMF October estimates show a decline of 4.4% in the global economy in 2020, while in 2021 a recovery of the economic growth of 5.2% is expected, thus the GDP level in 2021 will be slightly above the level of 2019. These numbers indicate a slight upward revision for 2020 compared to the June forecasts, amid better performances than previously expected, especially in the developed countries, due to the opening of economies as of May-June, as well as due to stronger recovery in the third quarter. Regarding 2021, the October forecasts indicate a slightly weaker growth than previously expected, thus reflecting the moderate decline which was projected for 2020. The basic scenario assumes that part of the containment measures will continue in 2021 as well, but according to the expectations for a vaccine and improved treatment for the virus, they will gradually loosen during the year.

The forecasts of the global economic growth indicate a significant uncertainty, mostly associated with the prospects for dealing with it. In general, the upcoming risks are downward and refer to the unpredictability related to the developments around the pandemics and the effects on the economic activity (especially in those sectors where the social interaction is more pronounced, and therefore the possibility for virus spread is greater). Risks are also related to the intensity of the negative spillover effects on certain economies from the weak global demand, as well as due to the reduced inflows from tourism and remittances. Risks related to the developments on financial markets and the consequences on the global capital flows are also pronounced, as well as the possible effect on the production potential of the economies. Regarding the positive risks, there is a possibility for faster economic recovery in case of a mass vaccination and improved medical treatment, as well as in possible change in the behavior of the economic entities, i.e. greater protection and reduced infection rate. Also, the possible introduction of new additional fiscal measures to stimulate the activity could accelerate the economic recovery. Observing risks, the IMF develops two alternative scenarios, the first one assuming that the measures to prevent the virus spread will make a greater adverse effect on the economic activity in the second half of 2020, while the assumptions for 2021 are that the progress in the fight against the virus will be slower compared to the baseline scenario, while the second scenario is more optimistic and assumes materialization of part of the positive risks and faster recovery of the world economy, compared to the baseline scenario[6].

When it comes to global inflation, it is relatively low in the third quarter, mainly due to the low energy and food prices. Observed by country, the changes in the inflation rate are in different directions due to specific factors, but no significant price pressures have been observed. Thus, in the euro area, the annual inflation rate in the third quarter equaled 0% (compared to 0.2% in the previous quarter), amid low energy prices, still weak domestic demand and imbalances in the labor market. The average inflation in the US in the third quarter slightly accelerated (partly due to the increase in the prices of medical care). In the period July-August, the inflation rate recorded a slight acceleration in japan as well, due to the increased food prices in economy. On the other hand, the average annual inflation rate in the period July-August in the UK remains unchanged compared to the second quarter.



The euro area in the second quarter of the year registered a real annual decline of 14.7% (a significant deterioration compared to the decline of 3.2% in the first quarter), amid reduced household consumption and investments, reduced inventories and sharp decline in export and import of goods and services. Public consumption also decreased in the second quarter. Analyzed by country, the highest decline in the economic activity was registered in Spain, France and Italy, which in fact were the countries most affected by the pandemic. Regarding the unemployment in the euro area, the first two months of the third quarter noted slight deterioration, thus in the period July-August the unemployment rate amounted to 8% (as opposed to 7.6% during the second quarter). According to the ECB September forecasts, 2020 expects real annual decline in GDP in the euro area of 8% and an annual growth of 5% and 3.2% in 2021 and 2022, respectively. Compared to the June forecasts[7], there was a slight

[6]Compared to the first scenario, the growth of the global GDP in 2020 is expected to be lower by around 3/4 and by almost 3 percentage points in 2021 relative to the baseline scenario. According to the second scenario, the growth of the global GDP is expected to gradually accelerate compared to the baseline scenario, thus in 2021 it would be by 1/2 percentage point higher compared to the baseline scenario.

[7] In September, the ECB revised the June forecasts for 2020, 2021 and 2022, according to which the real GDP growth was forecasted to drop by 8.7% in 2020, while 2021 and 2022 expect a growth of 5.2% and 3.3%, respectively.

upward revision for 2020 and insignificant changes for 2021 and 2022[8]. **The annual inflation rate in the euro area in the third quarter averaged 0%** (in August and September the annual inflation rate was negative and equaled -0.2% and -0.3%, respectively), which is a slowdown compared to the second quarter when the average annual inflation rate was 0.2%. Given the current and expected oil prices, the weak demand and low pressures from wages, as well as the temporary decrease in the VAT rate in Germany, the inflation rate is expected to remain in the negative zone by the end of the year[9]. According to the ECB forecasts from June, the inflation rate in the euro area would be 0.3% in 2020, and then it would accelerate and reach 1% in 2021 and 1.3% in 2022. Compared to the June forecasts, 2021 noted a slight upward revision (of 0.2 percentage points), while there are no changes for 2020 and 2022[10].

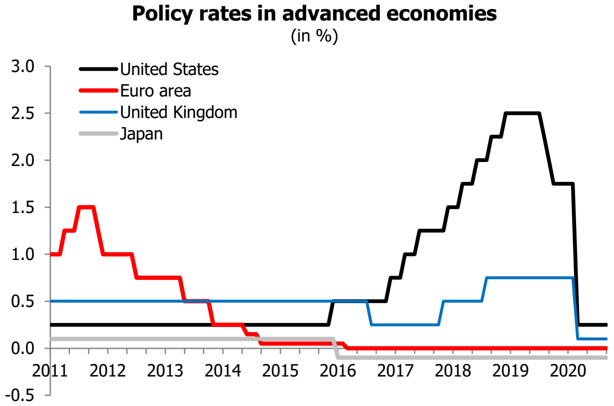
In the third quarter of 2020, the developed countries continued with the stimulating monetary policy to mitigate the negative effects of the pandemic. In terms of the interest rate policy, they were maintained at the current levels in the US, the euro area, the UK and Japan. The FED kept the interest rate at 0.25%, and at the same time continued with the measures to stimulate the economic activity. Also, at the end of September, the FED announced continuation of part of the measures aimed at maintaining the capitalization of the banking system at a high level during the fourth quarter of the year[11]. The bank of England kept the interest rate during the third quarter at 0.1%, thus continuing the implementation of set of other measures aimed at supporting economy, easing the financial burden for the large companies in order to timely pay liabilities, as well as to stimulate corporate and household lending. The interest rate in the euro area remained at the same level of 0%, while the ECB continued implementing measures to encourage economic activity. In particular, these measures include continuation of the Assets Purchase Programme by June 2021 at the earliest (in the amount of Euro 1,350 billion), continuation of the quantitative easing program (in the amount of Euro 20 billion), purchase of additional Euro 120 billion by the end of the year, as well as continuation of the targeted long-term repo operations, which will provide greater liquidity. The bank of Japan did not change its interest rate (-0.1%) as well and continued to implement the additional measures to stimulate economic activity, such as monetary easing through increased purchase of corporate securities, special fund to facilitate the financing of the private sector, and at the same time to continue with the purchase of government securities and provide domestic and foreign currency liquidity to stabilize financial markets.

[8]Due to the great pandemic-related uncertainty and its effect on the economy, two additional risk scenarios were prepared. Compared to the baseline scenario, the medium-risk scenario estimated a lower real economic decline in 2020 by 0.8 percentage points, while within the scenario with more pronounced risks, the decline in GDP in 2020 would be steeper by 2 percentage points. On the other hand, the inflation rate for 2020 within the medium-risk scenario and the scenario with more pronounced risks remained unchanged compared to the baseline scenario and equaled 0.3%

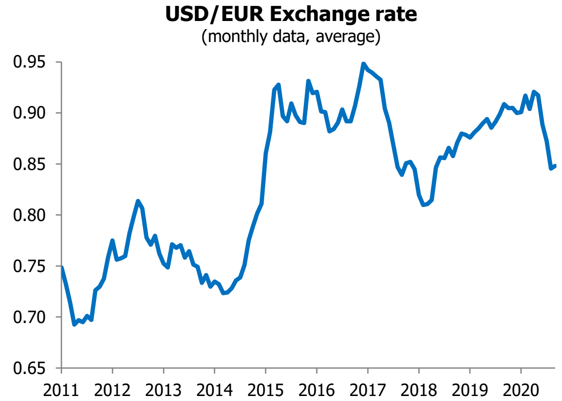
[9]The German government decided to temporary reduce the VAT rate in the period from 01.07.2020 to 31.12.2020, thus reducing the basic rate by 16% (from 19%), while the preferential rate was reduced to 5% (from 7%).

[10]In June, the inflation rate in the euro area was expected to equal 0.3% in 2020, 0.8% in 2021 and 1.3% in 2022.

[11]During the fourth quarter, large banks (those with total assets in excess of US dollar 100 billion) were prohibited from purchasing shares, and additionally the dividend payment shall be limited and depend on the current profit. The measures are still in effect, given that in the third quarter they kept the strong capital positions of banks. Despite the fact that according to the FED analyses from June, all of the large banks were well capitalized, given the overall economic uncertainty, the FED adopted additional restrictions to protect the banks' capital, which provide protection and better credit activity of banks.



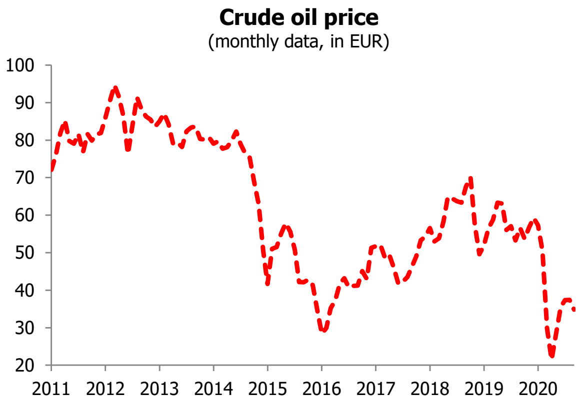
Source: Central banks.



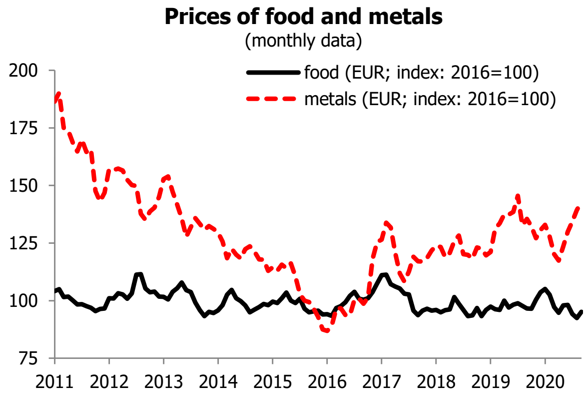
Source: Bundesbank.

In the third quarter of 2020, the value of the US dollar depreciated against the euro, on average by 5.9% compared to the previous quarter and amounted to 0.86 euros. Such change is mostly due to the prospects for weaker economic performances and low interest rates in the US. Annually, in the third quarter, the US dollar depreciated by 4.9% against the euro.

The price of oil in the third quarter of 2020 registered a significant increase of 28.3% compared to the last quarter, whereby the average price reached 36.5 euros per barrel. Moreover, the increase in oil prices was due to the enhanced demand for oil as a result of the recovery of the global economic activity, amid relaxed containment measures to prevent the virus spread, as well as due to agreement between OPEC+ countries for limited and temporary halted production of oil in the US and Canada. However, observed annually, in the third quarter of 2020, the oil price registered a severe decline of 34.3%.



Source: IMF monthly database and NBRNM calculations.



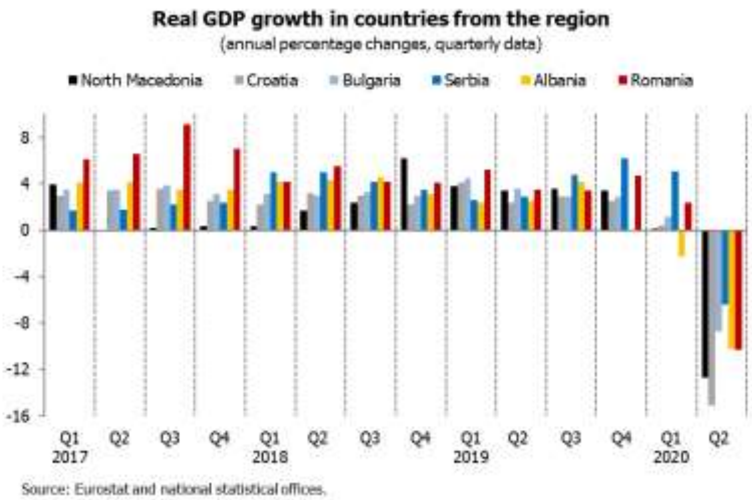
Source: IMF monthly database and NBRNM calculations.

Prices of non-energy primary products[12] (in euros) registered a quarterly growth of 2.6% in the third quarter of 2020 compared to the previous quarter. Analyzed by groups of products, the growth is due to the increase in metal prices, caused by the growth in the prices of basic and precious metals. Thus, the index of basic metals[13] increased by 12.4% compared to the previous quarter, due to the increase in the prices of almost all

[12]This aggregate index includes the precious metals index, the food and beverages index, the agricultural raw materials index and the index of basic metals.
[13]This index includes the following metals: Aluminum, cobalt, coper, iron, steel, molybdenum, nickel, tin, uranium, and zinc.

metals, namely iron and copper, largely due to the gradual economic recovery and demand from China. On the other hand, the food prices slightly declines, i.e. the index of food prices[14] reduced by 3.1% compared to the previous quarter (amid decline in almost all food categories, except prices of vegetable oil and sugar on the free market). **On an annual basis, the euro prices of primary non-energy products increased by 2.5%.**

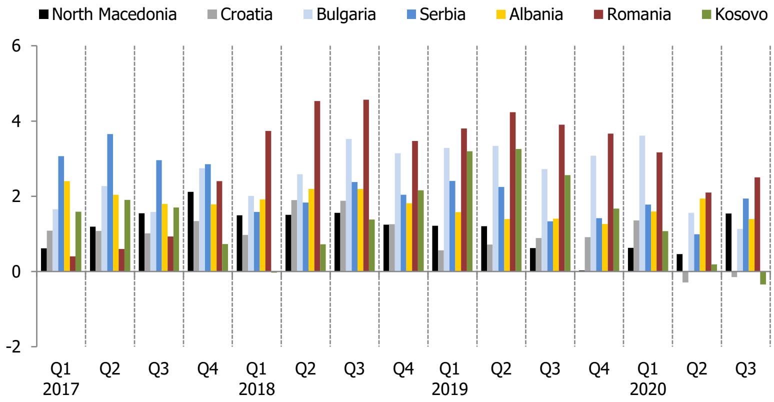
The health crisis and the measures taken to prevent the further virus spread adversely reflected the macroeconomic performance of economies in the region in the second quarter of the year. The steepest decline was registered in Croatia (a decline of 15.1%) amid significant decrease in private consumption, investments and net exports. High real annual decline was also registered in Romania (10.3%), mostly due to significantly reduced private consumption, as well as in Albania (10.2%), amid decline in domestic and net export demand. Bulgaria registered a decline of 8.7% amid decline in investments and unfavorable movements in the external sector. Of the countries in the region, the slightest real decline on an annual basis in the second quarter was registered in Serbia (decline of 6.4%), amid unfavorable performances in all categories, excluding the private consumption which slowly increased.



In the third quarter of 2020, the countries from the region registered different movements in the annual inflation rate. Thus, Serbia and Romania registered a slight acceleration of the average annual inflation rate compared to the second quarter. In Serbia, the inflation acceleration was due to higher prices of food, beverages and tobacco, communication and recreation, while Romania, in the period July-August, the acceleration in inflation was mainly due to higher prices in the service sector. On the other hand, in Albania and Bulgaria there is a slight deceleration in the annual inflation rate in the third quarter compared to the previous quarter, mainly due to lower prices in transport in both countries. The lower prices in transport, coupled with the reduced prices in the following categories: recreation and culture, housing and utilities, furniture and clothing and shoes, led to a negative inflation rate in Kosovo (-0.3%). The inflation rate in Croatia remained in the negative zone in the third quarter due to low prices of clothing and shoes, although more moderate compared to the previous quarter (-0.1%, against -0.3% in the second quarter).

[14]This index includes the following food products: Cereals, vegetable oil, meat, sea food, sugar and other food.

Inflation in countries from the region
(annual percentage changes)



Source: Eurostat and national statistical offices.

1.2. Domestic supply

After the minimal economic growth in the first quarter of only 0.2%, in the second quarter of 2020 the real GDP decreased by 12.7% annually[15]. This steep decline in GDP is due to the health and economic crisis caused by the COVID-19 pandemic, which significantly worsened the business activity in this period and affected the confidence and expectations of companies and consumers. The crisis had a significant and dispersed effect on almost all product segments of the economy, mostly pronounced in the part of the industry and activities in trade, transport and catering. The currently available high-frequency data for the third quarter of 2020 indicate more moderate negative effects of the health crisis on the economic activity. **This is evident through the slowdown in the annual rates of decline in the main economic sectors for the period July-August 2020.** ***Such movements correspond to the estimations on the business situation of corporations and retail trade, construction, manufacturing industry and services sector, which are more favorable in the third quarter. Also, the managers of these activities showed further optimism related to their expectations for the upcoming period, which are more favorable compared to the previous quarter.***

In the second quarter of 2020, the domestic economy registered a significant real decline of 12.7% annually, compared to the slight increase of 0.2% in the first quarter of the year. A significant quarterly decrease of 11.2% was also registered (seasonally adjusted). These performances reflect the unfavorable external environment, as well as the effects of the measures taken to deal with the COVID-19 which were applied as of the second half of March and continued during the second quarter. Structurally observed, most of the activities registered a real annual decline, with the highest negative contribution made by the industry and the activities of the group trade, transport and catering[16]. Regarding industry, the decline is mostly due to unfavorable performances in manufacturing industry, with negative developments in energy and mining sector as well. On the other hand, in the

[15]The only decline with identical intensity was registered in the third quarter of 2001 amid war in the country.
[16]Negative contribution in the economic growth was also made by financial and insurance activities and administrative and auxiliary services.

second quarter real annual growth and consequently positive contributions were registered in agriculture, public administration and defense, mandatory social insurance, education, health and social welfare.

Annual growth rates (in %)

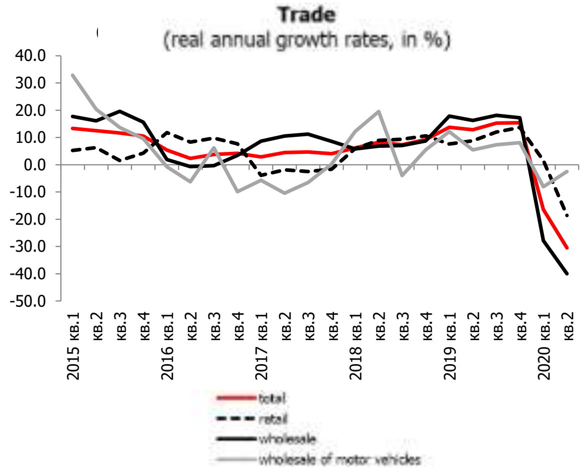
	annual growth rates, in %									
	2016	2017	2018	2019	Кв.1 2019	Кв.2 2019	Кв.3 2019	Кв.4 2019	Кв.1 2020	Кв.2 2020
Agriculture	**-0.4**	**-12.5**	**7.4**	**3.8**	9.6	3.6	0.6	3.1	2.8	4.5
Industry	**-3.0**	**1.4**	**4.1**	**3.1**	5.7	4.3	6.8	-3.1	-5.1	-25.2
Manufacturing	**-1.5**	**1.6**	**4.5**	**-0.1**	1.9	-0.7	-0.5	-0.7	-1.3	-29.4
Construction	**-2.8**	**1.6**	**-11.9**	**5.9**	6.7	4.8	5.5	6.7	1.5	-0.5
Trade and transport	**8.7**	**7.1**	**5.9**	**4.7**	3.4	2.1	4.9	8.1	-1.3	-23.4
Information and communication	**7.2**	**7.6**	**-6.4**	**-0.9**	-5.5	-6.1	2.2	5.7	10.4	0.9
Financial and insurance activities	**1.5**	**1.9**	**2.6**	**0.2**	-0.8	0.4	0.9	0.2	-1.9	-3.1
Real estate activities	**-3.2**	**-1.6**	**0.1**	**3.3**	3.7	4.2	2.4	2.9	6.5	0.0
Professional, scientific and technical activitiess	**11.5**	**8.8**	**7.5**	**3.1**	-0.1	3.6	4.5	4.5	-2.8	-3.1
Public administration	**3.5**	**-2.2**	**2.6**	**2.9**	5.6	3.6	1.2	1.3	-0.9	2.2
Other service activities	**7.2**	**3.1**	**3.0**	**-2.0**	-8.6	-3.8	1.0	4.1	5.2	-0.2
Gross Domestic Product	**2.8**	**1.1**	**2.7**	**3.6**	**3.8**	**3.4**	**3.6**	**3.4**	**0.2**	**-12.7**

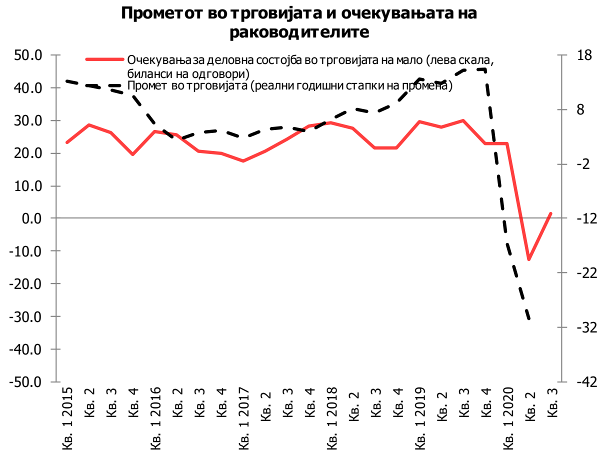
Contributions to the GDP growth (in percentage points)

	contribution in GDP growth, in p.p.									
	2016	2017	2018	2019	Кв.1 2019	Кв.2 2019	Кв.3 2019	Кв.4 2019	Кв.1 2020	Кв.2 2020
Agriculture	**0.0**	**-1.1**	**0.6**	**0.3**	0.6	0.2	0.1	0.4	0.2	0.3
Industry	**-0.5**	**0.2**	**0.7**	**0.6**	1.0	0.8	1.2	-0.6	-1.0	-4.7
Manufacturing	**-0.2**	**0.2**	**0.6**	**0.0**	0.2	-0.1	-0.1	-0.1	-0.2	-3.9
Construction	**-0.2**	**0.1**	**-0.8**	**0.3**	0.3	0.3	0.3	0.4	0.1	0.0
Trade and transport	**1.6**	**1.3**	**1.2**	**0.9**	0.7	0.4	1.0	1.5	-0.3	-4.7
Information and communication	**0.2**	**0.2**	**-0.2**	**0.0**	-0.2	-0.2	0.1	0.1	0.4	0.0
Financial and insurance activities	**0.0**	**0.1**	**0.1**	**0.0**	0.0	0.0	0.0	0.0	-0.1	-0.1
Real estate activities	**-0.4**	**-0.2**	**0.0**	**0.3**	0.5	0.4	0.2	0.2	0.7	0.0
Professional, scientific and technical activitiess	**0.4**	**0.3**	**0.3**	**0.1**	0.0	0.1	0.2	0.2	-0.1	-0.1
Public administration	**0.4**	**-0.3**	**0.3**	**0.3**	0.7	0.4	0.1	0.2	-0.1	0.3
Other service activities	**0.2**	**0.1**	**0.1**	**-0.1**	-0.3	-0.1	0.0	0.1	0.1	0.0
Gross Domestic Product	**2.8**	**1.1**	**2.7**	**3.6**	**3.8**	**3.4**	**3.6**	**3.4**	**0.2**	**-12.7**

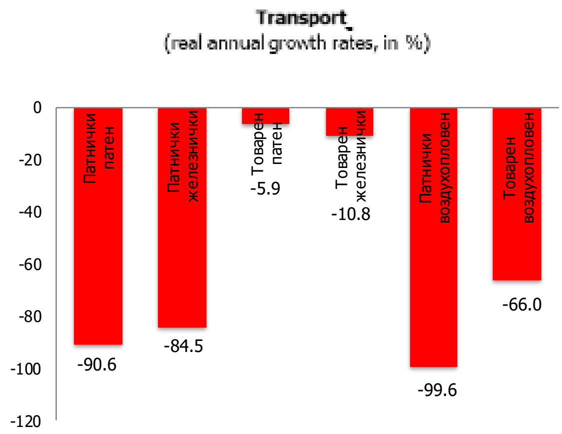
Source: NBRNM calculations.

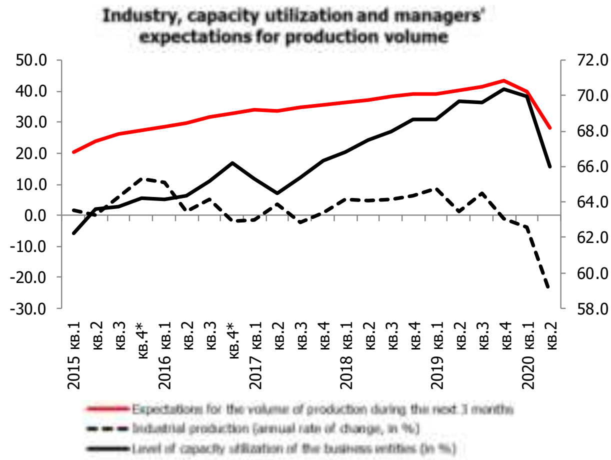
The trade registered high real annual decline, with a significant negative contribution in the second quarter of the year. This almost entirely reflects the developments related to the new viral infection and the measures taken to prevent its spread. Observed by type of trade, unfavorable performances, i.e. decline in the activity is registered in all three types of trade (wholesale trade, retail trade and trade in motor vehicles). In the period July-August, total trade turnover registered a real fall of 27.5% on an annual basis, reflecting the unfavorable performances and the decline in the wholesale and retail trade, while the trade in motor vehicles registered a high real growth. However, in the period July-August, the decline in the total trade turnover, as well as in retail trade, was milder in relation to the decline in the second quarter. Also, the perceptions of the corporate managers in the retail trade sector on their turnover during the third quarter were more favorable compared to the previous quarter. As for the expectations in terms of demand, consumer prices, as well as the number of employees for the upcoming period, they are improved with a gradual return of optimism.





Regarding the **transport**, significant decline in the activity on an annual basis in the second quarter of the year is registered in almost all types of transport, given the movement restrictions, both locally and internationally. Thus, the most pronounced decline on annual basis was recorded in the passenger air, road, rail traffic, as well as freight air traffic, while slight decline was registered in freight rail and road traffic.



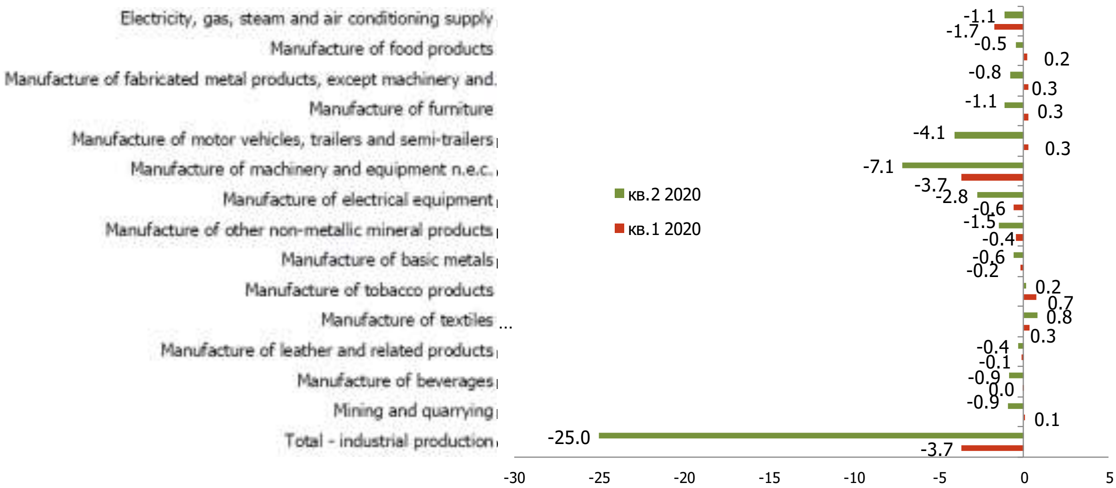


The COVID-19 crisis and the measures taken to prevent the virus spread led to a sharp real annual decline in industry in the second quarter of 2020. Analyzed by activity, through industrial output index, the most pronounced annual decline is registered in manufacturing industry[17], with a slight negative contribution typical for the energy sector, as well as for mining[18]. Analyzing the manufacturing industry, most of the activities registered negative contributions in the second quarter. Moreover, the most pronounced negative contribution was registered in the group of activities engaging foreign export facilities, such as production of machinery and devices not elsewhere mentioned, production of motor vehicles, trailers and semi-trailers and production of electrical equipment. In traditional activities, the second quarter registered more significant negative contribution in production of clothes, and production of textile, with a pronounced negative contribution in production of furniture. On the other hand, the production of basic pharmaceutical products and pharmaceutical preparations has

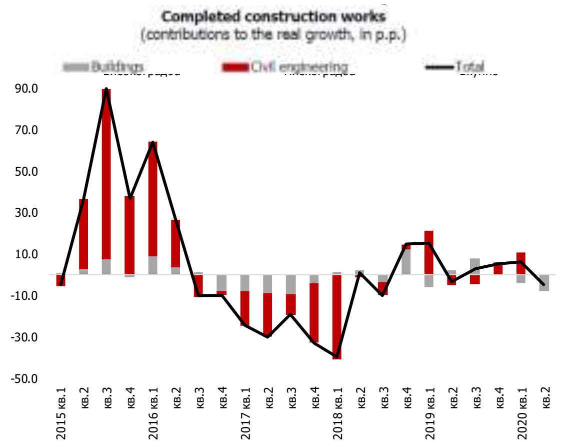
[17] Since mid-March until mid-May, part of the new industrial facilities temporarily interrupted the production process as a reflection of the disrupted global value and logistics chains.
[18] The analysis of trends in industry uses data on the SSO's monthly data for the industrial output indices.

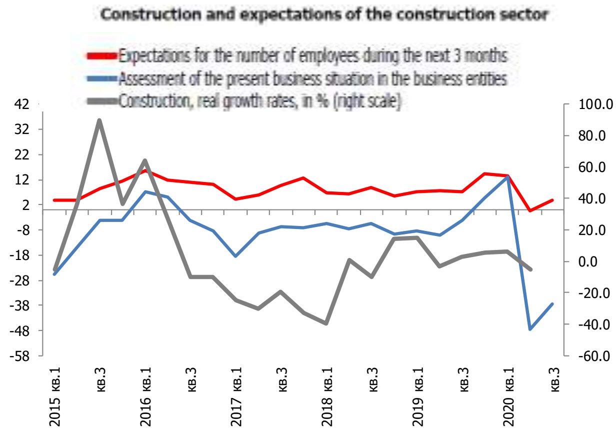
the highest positive contribution. In the period July-August, the industrial output registered a significant deceleration in the decline, which dropped at 9.3% annually (compared to the decline of 25% in the second quarter of the year). Thus, observed by main industrial activities, in the period July- August,, the largest drop and consequently the highest negative contribution is still registered in the manufacturing industry, amid simultaneous, but smaller decline in also registered in both, mining and energy sector. Similar to other sectors, the perceptions of the industrial sector managers are slightly more favorable in the third quarter compared to the previous quarter, while improved and more optimistic expectations in terms of the movement of production, consumer prices and the number of employees are registered for the last quarter of the year.

Contributions of selected industries to the total industrial production, annual rate of change (in percentage points)



In the second quarter of the year, the construction sector registered a real annual decline on an annual basis as well. Observing the high-frequency data, the completed construction works in the second quarter registered a real annual decline in activities (as opposed to the solid growth in the first quarter), which is entirely due to the high real annual decline in building construction (significantly steeper compared to the decline in the first quarter). On the other hand, the civil engineering registered a real annual growth in the second quarter (albeit significantly slower compared to the growth in the first quarter). Similar to other sectors, the weak performances in construction largely result from the measures taken to prevent the virus spread which were applied during the second quarter. In July 2020, the construction sector registered a slight decrease in the activity (real annual decline of 0.9%), which is an evident slowdown in the decline compared to the second quarter (decline of 5.1%). The slight decline in July is entirely due to the decline in the building construction, while the civil engineering registered a high degree of real annual growth and significant acceleration of the activity compared to the second quarter. According to these performances, the perceptions of corporate managers in the construction sector for the movement of their construction activity in the third quarter are more favorable compared to the previous quarter. Also, the expectations for the consumer prices, the total number of orders and the number of employees for the period ahead registered a slight improvement and gradual return of the optimism.



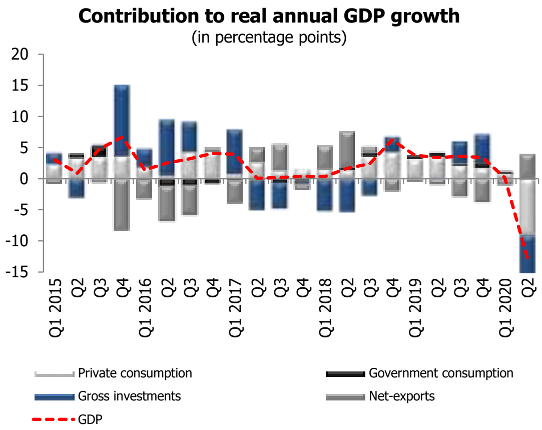


1.3. Aggregate demand

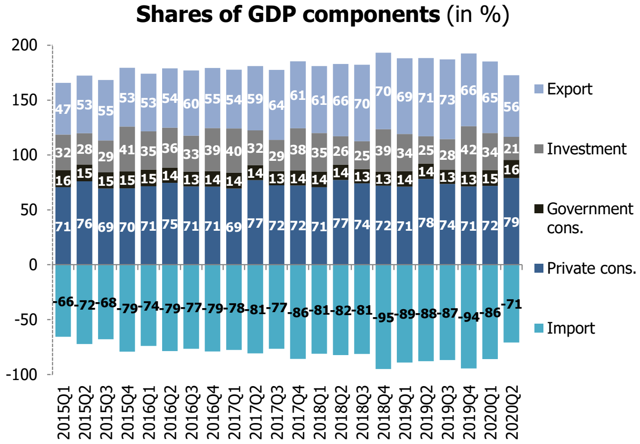
Observed by the aspect of the demand, the steep annual GDP decline of 12.7% in the second quarter of 2020 is due to the significant decrease in almost all components. Consequently, the contribution of the domestic demand to the growth is significantly negative, amid decline in private consumption and gross investments. Regarding the components of domestic consumption, only public consumption slightly grew. On the other hand, amid high double-digit rates of decline in both, exports and imports of goods and services, the contribution of net exports was positive, due to the increased downward adjustment of imports (in absolute amounts), thus partly neutralizing the adverse effect of the domestic demand. The deeper downward adjustment in imports reflects significant downward shift in domestic demand and exports, given the import dependence of the domestic economy.

The structural analysis of the GDP components[19] in terms of demand shows that the decline is due to significant decrease in almost all components. Thus, the domestic demand made a significantly negative contribution amid significant decline in private consumption and gross investments due to the health and economic crisis caused by the COVID-19 and restrictive measures taken to deal with it which worsened the business activity and increased the uncertainty among companies, as well as postponed part of the household consumption. Only public consumption slightly grew. The reduced foreign demand and the problems with the transport due to the pandemic led to further decline in exports in the second quarter, thus exports made the largest individual negative contribution to the GDP growth for two consecutive quarters. As a result of the weak domestic demand, as well as the reduced export, the import registered a sharp annual decline in the second quarter as well. In conditions of higher decline in import than in export of goods and services (in absolute amounts), the net export made a positive contribution, thus partly neutralizing the adverse effect of the domestic demand.

[19] The quarterly changes of the GDP and its components are calculated using seasonally adjusted data.



Source: State Statistical Office and NBRNM calculations.



Source:SSO and NBRNM calculations.

	Real annual growth rates (%)											Contributions to real annual growth (in p.p.)**										
	2015	2016	2017	2018	2019	2019-Q1	2019-Q2	2019-Q3	2019-Q4	2020-Q1	2020-Q2	2015	2016	2017	2018	2019	2019-Q1	2019-Q2	2019-Q3	2019-Q4	2020-Q1	2020-Q2
Private consumption	4.4	3.9	2.1	3.7	3.5	4.4	4.4	2.9	2.4	1.2	-11.6	3.1	2.7	1.4	2.4	2.3	2.8	3.0	1.9	1.6	0.8	-8.1
Government consumption	3.9	-4.9	-2.6	2.0	4.5	3.8	4.8	2.0	7.1	2.4	1.5	0.7	-0.8	-0.4	0.3	0.7	0.6	0.7	0.3	1.0	0.4	0.2
Exports of goods and services	8.5	9.1	8.3	15.6	8.3	17.8	11.7	8.3	-1.6	-5.4	-31.3	4.0	4.4	4.2	8.6	5.0	9.9	7.0	5.2	-1.1	-3.3	-19.7
Imports of goods and services	9.9	11.1	5.2	9.1	9.0	13.8	10.4	10.7	2.8	-3.2	-29.6	-6.5	-7.2	-3.4	-6.2	-6.6	-9.7	-7.4	-7.5	-2.3	2.4	21.9
Gross capital formation	8.3	12.5	-2.2	-7.3	6.6	-0.2	-0.4	14.1	11.5	-0.5	-25.6	2.5	3.8	-0.7	-2.4	2.1	0.3	-0.6	3.1	5.1	-0.1	-7.0
Domestic demand	*5.4*	*5.1*	*0.3*	*0.3*	*4.4*	*3.0*	*3.4*	*5.3*	*5.7*	*0.9*	*-13.0*	*6.3*	*5.6*	*0.3*	*0.4*	*5.1*	*3.7*	*3.1*	*5.3*	*7.8*	*1.1*	*-14.9*
*Net exports**	*14.1*	*16.7*	*-2.7*	*-9.4*	*11.3*	*2.1*	*5.4*	*25.1*	*15.0*	*4.5*	*-22.5*	*-2.4*	*-2.8*	*0.8*	*2.3*	*-1.5*	*0.3*	*-0.4*	*-2.3*	*-3.4*	*-0.9*	*2.2*
Statistical discrepancy												*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*-0.2*	*0.6*	*0.6*	*-1.0*	*0.0*	*0.0*
GDP	**3.9**	**2.8**	**1.1**	**2.7**	**3.6**	**3.8**	**3.4**	**3.6**	**3.4**	**0.2**	**-12.7**	**3.9**	**2.8**	**1.1**	**2.7**	**3.6**	**3.8**	**3.4**	**3.6**	**3.4**	**0.2**	**-12.7**

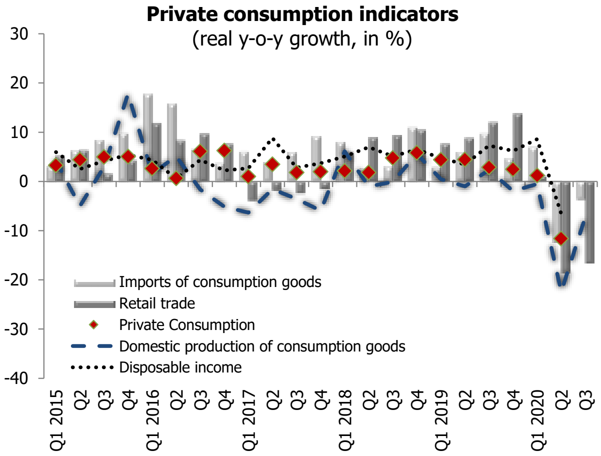
**decrease represents lower deficit*
*** Contribution components do not sum to total GDP due to statistical discrepancies in real amounts.*
In order to comply with the official real growth rates, the statistical discrepancy is included in the aggregate GDP.
Source: SSO and NBRNM calculations.

1.3.1. Private consumption

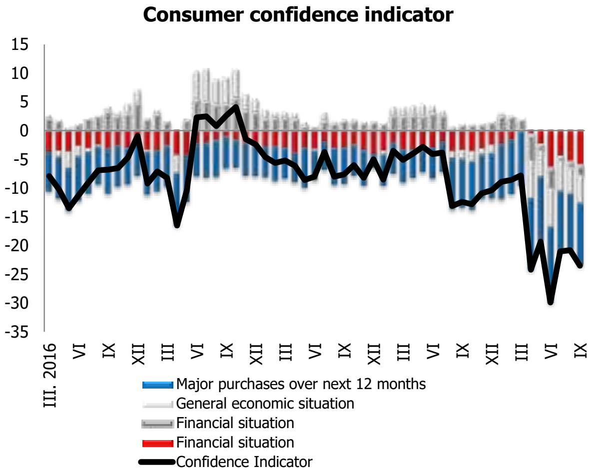
The presence of the restrictive measures during the second quarter, together with the uncertainty of the further virus spread and the first indications for unfavorable conditions on the labor market, resulted in decrease in household consumption. In such conditions the private consumption in the second quarter of 2020 registered a double-digit annual decline of 11.6% (quarterly decline of 10.3%). After almost seven years of steady annual growth, the disposable income registered a sharp decline in the second quarter, primarily due to the double-digit decline in inflows from private transfers amid global uncertainty and limited movement of the population. At the same time, the wage bill registered a significantly slower growth rate[20]. On the other hand, pensions grew faster, with a further growth in household lending by banks in the second quarter, yet more moderate.

[20]The slowdown in the growth of wages in the second quarter partly reflects the more pronounced decrease in wages which is registered in the most affected sectors of the economy by the COVID-19 crisis (for more details, see section 1.3. Employment and wages).

In the third quarter of the year the indicators of the movement in **private consumption**[21] still point to reduced consumption, with a significantly less pronounced decline than the one in the second quarter of the year. The slowdown in the decline in this period is recorded in retail trade and gross revenues from VAT, with a significantly lower decline in domestic production of consumer goods and imports of consumer goods. Such movements could partly be related to the economic measures to support private consumption[22]. The consumer confidence indicator[23] registered favorable movements in the surveys conducted in the third quarter, and points to slight reduction in consumer pessimism (less negative prospects and expectations for their financial and overall economic situation in the country, as well as expectations for higher consumption in the following period). In terms of private consumption financing sources, solid growth is still registered in almost all sources. Thus, from the main categories of disposable income, growth acceleration was registered in wages, with a further solid growth of pensions and household lending. On the other hand, the results of the Bank Lending Survey from September show a slight net tightening of the overall credit conditions, amid slight net reduction of the demand for household loans, compared to the previous quarter.



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



Source: European Commision and NBRNM's

1.3.2. Public consumption

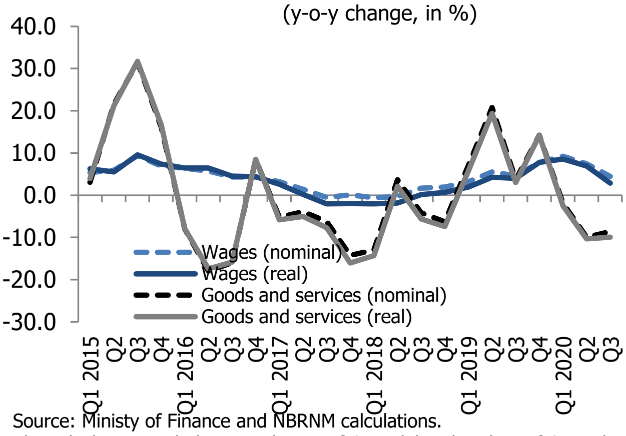
Public consumption registered an annual and quarterly growth of 1.5% and 1.1%, respectively in the second quarter of 2020. Despite the slower growth, it was the only expenditure component which increased and made a positive contribution to the developments of the domestic economy. Analyzing budget data, the annual growth was supported by the increase in most of the major categories of public consumption (mainly higher transfers to local

[21] Data on wages are as of July 2020, while data on household loans, pensions, retail trade, domestic production of consumer goods, import of consumer goods and gross revenues from VAT refer to the period July-August 2020.
[22] The third package of economic measures of the Government for revival of the Macedonian economy through direct support to the citizens and the economy in conditions of COVID-19, provided for awarding a domestic payment card to selected categories, totaling Euro 28 million. The deadline for using these funds was 15 August 2020. For more information visit: https://vlada.mk/node/21426 и https://finance.gov.mk/mk/node/8798.
[23] European Commission's Consumer Survey as of September 2020. 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. Starting from January 2019, the European Commission revised the structure of consumer confidence indicator, and accordingly, the composite indicator of economic confidence. For more information on the new methodological changes visit: https://ec.europa.eu/info/files/revised-consumer-confidence-indicator_en . In its press release from 23 March 2020, the European Commission pointed out that due to the coronavirus, the data collection period in most the countries stopped earlier than usual. Only about 15% of the consumers' responses were provided after the introduction of the tough restrictive measures by the individual countries.

governments, higher health care transfers, as well as higher expenditures for wages[24]), while larger downward adjustment was registered in expenditures for goods and services.

Budget performances in the period July-August 2020 point to further annual growth of **public consumption** in the third quarter, amid growth in most of the main categories of public consumption. Thus, higher health care transfers and transfers to local government were registered, with increase in expenditures for wages, yet at a slower pace. On the other hand, decline was registered only in expenditures for goods and services.

Expenditures for Wages and salaries and Goods and services
(y-o-y change, in %)



Source: Ministy of Finance and NBRNM calculations.
The calculations include expenditures of Consolidated Budget of Central Government and Funds, deflated by CPI.

1.3.3. *Investment consumption*

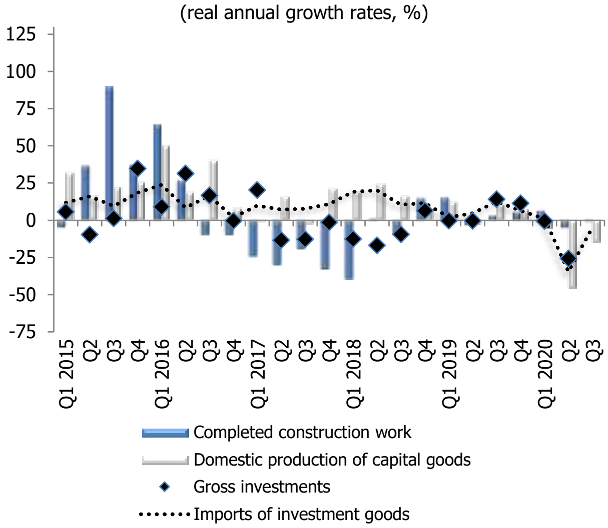
After the slight decline in the first quarter, the second quarter registered a high double-digit annual decline of 25.6% (quarterly decline of 24.8%) in gross investments. The negative effects of the pandemic and the deteriorated economic prospects reflected the trust and expectations of the business entities. Such downward movement of the investment demand corresponds to the decline in construction activity, as well as to the significant decline in imports of machinery and equipment in this period, as key components of the investments in fixed assets, with a decline in government capital investments as well. In conditions of increased global uncertainty, decline was also registered in foreign direct investments. On the other hand, the support to banks by long-term corporate loans continued in the second quarter, but with a slightly moderate annual growth.

The high frequency data on the **gross investments[25]** for the period July-August 2020 moved in different directions, yet indicating more favorable developments. Thus, the decline significantly decelerated in construction, industrial output, the domestic production of capital goods and import of capital goods. The only acceleration of the annual decline is registered in income tax, partly related to the measure for a delayed payment of this tax[26]. At the same time, the faster growth in long-

[24]In accordance with the wage increase for the public sector employees (more details, see section 1.3. Employment and Wages).
[25] Data on completed construction works are as of July 2020, while data on long-term corporate loans, the government capital investments, the industrial production, the import of investment goods and the domestic production of capital goods refer to the period July-August 2020.
[26] Related to the measure adopted from the beginning of the crisis for release from corporate tax advances for all companies that are affected by the virus and that meet the required conditions (the company not to reduce the number of employees below the number of employees from February 2020, haven't paid off dividends in 2020 and remunerations and bonuses after the measure

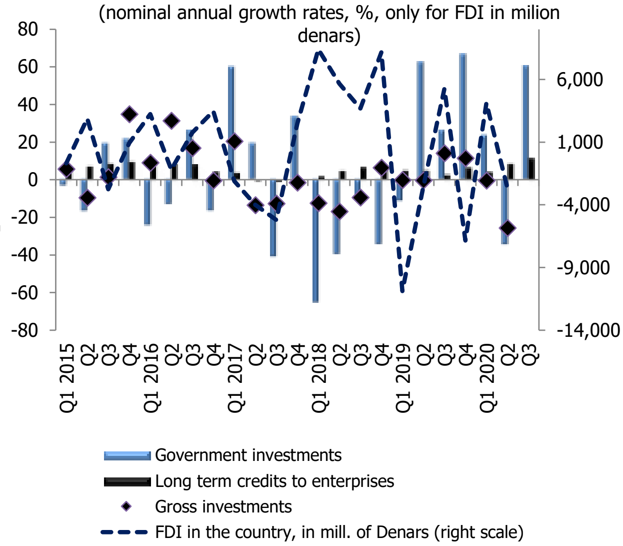
term corporate lending by banks continued, which was also due to the series of measures taken in order to improve the liquidity conditions and ease the financing conditions. The results of the Bank Lending Survey for the third quarter point to net tightening of the credit conditions and reduced net demand for loans, compared to the previous quarter. Accelerated growth was also registered in government capital investments.

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



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

Gross investments and determinants
(nominal annual growth rates, %, only for FDI in milion denars)



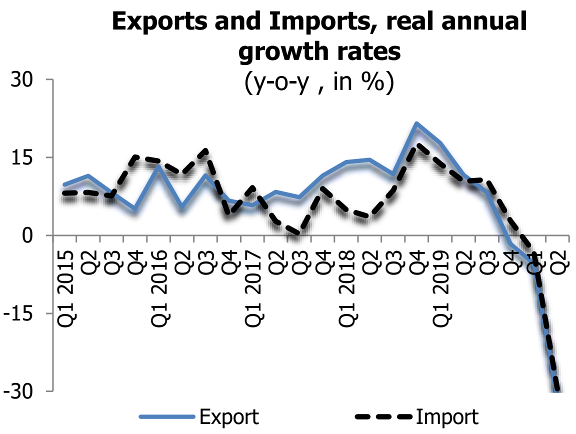
Source: State Statistical Office, Ministry of Finance and NBRNM calculations.

1.3.4. Net external demand

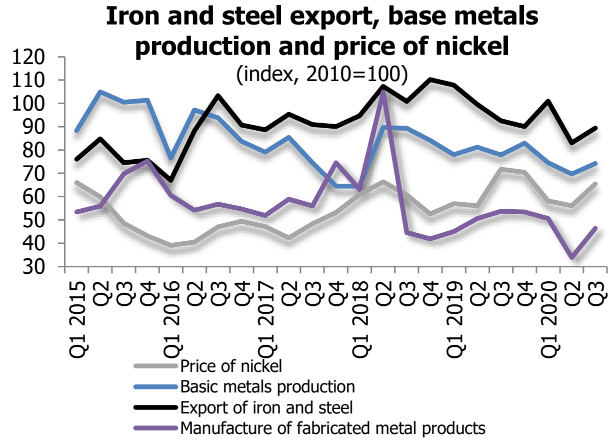
Unlike the previous four quarters, net exports in the second quarter of 2020 made a positive contribution amid higher annual decline in imports of goods and services (in absolute amounts), which partly neutralizes the negative effect of the domestic demand. Moreover, the decline in the foreign demand and the disrupted global production and logistics chains due to the pandemics caused a direct effect on the export demand. Thus, in the second quarter the export made a steep double-digit decline on annual and quarterly basis of 31.3% and 27.4%, respectively. For the second consecutive quarter the export component made the highest individual negative contribution to the GDP growth. Analyzing the high frequency foreign traded statistics, such performances on the export side primarily resulted from lower export of economic facilities related to automotive industry, which in April and May had interruption of the activities or operated at reduced capacity, while more pronounced negative contribution was made from part of the traditional sectors (iron, textile and food). Taking into consideration the import dependence of the domestic economy, the decline in exports together with the decline in domestic demand, contributed to a double-digit annual and quarterly decline in imports of 29.6% and 26.8%, respectively.

Foreign trade data in July-August 2020 indicate potential deficit tightening in the third quarter of the year compared to the same period last year, amid smaller nominal decline in the export than the import of goods.

takes effect). The fourth package of measures provides for an extension of this measure until March 2021, for companies that reported a decline in their income larger than 40%.



Source: State Statistical Office



Source: State Statistical Office, IMF monthly database and NBRNM calculations.

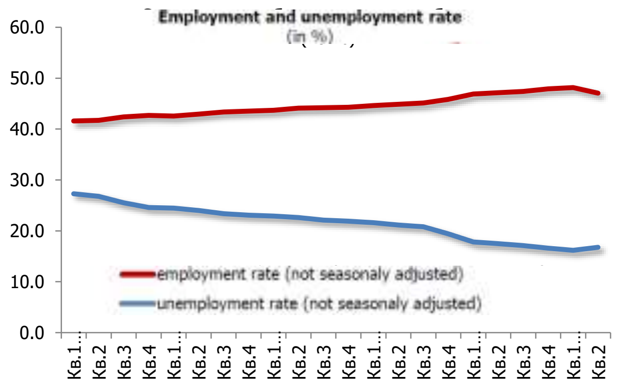
1.4. Employment and wages

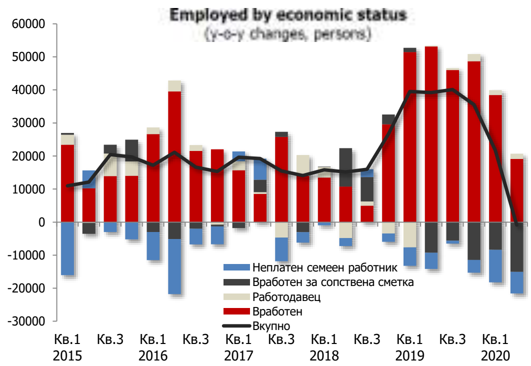
In the second quarter of the year the labor market indicators worsened as a result of the unfavorable effect of the health and economic crisis caused by the COVID-19 pandemic. Thus, for the first time, after a multi-year steady growth, the number of employees decreased, albeit minimally, while the unemployment rate slightly increased. The number of employees in this quarter decreased by 0.1% annually, while the unemployment rate reached 16.7% (16.2% in the previous quarter). Compared to the expectations for the second quarter, the business tendency surveys indicate moderately improved expectations of the corporate managers in terms of employment for the third quarter, with further favorable expectations for employment in the following period. In terms of labor supply, the active population in the second quarter of 2020 slightly decreased, thus interrupting the positive trend since the last quarter of 2016. In terms of the competitiveness indicators, the labor productivity further reduced, while unit labor costs continued to grow.

The health and economic crisis caused by the COVID-19 pandemic reflected on the labor market, thus reducing the number of employees in the second quarter of the year (by 0.1%, on an annual basis and 1.7%[27], on a quarterly basis). However, the reduction is relatively low and can be partly related to the extended employment measures[28], as well as to the new government measures to save jobs[29] taken during the crisis. Observed by individual activity, the largest contribution to the employment fall was made from activities related to agriculture, forestry and fishing, then accommodation and food service activities, professional, scientific and technical activities, water supply, waste water disposal, waste management and environment sanitation, transport and storage and

[27] Analysis of quarterly dynamics of employment, unemployment and total active population is made by using seasonally adjusted data.
[28]The active employment measures create jobs amid health and economic crisis caused by the COVID-19. The financial support for hiring unemployed in the amount of Denar 236 million supported 1223 new employments.
[29] At its 32nd meeting from 30 and 31 March 2020, the Government adopted the second package of economic measures for dealing with the crisis in order to save as much as possible the jobs of the citizens and to help the economy (https://vlada.mk/ekonomski-merki-covid19). From them, the first three measures: measure 1 - the government saves jobs, Denar 14,500 per month per employee for April and May, for companies hit by the crisis or 50% of the costs for contributions for each employee; measure 2 - assistance for athletes - Denar 14,500 for April and May, direct funds for athletes and sports workers in order to keep their jobs; measure 3 - assistance for artists, provide direct support to the most vulnerable segments in order to minimize the damage from the corona crisis and save as many jobs as possible.

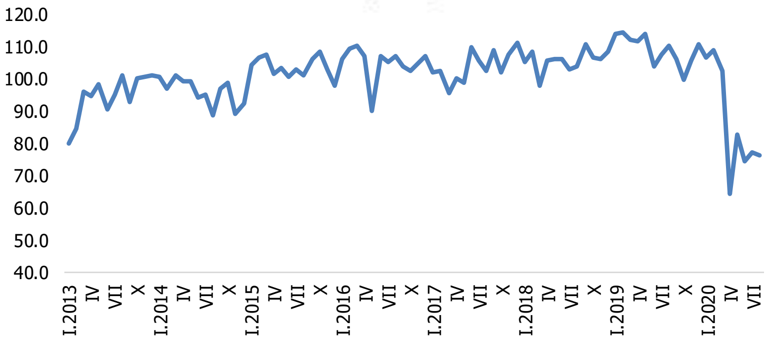
activities related to electricity, gas, steam and air conditioning In terms of the economic status[30], the fall in the number of employees is explained by the category "own-account workers" and the category "unpaid family workers".





In the second quarter of 2020, the employment rate amounted to 47.1%, which is an annual decrease of 0.1 percentage point. On the other hand, aggregated signals from the business tendency surveys**[31]** mainly point to moderately improved expectations of the corporate managers in terms of employment expectations for the third quarter, amid reduced containment measures against COVID-19, with expectations for extended optimism and more favorable prospects for the upcoming period.

Employment expectations indicator*
(composite indicator of employment expectations , seasonally adjusted)

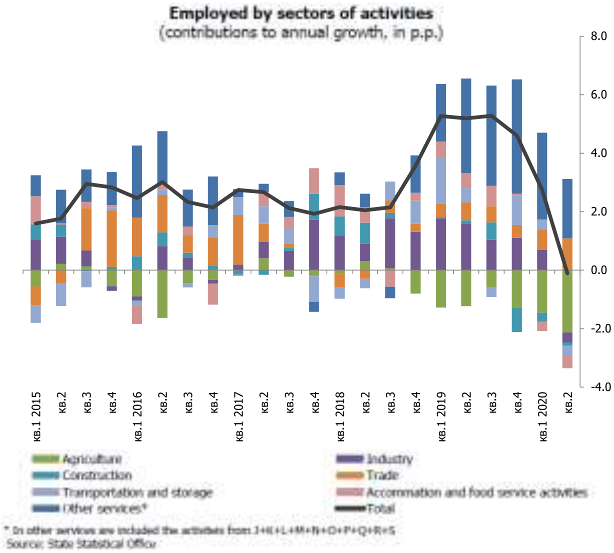


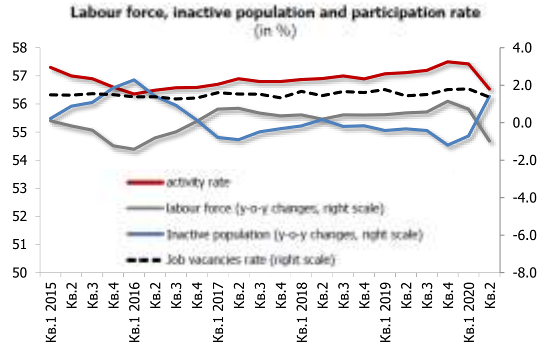
Source: European Commission, Business and consumer surveys.
*Managers employment expectations for the next 3 months in the companies in the four sectors: industry, services, retail trade and construction .

In the second quarter of 2020, **the job vacancy rate[32] equals 1.4%** (as in the same quarter of 2019). The job vacancy rate has been relatively stable for a long time, which indicates a possible

[30] 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).
[31] Source: European Commission, business tendency surveys, employment expectations in the next 3 months in industry, services, retail trade and construction (surveys conducted in July and August 2020).
[32] 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.

improvement of the process of connection of the supply of with the demand for skills in the labor market. Observed by activity, similar to the previous quarter, the highest job vacancy rates were registered in construction (3.5%), mining and quarrying (3.4%), administrative and support service activities (3.2%), information and communication (2.5%), as well as manufacturing industry (1.7%).





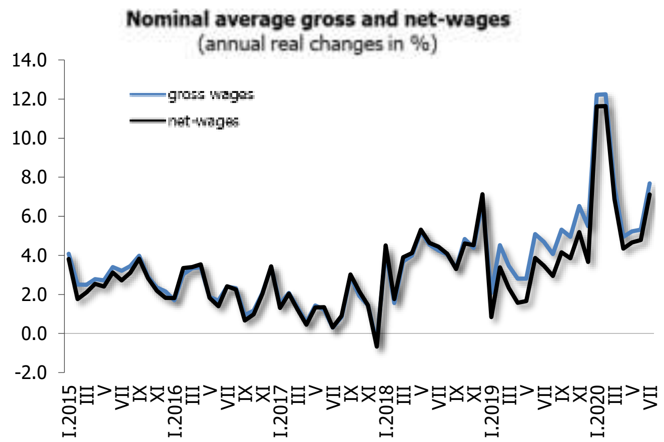
Similar to demand, the labor supply in the second quarter of 2020 registered a slight downward adjustment, thus interrupting the favorable shifts recorded since the last quarter of 2016. Namely, in the second quarter, the total labor force decreased by 1% annually, while the activity rate equaled 56.5% (57.4% in the previous quarter).

The sharper annual decline in labor supply relative to the decline in demand in second quarter of 2020 led to a further decline in unemployment, yet at a slower pace compared to the decline in the previous quarter. Thus, the number of unemployed in the first quarter decreased by 5.1% on an annual basis (decline of 8.6% in the previous quarter), while the unemployment rate was 16.7% (annual reduction of 0.7 percentage points). However, compared to the previous quarter there is an increase in the unemployment rate of 0.6 percentage points in accordance with the quarterly increase in the number of unemployed.

The average net and gross wages paid in the second quarter marked a further annual growth, yet at a significantly slower pace. Thus, net and gross wages in the second quarter registered an annual growth of 5.1% and 5.7%[33], respectively, (in the previous quarter growth of 10.7% and 11.4%, respectively). The wage growth, same as in the previous period reflects: The increase in the

[33] The faster increase in gross wages compared to net wages is a result of the increase in the rates at which contributions for compulsory pension and disability insurance and compulsory health insurance are paid. The rates at which contributions are paid in 2020 are 18.8% for compulsory pension and disability insurance and 7.5% for compulsory health insurance (previously these rates were 18.4% and 7.4%, respectively).

minimum wage[34], the increase in the wages in the public sector[35], as well as the effect of the measure for subsidizing contributions due to wage increase[36]. The wage growth was registered in most of the economic activities, and the growth was highest in the activities related to education, information and communications, health and social care activities, construction and agriculture. On the other hand, part of the activities registered a decrease in the wages paid (accommodation and food service activities, arts, entertainment and recreation and transport and storage), which could be partly related to the effects of the infection. In the second quarter, given the small growth of consumer prices, **the real annual growth of net and gross wages was 4.6% and 5.2%, respectively**. In July 2020, the nominal annual growth of the average net wage was 8.5% which shows an acceleration of the growth.



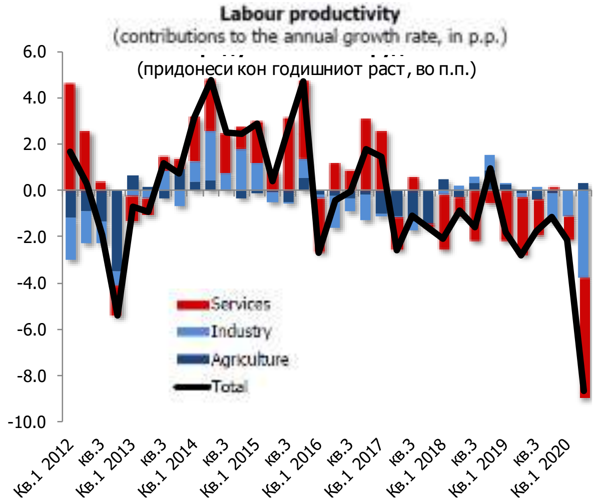
In terms of labor productivity, in the second quarter of the year the annual fall deepened. In conditions of minimal decrease in employment as opposed to the decrease in the value added, the labor productivity[37] decreased by 8.6% (decline of 2.1% in the previous quarter). The sector-by-sector analysis shows that the decrease mainly stems from the lower productivity in the service sector and industry. **The further wage growth, albeit slower, amid productivity decline, contributed to further increase in unit labor costs, which in the second quarter equaled 15.9%** (12.8% in the previous quarter). Thus, most of the growth is explained by the higher costs in the service sector, amid slight increase in industry costs, with slightly increased costs in agriculture registered in this sector as well.

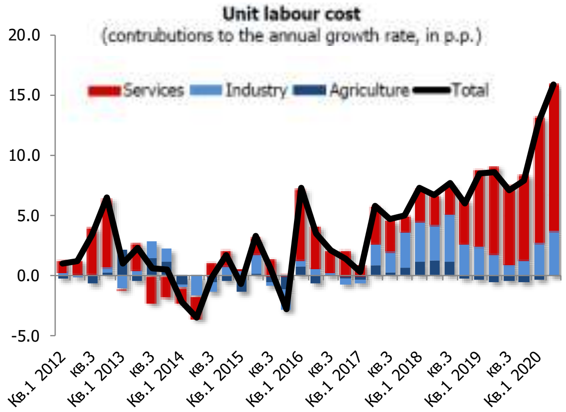
[34] During 2019, the minimum wage was increased twice, in April and December. In April, the minimum wage was increased from Denar 12,165 to Denar 12,507 net wage (gross from Denar 17,370 to Denar 17.943) in accordance with the adjustment with the increase for the previous year of the average wage paid in the RNM, the consumer price index and the real GDP growth (with one third of the growth of each indicator, respectively, Law on Minimum Wage, Official Gazette of the Republic of North Macedonia No. 59/19). With the additional increase in December (of around Denar 2000 net), the amount of minimum wage which is paid for the period from December 2019 to March 2020 is Denar 14,500 in net amount (Law on Minimum Wage, Official Gazette of the Republic of North Macedonia No. 239/19). With the Government Decree, the amount of 14,500 denars was extended until June2020, i.e. until the cessation of the state of emergency.

[35] The wages of health workers were increased by 5%, starting with the payment of the September wage in 2019. The wages of social workers were also increased by 5% with the payment of the September wage in 2019. In addition, there was 5% salary increase for employees in education, police, defense and the entire public sector, starting with the September wage in 2019. In January 2020, the wages in education were additionally increased by 10%, and from February 2020, the wages of employees in health were additionally increased (growth of 25% for specialists, 15% for general practitioners, 10% for nurses, and by 5% for health associates and ancillary-technical staff).

[36] According to the Law on subsidizing contributions from compulsory social insurance due to wage increase, which started to be enforced with the payment of the November wage (Official Gazette of the Republic of North Macedonia No. 239/19), whereby the subsidizing of contributions is approved if the increase in the net wage is in the amount of at least Denar 600 up to Denar 6000 per month by insuree (Official Gazette of the Republic of North Macedonia No. 239/19, Articles 2 and 3).

[37] Total labor 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.





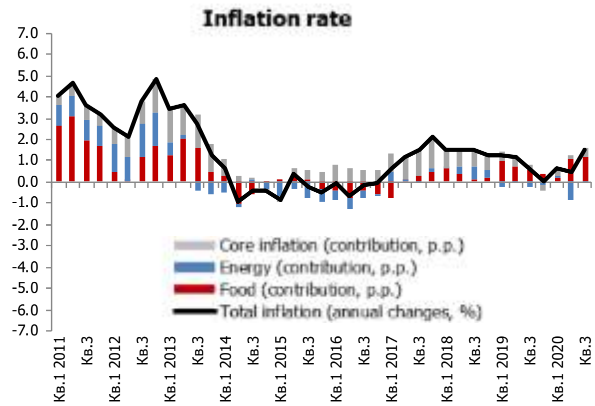
1.5. Inflation

Domestic consumer prices in the third quarter of 2020 increased by 1.5% annually, which is an accelerated growth compared to the annual rate from the previous quarter (0.5%). This movement in inflation is a result of the higher performances in all three index components. The highest positive contribution is still made by the food prices, while the energy component registered diminishing of the negative contribution due to the decelerated decline in the prices of oil derivatives and increase in the domestic price of energy in August. Regarding the future short-term dynamics of consumer prices, the imported inflation and the producer prices of domestic producers registered a moderate acceleration in the growth rate, in conditions of steady double-digit growth in unit labor costs. However, as before, it is estimated that amid significantly reduced domestic demand and negative output gap, these factors would not cause significant upward pressures on the prices of final products. The National Bank Survey shows that economic analysts expect an inflation of 0.6% in 2020 and its moderate acceleration in 2021 and 2022, reaching 1.3% and 1.6%, respectively.

1.5.1. Current inflation

In the third quarter of 2020, the annual inflation rate reached 1.5% (as opposed to 0.5% in the previous quarter)[38]. The acceleration in the growth of consumer prices is due to the higher performances of all three components. Such dynamics was mostly affected by the significant decrease in the negative contribution of energy prices, mainly due to the decelerated decline in the prices of oil derivatives and increase in the domestic electricity price in August. Also, this quarter registered larger positive contribution from the increase in the prices of food and core component. The increase in food and core inflation partly reflects the developments related to COVID-19, partly related to the easing of the containment measures and the pronounced consumption of certain goods and services in this period, with a certain effect of the limitations on the supply side.

[38] On a quarterly basis, domestic consumer prices increased by 0.7%, and by 0.9% seasonally adjusted.



The core inflation further increased in the third quarter by 0.9% annually, against 0.5% in the previous quarter. The accelerated growth of the core inflation is a result of the higher performances of several categories of the index, as well as the reduced negative contribution in the categories: clothing and footwear and non-performing household products Given the structure of the annual core inflation growth, the highest positive contribution was made by tobacco[39], catering services, accommodation services, package tours and electrical appliances for personal hygiene and other appliances. On the other hand, the highest negative contribution to the annual change of the core inflation was made by the prices of air traffic, clothing and footwear, computer equipment and radio and television sets, video players/recorders and the like. The other inflation sub-indices, which exclude the most volatile prices, also increased in the third quarter of 2020, with a slight deceleration compared to the previous quarter. Thus, the total index, excluding energy[40], liquid fuels and lubricants (for transport) and unprocessed food registered an annual growth of 1.6% (1.7% in the previous quarter), while the total index excluding energy, liquid fuels and lubricants (for transport), unprocessed food, tobacco and alcoholic beverages registered an annual growth of 1.4% (1.5% in the previous quarter).

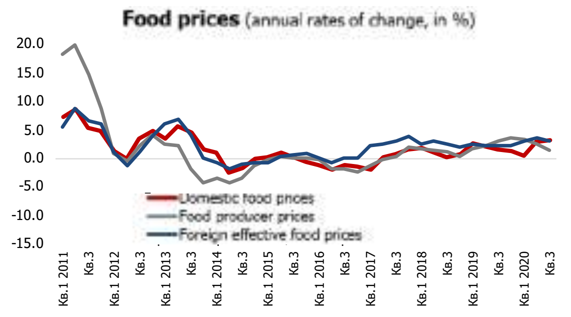
	(annual changes, in %)									(contributions to annual changes, in p.p.)								
	2018	**2019**				**2019**	**2020**			**2018**	**2019**				**2019**	**2020**		
		Кв.1	**Кв.2**	**Кв.3**	**Кв.4**		**Кв.1**	**Кв.2**	**Кв.3**		**Кв.1**	**Кв.2**	**Кв.3**	**Кв.4**		**Кв.1**	**Кв.2**	**Кв.3**
Consumer price index - all items	**1,5**	**1,2**	**1,2**	**0,6**	**0,0**	**0,8**	**0,6**	**0,5**	**1,5**	**1,5**	**1,2**	**1,2**	**0,6**	**0,0**	**0,8**	**0,6**	**0,5**	**1,5**
Food	0,9	2,7	2,1	1,5	1,2	1,9	0,5	2,9	3,3	0,3	1,0	0,7	0,5	0,4	0,7	0,2	1,0	1,2
Energy	2,6	-1,4	-0,2	-1,7	-1,2	-1,1	0,7	-6,4	-0,5	0,3	-0,2	0,0	-0,2	-0,2	-0,2	0,1	-0,8	-0,1
Electricity	-0,1	0,0	0,0	0,0	0,0	0,0	0,0	0,0	4,9	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,4
Heat energy	-2,7	-2,9	-2,9	-5,2	-6,4	-4,3	-6,4	-6,4	-2,2	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
Fuels and lubricants	10,7	-4,5	0,1	-5,1	-3,3	-3,2	3,4	-22,8	-11,8	0,4	-0,2	0,0	-0,2	-0,1	-0,1	0,1	-0,8	-0,4
Food and energy (volatile prices)	1,4	1,6	1,5	0,6	0,5	1,0	0,6	0,4	2,3	0,7	0,8	0,7	0,3	0,2	0,5	0,3	0,2	1,1
Core inflation calculated by the NBRM (total index - food and energy (categories 01.1, 04.5, 07.2.2))	1,5	0,9	1,0	0,6	-0,4	0,5	0,7	0,5	0,9	0,8	0,4	0,5	0,3	-0,2	0,3	0,4	0,3	0,4
Overall index excluding energy, liquid fuels and lubricants and unprocessed food (SSO)	1,0	0,6	0,9	1,1	0,6	0,8	1,7	1,7	1,6									
Overall index excluding energy, liquid fuels and lubricants, unprocessed food, tobacco and alcoholic beverages (SSO)	0,7	0,3	0,5	0,9	0,3	0,5	1,4	1,5	1,4									

Извор: Државен завод за статистика и пресметки на НБРСМ.

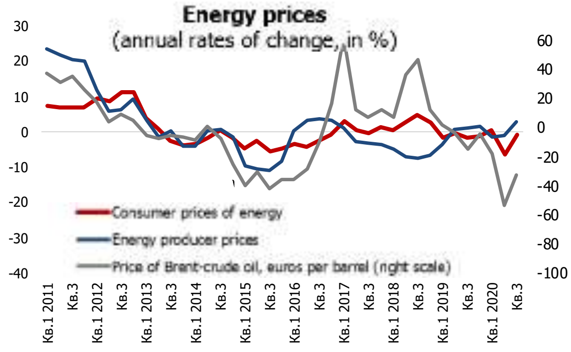
In the third quarter of 2020, **food prices** registered an annual growth of 3.3% (2.9% in the previous quarter). The slight acceleration of the increase in food prices is a result of the higher prices of vegetables (annual decline in the previous quarter), and to a lesser extent of the accelerated increase in the prices of other food products. Observing the structure, the annual growth in the prices of food mainly results from the prices of fruit, bread and cereals, meat, milk cheese and eggs, with a smaller positive contribution from oil and fat. The third quarter[41] registered a growth in the sales prices of domestic food

[39]The annual growth of tobacco price in third quarter reflects the increase in cigarette prices in March 2020, in line with the annual scheduled increase in cigarette excise duties by Denar 0.20 per piece as of 1 July 2023.
[40] The category "energy" refers to electricity, gas, liquid and solid fuels for heating and central heating.
[41] The analysis of sales prices of domestic food producers and foreign effective food prices refers to the first two months of the third quarter.

producers and foreign effective prices. **Energy prices** in this quarter registered a slight annual decline, due to the movements in the domestic prices of oil derivatives and central heating prices[42]. In accordance with the movement of the "Brent" oil price on the world market, the domestic prices of oil derivatives further declined on annual basis, despite the effect of the higher excise duty on the unleaded gas, diesel fuels and fuels for heating (by three denars, as of the end of April[43]). However, the decline in the energy prices in the third quarter is slightly more moderate compared to the decline in the previous quarter, as a result of the regulatory increase in the electricity prices in August 2020[44]. Consequently, the sales prices of energy producers (referring only to electricity) grew annually[45].



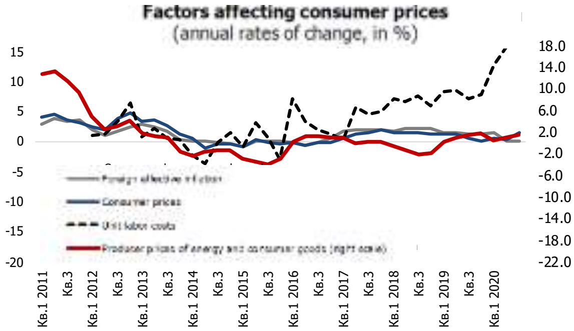
* Foreign effective food prices are calculated as weighted sum of food prices in countries that are major trade partners with North Macedonia.
Source: State statistical office, Eurostat and NBRNM calculations.



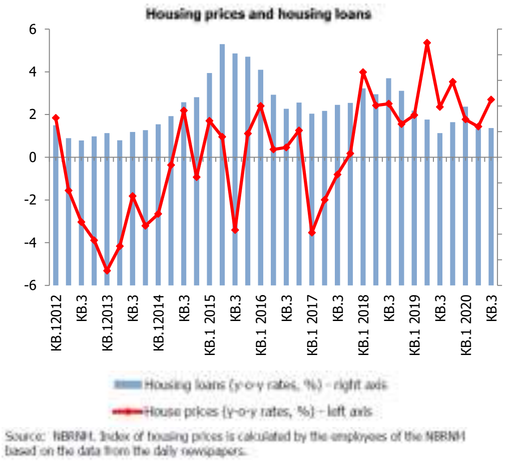
Source: State statistical office and NBRNM calculations.

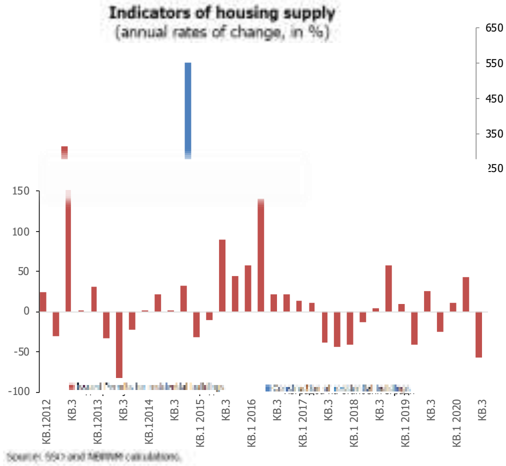
The producer prices of industrial products registered a small accelerated growth of 0.6% (0.3% in the previous quarter). Also, **producer prices of energy and consumer goods** as one of the factors that influence the dynamics of consumer prices, registered a cumulative annual growth of 1.6% (1.0% in the previous quarter)[46]. In the third quarter, **the foreign effective inflation[47]**, as an indicator of imported inflation, remained at a very low level, with a minimal slowdown as well (0.1% as opposed to the annual inflation rate of 0.2% in the last quarter). On the other hand, the growth of **unit labor costs** in the second quarter further accelerated (annual rate of 15.9%, compared to the growth of 12.8% in the first quarter). However, given the significant decrease in the domestic demand and the negative production gap[48] in the domestic economy, as well as the absence of significant pressures on the domestic economy through the foreign prices and producer prices channel, the higher labor costs would not cause significant upward pressures on the prices of final products in the forthcoming period.

[42]According to the decision of the Energy Regulatory Commission, the price of heat for households in the BEG system, as the largest supplier of thermal energy in Skopje is reduced by 6% as of August 2019, as a result of the previously adopted decision to reduce the VAT for thermal energy from 18 to 5%.
[43]This Government measure was adopted to mitigate the economic consequences of the increased expenditures to deal with the coronavirus and providing funds for regular repayment of budgetary needs. The proposed mechanism enables gradual return of the current excise duty amounts amid normalization of the market prices.
[44] By the decision of the ERC, as of 1 August 2020, the price of electricity is higher by 7.4%, i.e. for a high tariff it is 5.95 den/kWh, for a low tariff it is 2.99 den/kWh, while for one-tariff measurement it is 4.77 den/kWh (https://www.erc.org.mk/pages.aspx?id=153).
[45]The analysis of the oil prices and the sales prices of energy producers refers to the first two months of the third quarter.
[46] The analysis of producer prices of industrial products and producer prices of energy and consumer goods refers to the first two months of the third quarter of 2020.
[47] 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 North 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.
[48] The National Bank assessments show that domestic production is below the potential level (negative output gap) in 2020.



In the third quarter of 2020, apartment prices, as measured by the Hedonic index[49] increased annually by 2.7% which is a small acceleration compared to the previous quarter. In terms of supply, the value of residential buildings declined in the second quarter of 2020, while the issued construction licenses for residential buildings registered a decrease in their value[50] in the third quarter of the year. Analyzing the demand for apartments, in the third quarter of 2020, it was also supported by the two-digit rise in housing loans[51].





1.5.2. *Inflation expectations*

Regarding the trajectory of the future price movement, most of the domestic and international institutions expect relatively low inflation rate in 2020 and gradual and moderate acceleration of the inflation rate in the next two years. These expectations are mostly due to the expected decline in the economic activity for this year, both globally and in domestic economy and are in line with the expectations for gradual recovery in the following period. According to the **Inflation and Real GDP Expectations Survey[52]** conducted in September 2020, inflation is expected to be 0.6%. During the

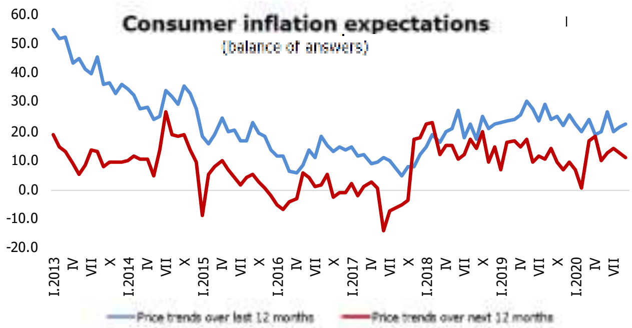
[49] Hedonic index of housing prices, prepared by the National Bank on the basis of the notices of sale in the capital city, and published by the agencies dealing with trade in real estate. The apartment price is a function arising from the size of the apartment, the location, the floor, whether the apartment has central heating and whether the apartment is new.
[50] The analysis refers to the first month of the third quarter of 2020.
[51] Available data for the first two months of the quarter.
[52] Starting from October 2017, the National Bank 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).

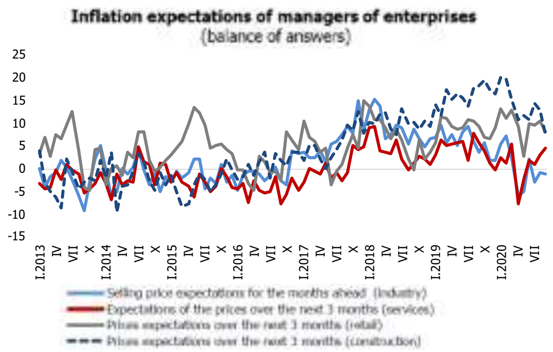
next two years, according to economic analysts, the growth of domestic consumer prices will accelerate to 1.3% in 2021 and 1.6% in 2022.

Forecasts and expectations for the inflation rate

	2020	2021	2022
Economic analysts	0,6	1,3	1,6
IMF	0,9	1,3	1,6
Consensus Forecast	0,6	1,8	/
Ministry of Finance	1,0	1,5	/
NBRNM	1,1	1,5	2,0

Similar are the short-term expectations of consumers and corporate executives for the price movements expressed in surveys in the third quarter, i.e. as of 2020, amid constant spread of COVID-19 in our country. Thus, according to the **consumer expectations for price changes in the next 12 months[53],** those who expect an increase in prices in the next 12 months exceed the number of those who expect them to reduce or remain unchanged. However, the expectations for price growth are more moderate compared to those in the previous quarter. Observing the expectations in the **corporate sector[54]**, the executives of trade companies expect decrease in prices in the next three months, but more moderate compared to the previous quarter, while the executives in industry, construction and services sector expect further increase in the prices in the following period.





1.6. Balance of payments

In the second quarter of 2020, the current account deficit of the balance of payments registered a slight deepening annually, entirely due to the decrease in the secondary income surplus. The COVID-19 crisis strongly affected the foreign currency supply in the exchange operation. Border shutdowns and the containment measures significantly affected the cash remittances entering the economy, which reduced the secondary income surplus. These unfavorable movements were partly mitigated by the tightening of the trade deficit, the primary income, as well as by the improved surplus of services registered in several categories of services. Moreover, the financial account, during the second quarter registered high net inflows, mostly due to the government borrowing through issuance of the Eurobond

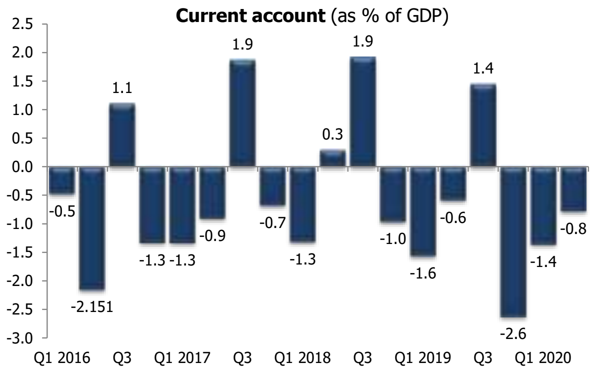
[53] European Commission's Consumer Survey as of September 2020.
[54] European Commission's business tendency surveys in industry, retail trade, construction and services sector as of September 2020.

on the international capital market and in a form of long-term loans with official international financial institutions (IMF). Such shifts in the balance of payments enabled full financing of the current account deficit and growth of the foreign reserves in the second quarter of 2020.

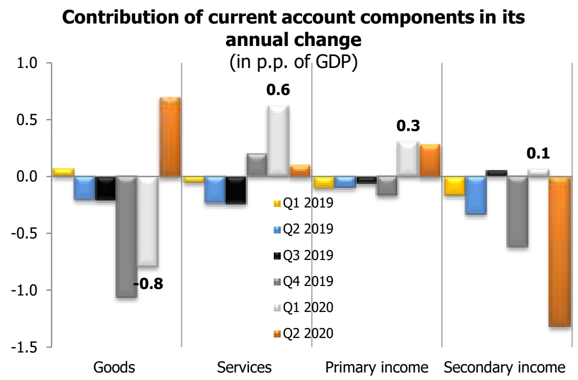
	2019						2020			2019						2020		
	Кв.1	Кв.2	Кв.3	Кв.4	I-VI	I-XII	Кв.1	Кв.2	I-VI	Кв.1	Кв.2	Кв.3	Кв.4	I-VI	I-XII	Кв.1	Кв.2	I-VI
I. Current account	**-175.0**	**-65.6**	**162.2**	**-293.9**	**-240.6**	**-372**	**-148.3**	**-85.0**	**-233.4**	**-1.6**	**-0.6**	**1.4**	**-2.6**	**-2.1**	**-3.3**	**-1.4**	**-0.8**	**-2.1**
Goods and services	**-373.1**	**-346.7**	**-261.8**	**-638.2**	**-719.8**	**-1620**	**-381.2**	**-247.4**	**-628.6**	**-3.3**	**-3.1**	**-2.3**	**-5.7**	**-6.4**	**-14.5**	**-3.5**	**-2.3**	**-5.8**
Credit	1623.5	1698.3	1848.0	1788.0	**3321.7**	**6958**	**1514.1**	**1172.7**	**2686.9**	14.5	15.2	16.5	16.0	**29.6**	**62.1**	**13.9**	**10.8**	**24.7**
Debit	1996.5	2045.0	2109.8	2426.2	**4041.6**	**8578**	**1895.4**	**1420.1**	**3315.4**	17.8	18.2	18.8	21.6	**36.1**	**76.5**	**17.4**	**13.0**	**30.4**
Goods	-475.1	-443.5	-436.3	-614.7	**-918.6**	**-1970**	**-548.2**	**-354.0**	**-902.1**	-4.2	-4.0	-3.9	-5.5	**-8.2**	**-17.6**	**-5.0**	**-3.2**	**-8.3**
Services	102.0	96.8	174.5	-23.5	**198.8**	**350**	**167.0**	**106.6**	**273.6**	0.9	0.9	1.6	-0.2	**1.8**	**3.1**	**1.5**	**1.0**	**2.5**
Primary income	**-129.9**	**-127.7**	**-130.2**	**-131.9**	**-257.5**	**-520**	**-92.9**	**-91.7**	**-184.6**	**-1.2**	**-1.1**	**-1.2**	**-1.2**	**-2.3**	**-4.6**	**-0.9**	**-0.8**	**-1.7**
Secondary income	**328.0**	**408.8**	**554.1**	**476.2**	**736.8**	**1767**	**325.8**	**254.0**	**579.8**	**2.9**	**3.6**	**4.9**	**4.2**	**6.6**	**15.8**	**3.0**	**2.3**	**5.3**
II. Capital account	**0.6**	**0.1**	**5.9**	**1.6**	**0.7**	**8**	**0.3**	**1.4**	**1.7**	**0.0**	**0.0**	**0.1**	**0.0**	**0.0**	**0.1**	**0.0**	**0.0**	**0.0**
Net lending (+) / net borrowing (-) (balance from current and capital account)	-174.4	-65.5	168.1	-292.3	**-239.9**	**-364**	**-148.1**	**-83.6**	**-231.7**	-1.6	-0.6	1.5	-2.6	**-2.1**	**-3.2**	**-1.4**	**-0.8**	**-2.1**
III. Financial account	**-170.5**	**-101.2**	**13.9**	**-422.0**	**-271.7**	**-680**	**87.4**	**-666.5**	**-579.1**	**-1.5**	**-0.9**	**0.1**	**-3.8**	**-2.4**	**-6.1**	**0.8**	**-6.1**	**-5.3**
Direct investment	-59.3	-29.2	-82.3	-192.5	**-88.5**	**-363**	**-128.1**	**13.7**	**-114.4**	-0.5	-0.3	-0.7	-1.7	**-0.8**	**-3.2**	**-1.2**	**0.1**	**-1.0**
Portfolio investment	22.3	19.9	72.7	36.3	**42.3**	**151**	**31.6**	**-632.5**	**-600.9**	0.2	0.2	0.6	0.3	**0.4**	**1.3**	**0.3**	**-5.8**	**-5.5**
Currency and deposits	35.0	-30.6	98.5	-29.3	**4.4**	**74**	**71.8**	**130.9**	**202.7**	0.3	-0.3	0.9	-0.3	**0.0**	**0.7**	**0.7**	**1.2**	**1.9**
Loans	-16.9	-25.2	-54.9	-128.1	**-42.2**	**-225**	**113.0**	**-167.9**	**-54.9**	-0.2	-0.2	-0.5	-1.1	**-0.4**	**-2.0**	**1.0**	**-1.5**	**-0.5**
Trade credit and advances	-153.2	-35.7	32.3	-160.8	**-188.8**	**-317**	**-0.9**	**-10.9**	**-11.8**	-1.4	-0.3	0.3	-1.4	**-1.7**	**-2.8**	**0.0**	**-0.1**	**-0.1**
Other accounts receivable/payable	0.0	-0.3	-52.4	52.5	**-0.3**	**0**	**0.0**	**0.1**	**0.1**	0.0	0.0	-0.5	0.5	**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**	**-0.1**	**-0.1**	0.0	0.0	0.0	0.0	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
IV. Net errors and omissions	**-1.7**	**13.8**	**20.2**	**26.7**	**12.1**	**59**	**-13.8**	**21.1**	**7.3**	**0.0**	**0.1**	**0.2**	**0.2**	**0.1**	**0.5**	**-0.1**	**0.2**	**0.1**
V.Reserve assets	**-5.6**	**49.4**	**174.4**	**156.4**	**43.8**	**375**	**-249.3**	**604.0**	**354.7**	**0.0**	**0.4**	**1.6**	**1.4**	**0.4**	**3.3**	**-2.3**	**5.5**	**3.3**

Source: NBRNM.

1.6.1. Current account



Source: NBRM.



Source: NBRM.

In the second quarter of 2020, current account deficit was Euro 85 million or 0.8% of GDP[55]. The analysis on an annual basis indicates higher current account deficit (by 0.2 percentage points of GDP), which largely stems from the worsened secondary income surplus. . The COVID-19 crisis caused a significant decrease in net inflows from exchange operations. These developments reflect the reduced supply of foreign currency, largely due to the lower inflows through cash remittances from emigrants, in conditions of closed borders and limited movements. This period also registered a decrease in the demand of foreign currency. On the other hand, the goods and services balance improved annually, mostly due to the tightening of the trade deficit primarily caused by the energy deficit, and the favorable movements in non-energy balance. The surplus in services registered a slight annual movement mainly due to the higher surplus in processing services, telecommunication and computer services and transport.

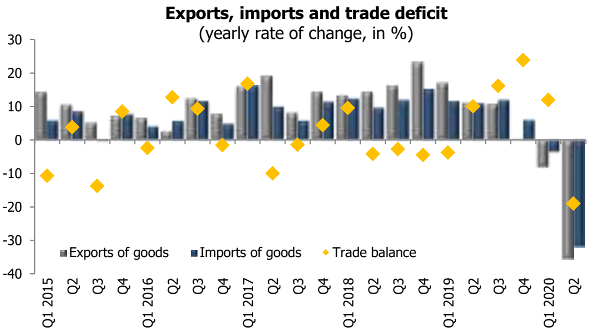
[55] The calculations use the nominal GDP forecast (from October 2020).

Given the nature of the crisis and the significant decrease in domestic and foreign demand, the second quarter registered a significant downward adjustment of both import and export of services. The primary income deficit registered a decrease, amid estimate of a lower amount of newly created profit for 2020 compared to last year, and thus a larger deficit for 2020 in investment income.

Annex: Foreign trade in goods and movement of the Nominal and the Real Effective Exchange Rate (NEER and REER)[56]

In the second quarter of 2020, the foreign trade amounted to Euro 2,469.5 million, or 22.7% of GDP, which is a significant decrease of 33.6% or 10.5 percentage points of GDP. Such pronounced decline in the foreign trade of the domestic economy is due to the decrease in both export and import component as a result of the COVID-19. The spread of COVID-19 in the second quarter led to containment measures in the domestic economy, as well as in the large part of the global economy, which caused significant decline in demand and intensive decrease in foreign trade globally. As of the second half of March and during April and part of May, the domestic economy was under considerable negative pressure due to the spread of COVID-19. Containment measures were established in both the domestic economy and in most of the countries in the EU, our most important trading partner, the borders of most countries in Europe were closed for passengers, with certain difficulties also recorded in the transport of goods. In such conditions, part of the production facilities in the domestic economy, including the new export-oriented facilities remained closed in this period. This situation resulted in decrease in both export and import. Thus, the decrease was more pronounced in April and May, with a certain stabilization in June.

Source: SSO and NBRNM.



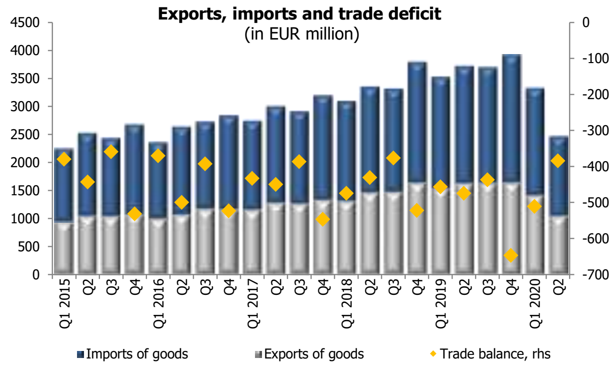
Source: SSO and NBRNM.
* Negative change in the trade balance indicates contraction of the deficit.

The export of goods in the second quarter of 2020 dropped sharply on an annual basis by 35.7%. In terms of structure, the decline mostly (around 75%) resulted from the export of new facilities in the economy, amid temporary interrupted car manufacturing chain and temporary closure of part of the domestic facilities in this industry. The decrease was most pronounced in April and May, followed by a significant stabilization. The decline in the export of these companies is evident in the categories equipment and machinery, chemical products and part of the category furniture. The consequences of the pandemic were felt by most of the traditional export sectors, although the intensity of the decrease in these export sectors was slightly pronounced and dispersed among the export of textile, iron and steel, energy, food and ore. **The pronounced decline on an annual basis of 31.9% was registered in the import component of foreign trade.** Corresponding to the export performance, the raw material component of the new export companies in the economy is a significant factor that explains almost two thirds of the annual decline in imports. In addition, the sharp decline

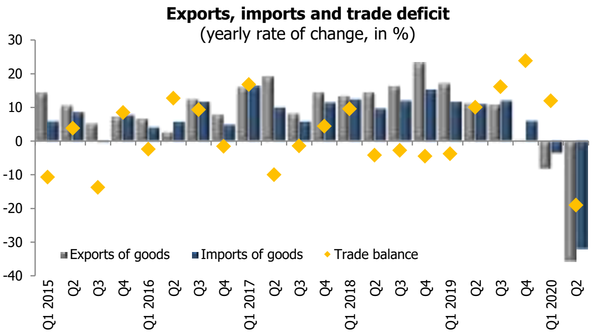
[56] According to the Foreign Trade Methodology, data on export of goods are published on an f.o.b. basis, and on import of goods, on a c.i.f. basis.

in the price of crude oil in April[57], which continued moderately in the next two months of the quarter, led to a significant decline in the import of oil derivatives, and thus in the total energy imports. The decline in energy imports was due to the lower imported quantities, as a result of the reduced domestic consumption, amid reduced activity and restricted movements in this period. Annual decline in imports was also registered in most of the remaining import categories, more pronounced in investment products-equipment and machinery and vehicles, as well as raw materials for the textile industry. **Both foreign trade components in the second quarter of 2020 narrowed the trade deficit by 19% on an annual basis.** Observing balances, the annual growth results from both energy and non-energy component, with larger contribution of the energy balance.

The latest available data on foreign trade for July and August 2020 point to a significantly slower decline on annual basis. The decline in the export of goods in July and August reduced to 4.3%, which is mostly due to the positive trends in new export-oriented companies, whose annual decline in exports is significantly lower in the last two months. In this period, the decline in the total exports is primarily due to price-sensitive export categories, such as ore, energy and iron and steel. In terms of import, the annual decline of 6.5% was mostly due to the lower energy imports a combination of lower prices and lower quantities of energy imports, amid smaller contribution of the decline in other categories, excluding the import of chemical products, vehicles and ores which increased.



Source: SSO and NBRNM.

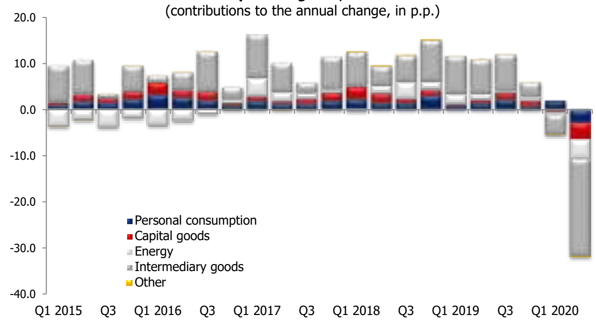


Source: SSO and NBRNM.
* Negative change in the trade balance indicates contraction of the deficit.

Analyzing imports of goods in the System of National Accounts, in the second quarter of 2020, the decline in imports was mainly due to imports of intermediary products, while other categories (energy, capital goods and personal consumption) had a significantly moderate contribution in total decline. The analysis of the import of private consumption indicates that the annual decline in this category is mostly due to the lower import of consumer goods, and to a lesser extent to the import of passenger vehicles and private consumption food. Analyzed dynamically, the decline in the imports of private consumption in the second quarter of the year comes after a longer period of positive rates in this category, which was expected in conditions of reduced demand and rising uncertainty.

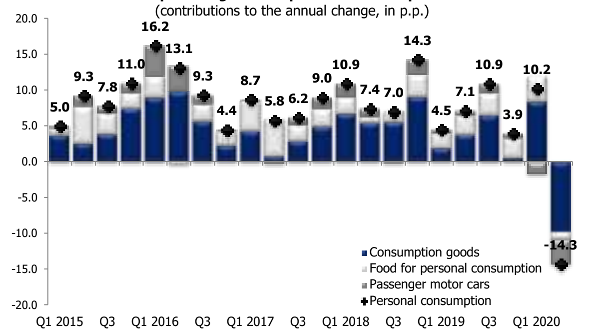
[57]The market price of crude oil in April decreased by 67.2%, due to reduced consumption, and negative perceptions of global economy as well. The decline was slightly milder in the next two months and amounted to 54.4% for the entire second quarter, compared to the same period last year.

Imports of goods, SNA*
(contributions to the annual change, in p.p.)



* Classification: System of national accounts (SNA).
Source: NBRNM.

Imports of goods for personal consumption
(contributions to the annual change, in p.p.)

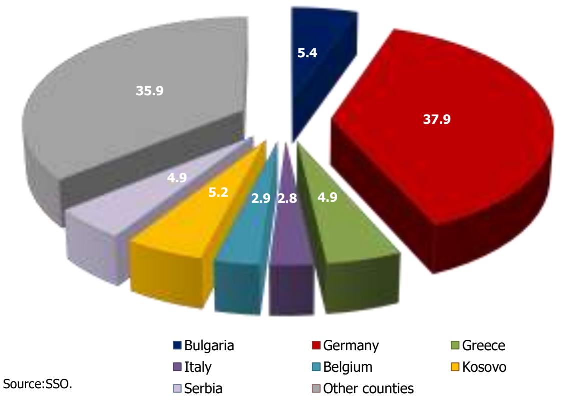


Source: NBRNM.

The analysis of the foreign trade according to the trading partners in the second quarter of 2020 indicates further dominant share of the EU countries in total foreign trade of domestic economy, with a share of 65.2% in this quarter[58]. On the *export* side, the annual decrease almost entirely results from lower export to EU, primarily the export to the largest European economy, Germany. The negative effects of the COVID-19 crisis were seen through the significant decrease in export of chemical products and equipment and machinery in Germany, which are also export products of the new facilities in the economy on this market. Moreover, during the second quarter the exports of clothing and textile to our major trading partner registered a decrease. The reduced activity in automotive industry in this period caused lower exports to Belgium and Romania, significant markets for the new export-oriented facilities. In addition, the decline in exports of ores is the main reason for lower exports to Bulgaria compared to the same period last year. Regarding the export outside of the EU countries, lower export was registered to Kosovo as well, mainly due to the energy component of exports to this trading partner. On the other hand, the exports to Russia and China slightly improved annually, caused by the slightly higher export of medical equipment to Russia and the higher export of ores and iron and steel to China. The analysis on the *import* side also indicates that the EU countries have the largest contribution to the decline. Observed individually, Great Britain has the largest contribution and such decline in imports from this trading partner is solely due to lower import of precious metals. The lower import of precious metals is the reason for the reduced import from the South African Republic and Italy. The lower import from Germany resulted from the import of equipment and machinery, vehicles and import of ceramic products, while the lower energy import is the main reason for the reduced import from Greece. Regarding the foreign trade balances with individual economies, the narrowing of the trade balance in the second quarter was due to the lower trade deficit in the trade with Great Britain, and to a lesser extent to the lower deficit with Greece and Italy. The improved position in the trade with South African Republic also contributed to the narrowing of the negative trade balance. On the other hand, the reduced surplus with Germany due to the lower export to this trading partner contributed to the expansion of the total trade balance.

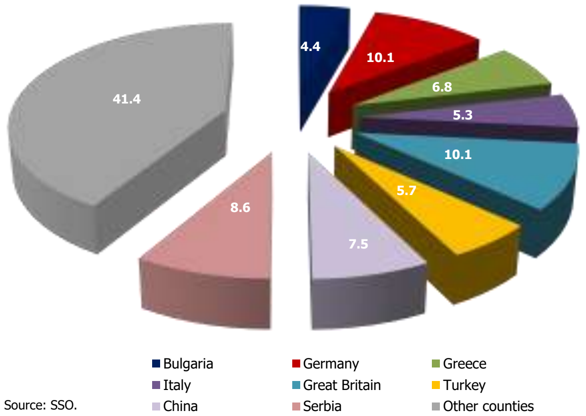
[58]Great Britain is included within EU countries. Despite the BREXIT on 1 January 2020, they remain part of the EU customs union in this transitional period and accordingly the same trading rules remain between our country and Great Britain. Accordingly, for analytical reasons, in this transitional period we analyze Great Britain within the EU.

Export of goods, by countries in the second quarter of 2020
(share, in %)



Source:SSO.

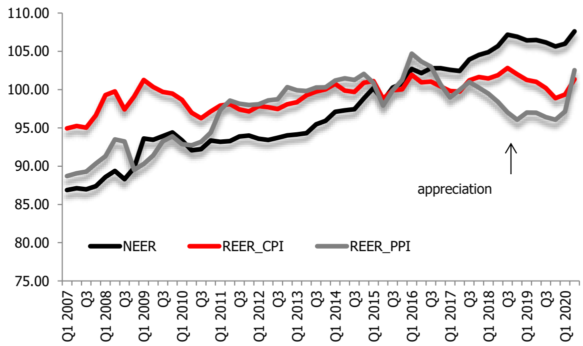
Import of goods, by countries in the second quarter of 2020
(share, in %)



Source: SSO.

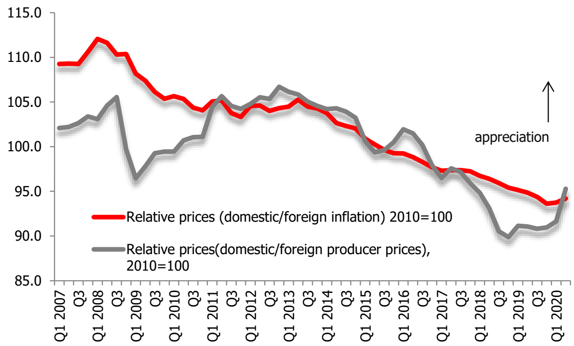
With regard to the price competitiveness indicators of the Macedonian economy, in the second quarter of 2020 the real effective exchange rate index calculated by consumer prices slightly appreciated by 0.3% compared to the previous year, while the appreciation of the index deflated by producer prices was more pronounced and equaled 5.7%. Thus, the relative consumer prices decreased annually (by 0.7%), as opposed to the increase in relative producer prices (of 4.6%). The NEER index appreciated by 1.1% compared to the same period last year, due to the depreciation of the Russian ruble and the Turkish lira against the denar.

NEER and REER
(according to CPI and PPI, 2015=100)



Source:NBRNM.

Relative prices
(2015=100)



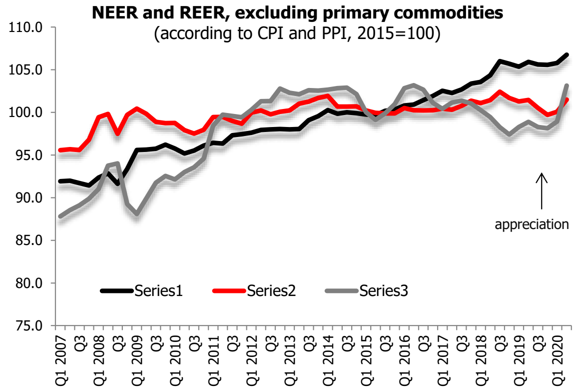
Source:NBRNM.

The movements of REER indices, as measured using weights based on the foreign trade without primary commodities, are similar[59]. More specifically, the REER deflated by consumer prices remained unchanged on an annual basis, while REER deflated by producer prices appreciated by 4.3% compared to the same period last year. The nominal effective exchange rate registered a slight annual appreciation of 0.8% amid decline in relative consumer prices (of 0.8%) and increase in relative producer prices on annual basis (of 3.5%). The change in NEER is largely due to the depreciation of the Turkish lira against the denar.

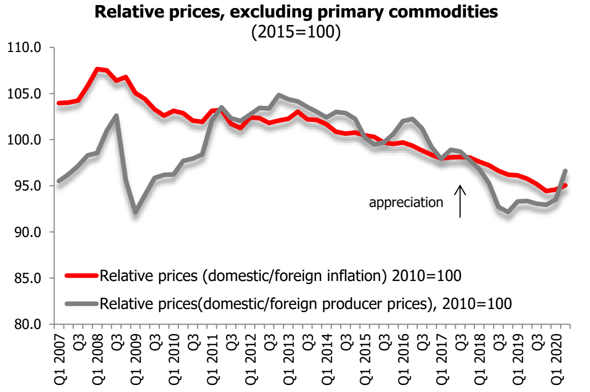
In July-August 2020 the REER index deflated by consumer prices registered a slight appreciation of 2.7%, while the REER index deflated by producer prices appreciated by 5.3%. Similar movements were registered in the index calculated by weights based on foreign trade statistics without primary

[59] 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

commodities acted in the same direction, namely, consumer price index registered an appreciation of 2% on an annual basis and producer price index registered an appreciation of 4%.

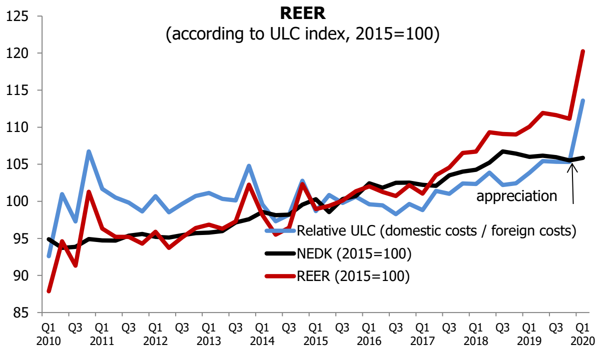


Source:NBRNM.



Source:NBRNM.

REER indices deflated by unit labor costs appreciated as well. Thus, in the second quarter of 2020 the REER index calculated by weights based on total foreign trade appreciated annually by 9.4%, amid increase in relative prices (of8.2%) and NEER appreciation of 1.1%. The REER index calculated by using weights based on the foreign trade without primary commodities appreciated by 10.3%, reflecting the growth of the relative labor costs (of 9.4%) amid slight NEER appreciation (of 0.8%).



Source: NBRNM.

Извор: НБРСМ.

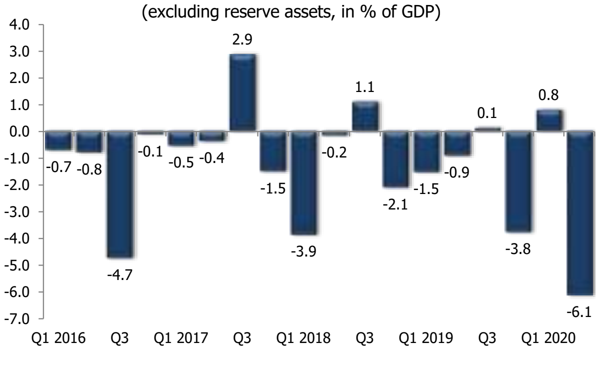
1.6.2. Financial account

In the second quarter of 2020, the financial account of the balance of payments registered net inflows of Euro 666.5 million, or 6.1% of GDP. The high net inflows are largely due to the issuance of Eurobond on the international capital market by the government and the high inflow on this basis with portfolio investments[60], as well as the external government borrowing in a form of long-term loans with official international financial institutions[61], and to a lesser extent due to the inflows based on trade credits. Net outflows in currencies and deposits and to a lesser extent direct investments acted in the opposite direction. Currencies and deposits registered high net outflows in other sectors of the economy, amid positive net flows in depository institutions. In terms of direct investments in the second quarter of 2020, there are slight net outflows primarily due to lower liabilities based on

[60] In May 2020 Ministry of Finance issued the seventh Eurobond in the amount of Euro 700 million, at an interest rate of 3,675%
[61] In April 2020, the Ministry of Finance took out a loan from the IMF in the amount of Euro 176.8 million.

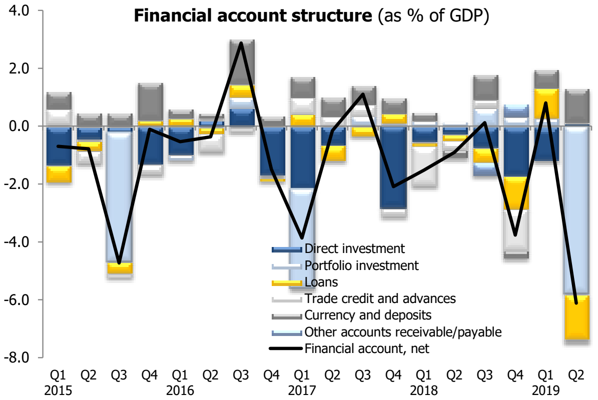
intercompany borrowing. On the other hand, flows based on equity and reinvested earnings were positive.

Financial account
(excluding reserve assets, in % of GDP)



Source: NBRM.

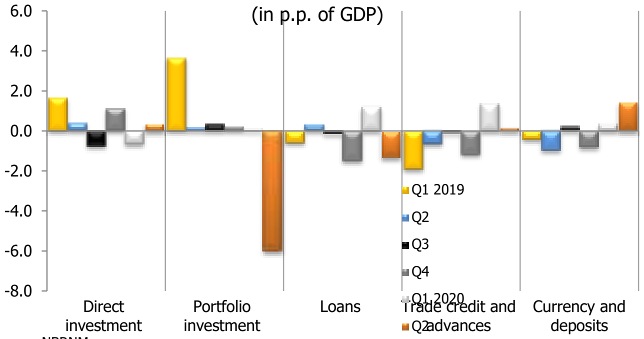
Financial account structure (as % of GDP)



Source:

The annual analysis indicates higher net inflows in the second quarter of 2020. Favorable annual movements were registered in inflows based on portfolio investments (due to issued Eurobond), as well as inflows based on financial loans, due to increased government borrowing. Other flows have seen moderate worsening. Currencies and deposits registered high net outflows, unlike the second quarter of 2019 which registered net inflows. Thus, net outflows were mostly due to higher outflows in other sectors, as well as lower net inflows in depository institutions.

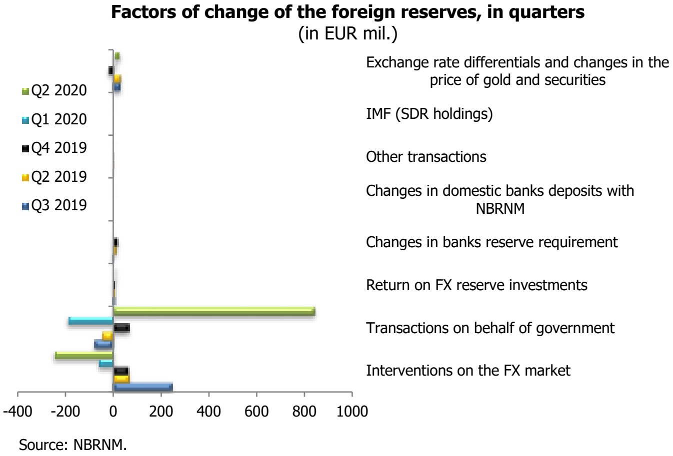
Contributions to the annual change in the financial account
(in p.p. of GDP)



Source: NBRNM.

At the end of the second quarter of 2020, the gross foreign reserves amounted to Euro 3,639.7 million, which is a quarterly increase of Euro 622.4 million. The increase in foreign reserves results from transactions on behalf of the Government[62], amid National Bank's net sale of foreign currency during the second quarter. The remaining categories had a moderate impact on the growth of foreign reserves in this period.

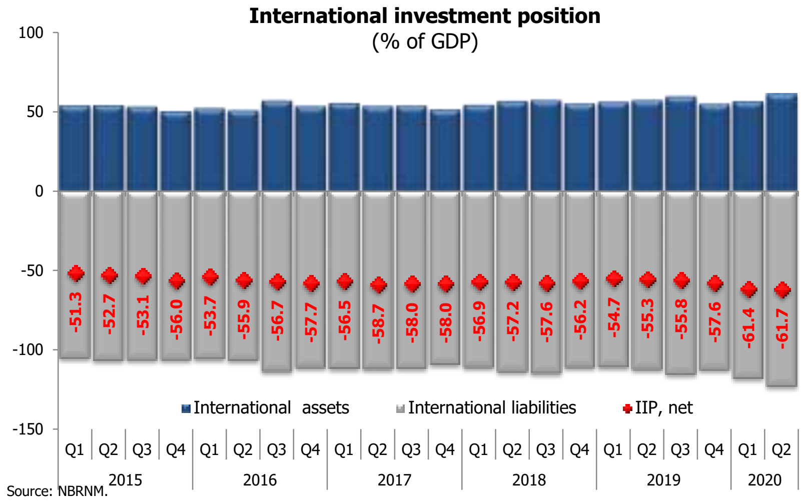
[62] Eurobond issued.



At the end of the third quarter of 2020, the gross foreign reserves stood at Euro 3,480.2 million. During the third quarter of 2020, the main foreign reserves growth factors were the regular repayment of external public sector liabilities and National Bank's interventions on the foreign exchange market.

1.6.3. International investment position and gross external debt

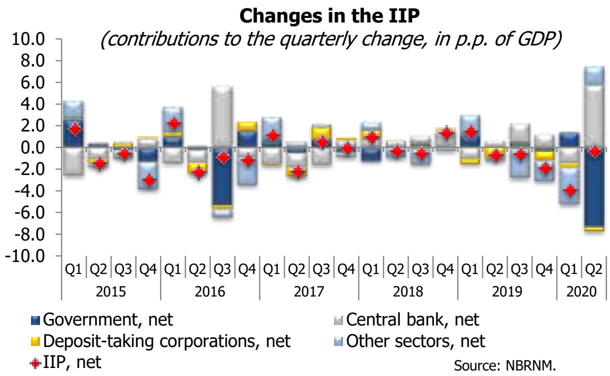
At the end of the second quarter of 2020, the negative net investment position of the Macedonian economy equaled Euro 6,718.7 million, or 61.7% of GDP[63]. Compared to the previous quarter, the negative net investment position slightly increased by 0.2 percentage point of GDP, given the higher growth of international liabilities relative to the growth of international assets. The sector-by-sector analysis shows that the quarterly change is mostly due to the increase in the Government net liabilities, i.e. the Government borrowing on the international capital market through the issuance of new Eurobond and a long-term loan from an international financial institution. Additional smaller contribution to the quarterly growth was made by higher net liabilities with the banking sector. On the other hand, the central bank noted a growth in net assets, i.e. higher foreign reserves, with reduced net liabilities with the other sectors in the economy, based on trade credits, portfolio investments and to direct investors.

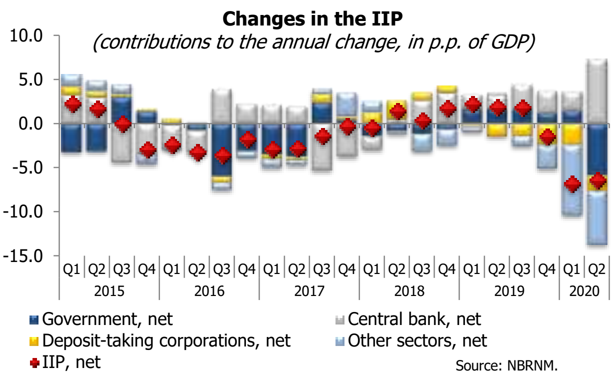


The annual change in the international investment position also points to an increase (of 6.4 percentage points of GDP), as a result of the higher growth of international liabilities relative to the

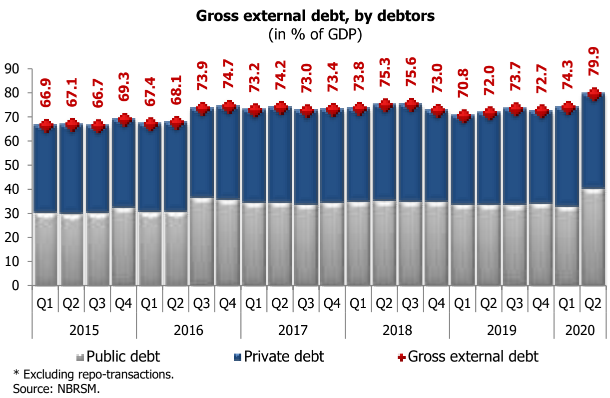
[63] The calculations use the nominal GDP forecast (from October 2020).

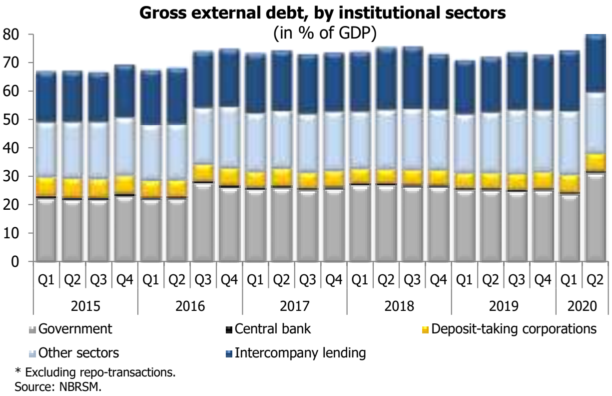
growth of international assets (by 10.6 and 4.2 percentage points of GDP, respectively). Observed by sector, the annual growth mostly stems from increased net liabilities with other sectors in the economy, mainly due to increased net liabilities to direct investors, higher net government liabilities and less to net position of depository institutions (lower net assets with currencies and deposits). Moreover, central bank's net assets grew (due to the increase in foreign reserves), which partly neutralized the shifts in other sectors in the international investment position.





At the end of the second quarter of 2020, the level of the gross external debt was Euro 8,781.7 million, or 80.6% of GDP, which is an increase of 4.3 percentage points of GDP, compared to the previous quarter. *By excluding the effect of the specific activities for managing the foreign reserves of the National Bank*[64]*, the gross external debt registers a quarterly growth of 5.6 percentage points of GDP.* Such shift in the level of the gross external debt entirely results from the growth of the public external debt, amid slight decline in the private sector debt. The quarterly increase in the public debt is almost entirely due to the external government borrowing in the form of long-term securities and loans. On the other hand, the change in the private debt mainly results from the reduction of the intercompany debt, as well as from the reduced liabilities of the banking sector based on trade credits.

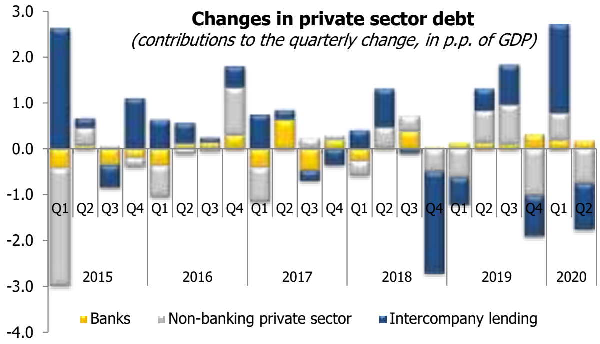


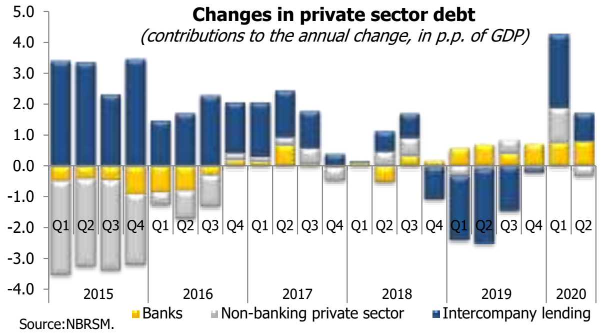


The annual change in the gross external debt indicates an increase of 7.9 percentage points of GDP, amid increase in both public and private debt (of 6.5 and 1.4 percentage points of GDP, respectively). The annual growth of the public debt was largely due to the higher central government debt (issuance of the new Eurobond and borrowings from the IMF), and less to the higher debt of public enterprises. The increase in the private sector debt mainly results from the banking sector (higher

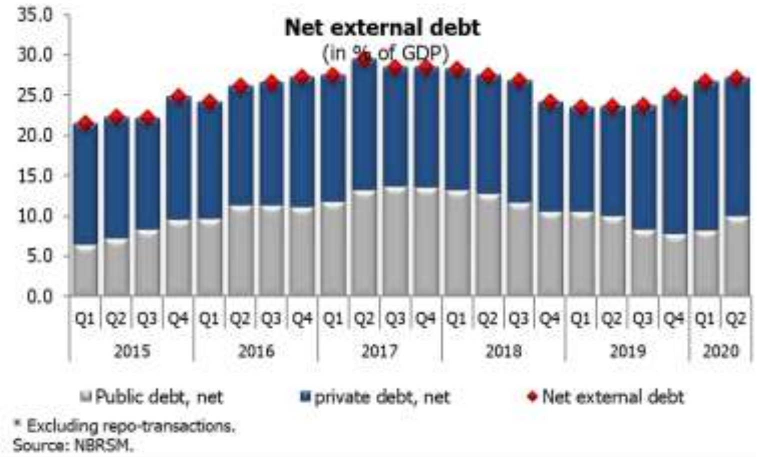
[64] The specific foreign reserves management activities of the central bank include repo agreements and other foreign reserves management operations.

liabilities from currencies and deposits and long-term loans), as well as from higher intercompany debt, amid decrease in liabilities based on trade credits with the non-banking private sector.





At the end of June 2020, the net external debt stood at Euro 2,953.8 million, or 27.1% of GDP, which is a small quarterly increase of 0.4 percentage points of GDP. The higher net external debt is mainly due to the increased net public debt (by 1.7 percentage points of GDP), given the slight decline in net private debt (of 1.3 percentage points of GDP).



External debt ratios of the national economy remain in the safe zone. Gross external debt to GDP ratio still classifies our economy in the group of highly indebted countries, while all other solvency and liquidity ratios point to low indebtedness of the country.

Indicators for external indebtness	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 %
31.12.2010	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
31.12.2015	2.69	143.9	73.2	20.0	1.69	1.13	21.3
31.12.2016	2.37	149.39	79.33	14.89	1.65	1.16	21.93
31.12.2017	2.69	139.17	76.88	12.72	1.32	0.89	23.94
31.12.2018	2.22	131.37	77.42	15.77	1.42	1.04	25.75
31.03.2019	2.05	119.55	74.37	8.89	1.40	0.98	25.81
30.06.2019	2.05	121.51	75.59	8.89	1.37	0.97	26.39
30.09.2019	2.05	124.39	77.38	8.89	1.37	0.97	27.62
31.12.2019	2.05	123.15	76.61	8.89	1.56	1.02	25.52
31.03.2020	2.45	121.76	73.94	16.79	1.39	0.95	26.63
30.06.2020	2.45	121.76	73.94	16.79	1.39	0.95	26.63
*Moderate indebtedness criterion**	*12 - 20%*	*165 - 275%*	*30 - 50%*	*18 - 30%*		*1.00*	

*The moderate indebtedness criterion is accordng to the World bank's methodology of calculationg 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).

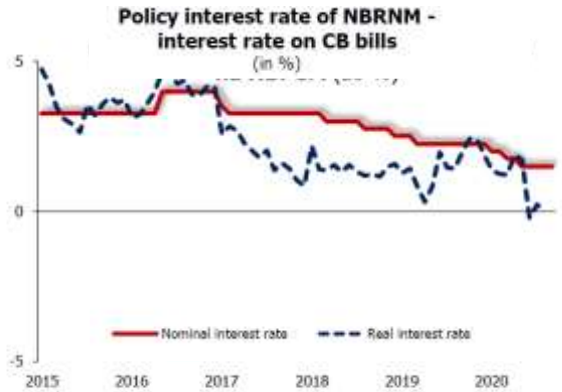
Source: NBRNM.

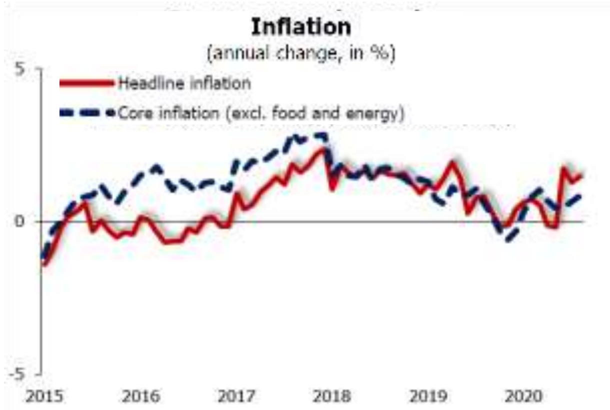
II. Monetary policy[65]

In the third quarter of the year the National Bank did not change the monetary policy stance, maintaining the policy rate at 1.5% after the three-time reduction since early this year. The monetary easing supported credit flows in the economy and increased liquidity in the banking system. Foreign reserves in the third quarter of the year remain at an appropriate level and within the safe zone. Total deposits and total loans still grow on annual basis. The National Bank will continue to carefully monitor the indicators and potential risks of the domestic and external environment, in order to adequately adjust the monetary policy setup.

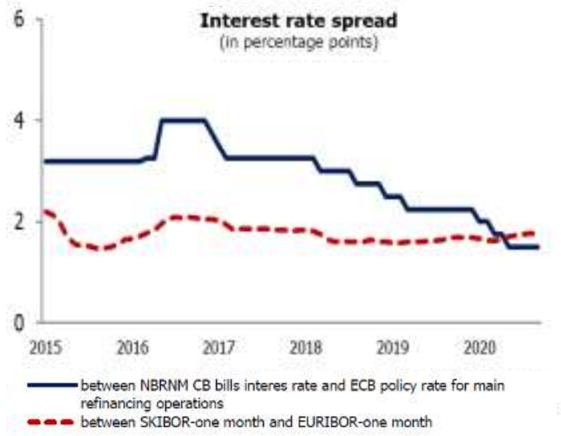
After the three-time decrease in the interest rate on CB bills since early this year, in the third quarter of 2020, the National Bank maintained its policy rate at the record low of 1.5%. Given the already performed monetary easing in the previous period, amid continued risks, the monetary stance was assessed as appropriate to the current economic and financial conditions. The monetary loosening so far increased the liquidity of the banking system and supported the credit flows in the economy.

[65] For more information on the new monetary measures, see the National Bank website: http://www.nbrm.mk/content/Hronologija_na_promenite_vo_postavenosta_na_monetarnite_instrumenti_na_NB_1-13_9-20.pdf



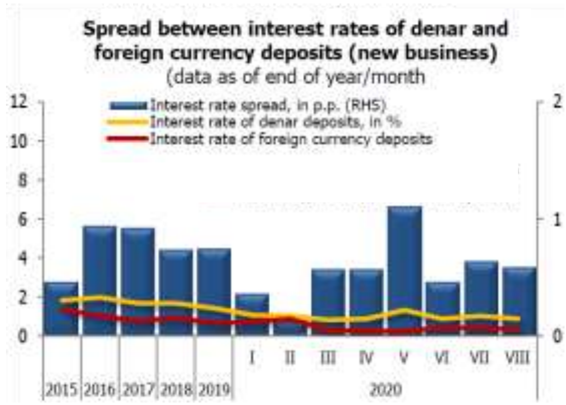


The main macroeconomic indicators in the domestic economy point to certain deviations from the April forecasting round. In terms of the inflation movements, the average annual growth rate of consumer prices for the period July-August amounted to 1.4%, which exceeds the expectations for the third quarter. Such performance, supplemented with increased volatility of import prices, pointed to raising uncertainty around the projected inflation rate for 2020. In terms of economic activity, in accordance with the disclosed estimated GDP data, in the second quarter of 2020 the real GDP decreased by 12.7% annually, which is in line with the expectations in the April forecast. Such decline in GDP is due to the health and economic crisis caused by the COVID-19 pandemic, which significantly worsened the business activity in this period and affected the confidence and expectations of companies and consumers. The available high-frequency data for the third quarter of 2020 indicated more moderate negative effects of the health crisis on the economic activity. Regarding the foreign reserves, the latest data show that they are maintained at an appropriate level and in a safe zone. In the third quarter, the regular repayment of external public sector liabilities and National Bank's interventions on the foreign exchange market had the largest impact on the change in the foreign reserves. Analyzing total deposits and total loans, the August data show further annual growth, higher than the expectations according to the April forecast.



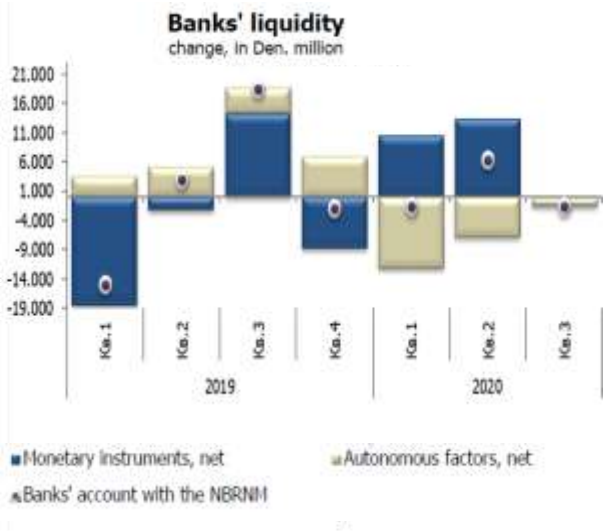
In terms of the external environment, the ECB made no changes to the current monetary setup, keeping the same interest rate. Amid improved conditions and private sector expectations, as well as a decelerated annual decline of the economic activity in the third quarter, the ECB revised the economic growth upward for 2020, while the estimates for the next two years remained almost unchanged. Consequently, amid unchanged policy rates by the National Bank and the ECB during the third quarter, the spread between this interest rates remained at the level of the previous quarter. Regarding the indicative market interest rates on one-month EURIBOR and one-month SKIBOR, the spread between them moderately expanded at the end of the third quarter. The widening in the third quarter primarily stems from the decrease in the one-month EURIBOR, while the one-month SKIBOR slightly decreased, compared to the previous quarter.

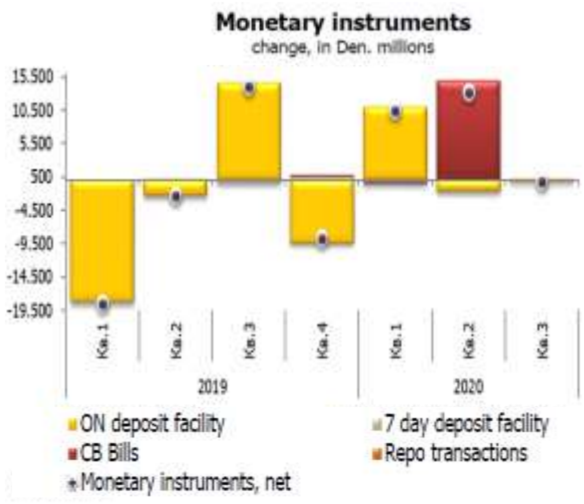
As for the domestic economy, in the interest rates on total deposits (denar and foreign currency), the interest rate spread slightly tightened to 0.8 percentage points in August. (0.9 percentage points), due to the decrease in interest rate on denar deposits of 0.1 percentage points, at unchanged interest rate on foreign currency deposits. In total newly accepted deposits, the interest rate spread widened to 0.6 percentage point in August (from 0.5 percentage points in June), given the decrease in the interest rate on foreign currency deposits of 0.1 percentage points and unchanged interest rate on denar deposits compared to the previous quarter.



2.1. Bank liquidity

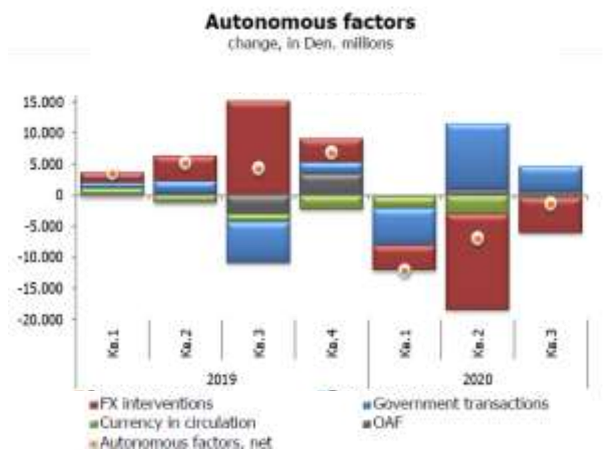
In the third quarter of 2020, the banks' denar liquidity decreased, which mostly results from the change in the autonomous factors, primarily the National Bank's foreign currency interventions. The monetary instruments, net, contributed to slight liquidity withdrawal from the banking system, due to higher amount of banks' assets placed in overnight deposits.





The banks' deposit facilities with the National Bank contributed to withdrawing liquidity (by Denar 202 million) entirely reflecting the increase in overnight deposit facilities (by Denar 325 million), while the 7-day deposit facilities slightly decreased (by Denar 123 million). At the end of the third quarter the stock of the main instrument - the CB bills of the NBRNM was Denar 10,000 million and registered no changes compared to the end of the second quarter.

The autonomous factors, net, in the second quarter withdrew liquidity in the amount of Denar 1,333 million. Such change is a result of the National Bank's interventions on the foreign exchange market by selling foreign currency, amid increase in currency in circulation, while government transactions created liquidity in the banking system.



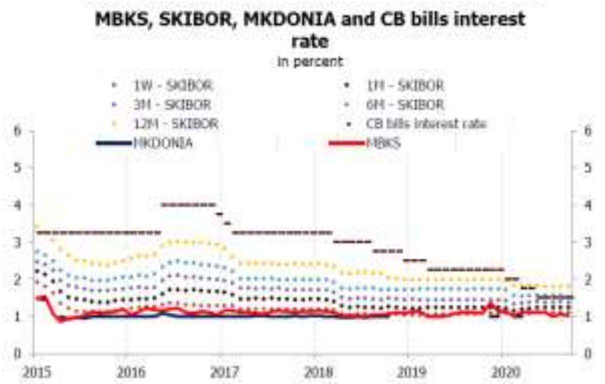
Analyzing reserve requirement, in the third quarter of the year, the banks had more allocated funds on the accounts with the National Bank than the determined amount of the reserve requirement in denars, by about 12% on average.

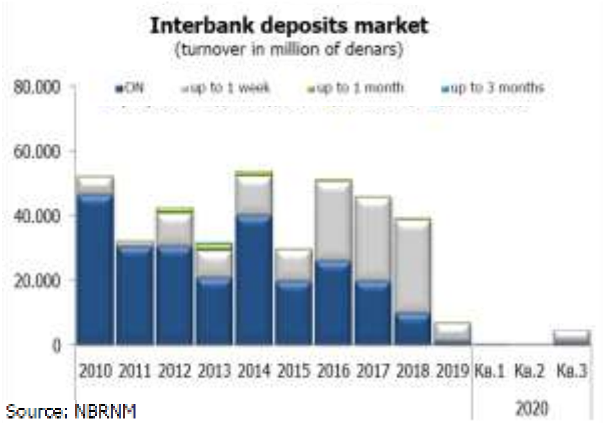
III. Financial market developments

The interbank interest rate on deposit market in the third quarter of 2020 slightly decreased and averaged 1.03%. Amid unchanged policy rate by the National Bank, no significant changes were registered in SKIBOR quotations, except the six-month and twelve-month interest rates, which moved slightly downward. In the primary government securities market, the new issues were mainly in longer maturities and in domestic currency, while the secondary market registered trade mainly in treasury bills. The Macedonian Stock Exchange Market witnessed uncertainty by investors about possible negative economic consequences from the COVID-19, thus the stock exchange turnover was lower compared to the previous quarter. However, influenced by the value of shares of several joint-stock companies, the MBI-10 value grew, as opposed to the downward shifts of stock exchange indices from the region amid expected second wave of coronavirus spread. On the international financial markets, financial conditions indexes reduced, which indicates certain stabilization of the expectations. The yields on Macedonian Eurobonds registered faster reduction compared to the reduction in the German government bonds which narrowed the spreads between these two bonds.

3.1. Unsecured interbank deposit market

In the third quarter of the year, the interest rate on the interbank deposit market (MBKS) slightly decreased by 0.2 percentage points on average compared to the previous quarter, from 1.1% to 1.03%, amid unchanged policy rate of the National Bank.. Trading on the interbank deposit market in the third quarter of the year registered the highest turnover since the beginning of the year of Denar 4,624 million (Denar 480 million in the previous quarter), which is entirely due to transactions with maturity up to 7 days. The interest rates of SKIBOR quotations remained unchanged on average, except the slight downward movement in six-month and twelve-month interest rates.

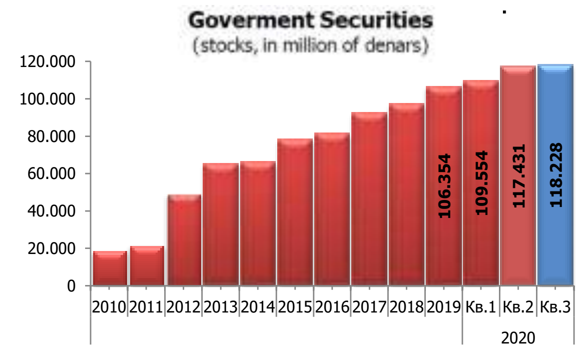


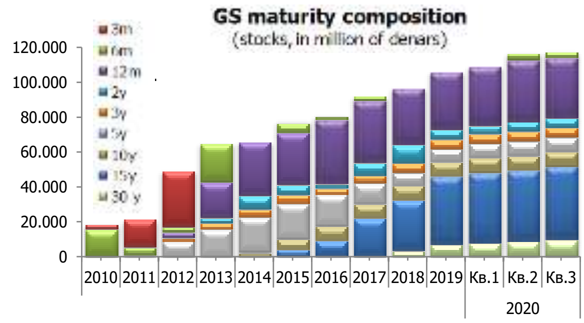


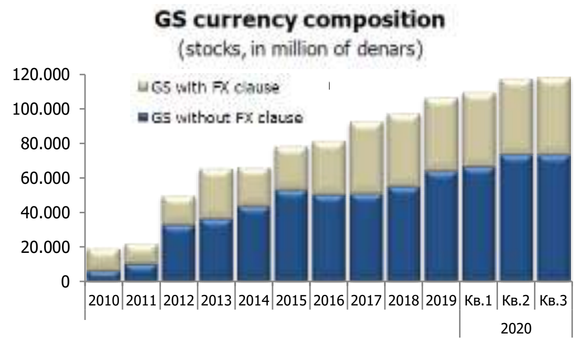
Source: NBRNM

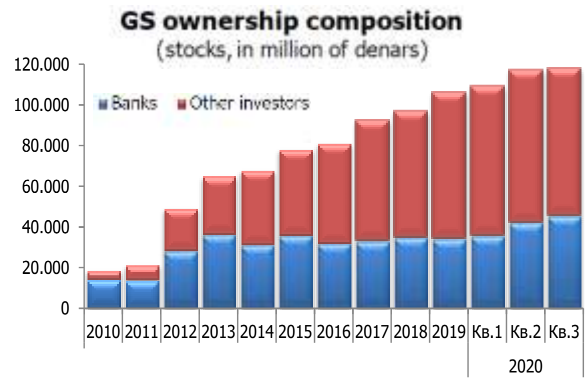
3.2. Government securities market

In the primary government securities market, the issued government securities in the third quarter of the year further increased. Structurally speaking, the growth is entirely due to the increase in government bonds, amid decline in treasury bills. Government bonds remain dominant category (with a share of 67.5%) in the stock of total government securities issued on the primary market. In terms of maturity, the most common are 15-year government bonds and 12-month treasury bills, with a share of 35.5% and 29.3%, respectively, in total government securities. Analyzing the currency structure, government securities without currency clause maintained their dominant share of 62% in total government securities (62.5% in the previous quarter). Banks in this quarter also mainly invested in government securities, thus their share in the ownership structure of the government securities increased from 36.1% to 38.6%. However, most of the total issued government securities are still owned by other investors (61.4%), mostly pension funds.



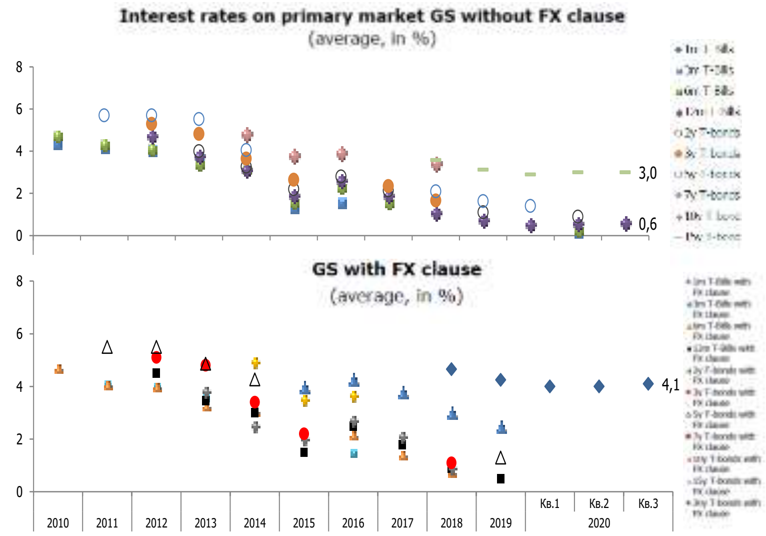






Interest rates on government securities are relatively stable in the third quarter as well, thus on the primary market 12-month treasury bills were issued without currency clause with interest rate of 0.6%. Also, 15-year government bonds without currency clause and 30-year government bonds with currency clause were issued on the primary market at interest rates of 3% and 4.1%, respectively[66].

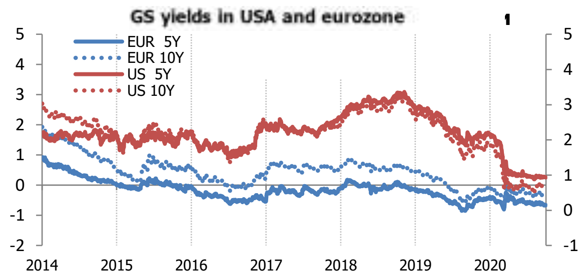
[66] The third quarter of 2020 registered a slight increase in the interest rate of the 30-year government bonds with currency clause from 0.4% to 4.1%.

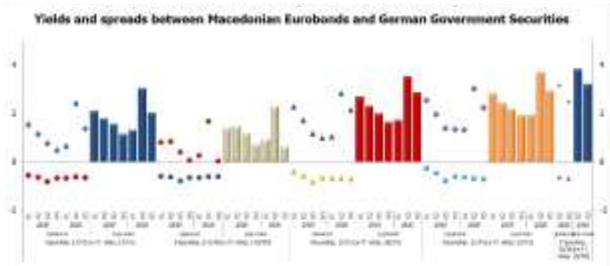


Trading in securities on the secondary market in third quarter of the year was the highest since the beginning of the year, with this market segment being dominated by outright treasury bills transactions, with a small share of government bonds as well. Observing maturity, there were transactions with residual maturity up to 1 month, from 1 to 3 months, from 6 to 12 months and from 15 to 30 years (with an average yield to maturity of 1%, 0.6%, 0.8% and 4.0%, respectively).

Globally, amid rapid coronavirus spread, most of the central banks decreased the interest rates, and in coordination with the governments took additional measures to support economies and lending by creating liquidity. In such circumstances, in the third quarter, on the financial markets in the euro area, the yields on 10-year government securities[67] remained relatively stable and averaged around -0.3% (-0.2% in the second quarter), while the yields on 10-year US government bonds[68] amounted to 0.6% (0.7% in the second quarter of the year). The yields on Macedonian Eurobonds[69] in the third quarter of the year on average registered a faster decline compared to the decline in the German government bonds, which narrowed the spreads between these two bonds, which averaged 2.03, 0.7, 2.9, 2.9 and 3.2 percentage points, respectively.

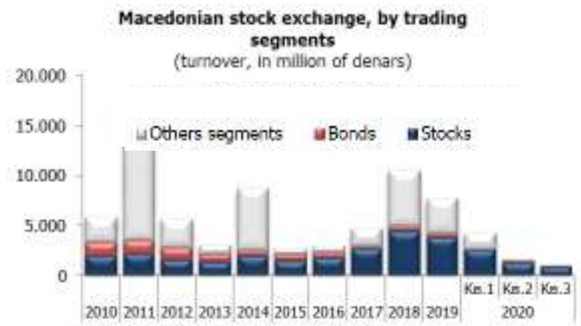
[67] Those are generic government bonds derived from the yield curves of government bonds of Germany and France.
[68] Those are generic yields derived from the yield curve of government bonds of the United States.
[69] It refers to Macedonian Eurobonds issued in July 2014, in December 2015, July 2016, in January 2018 and in June 2020. Eurobonds are issued in the nominal amount of Euro 500 million, Euro 270 million, Euro 450 million, Euro 500 million, and Euro 700 million, respectively, with a maturity of 7, 5, 7, 7 and 6 years, respectively, and annual interest rates of 3.975%, 4.875%, 5.625%, 2.75% and 3.675%, respectively.

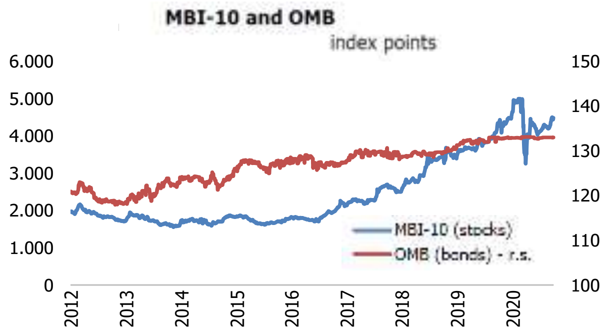




3.3. Stock markets

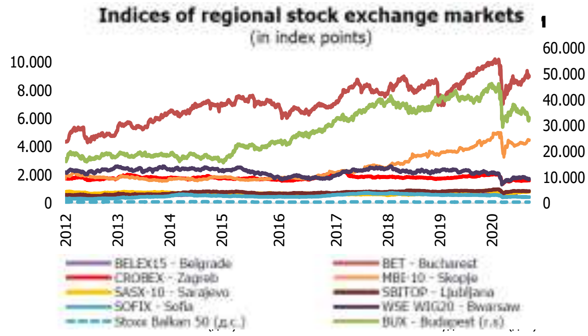
On the Macedonian Stock Exchange, MBI-10 increase by 9% and at the end of the third quarter amounted to 4,485 index points. Moreover, the increase in the MBI-10 was not dispersed, but driven by the value of the shares of several joint stock companies. However, amid increased uncertainty among investors from the adverse pandemic effects, the stock exchange turnover was lower compared to the previous quarter, amid decrease in the trading volume of all segments. The value of the bond index (OMB) during the third remained relatively stable and at the end of the third quarter equaled 133, as at the end of the previous quarter.

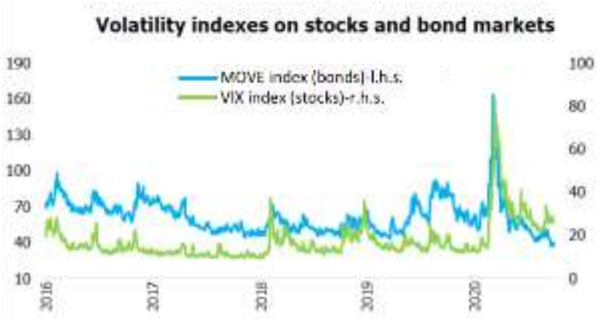




In the third quarter of the year the stock exchange indices in the region moved slightly downward, by an average of 0.5%, despite the 10% increase in the previous quarter. Significant downward adjustment was registered in the Hungarian and Polish indices that registered a quarterly decline of 8% and 6%, respectively. The indices of the other stock exchanges in the region, such as the Serbian, Romanian and the Bosnian index, moderately increased their value on a quarterly basis, by 4.1%, 4% and 6%, respectively. In the third quarter, the volatility indices on the bond and stock markets, such as VIX[70] and MOVE, decreased on a daily basis by an average of 25%, which indicates stabilization of the expectations.

[70] 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 indices as indicators of the conditions and expectations for the financial markets volatility. Downward path in indices indicates a decrease in volatility.





IV. Monetary and credit aggregates[71]

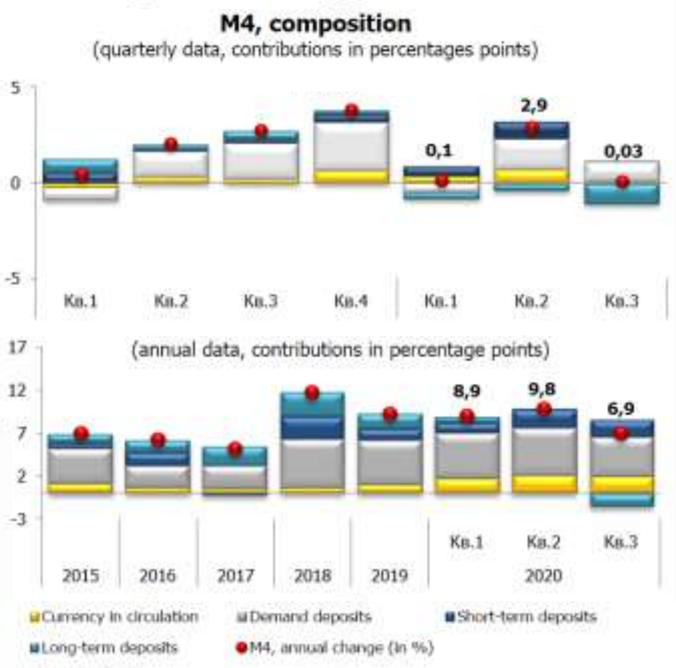
At the end of the third quarter the monetary and credit aggregates remained almost at the same level as in the previous quarter. However, if data are corrected by the effect of the license revocation of one bank in mid-August, total deposits and loans will grow quarterly. Structurally, amid increased uncertainty due to the pandemic and the preference for holding liquid assets, there is a decrease in long-term deposits and increase in the most liquid component of currency in circulation-demand deposit. In addition, since the beginning of the crisis the government continuously paid funds to companies and households from the set of economic measures to deal with the COVID-19 crisis, in order to maintain the liquidity of companies and the purchasing power of households. The National Bank also mitigated the consequences of the crisis by adopting set of measures, aimed at reducing the cost of financing through loans from banks, as well through injecting additional liquidity in the banking system, in order to stimulate credit activity. Consequently, total loans to private sector grew during the third quarter as well. The results of the Lending Survey for the third quarter indicate net decrease in demand, in both households and companies, with most of the banks indicating unchanged credit standards in both sectors.

4.1. Monetary aggregates

In the third quarter of 2020, the broad money M4 slightly increased on a quarterly basis, compared to the increase of 2.9% in the second quarter. Observing the money supply structure, the most liquid components, currency in circulation and demand deposits increased quarterly (contribution of 0.1 and 1.0 percentage points, respectively), amid decrease in long-term deposits (negative contribution of 1.1 percentage points). Short-term deposits registered no significant change in relation to the end of the second quarter. Regarding the currency structure, denar deposits made a negative contribution of 1.3 pp to the quarterly growth of the broad money M4, with a positive contribution of foreign currency deposits (of 0.2 percentage points). Consequently, the share of foreign currency deposits in M4 at the end of the third quarter of the year was 35.7% which is slightly higher compared to the end of the

[71] Monetary aggregates, and total deposits and loans data since August 2020 do not include data on a bank whose founding and operating license was revoked and which went into bankruptcy in August 2020. For more realistic understanding of the banking system flows without the effect of this change in the monetary statistics chart, the total deposit and credit flows in the third quarter were adjusted with data for the respective bank. The adjustment in total deposits was made by including the amount of deposits which is not subject to compensation by the Deposit Insurance Fund in the current balance of total deposits, while the adjustment of total loans was made by including the July data on the balance of bank's loans in the current balance of total loans.

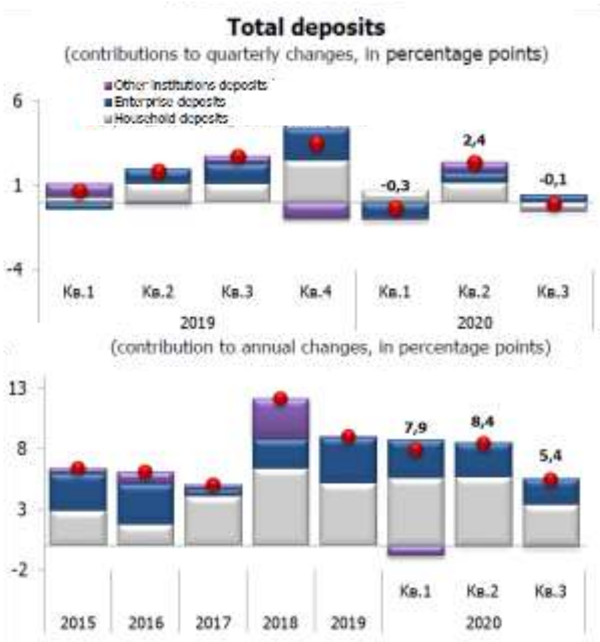
previous quarter (35.4%). Annually, the growth of M4 was 6.9% at the end of the third quarter (9.8% at the end of the previous quarter).



Source: NBRNM.

After the growth of 2.4% in the previous quarter, total deposits in the financial system[72] in the third quarter of 2020 slightly decreased by 0.1% on a quarterly basis (increase of 0.5% with adjustment for the effect of the aforementioned bank). Observed by sector, the quarterly decline in total deposits is a result of the decrease in household deposits, amid positive contribution of corporate deposits. From currency point of view, total denar deposits made a negative contribution of 0.4 percentage points to the quarterly growth of total deposits (given the growth of demand deposit and decrease in denar deposits), amid moderate positive contribution by foreign currency deposits (of 0.3 percentage points). Observing the maturity structure of savings, long-term deposits decreased, amid unchanged short-term deposits. On an annual basis, the growth of total deposits at the end of September slightly decelerated at 5.4% (8.4% at the end of the previous quarter), i.e. 6.1% with adjustment for the effects of the aforementioned bank.

[72] Data refer to non-government deposits in banks and savings houses, funds of other financial institutions on the accounts with the National Bank and funds of local government authorities on the accounts with the National Bank. The data are consistent with the methodological changes of the National Bank from June 2018. For more information on the methodological changes visit: http://www.nbrm.mk/monetarna_statistika_i_statistika_na_kamatni_stapki.nspx.



Total deposits

	2019				2020		
	Кв.1	Кв.2	Кв.3	Кв.4	Кв.1	Кв.2	Кв.3
quarterly change, in %							
Total deposits	0,7	1,9	2,7	3,5	-0,3	2,4	-0,1
contributions to quarterly growth, p.p.							
Deposit money	-0,7	1,4	2,0	2,7	-0,5	1,7	1,1
Denar deposits	0,4	0,5	0,1	0,1	-0,7	-0,4	-1,4
FX deposits	0,9	-0,1	0,6	0,6	0,9	1,0	0,3
Short-term deposits	0,6	0,1	0,2	0,5	0,6	1,0	0,0
Long-term deposits	0,8	0,3	0,5	0,3	-0,4	-0,4	-1,2
Households	0,3	1,1	1,1	2,5	0,7	1,2	-0,5
Enterprises	-0,4	0,9	1,2	1,9	-0,9	0,6	0,5
Other institutions deposits	0,8	-0,1	0,4	-1,0	-0,1	0,6	-0,1

Household deposits registered a quarterly decline of 0.7% in the third quarter of the year (increase of 1.8% in the previous quarter). Including the effect of the aforementioned bank, the quarterly decline of the household deposits was minor and amounted to 0.1%. The quarterly decrease was registered in denar deposits, amid growth in foreign currency deposits. Observing the maturity structure of savings, long-term deposits registered a decrease, amid moderate growth of short-term deposits. The annual increase in total household deposits was 6.1% at the end of September (8.7% in the previous quarter). Including the effect of the aforementioned bank, the annual growth of household deposits in September equaled 6.7%.

Corporate deposits registered a quarterly increase of 1.8% in the third quarter of 2020, more moderate compared to the previous quarter (2.2%). Including the effect of the aforementioned bank, the quarterly increase in corporate deposits was stronger and amounted to 2.5%. Observing currency, the change in corporate deposits was entirely due to the increase in denar deposits, i.e. demand deposits, amid slight decrease in denar deposits. Analyzing the maturity, short-term deposits registered a quarterly decline, amid slight increase in long-term deposits. Annually, at the end of September corporate deposits increased by 8.0% (11.2% at the end of the previous quarter). Including the effect of the aforementioned bank, the annual growth of corporate deposits in September amounted to 8.8%.

in August, observing the returns[73] on new savings, the interest rates on the newly accepted[74] denar and foreign currency household deposits equaled 1.0% and 0.4%, respectively (1.2% and 0.6%, respectively , in June). In such circumstances, the interest rate spread between the new denar and foreign exchange household savings in August amounted to 0.6 percentage points, same as in the previous quarter. Interest rates on newly accepted denar and foreign currency corporate deposits equaled 0.8% and 0.2% respectively in August (0.6% and 0.2%, respectively in June). Taking into account these movements, the interest rate spread between the newly accepted denar and foreign currency corporate deposits at the end of August widened from 0.4 percentage points in June to 0.6 percentage points in August. Regarding the total accepted deposits (denar and foreign currency), the interest rates on household and corporate deposits in August amounted to 1.0% and 1.1%, respectively (1.1% and 1.3%, respectively in June).

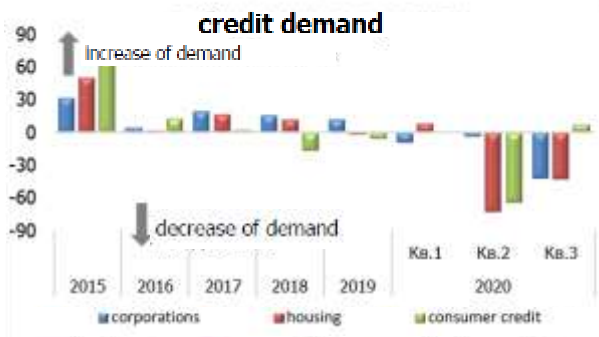
4.2. Lending activity

After the growth of 2.6% in the second quarter, total loans to private sector in the third quarter of 2020 significantly increased quarterly, thus maintaining at the same level as at the end of the previous quarter (quarterly growth of 1.7% by adjusting the effect of the aforementioned bank). In order to encourage lending activity, the National Bank since the beginning of the crisis has adopted a series of measures, in order to reduce the cost of financing through loans from banks, as well as to provide additional liquidity in the banking system. According to the results of the Lending Survey, the third quarter witnessed slight net tightening of credit standards for the corporate sector and consumers loans, amid net easing of the conditions for approving housing loans. However, most banks indicate unchanged credit standards for both sectors. At the same time, there is a downward adjustment of demand for corporate and housing loans, amid moderate net increase in demand for consumer loans. For the last quarter of 2020, banks expect a net increase in the total demand for loans by both sectors, amid net easing of the credit standards.

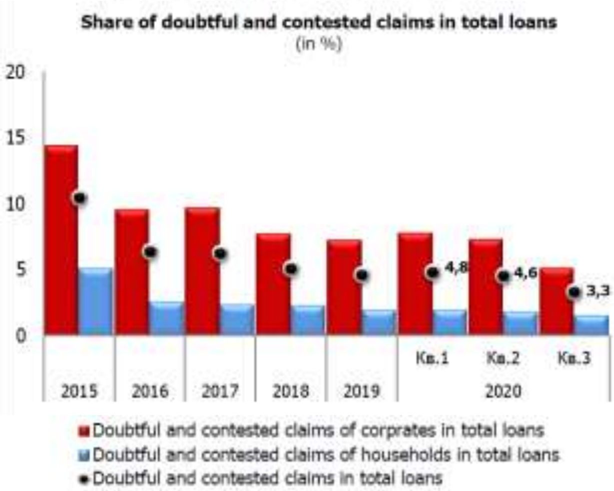
[73] Data on interest rates are in accordance with the methodological changes of the National Bank from June 2018. For more information on the methodological changes visit:
http://www.nbrm.mk/monetarna_statistika_i_statistika_na_kamatni_stapki.nspx.
[74] Note that the interest rates on newly accepted deposits typically vary. Volatility of interest rate on newly accepted deposits results from the fact that they result from the volume of newly accepted deposits (which varies from month to month) and their interest rate.

Total credits of private sector

	2019				2020		
	Кв.1	Кв.2	Кв.3	Кв.4	Кв.1	Кв.2	Кв.3
	quarterly change, in %						
Total credits of private sector	0,8	1,8	-0,5	3,8	0,7	2,6	0,03
Contribution in quarterly change of total credits (in p.p.)							
Denar credits	0,4	0,8	-0,8	2,0	0,5	1,7	-0,1
Foreign currency credits	0,5	1,0	0,3	1,8	0,2	0,9	0,1
Short-term credits	-0,1	-0,3	-0,9	0,6	0,1	-0,4	-1,1
Long-term credits	0,8	1,8	1,2	3,2	0,3	2,7	2,2
Households	0,9	1,7	1,1	1,4	0,8	1,1	1,4
Corporations	0,0	0,2	-1,7	2,5	-0,1	1,5	-1,4



Regarding sectors, the third quarter recorded increase in household loans, amid decline in corporate loans, at almost the same pace. The currency structure recorded slight changes, amid increase in foreign currency loans[75] and decline in denar loans. Analyzing the maturity structure, long-term loans registered a quarterly growth, amid decrease in short-term loans. The share of doubtful and contested claims in total loans at the end of September equaled 3.3% and decreased by 1.3 percentage points compared to the end of June 2020.



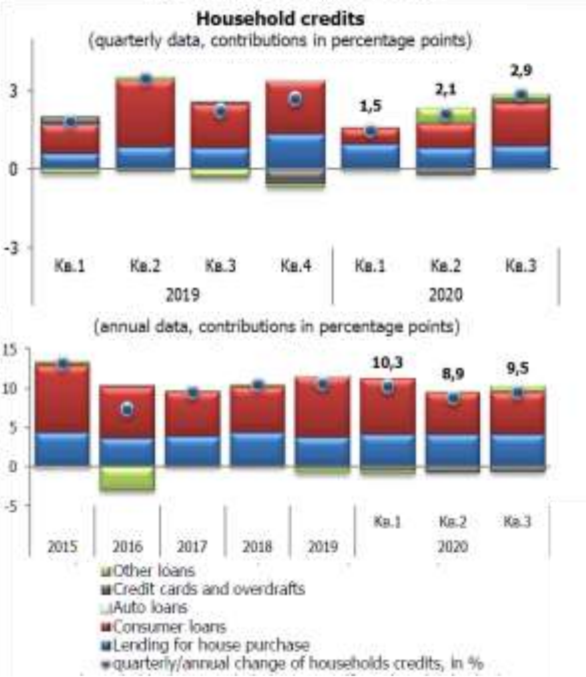
The solid annual growth of total loans continued in the third quarter of 2020, at a rate of 7.3% (6.6% in the previous quarter), i.e. at a rate of 9.1% by adjusting the effects of the aforementioned bank. The annual growth of total loans is still primarily due to the growth of household loans, amid increasing corporate loans. The share of total loans in total deposits at the end of September registered no significant change in relation to the end of June and amounted to 82.6% (82.5% in June).

[75] Foreign currency loan data also include denar loans with currency clause.

In the third quarter of 2020, the growth of household lending accelerated compared to the previous quarter. The quarterly growth of 2.8% (2.1% in the previous quarter) largely stems from the increase in consumer and housing loans, amid slight positive contribution of other loans. Credit cards and overdrafts had minor positive effect on the growth of household loans. According to the results of the Bank Lending Survey for the third quarter, the households registered net decrease in the housing loan demand, amid moderate net increase in consumer loan demand and slight net tightening of the credit standards. Analyzing the currency, the growth of household loans mostly results from the increase in denar loans, amid slight positive contribution of foreign currency loans (including loans with foreign currency clause). Analyzing the maturity structure, the quarterly growth of household loans was due to long-term loans, amid almost unchanged short-term loans. Annually, at the end of September, total loans to households increased by 9.5% (8.8% at the end of June).

Total credits of households

	2019				2020		
	Кв.1	Кв.2	Кв.3	Кв.4	Кв.1	Кв.2	Кв.3
	quarterly change, in %						
Total credits of households	3	3,4	2,2	2,7	1,5	2,1	2,8
	Contribution in quarterly change of total credits (in p.p.)						
Denar credits		1,7	0,8	1,3	0,9	1,6	2,5
Foreign currency credits		1,7	1,4	1,3	0,6	0,5	0,3
Short-term credits		0,0	0,0	-0,3	0,0	-0,4	0,0
Long-term credits		3,2	2,5	3,1	1,5	1,9	2,6

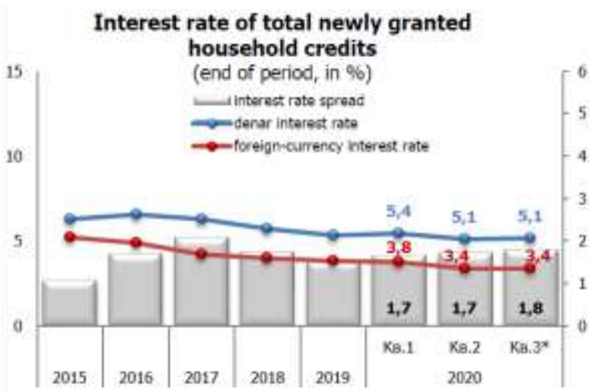


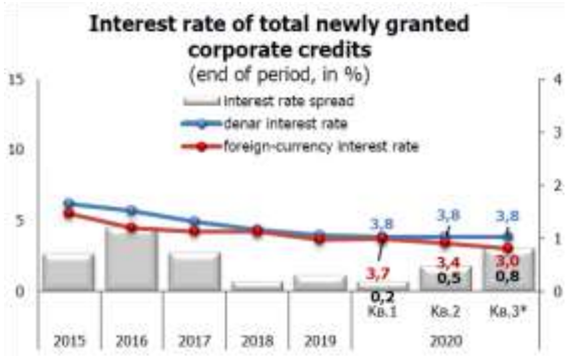
In the third quarter of 2020, total loans extended to the corporate sector registered a quarterly decrease of 2.8% (increase of 3.2% in the previous quarter). The Bank Lending Survey for the third quarter indicates a significant decrease in the corporate loan demand, amid slight net tightening of credit standards. Observing currency, denar corporate loans recorded a significant decrease, amid slight decline in foreign currency loans as well. Analyzing the maturity structure, short-term loans decreased, amid increase in long-term loans. Annually, at the end of December, total corporate loans increased by 5.2% (4.6% at the end of June).

Total credits of corporations

	2019				2020		
	Кв.1	Кв.2	Кв.3	Кв.4	Кв.1	Кв.2	Кв.3
	quarterly change, in %						
Total credits of corporations	0,0	0,3	-3,4	5,1	-0,2	3,2	-2,8
	Contribution in quarterly change of total credits (in p.p.)						
Denar credits	-0,8	0,1	-2,5	2,7	0,0	1,8	-2,8
Foreign currency credits	0,7	0,2	-0,9	2,4	-0,2	1,3	-0,1
Short-term credits	-0,5	-0,7	-2,0	1,8	0,1	-0,4	-2,2
Long-term credits	0,4	0,4	-0,1	3,5	-0,9	3,7	1,9

According to the data on the interest rates[76] on newly approved loans[77] in August, the interest rates on denar and foreign currency loans to households equaled 5.1% and 3.4%, respectively and remained at the same level as in the previous quarter. In such conditions, the interest rate spread between the new denar and foreign currency household lending amounted to 1.8 percentage points. As for the companies, the interest rates on newly approved denar and foreign currency loans in August equaled 3.8% and 3.0%, respectively (3.8% and 3.4%, respectively, in the previous quarter), thus widening the interest rate spread to 0.8 percentage points. Regarding total loans granted to the private sector, at the end of August interest rates on household and corporate loans amounted to 5.6% and 3.8%, respectively (5.6% and 3.9%, respectively in June).





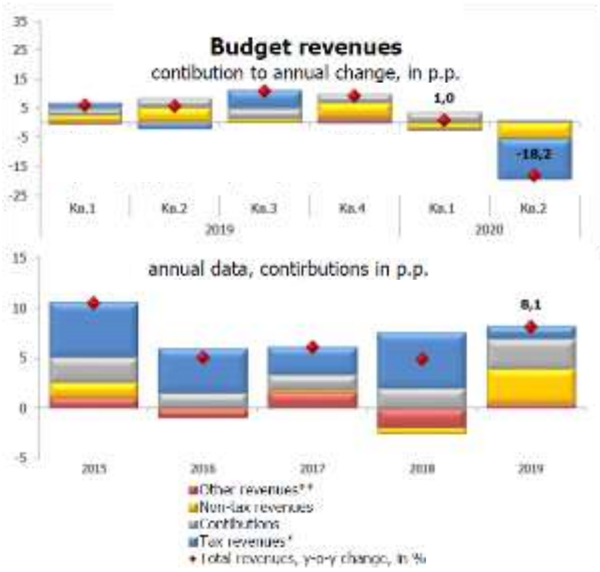
V. Public finance

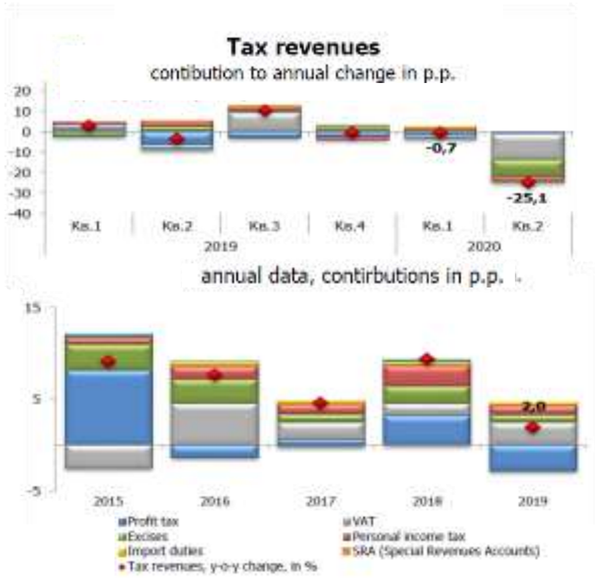
The economic consequences of the health crisis in the second quarter of 2020, had an adverse effect on the fiscal sector as well. Amid sharp decline in economic activity, total budget revenues went down by 18.2% on annual basis, amid further growth of budget expenditures of 10.3%. In such conditions, the budget deficit reached2.3% of GDP and is higher compared to the same quarter last year. In conditions of continuous, yet significantly moderate worsening of the economic performances in July and August, for the period January-August 2020, the budget deficit expanded to 5.2% of GDP, which accounts for 75.6% of the Budget revision for 2020[78]. In the period January-August, the budget deficit was mostly financed through foreign borrowing, and in part through domestic borrowing, with part of the inflows kept as government deposits in the National Bank. At the end of the

[76] Data on interest rates are in accordance with the methodological changes of the National Bank from June 2018. For more information on the methodological changes visit: http://www.nbrm.mk/monetarna_statistika_i_statistika_na_kamatni_stapki.nspx.
[77] Regarding the interest rates on newly approved loans, one should have in mind that they are characterized with variable movements. Volatility of interest rate on newly approved loans depends on the volume of newly approved loans (which can change from month to month) and their interest rate.
[78]The realization of budget deficit of 75.6% is calculated in relation to the revision from 15 May 2020 (Official Gazette of the Republic of North Macedonia No. 126 of 15 May 2020). In the meantime, there was a second Budget revision for 2020 on 4 November 2020, thus as of August, the total revenues, the total expenditures and the Budget deficit account for 60.9%, 61.1% and 61.8% of the second revision, respectively (Official Gazette of the Republic of North Macedonia No. 262 of 4 November 2020) was adopted.

second quarter of 2020, total public debt equaled 59.9% of GDP, which is by 8.9 percentage points more compared to the previous quarter.

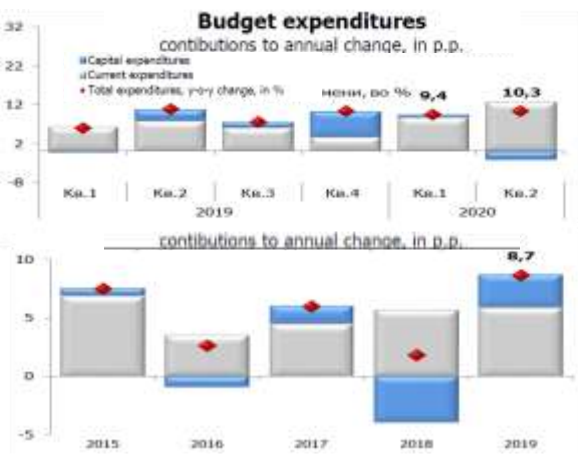
After the significantly slower increase in the first quarter, the total Budget revenues in the Budget of the Republic of North Macedonia[79] in the second quarter of 2020 decreased by 18.2% annually, reflecting the worsened condition in the economy due to health crisis. Analyzed by individual categories within budget revenues, annual decrease was registered in almost all categories, except the contributions and other revenues, which recorded positive movements. The deep decline in economy in the second quarter led to a decrease in tax revenues, which declined annually by 25.1% (negative contribution of 14.3 percentage points), with lower non-tax revenues[80] by 52.2% (negative contribution of 5.2 percentage points). On the other hand, the contributions grew by 4.1% (contribution of 1.3 percentage points) due to increased rates on mandatory pension and disability insurance and compulsory health insurance, which came into effect in early 2020, as well as the measures taken for wage increase[81]. Other revenues[82] slightly increased by 1.0% (contribution of 0.02 percentage points).

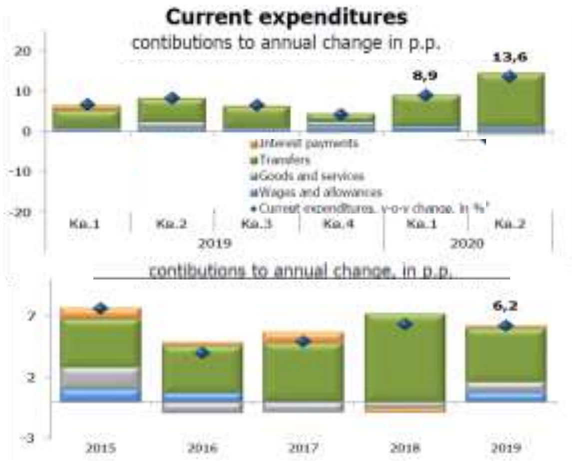




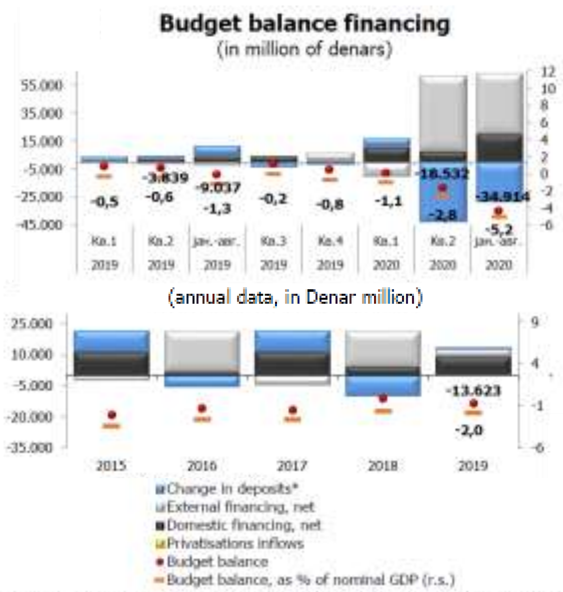
The decline in total tax[83] revenues of 25.1% during the second quarter of the year resulted from lower revenues from all types of taxes. The most pronounced negative contribution was made by the decrease in VAT revenues[84] and excise (with negative contribution of 12.6 and 8.1 percentage points, respectively), amid moderate negative contribution of the decrease in personal income tax, corporate tax[85] and import duties (2.1, 1.1 and 0.5 percentage points, respectively).

[79] Central budget and budgets of funds.
[80] Lower non-tax revenues are mostly due to the higher base effect in the second quarter of 2019 when there were higher inflows to the Pension and Disability Insurance Fund's account in the RNM Budget. These inflows resulted from the transfer of funds of the private pension funds in accordance with the Law Amending the Law on Mandatory Fully Funded Pension Insurance and the Law Amending the Law on Pension and Disability Insurance (Official Gazette of RM No. 245 of 28.12.2018).
[81] There was an increase from 18.4% in 2019 to 18.8% in 2020 in the rates on mandatory pension and disability insurance and from 7.4% in 2019 to 7.5% in 2020 on compulsory health insurance. Also, the increase in contributions is also associated with the increased base as a result of the increased minimum net wage to Denar 14,500 in December 2019, the increase in the wages in the public sector, as well as the effect of the measure for subsidizing contributions due to wage increase.
[82] Other revenues include capital revenues, donations from abroad and revenues from recovered loans.
[83] It also includes own revenue accounts (SSP).
[84] The negative contribution of net VAT revenues in the second quarter of 2020 results from the decrease of gross VAT revenues of 19.6% annually, amid slight decrease in VAT refunds of 0.5% annually.
[85] Regarding the corporate tax, the reduction can be related to the measure for release from payment of the amount of the corporate tax advances for the period from April to June.

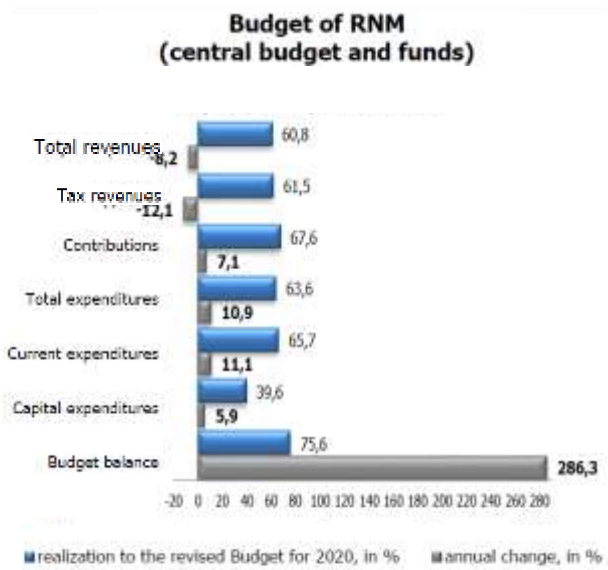




Total Budget revenues in the second quarter of 2020 went up by 10.3% annually (9.4% in the previous quarter), mostly due to the fiscal measures taken to deal with the effects caused by the COVID-19 crisis. In this period, the Government adopted five fiscal measures aimed at supporting companies and households, in order to mitigate the economic consequences of the rapid spread of COVID-19. The growth mostly results from the higher current expenditures (contribution of 12.6 percentage points) amid decrease in capital expenditures (of 2.3 percentage points). Annually, current expenditures increased by 13.6%, with the largest contribution to the growth of the category of transfers[86] (13.4 percentage points), mainly due to the increased payment of funds to support companies and households hit by the COVID-19 crisis.



* Positive change - deposits withdrawal; negative change - deposits accumulation.
Source: Ministry of finance



Source: Ministry of Finance and NBRNM's calculations

With the significantly reduced revenues and increased budget expenditures, in the second quarter of 2020, the budget deficit expanded to Denar 18,532 million or 2.8% of GDP[87], which is higher compared

[86] The increase in transfers is mostly associated with agriculture subsidies, wage subsidies for companies affected by the corona crisis, pension costs, social care costs and health care costs.
[87] The analysis uses the National Bank's October forecasts for the nominal GDP for 2020.

to the same period last year (0.6% of GDP). The budget deficit was generally financed by external[88] and domestic borrowing, with most of the inflows being retained as government deposits with the National Bank.

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

	2020						2020					
	Budget for 2020	Reallocation 2020	Revised Budget for 2020	Кв.1	Кв.2	Jan.-Aug.	Кв.1		Кв.2		January-August	
							Annual changes,	Contributions in annual changes,	Annual changes,	Contributions in annual changes,	Annual changes,	Contributions in annual changes,
TOTAL REVENUES	**222.308**	**222.308**	**196.768**	**46.484**	**40.951**	**119.549**	**1,0**	**1,0**	**-18,2**	**-18,2**	**-8,2**	**-8,2**
Tax revenues and contributions	197.162	197.162	172.407	42.175	37.382	109.238	3,8	3,3	-14,9	-13,0	-5,6	-5,0
Taxes	127.810	127.810	106.730	26.137	21.178	65.648	-0,5	-0,3	-24,9	-14,0	-12,1	-6,9
Contributions	67.033	67.033	63.397	15.773	15.988	42.852	12,2	3,7	4,1	1,3	7,1	2,2
Non-tax revenues	17.322	17.322	17.063	3.327	2.385	7.184	-22,5	-2,1	-52,2	-5,2	-37,5	-3,3
Capital revenues	2.183	2.183	2.139	378	137	973	75,0	0,4	-22,6	-0,1	46,1	0,2
Foreign donations	5.541	5.541	5.159	604	1.047	2.154	-32,0	-0,6	5,2	0,1	-11,2	-0,2
TOTAL EXPENDITURES	**239.693**	**239.693**	**242.948**	**53.894**	**59.483**	**154.463**	**9,4**	**9,4**	**10,3**	**10,3**	**10,9**	**10,9**
Current expenditures	215.922	219.382	223.402	51.883	57.066	146.719	8,9	8,6	13,6	12,6	11,1	10,6
Capital expenditures	23.771	20.311	19.546	2.011	2.417	7.744	24,5	0,8	-34,1	-2,3	5,9	0,3
BUDGET DEFICIT/SURPLUS	**-17.385**	**-17.385**	**-46.180**	**-7.410**	**-18.532**	**-34.914**						
Financing	17.385	17.385	46.180	7.410	18.532	34.914						
Inflow	**60.598**	**60.598**	**88.287**	**18.960**	**21.106**	**49.694**						
Privatisation receipts	300	300	490	73	582	689						
Foreign loans	34.334	34.334	76.872	622	55.219	56.058						
Deposits	-1.108	-1.108	-19.222	5.787	-42.580	-28.213						
Treasury bills	27.062	27.062	30.137	12.478	7.885	21.160						
Sale of shares	10	10	10	0	0	0						
Outflow	**43.213**	**43.213**	**42.107**	**11.550**	**2.574**	**14.780**						
Repayment of principal	43.213	43.213	42.107	11.550	2.574	14.780						
External debt	26.923	26.923	26.855	10.450	2.082	13.188						
Domestic debt	16.290	16.290	15.252	1.100	492	1.592						

In the period January - August 2020, total budget revenues decreased by 8.2% compared to the same period last year. The decrease in total revenues in this period was mostly due to the lower performances in taxes, by 12.1%, which reflects the significantly worsened economic performances due to the COVID-19 pandemic (negative contribution of 6.9 percentage points). Non-tax revenues[89] also decreased by 37.5% (negative contribution of 3.3 percentage points), while income from contributions[90] increased by 7.1% (positive contribution of 2.2 percentage points). In the period January-August, the budget revenues grew by 10.9% annually, almost fully due to the increase in current costs, amid slight contribution of the increase in capital expenditures. Within the current costs, there was a decrease in the costs of goods and services, amid higher "transfer" costs associated with the agriculture subsidies, wage subsidies for companies affected by the crisis, pension costs and health care costs. To mitigate the pandemic effects on the economy, in July and August the government continued to provide targeted

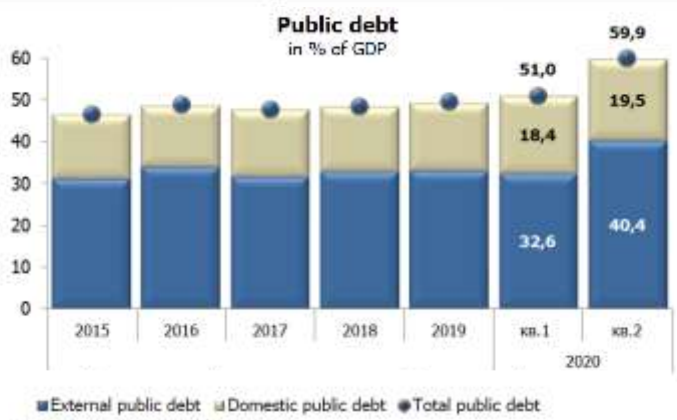
[88]At the beginning of April, the International Monetary Fund confirmed financial support for our country, through the Rapid Financing Instrument, in the amount of around Euro 176 million. Also, in June, there was an inflow of funds from the new Eurobond issued on a nominal amount of Euro 700 million, at an annual interest rate of 3.675% and maturity of six years.

[89]The decrease is a result of the high base in the period from January to August 2019. In January and May 2019, non-tax revenues increased due to the higher inflows to the Pension and Disability Insurance Fund's account from private pension funds. These inflows resulted from the transfer of funds of the private pension funds in accordance with the Law Amending the Law on Mandatory Fully Funded Pension Insurance and the Law Amending the Law on Pension and Disability Insurance (Official Gazette of RM No. 245 of 28.12.2018).

[90]There was an increase from 18.4% in 2019 to 18.8% in 2020 in the rates on mandatory pension and disability insurance and from 7.4% in 2019 to 7.5% in 2020 on compulsory health insurance. Besides, the increase in contributions is also associated with the increased base as a result of the increased minimum net wage to Denar 14,500 in December 2019, the increase in the wages in the public sector, as well as the effect of the measure for subsidizing contributions due to wage increase.

support to households and businesses through subsidized wages and contributions[91], domestic payment card, tourism support vouchers and unemployment benefits.

The unfavorable conditions in the economy caused the budget revision[92] in May, namely, thus upwardly correcting the deficit for 2020 from Denar 17,385 million (or 2.6% of GDP) to Denar 46,180 million (or 6.9% of GDP). In the period January-August 2020, the budget deficit amounted to Denar 34,914 million or 5.2% of GDP[93], constituting 75.6% of the plan for the 2020 Budget revision in May 2020. The budget deficit in this period was mostly financed through foreign and domestic borrowing, with part of the inflows kept as government deposits in the National Bank.



Source: MoF and NBRNM calculations.

At the end of the second quarter of 2020, total public debt[94] equaled 59.9% of GDP[95], which is an increase of 8.9 percentage points of GDP compared to the previous quarter. Such change was driven by the external public debt, which increased by 7.8 percentage points of GDP to 40.4% of GDP at the end of the quarter, while the internal public debt slightly increased by 1.1 percentage points and reached 19.5% of GDP. Observing the debt structure, total government debt[96] equaled 51.0% of GDP and increased by 9.0 percentage points, compared to the previous quarter, while the debt of public enterprises (guaranteed and non-guaranteed)[97] was 8.9% of GDP. At the end of the first quarter of 2020, compared to the same period of 2019, total public debt increased by 12.6 percentage points of GDP.

[91]There was no payment of subsidized wages and contributions in August. The last payment for the June subsidies was in July.
[92]At its session held on 15 May 2020, the Government of the Republic of North Macedonia adopted a decree with legal force on amending the Budget of the Republic of North Macedonia for 2020 during a state of emergency (Official Gazette of the Republic of North Macedonia No. 126 of 15 May 2020).
[93] The analysis uses the National Bank's October forecasts for the nominal GDP for 2020.
[94] The public debt is defined under the Law on Public Debt (Official Gazette of the RM No. 62/05, 88/08, 35/11, 139/14 and 98/19) as the sum of government debt and 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.
[95] At the end of the second quarter of 2020, the total public debt equals Euro 6,527 million.
[96] Government debt is defined as a sum of debts of the central government, the public funds and the municipalities.
[97] According to the amendments to the Law on Public Debt from May 2019, the non-guaranteed debt of public companies and joint stock companies established by the state or municipalities, municipalities within the City of Skopje and the City of Skopje is calculated in the public debt (Official Gazette of the RM No. 62/05, 88/08, 35/11, 139/14 and 98/19).

VI. Macroeconomic forecasts and risks

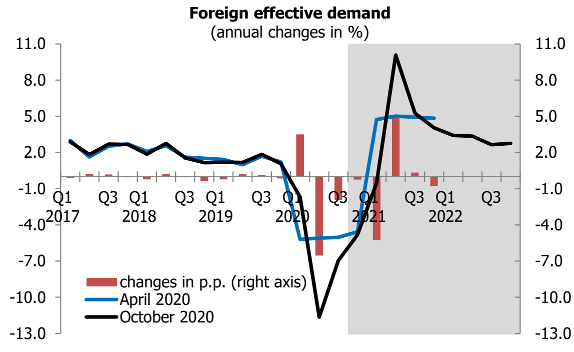
The October macroeconomic forecasts indicate deeper decline of the domestic economy in 2020 and moderate recovery in the next period compared to the April expectations. This is mainly a reflection of the ongoing development of the virus infection and the changed assumptions in terms of the duration of the health and economic crisis. The resurgence of the pandemic and the need for re-introduction of containment, yet less strict measures is a factor that significantly affects the prospects of both, global and domestic economy. The April forecasts included the assumptions for relatively fast pandemic management, gradual normalization as of the second half of 2020 and economic recovery in the following year. The new forecasting round assumes protracted health and economic crisis until mid-2021, followed by a period of normalization and gradual economic recovery.

In accordance with such assumptions, the estimates for the external environment were unfavorable, amid downward revision of the foreign demand in the period 2020-2021, which will probably have an adverse effect on the exports, remittances and foreign direct investments. Consequently, there are downward GDP revisions for the entire forecasting horizon, i.e. 2020 expects decline in GDP of 4.9%, followed by a gradual recovery and increase of 3.9% in 2021 and 3.6% in 2022 (decline of 3.5% in 2020 and increase of 4.7% and 4% in 2021 and 2022, respectively in April forecasts). The growth of the economy will continue in 2023, at a rate of 4%. There were no significant changes in terms of structure, i.e. this forecasting round expects a GDP decline in 2020 due to domestic demand, with a positive contribution from net exports, and in the following period, the recovery of the domestic demand will be crucial for the economic growth, amid negative contribution of net exports. **The inflation rate was revised upwards in 2020 relative to the April forecasts, thus expecting a price growth of 1.1% (0% in April), amid higher performances, primarily due to domestic factors and disruptions on the supply and demand side in conditions of pandemic and adjustments of import prices in a different direction. Given the** assessments for growth in import prices and moderate positive output gap in the following period, **gradual acceleration of the inflation rate is expected which will amount to 1.5% in 2021 and 2% in 2022- 2022, same as expected in the April forecasts. The assessments on the external sector movements point to moderate expansion of the current transactions deficit in 2020 to 3.7% of GDP, while in 2021, with the gradual weakening of the negative effects of the crisis, a deficit of 2.6% of GDP is expected. In the period 2022-2023, there are expectations for full exhaustion of the effects and stabilization of the current account deficit at an average level of 1.6% of GDP.** Throughout the forecast horizon, foreign reserves will remain appropriate.

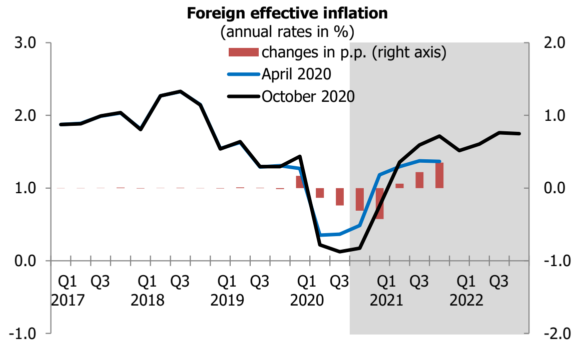
6.1. Underlying assumptions in the external environment forecast[98]

The latest estimates of the effective foreign demand[99] for 2020 and 2021 have been revised downward compared with the April forecasts. Thus, it is currently expected that the fall in the foreign effective demand in 2020 will equal 6.3% (decline of 5% in April), while in 2021 it is expected to recover and increase by 4.6% (4.9% in April). The downward revision for 2020 mostly results from the assessments for a deeper decline in almost all our partners especially Germany[100], Greece, Belgium and Italy, while for 2021, mainly from the expectations for weaker economic activity in Bulgaria and Serbia. Growth is expected to continue in 2022, with estimates for foreign demand growth of 3.0%.

Foreign effective inflation[101] was slightly revised downward for 2020, in relation to the April forecast, i.e. it is expected to equal 0.5% (0.6% in April), mostly due to the expectations for a lower inflation in Croatia[102]. On the other hand, growth of 1.4% is expected in 2021, which is a slight upward correction (1.3% April), mostly due to the expectations for increased price pressures in Germany. Growth is expected to intensify in 2022, with foreign inflation growth of 1.7%.



Source: Consensus forecasts and NBRNM calculations.



Source: Consensus forecasts and NBRNM calculations.

According to the latest forecasts on the euro/US dollar exchange rate for 2020 and 2021, there is a downward revision in relation to the April forecast. A depreciation of the US dollar is currently expected for both years, of 1.5% and 4.1% in 2020 and 2021, respectively (against the April forecast for appreciation of 1.1% in 2020 and slight depreciation of 1.9% in 2021). The revisions results from the investors' expectations for maintaining low interest rates in the US for a longer time period in accordance with the changes within the monetary policy conduct[103], and partly from the

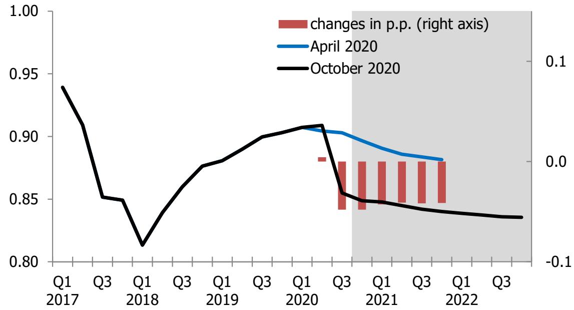
---

[98] 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 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.
[99] Foreign effective demand is calculated as the weighted sum of GDP indices of the major trading partners of the Republic of North Macedonia. The calculation of this index includes Germany, Greece, Italy, the Netherlands, Belgium, Spain, Serbia, Croatia, Slovenia and Bulgaria.
100 Forecast fall in Germany of 5.7% in 2020, versus 5% in April and forecast growth of 4.4% in 2021, similar to April (growth of 4.5%).
[101] 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 North 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.
[102] Inflation in Croatia has been adjusted for the changes in the exchange rate.
[103]On 27 August 2020, the FED announced an update of the long-term goals and the strategy for monetary policy conduct with the more significant changes including the following: 1) the maximum employment, where the decisions will be based on the assessments for downward deviations from the maximum level of employment, unlike the current practice for deviations from the maximum level in both directions; 2) the price stability, where FED has adjusted its strategy to reach the long-term goal-inflation

expectations for a greater fiscal stimulus in accordance with the US post-election policies. For 2022, the US dollar is expected to further depreciate against the euro, with a decline of 0.8%.

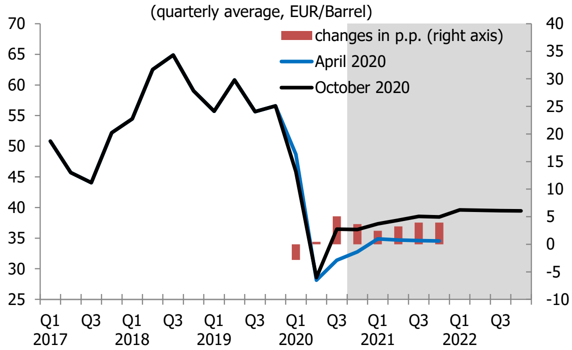
The latest assessments on oil price indicate a slight upward revision in relation to April. In 2020 the growth is currently expected to equal 35.6% (decline of 38.4% in April), while in 2022 a small growth of 3.4% is expected, instead of the projected fall of 1.6% in April. The upward revisions mostly result from the expectations for reduced oil production in the US and OPEC+ countries, which have extended the oil cut agreement on two occasions. In 2022 the estimates indicate further upward movement of the prices, expecting a growth of 3.8%.

EUR/USD exchange rate



Source: Consensus forecasts and NBRNM calculations.

Brent oil
(quarterly average, EUR/Barrel)

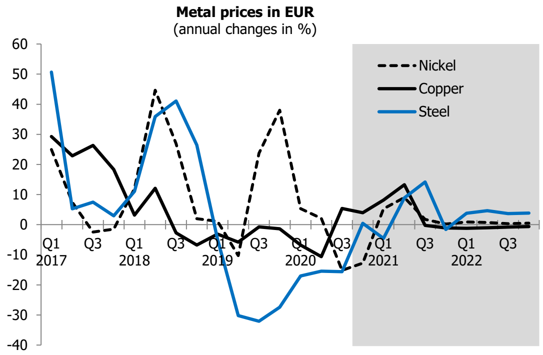


Source: IMF and NBRNM calculations.

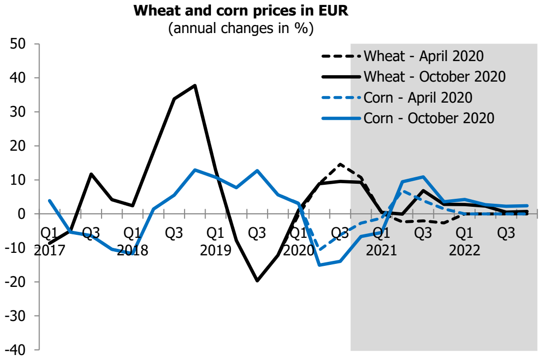
Metal prices were revised upwards for the entire forecast horizon compared to the April estimates. According to the latest assessments, a significantly smaller decline in nickel and copper prices is expected in 2020, as well as an increase instead of a decline in 2021. Such revisions in copper prices mostly result from the increase in the demand by China, as the largest consumer of copper, amid faster recovery of the Chinese economy from the crisis caused by the virus and the strong fiscal and monetary stimulus in the country, the reduction of global inventories and the concern over the production in part of the producing countries due to the pandemic. The revisions in the nickel prices are mainly related to the increased demand from the steel and electric car industry. In 2022, stabilization of metals prices and their maintenance at a relatively unchanged level is expected compared to the previous year.

Compared to the April forecasts, the current estimates for food prices have been revised downwards for 2020, while upwards for 2021. Thus, for 2020, there are expectations for slower growth of the wheat price and faster fall in the corn price compared to April. Such movements mostly result from the expectations for greater production of wheat in Australia, Europe and the Russian Federation and the expectations for a record-breaking global production of wheat, amid still weak demand, especially for industrial purposes. On the other hand, the current assessments for 2021 indicate an increase in the price of wheat instead of the previously projected decline and a faster increase in wheat price compared to April. For 2022, a small increase in stock exchange food prices is expected.

of 2%, thus trying to reach a 2% inflation in a certain point in time, i.e. after the periods when the inflation has always been below 2%, the monetary policy will aim at reaching inflation moderately above 2% in certain time period.

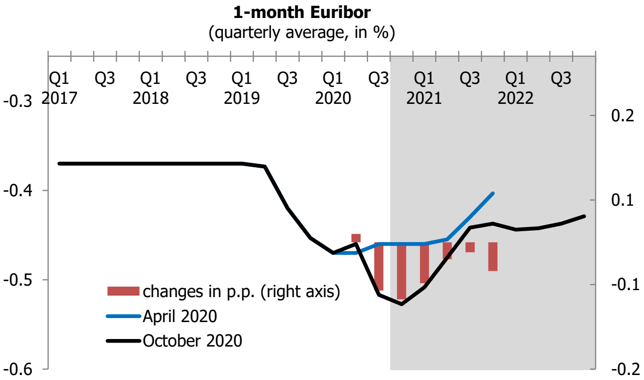


Source: IMF and NBRNM calculations.



Source: IMF and NBRNM calculations.

Minor downward revision has been made in **one-month Euribor interest rate** compared to April forecast, thus still expecting it to move in the negative zone for the entire forecasting horizon. Namely, it is now expected that the one-month Euribor would average -0.49% in 2020 (-0.47% in April) and -0.47% in 2021 (-0.44% in April). In conditions of negative inflation rates in the Euro area in August and September, such revisions mostly reflect the expectations that the ECB will increase the volume and will prolong the measure for purchasing assets for emergency economic support due to pandemics, that is scheduled to last until the middle of the following year. For 2022, the EURIBOR interest rate is expected to remain in the negative zone and will be -0.44%, on average.

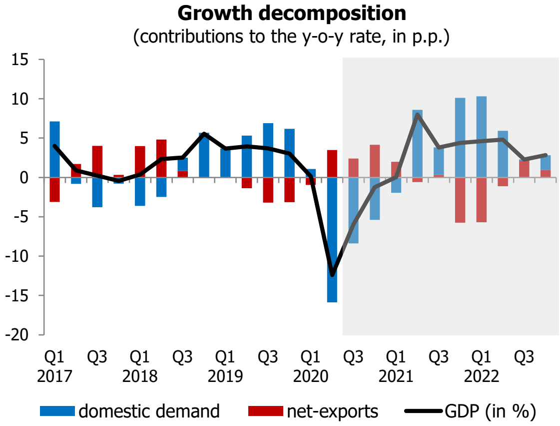


Source: Consensus forecasts and NBRNM calculations.

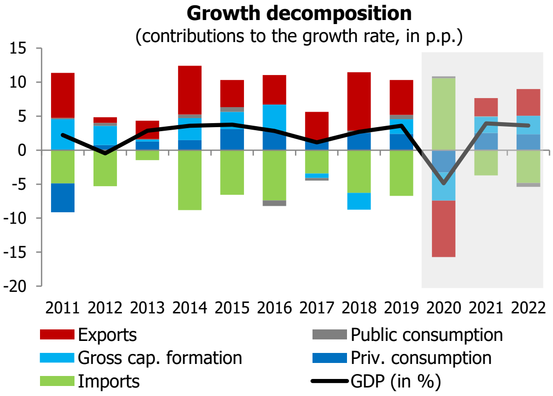
6.2. Forecast and effects on monetary policy

The October macroeconomic scenario of the Macedonian economy points to stronger adverse effects of the current health crisis and pronounced downward risks in relation to the April forecast, without major changes in the growth structure perceptions. Nonetheless, the latest forecasts still indicate stable external position of the economy and foreign reserves, which in the next period will be maintained at an appropriate level. *The prolonged uncertainty and the significantly reduced international movement of passengers due to the pandemic will adversely affect the inflows from remittances which will lead to major decrease in the surplus in this year's secondary income, as well as its slower recovery in the following period. On the other hand, the improvement of the trade balance in 2020 is expected, amid pronounce decrease in import demand, as a combined effect of the decrease in exports and decline in domestic demand, coupled with the strong decline in energy prices. In the following period, in line with the recovery of the domestic economy, greater import pressures and widening of the deficit are expected, which, however, will not disrupt the* *external equilibrium. Consequently,* ***a moderate worsening of the current account deficit is expected this year and its gradual tightening in the rest of the forecasting horizon.*** *Observing the entire forecasting round, the current account deficit will remain moderate and* ***mainly financed by the public sector borrowing and inflows from foreign direct investments. The latest assessment of foreign interest rate, as an important external factor for implementing domestic monetary policy, are similar to the April forecasts*** *i.e. the one-month Euribor interest rate will remain in the negative zone for the entire forecast horizon. Also, observing the ECB's policy setup, in conditions of reduced prospects for the future expected growth, in line with the fall wave of COVID-19 and decline in prices in the third quarter, the ECB is expected to take additional stimulus measures* ***aimed at creating liquidity in the system and supporting lending. Risks underlying the baseline macroeconomic scenario are still assessed as markedly downward and are almost entirely related to the COVID-19 pandemic.*** *Currently, the main downward risk is related to the potential reintroduction of restrictive measures to contain virus spread, in response to the current second wave of the pandemic, as well as any slower virus management than currently expected. Any materialization of these risks could lead to re-disruption of production chains and demand and to a significant slowdown in the expected pace of economic recovery, and thus to difficulties in the survival of companies and significantly worsened labor market.* ***On the other hand, faster progress in the coronavirus treatment, as well as the vaccine development are potential positive risks****. If the coronavirus threat is overcome faster than expected, enhanced confidence could significantly boost global and accordingly, domestic economy. Also, our country's NATO membership and the start of EU accession negotiations remain positive risks to the forecast, in the medium term.*

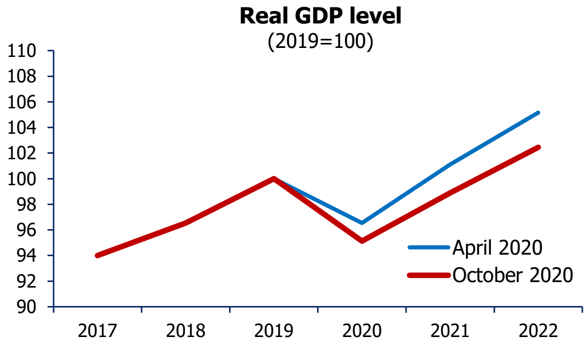
The health crisis and measures taken to prevent the virus spread and to protect the public health led to significant decrease in the economic activity in the domestic economy in the first half of 2020, of 6.3%. Moreover, the decline in this period entirely stems from the high negative contribution of the domestic demand, amid positive contribution of net exports. By components, the export is a component with the highest individual contribution to the GDP decline, amid decline in foreign demand and temporary disrupted global production chains and transport, which adversely affected the foreign export-oriented facilities, and to a lesser extent the traditional export sectors. Negative contribution to the GDP decline was made by the component of the domestic demand-private consumption and gross investments, given that the high uncertainty and the restraint from consumption and investments, the reduced private transfers and reduced dynamics in pubic investments, while the public consumption increased in line with the increased health care support. These movements in export and domestic demand led to a decline in imports, with a positive contribution of the net exports to the total GDP. The available high frequency data and estimates for the third quarter indicate a significant slowdown of the decline, in accordance with the temporary strength reduction of the pandemic and gradual reduction of the previously introduced containment measures. Given the worsening of the situation with the pandemic, the economy is expected to remain in the negative zone in the last quarter of the year, but with a further slowdown of the decline. Hence, **decline in the domestic economy of 4.9% is expected throughout 2020,** amid negative contribution of domestic demand and positive contribution of net exports. Moreover, as opposed to the April expectations for exhaustion of the negative effects of the health and economic crisis by the end of 2020 and rapid recovery in 2021, the basic assumption is that the resurgence of the fall pandemic wave will have protracted negative effects on the economy in the next year as well. In accordance with this assumption, the economic activity will be slightly weaker in the first half of 2021, with faster recovery in the second half, thus **expecting a growth of the economy of 3.9% for the entire 2021. Furthermore, 2022 and 2023 expect prolonged growth of the economy at rates of 3.6% and 4%, respectively.** Analyzing the growth structure, the domestic demand will be the driver of the growth, mainly due to the increase in household consumption and investment activity, while net exports will have a negative contribution. **In accordance with such projected growth trajectory for the next period, given the global expectations, the return of the economy to the pre-crisis level (i.e. the level of 2019) is expected in 2022.**



Source: SSO and NBRNM calculations.

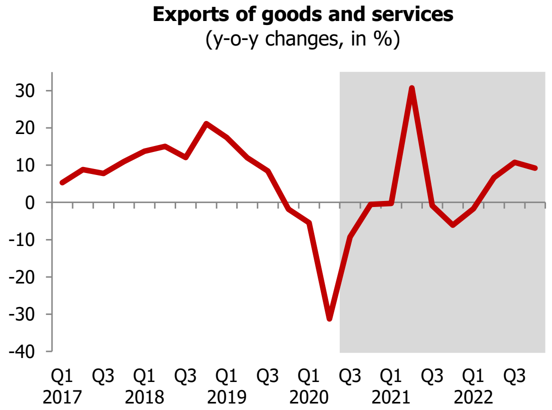


Source: SSO and NBRNM calculations.

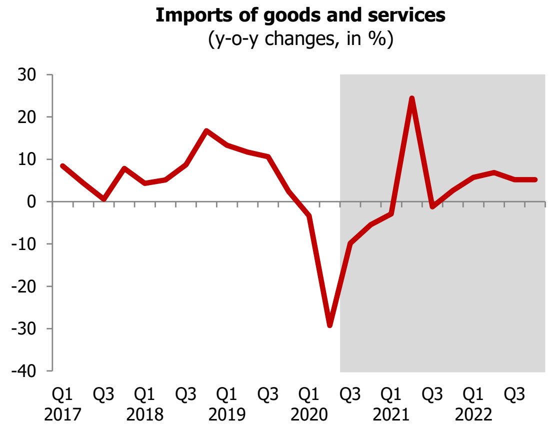


Source: State Statistical Office and NBRNM calculations.

Analyzed by individual GDP components, it is expected that the real export of goods and services will be one of the main factors for the economic contraction in 2020. The decline in export of goods and services which was registered in the first half will continue until the end of the year amid estimates for a decline in foreign demand and increased uncertainty due to the new fall pandemic wave, yet significantly weaker. Thus, it is estimated that the current export-oriented facilities, mainly in automotive industry, whose activity significantly decreased in the second quarter when part of them were temporarily closed, will gradually normalize the production, with a similar dynamics expected in the traditional export sectors. In the next two years, the exports is expected to gradually recover. With the recovery of the global supply chains and gradual exhaustion of the negative effects of the crisis, foreign export facilities are expected to further operate at full capacity. At the same time, increased export activity is expected in the traditional sector, amid recovery of the foreign effective demand and positive stimulus from the expectations for growth in metal prices. Hence, 2021 expects a moderate increase in exports and accelerated growth in 2022, whereby on a cumulative basis, the export would be a leading factor for the GDP growth in this period.



Source: SSO and NBRNM calculations.



Source: SSO and NBRNM calculations.

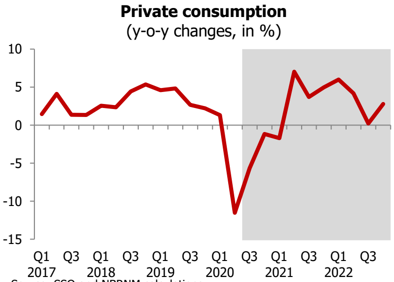
Decrease and negative contribution to GDP for 2020 is also expected in domestic demand. It is expected to partly recover in 2021, amid assumption for consumption and investments restraint in the first half of 2021. The forecasts assume normalization of the context and **further positive contribution of domestic demand in 2022.**

In terms of individual components of domestic demand, there are estimates for the highest negative contribution in 2020 from **gross investments**, amid decline in the first half, further risk aversion and restraint from new investments in private sector, weaker performance in public investments, decline in global economic activity and smaller inflows in foreign direct investments. On the other hand, in the period 2021-2022, a solid growth of gross investments is expected as well as their positive contribution to the GDP growth. Moreover, there are assumptions for intensive recovery of the investment activity from the second half of 2021, amid gradual increase in trust and expectations for increase in private investments, in line with the estimates for further increase in corporate lending, which includes government economic measures for favorable credit lines, enhanced government infrastructure projects, growth of foreign demand and exports and increased foreign direct investments.

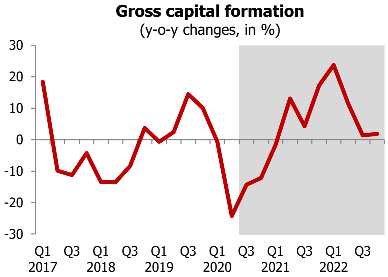
The great uncertainty around the pandemic during 2020 led to increased restraint from consumption and decline in **private consumption.** These effects are partly mitigated through the fiscal measures taken to support the economy and the consumption, as well as through the changes in central bank policy aimed at supporting credit flows and liquidity. Hence, in 2020 almost all factors of available income, except private transfers, would remain in the positive area, which in part is a second-round effect from the discretionary measures for wage increase in part of the public sector employees and increase in pensions, towards the end of 2019 and the beginning of 2020. At the same time, 2020 expects further increase in household lending in line with the favorable financial conditions, in accordance with the National Bank measures for mitigating the adverse pandemic effects. In 2021 there are expectations for partial recovery of the household consumptions, thus the uncertainty caused by the resurgence of the pandemic and the restraint from consumption would remain until the middle of the year, followed by a period of normalization and recovery. Hence, in the period 2021-2022 there are forecasts for solid growth rates of private consumption, with expectations for higher propensity for consumption, amid increase in disposable income and further credit support by banks. The strengthening of the economic activity leads to moderate positive movements in the number of employees, wages and pensions, as well as a significant increase in private transfers, in accordance with the global growth recovery and reduced restrictions.

In terms of public consumption[104], it expects a growth in 2020, in line with the increased consumption arising from the current health crisis and gradual consolidation of expenses in the period 2021-2022, which assumes their minor increase in 2021 and a decline in 2022. Hence, their aggregate effect on the economic activity in the forecasting horizon will be slightly negative

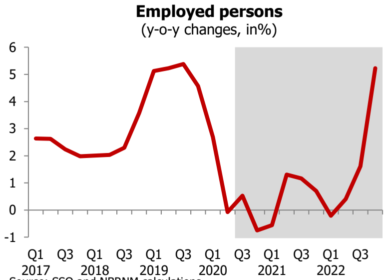
Amid decline in exports and domestic demand, 2020 expects significant decline in **import demand.** Thus, 2020 expects positive contribution in GDP rate from net exports. In the next two years, given the dynamics of the export recovery, as well as the increase in domestic demand, moderate increase in import demand is expected in 2021 and slightly accelerated growth in 2022, so that net exports will have a negative contribution in the total growth in the period 2021-2022.



Source: SSO and NBRNM calculations.

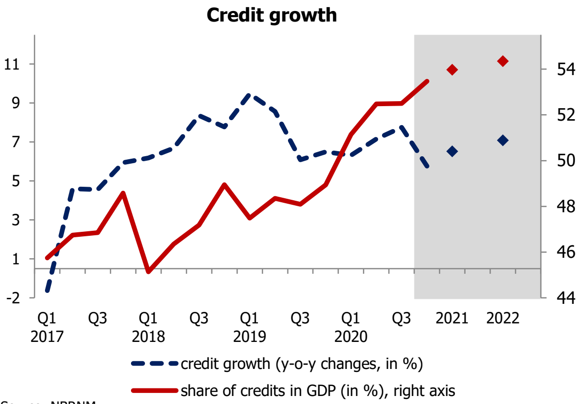


Source: SSO and NBRNM calculations.



Source: SSO and NBRNM calculations.

The latest credit market assessments in the forecast horizon point to solid credit activity in 2020 and moderate acceleration of growth rates in the next three years. The solid growth of loans in the first three quarters, supported by the measures taken by the National Bank to mitigate the adverse effects on the economy caused by the COVID-19 pandemic, is expected to continue until the end of the year. Thus, it is estimated that at the end of 2020 the growth rate of loans will amount to 5.3% (6% at the end of 2019). The next three years expect gradual stabilization of the lending activity, at an average rate of 6.3% in the period 2021 - 2022 and 7.6% in 2023, amid growth in the domestic economy, stabilization of the expectations and increased demand for household and corporate loans. The restraint from consumption and investments in 2020 and the taken economic measures to increase companies' liquidity and to support the household income retained the positive movements in deposits, which for the entire 2020 would increase by 4.4% (9% in 2019). The economic recovery expectations in the upcoming period will result in growth of the deposit base at faster rates of about 6.9% on average in 2021-2022 and additional 8.2% in 2023.



Source: NBRNM.

[104]The public consumption forecasts are based on information from the second Budget revision for 2020 from November 2020, the draft-Budget for 2021 and the Fiscal Strategy 2021-2023 from July 2020 coupled with information from the Ministry of Finance about the long-term fiscal consolidation trajectory for 2021-2025, from November 2020.

The current account deficit in 2020 would moderately expand by 0.4 percentage points of GDP, to the level of 3.7% of GDP, which is entirely due to the worsened expectations for the current transfers. The restrictive measures to prevent the virus spread have significantly reduced the international movement of passengers, which coupled with the prolonged uncertainty led to reduced remittances sent through informal channels. However, this effect was partly mitigated by redirecting the transfer of these remittances through formal channels. On the other hand, the goods and services balance will improve the current account deficit, due to more favorable expectations for both trade deficit and trade balance of services. The foreign trade expects downward adjustment on both export and import side and narrowing of the trade deficit. These downward adjustment are expected amid negative pressures on exports by reduced foreign demand and temporary disrupted production chains, as well as due to the adequate reduction of the import demand, coupled with lower import pressures of the decline in domestic demand as well as the lower crude oil prices in the world market. The significant downward correction of the energy prices, as well as the lower consumption due to the reduced movement of passengers, and the reduced economic activity would cause significant tightening of the energy deficit, amid slight non-energy balance widening. The primary income forecasts show deficit tightening, in accordance with the expected worsening of the performance domestic companies with foreign capital, amid pronounced uncertainty and worsened economic environment. The trade surplus is expected to improve, which is due to the more pronounced downward adjustment in imports against the downward adjustment in exports of services. **In the following year, 2021, the forecasts show improved current account deficit by 1.1 percentage points of GDP which would equal 2.6% of GDP.** The gradual exhaustion of effects from the pandemic would increase the secondary income surplus, amid partial stabilization of the situation and partial recovery of the global and domestic economy. The trade deficit is expected to expand, amid higher import pressures, due to the recovery of the domestic economy, as well as due to the import of raw materials of the export sector, which would increase in 2021. The higher import pressures would lead to certain deterioration in the balance of services, while the expected increase in the newly created value of foreign companies in domestic economy would cause widening of the primary income deficit. **It is expected that the current transactions deficit in the period 2020 - 2021 will be mostly financed through long-term government borrowing**, namely by Eurobond and long-term loans from international financial institutions, **as well as by foreign direct investments**. On the other hand, given the pronounced uncertainty and slower stabilization of expectations and confidence, net outflow in currencies and deposits is expected. **For the period 2022-2023, the current account deficit would additionally tighten and average 1.6% of GDP,** amid full exhaustion of pandemic risks, stabilization of the situation globally and recovery of the domestic economy, amid further improvement in the secondary income and stabilization in the goods and services balance. **Public sector debt, as well as inflows from foreign direct investment** are considered the main sources of financing the current account deficit, while their volume would enable additional growth of the foreign reserves. **Throughout the forecast horizon, foreign reserves are expected to remain appropriate.**

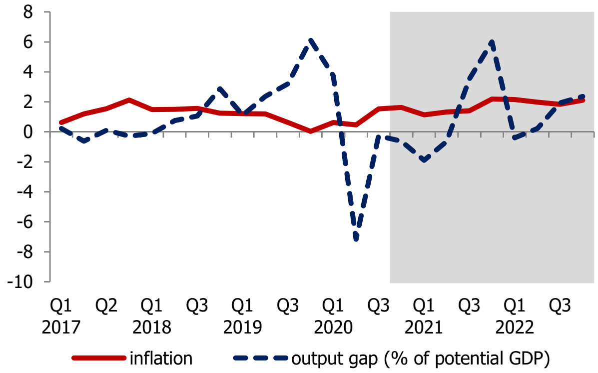
Balance of Payment forecast (% of GDP)

	2015	2016	2017	2018	2019	2020	2021	2022	2023
Current account	**-2.0**	**-2.9**	**-1.0**	**-0.1**	**-3.3**	**-3.7**	**-2.6**	**-1.7**	**-1.5**
Balance of goods & services	-16.2	-15.2	-14.1	-12.8	-14.3	-12.9	-13.3	-13.0	-12.9
Goods, net	-20.1	-18.8	-17.8	-16.2	-17.4	-16.4	-16.6	-16.4	-16.3
Services, net	3.8	3.5	3.7	3.5	3.1	3.5	3.3	3.4	3.4
Primary income, net	-3.2	-4.0	-4.0	-4.2	-4.6	-3.2	-3.3	-3.6	-4.0
Secondary income, net	17.4	16.4	17.0	16.9	15.6	12.5	14.0	14.9	15.3
Private sector, net	16.9	15.4	15.9	15.9	15.2	11.7	13.4	14.3	14.7
Capital account	**0.1**	**0.1**	**0.2**	**0.1**	**0.1**	**0.0**	**0.0**	**0.0**	**0.0**
Financial account	**0.1**	**-6.3**	**0.5**	**-5.0**	**-6.0**	**-3.2**	**-3.1**	**-3.3**	**-3.9**
FDI, net	-2.2	-3.3	-1.8	-5.6	-3.2	-1.6	-3.0	-3.3	-3.5
Portfolio Investment, net	-0.7	-4.4	0.2	-3.0	1.3	-2.6	-0.4	0.4	0.0
Other Investment, net	3.1	1.4	2.1	3.6	-4.1	1.0	0.3	-0.4	-0.4

Source: NBRNM.

It is assessed that the average inflation rate for the entire 2020 would equal 1.1% (0.8% in 2019), amid increase in food component prices and core inflation, and shifts on both demand and supply side for certain market segments due to the pandemics. The price of the energy component will have a negative contribution amid sharp decline in world oil prices, an effect which is partially neutralized by increased excise for certain oil derivatives and increase in energy prices in the domestic economy. In the following two-year period, the import prices will grow, positively affecting the domestic inflation, while on the demand side there are no expectations for stronger pressures given the moderately positive, on average, output gap. Hence, a positive contribution of all three components is expected in 2021, so the **inflation rate in 2021 will accelerate and amount to 1.5%. In 2022, further acceleration is expected, at the amount of 2%, maintaining the same price growth in 2023 as well.** Main risk to the inflation forecast remains associated with exceptionally high uncertainty about the future dynamics of the primary commodities market prices, especially oil, as well as the uncertainty about the future global economic growth caused by the health and economic crisis and the effect on the prices of primary commodities on the one hand and the limit on supply due to the restrictive measures, on the other hand.

Inflation
(y-o-y changes, in %)



Source: SSO and NBRNM calculations.

6.3. Comparison with the previous forecast

The latest macroeconomic projections have suffered significant changes in relation to April cycle. Thus, the economic growth forecast in the period 2020-2022 was revised downward compared to April, reflecting the lower performances and estimates for prolonged negative effects of the pandemic in the following period. In terms of price movements, there is an upward revision for 2022 in the inflation rate mainly due to the higher performances in domestic food and energy prices, while the forecast for 2021 and 2022 remains unchanged compared to April. The prolonged COVID-19 effects would lead to moderately higher average current account deficit in the period 2020-2022, compared to the April forecast, which is due to the worsened expectations for secondary income surplus, while the current forecast of the average primary income deficit is lower. In terms of goods and services balance, there are improved expectations in services at the expense of the higher trade deficit in goods, thus the aggregate expectations in three years have not been changed significantly compared to April.

Forecast of selected macroeconomic variables

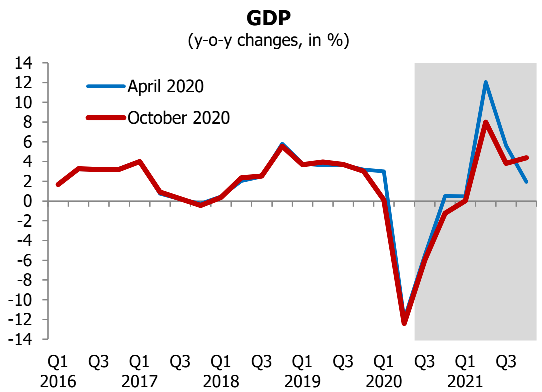
	2020 forecast		2021 forecast		2022 forecast
	Apr.	Oct.	Apr.	Oct.	Oct.
GDP, %	**-3.5**	**-4.9**	**4.7**	**3.9**	**3.6**
Private consumption	-4.3	-4.3	6.1	3.4	3.3
Gross capital formation	-10.4	-12.8	9.8	8.1	9.1
Public consumption	6.6	2.2	-1.5	0.8	-3.8
Exports of goods and services	-17.1	-11.7	25.0	4.1	6.1
Imports of goods and services	-15.4	-11.9	21.6	4.5	5.7
Inflation	**0.0**	**1.1**	**1.5**	**1.5**	**2.0**
Current account deficit, % of GDP	**-3.2**	**-3.7**	**-1.8**	**-2.6**	**-1.7**

Source: NBRNM.

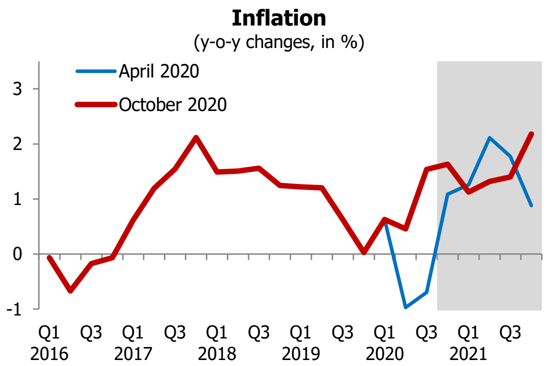
The emergence of the autumn wave of the new COVID-19 virus string both globally and domestically led to a deterioration of the prospects for the Macedonian economy compared to the April forecasts. Unlike in April, when a gradual overcoming of the health crisis was expected by the end of this year, it is now estimated that the negative economic effects will remain in the first half of 2021. **This assumption, together with the weaker performances in the first half of the year, led to a downward revision of the GDP forecast for 2020, thus expecting a decline of 4.9%, against 3.5% in April. Also, this forecasting round registered a downward revision of the estimates for the domestic economy growth in the medium run, from 4.7% to 3.9% for 2021 and from 4% to 3.6% for 2022.** However, observed cumulatively, there were no significant corrections in terms of the GDP structure, except in the intensity of the changes. Thus, the domestic demand is still expected to be the main driver of the GDP decline in 2020, with a more negative contribution compared with April. This is mainly due to the larger downward correction in the decline rate of gross investments, amid slower realization of the planned public investments and prolonged adverse effects of the crisis on the trust of the private sector investors. On the basis of weaker performances in the first three quarters and the new data from the second Budget revision, downward adjustment for this year has been made in both growth rate and the positive contribution of public consumption. On the other hand, the estimate for the private consumption in 2020 has not been changed and would have a negative contribution to the GDP decline similar to the April forecasts, which amid mostly upward shifts in its major determinants (except private transfers), indicates greater restraint of households from consumption due to the increased uncertainty caused by the pandemic.

Observing the components of net export demand, compared to the previous forecast, lower decrease in the real export of goods and services in 2020 is currently expected, given the faster recovery and better performance than expected in both the new export-oriented companies and part of the traditional sector. In accordance with the estimated export dynamics, moderate upward revision was made in the decline rate of the real import of goods and services this year. Observed on net basis, the larger upward correction in exports against the imports will lead to slightly larger positive contribution of net exports to the annual GDP growth for 2020 compared to April, which would partly make up for the larger negative contribution of domestic demand.

According to the assumption for prolonged negative effects of the global pandemic in 2021, moderate recovery of the domestic demand is expected, and consequently its slight positive contribution to the GDP growth compared to April. In such unfavorable conditions, major revision was made in private consumption which would achieve lower growth rate making its positive contribution to the GDP growth smaller compared to the previous forecast. At the same time, the estimate for increase in gross investments has been revised downward, which caused minimal downward changes in the estimated positive contribution of this component to overall growth. On the other hand, the latest assumptions on public consumption indicate moderate consolidation, i.e. its minor increase, as opposed to the April forecast for a slight decline, thus it will support the economy next year as well. In terms of the external sector, the growth of the real import and real export of goods and services in 2021 have been revised downward, reflecting the expectations for lower foreign effective demand, as well as moderate pressures from domestic demand, and thus their moderate recovery during the forecast horizon. The net exports will make a minor negative contribution to GDP growth, compared to the April forecast, on net basis.

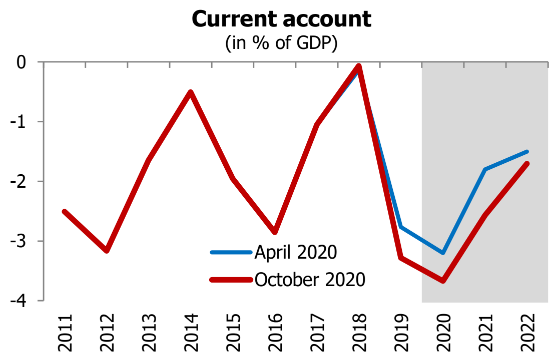


Source: SSO and NBRNM calculations.



Source: SSO and NBRNM calculations.

The inflation rate forecast for 2020 has been revised upwards, and it is now expected to be 1.1%, versus 0% in April. The upward correction was primarily due to domestic factors, which led to higher inflation in the first three quarters of the year, as opposed to the similar movements in foreign effective inflation and divergent corrections in import prices, compared to April. Upward revisions were registered in all inflation components, out of which the most important is the revision of the food inflation growth, mainly due to the higher price performances caused by certain disruptions on the side of supply and demand in a pandemic environment. The energy component also suffered a significant upward revision, with a slight decline, reflecting the effect of the increase in the electricity price in the third quarter (evident in the current higher performance), increase in the excise for certain oil derivatives in the beginning of the year, as well as the estimates for lower annual decline in oil prices on the world markets compared to April. At the same time, the core inflation has been revised slightly upward. On the other hand, the inflation rate forecast in 2021 remained unchanged, at 1.5%. Observed by component, upward correction was noted in energy inflation, amid positive second-round effects from the last year and growth estimates, instead of a decline in the global oil prices. In contrast to this, the food and core inflation forecasts in the following year have been revised downward compared to April.



Source: NBRNM.

The latest October forecast indicates a slightly higher current account deficit for the period 2020 - 2022 compared to the expectations in April, namely 2.6% of GDP compared to the share of 2.1% in GDP according to the April forecast. **There are more pronounces change in the expectations for 2020**

and 2021, while the expectations for 2022 remain close to the April forecast. The correction for 2020 amounted to 0.5 percentage points of GDP, while the expectations for the current account deficit for 2021 are higher by 0.8 percentage points of GDP, due to the changed environment and protracted COVID-19 pandemic which will probably continue in the next year, against the expectations for depletion of the negative effect of the virus spread in 2021 in accordance with the April forecasts. The changed expectations are due to the lower projected secondary income surplus, amid lower informal remittances in both years. In terms of the trade deficit, the change in 2020 refers to a slightly deeper deficit, while for 2021 the expectations have not been significantly corrected. In terms of the components, higher deficit in non-energy balance has been projected for both years, amid slight downward correction in energy component. The expectations for the export activity in the current year are more favorable in relation to April, amid significantly lower decline in exports compared to April, with a more moderate recovery for the next years. There is a corresponding correction in the import of goods in both years, with moderate downward movements in 2020 and slight import pressures in 2021. On the other hand, there are more favorable shifts in the surplus of services compared to the April forecast in accordance with the improved performance and more pronounced downward adjustment in the import of services, so we are expecting higher net inflows in this category in the next three years. **For 2022, the current account deficit is forecast to slightly increase by 0.2 percentage points of GDP compared to the April forecasts. Analyzing financial flows, lower net inflows are expected for 2020-2022 cumulatively, compared to the April forecast.** The changes arise from the higher outflows in short-term categories, namely in currencies and deposits and from the slight downward correction in foreign direct investments in 2021 and 2022, due to the slower depletion of pandemic effects and adequately increased uncertainly. On the other hand, the current assessments indicate higher external government borrowing in 2020 and 2021, in order to provide necessary funds to deal with the long-term effects of the health and economic crisis.

Comparison of GDP and inflation forecasts for North Macedonia from various organisations

Organisation	Month of publication	Real GDP growth, %			Inflation (average rate, %)		
		2020	2021	2022	2020	2021	2022
IMF	October 2020	-5.4	5.5	4.5	0.9	1.3	1.6
World Bank	October 2020	-4.1	3.6	3.5	0.5	1.6	2.0
European Commission	November 2020	-4.9	3.8	3.5	0.9	1.2	1.5
EBRD	September 2020	-5.0	3.0	-	-	-	-
Consensus Forecast	October 2020	-5.1	4.7	-	0.6	1.8	-
Ministry of Finance	November 2020	-4.4	4.1	4.6	1.0	1.5	-
National Bank of the Republic of North Macedonia	October 2020	-4.9	3.9	3.6	1.1	1.5	2.0

Source: IMF, World Economic Outlook, October 2020; World Bank, Western Balkans Regular Economic Report No.18, Fall 2020; European Commission European Economic Forecast, Autumn 2020; EBRD Regional Economic Prospects, September 2020; Consensus Forecast, October 2020; Ministry of Finance, 2020 2nd Budget revision, November 2020 and 2021 Draft Budget, November 2020; and the National Bank of the Republic of North Macedonia.

Alternative macroeconomic scenario

The resurgence of the COVID-19 pandemic and need for reintroduction of stricter containment measures were assessed as high-risk by all international institutions in the latest global growth reports. Since mid-October this risk has started to partly materialize, both in the country and globally, given the resurgence of the virus spread, yet for now without announcements for introduction of restrictive measures such as in the second quarter. The focus is mainly on the measures aimed at sectors with greater social interaction, to protect public health, on the one hand, and minimizing the adverse effects on the economic activity, on the other. However, any slower virus management than currently expected can lead to negative spillovers on other sectors of the economy which are not directly affected by the announced restrictive measures. Also, the increased number of infected and isolated persons, could create pressure on the companies' normal operations, which amid fiscal tightening, would increase the probability of insolvency and closing businesses, with long-term adverse effect on the labor market as well. The international mobility of the population would be hampered for a longer period, maybe strictly limited, while the uncertainty and the restraint of the economic agents would be more pronounced.

Hence**, the alternative scenario related to the current cycle of macroeconomic forecasts assumes significant adverse effects of the fall pandemic wave on the foreign effective demand, smaller inflows of informal remittances and foreign direct investments, more pronounced restraint of domestic economic agents in conditions of longer-term uncertainty, as well as prolonged, pronounced adverse effects on the labor market, compared with the baseline scenario for the period 2021 - 2022**.

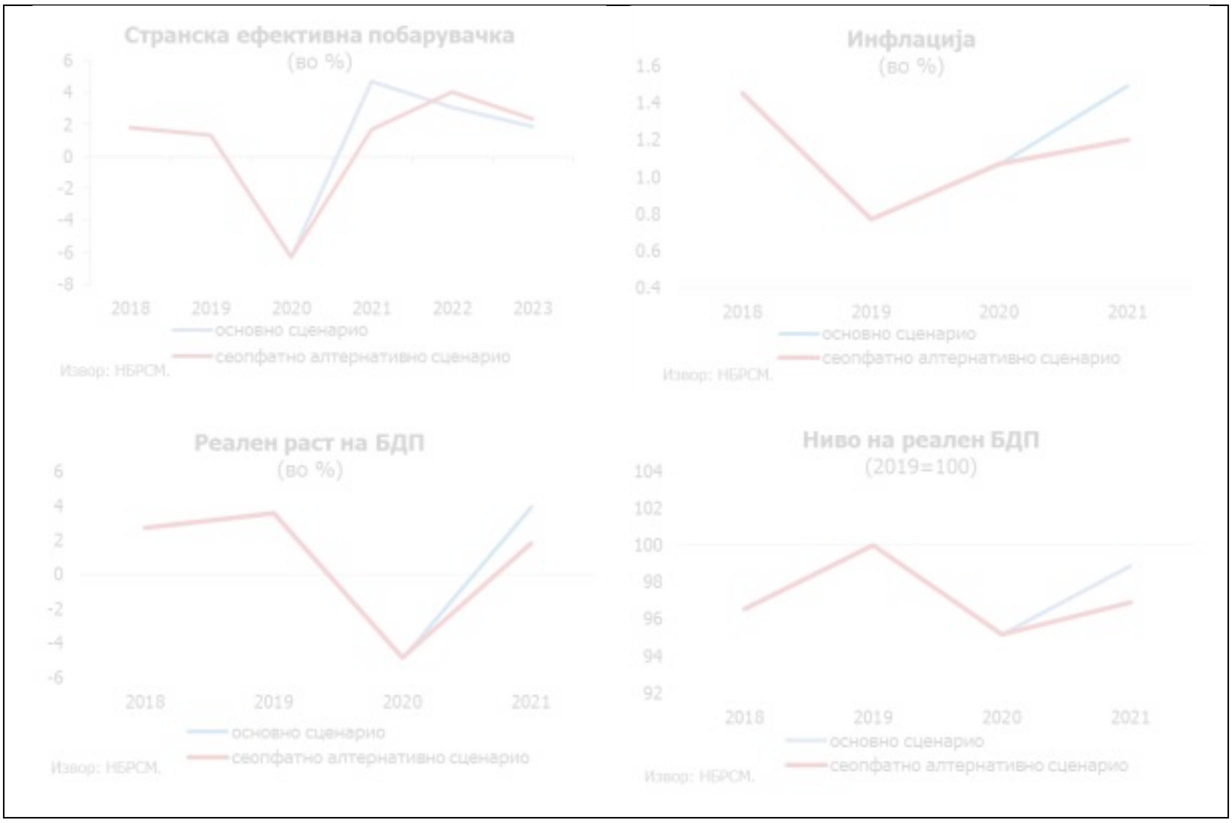
The possible restrictions to deal with the virus spread will worsen the outlook of the economic recovery pace, putting the global trade and the global production chains under fire again, which would adversely affect the foreign demand for Macedonian export products. In order to encompass this effect, the effects on the global growth assessed by the IMF[105] were taken into account within their pessimistic alternative scenario, i.e. smaller growth of foreign effective demand is assumed by 3 percentage points in 2021 and higher growth by 1 and 5 percentage points for 2022 and 2023, respectively. The downward correction in the foreign effective demand in 2021 would have a direct negative effect on exports, as well as on foreign direct investments and total investment activity. **The estimated direct effect of the lower foreign demand on total GDP indicates weaker economic growth by around 1 percentage point in 2021, compared to the increase in the baseline scenario.**

Of course, despite the direct effect of the weaker foreign demand, the worsened prospects and increased uncertainty may affect the domestic demand, through greater restraint from consumption and investments (domestic and foreign), and through labor market it may also affect the disposable income. Thus, the alternative scenario additionally assumes stagnation of employees and real wages in 2021 and slower recovery in 2022, compared to the slight growth in both years in the baseline scenario. The weaker global economic activity, especially in Europe, as well as the prolonged restrictions in terms of traveling would also hamper the recovery of foreign remittances, which assumes stagnation of net inflows from private transfers in 2021 (as a percentage of GDP) and gradual recovery in 2022, and the same assumption also refers to the level of foreign direct investments.

If all aforementioned assumptions are realized, one can expect slower recovery of the domestic economy in 2021, i.e. slower economic growth by around 2 percentage points compared with the baseline scenario, amid lower positive contribution from private consumption, investments and especially exports of goods and services, partially neutralized by the smaller negative contribution of imports. Hence, the **smaller GDP growth in the alternative scenario will result from the smaller positive contribution of domestic demand, while net exports will make a smaller negative contribution.**

Amid unchanged assumptions for world commodity prices, and estimated negative output gap, **the pressures on inflation will be more moderate, while the inflation rate slightly lower in 2021, compared to the baseline scenario.**

[105] World Economic Outlook, October 2020.


Странска ефективна побарувачка
(во %)
6
4
2
0
-2
-4
-6
-8
2018
2019
2020
2021
2022
2023
основно сценарио
сеопфатно алтернативно сценарио
Извор: НБРСМ.
Инфлација
(во %)
1.6
1.4
1.2
1.0
0.8
0.6
0.4
2018
2019
2020
2021
основно сценарио
сеопфатно алтернативно сценарио
Извор: НБРСМ.
Реален раст на БДП
(во %)
6
4
2
0
-2
-4
-6
2018
2019
2020
2021
основно сценарио
сеопфатно алтернативно сценарио
Извор: НБРСМ.
Ниво на реален БДП
(2019=100)
104
102
100
98
96
94
92
2018
2019
2020
2021
основно сценарио
сеопфатно алтернативно сценарио
Извор: НБРСМ.