

National Bank of the Republic of Macedonia



**Quarterly Report
August 2018**



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Introduction

After easing the monetary policy at the end of the first quarter, the National Bank kept the key interest rate at 3.00% in the second quarter of 2018. The current monetary setup was assessed as appropriate to the existing economic and financial conditions, given the sound economic fundamentals and the absence of imbalances in the economy. During the second quarter of the year, the movements on the foreign exchange market were favorable, with the National Bank continuing to intervene with net purchase of foreign currency from the market makers. Foreign reserves grew in the second quarter as well, and according to all adequacy indicators, they are still maintained in the safe zone. Favorable shifts were also registered in the banks' deposit base, which in this period¹ continued to grow at an accelerated pace and exceeded the April forecasts.

Regarding the sources of risks, no major changes compared to the April perceptions were registered. However, the risks from the external environment during the quarter were assessed as somewhat less favorable. This, above all, refers to the latest assessments of the effects on the global economic growth from the growing global trade protectionism and the intensified growth of oil prices on the world stock markets. These risks are further highlighted by the growing political and geopolitical problems in many regions of the world, as well as the effects of the uncertainty about the pace of normalization of the monetary policy of central banks in developed countries. **Risks related to the domestic environment were assessed as less pronounced compared to the previous period.**

The comparison of the latest macroeconomic indicators of the domestic economy with their forecasted dynamics within the April forecasting round showed some deviations. This primarily refers to the economic activity, given the initial data on GDP in the first quarter of 2018 for a minimum economic growth of 0.1%, which is below the forecasted trend. The deviation is a reflection of the slower growth of the domestic consumption and the larger decline in the investments, in conditions of temporarily slowed realization of public infrastructure investments. However, the contribution of net export demand is positive and slightly more favorable than expected. Export of goods and services remained the component with the highest individual positive contribution to growth, driven mainly by the activity of industrial capacities with foreign capital. The data available for the second quarter are not numerous and are divergent at the same time, but mainly indicate a slightly more favorable situation in the economy compared to the first quarter. On an annual basis, the April forecast predicted economic growth of 3.2% in 2018 and 3.5% in 2019. In addition to the export and private consumption growth, one of the key assumptions built into the forecast is the revival of investment activities, including the revitalization of public projects mainly related to road infrastructure. However, the performances in the first quarter of the year create downward risks for the forecasted growth for the whole of 2018.

In the second quarter of the year, the **inflation rate** averaged 1.5% on an annual basis, mostly due to the growth of core inflation, but the food and energy components also made a positive contribution. Inflation in this period was below the expectations for the quarter within the April forecast. Observed by components, the deviation is mostly related to the lower growth of the food component compared to the forecast, while the growth of the energy component and core inflation are generally in line with the expectations. In conditions of lower than forecasted performances and a simultaneous upward revision of the expectations for import prices, for now it is estimated that the risks of 2% around the inflation forecast for 2018 are balanced. However, the uncertainty about the future path of the movement of world prices of primary products and oil prices, above all, remains highlighted.

External sector data, viewed through the balance of payments position, indicate an absence of imbalances and a relatively favorable external position of the economy. In the first quarter, the current account deficit remained relatively low, at 1.4% of GDP. These performances were slightly higher compared to the April forecast, reflecting a higher than expected deficit in the foreign trade. On the other hand, the net inflows within the financial account reached 4% of GDP, which is a more favorable performance compared to the April forecasts, in conditions of significant positive deviations in foreign direct investment and long-term and short-term loans. Compared to the same period of the previous year, the current account

¹ Refers to the monetary data in the period April-May, as data available in the period of monetary decision-making during the second quarter of the year.



deficit remained almost unchanged, in conditions of slightly higher trade deficit and small unfavorable shifts in primary income, but with positive movements in the balances of secondary income and services. The realized net inflows in the financial account are higher on an annual basis, due to the higher net inflows based on portfolio investments, due to the issuance of the sixth Eurobond by the government and the higher direct investments. The latest data on the **gross foreign reserves** for the second quarter indicate quarterly growth, amid favorable movements on the foreign exchange market and net purchase of foreign currency by the NBRM. Moreover, the data available on the second quarter for the external sector are still not enough to be able to draw more specific conclusions about the balance of payments position in the second quarter and the deviations from the forecast for this period.

The credit activity of the banking sector has increased during the second quarter of the year, with the households sector making a larger contribution to the growth of the activity on the credit market. However, during the second quarter, the lending to the corporate sector was also solid and made a high contribution to the quarterly change in the activity on the credit market. On an annual basis, credit growth at the end of the second quarter reached 6.3% and exceeded the expectations of the April forecast (4.1%). The performances on the credit market in the second quarter of the year are generally in line with the results of the Bank Lending Survey². Namely, in terms of demand, the results of the Survey indicate further growth in the demand for loans by the corporate sector, amid a simultaneous reduced interest in loans by the household sector. In terms of supply, the Survey shows further moderate easing of the credit conditions, with the increased competition in the banking sector, as well as the sound solvency and liquidity position of banks still being factors that have a favorable impact on the lending conditions. Additionally, as a factor directed towards further easing of the credit conditions in this quarter, the expectations for more favorable movements of the economic activity in the second quarter are also pointed out. Regarding the sources of financing, **accelerated growth of the deposit base** was registered in the second quarter, whereby the annual growth of total deposits at the end of June reached 10.5%, which is also above the forecast (of 7.4%). The acceleration of the growth of deposits in the second quarter stems from corporate deposits, with a further positive contribution of household deposits. The positive trends in the banks' deposit base are expected to continue in the next period, providing stable sources of financing to the credit growth, which according to the April forecast, would range between 6.5% and 7.7% in the next two years.

All in all, despite the fact that the latest macroeconomic indicators and assessments in certain segments indicate certain deviations from the forecasted dynamics, they do not cause major changes in the perceptions of the environment in which the monetary policy is implemented. The domestic economy is expected to continue to be supported by the banks' lending activity, in the absence of inflationary pressures and maintaining a favorable external position, which will enable the maintenance of the foreign reserves in a safe zone. Downward risks for achieving the forecasted economic growth exist, and the future achievements in this segment will largely depend on the further dynamics of the activity of major infrastructure projects. The NBRM will continue to closely monitor the situation and the developments in the domestic economy and in the external environment in particular, as a source of potential risks, in order to timely and adequately adjust the monetary policy to successfully achieve the monetary goals.

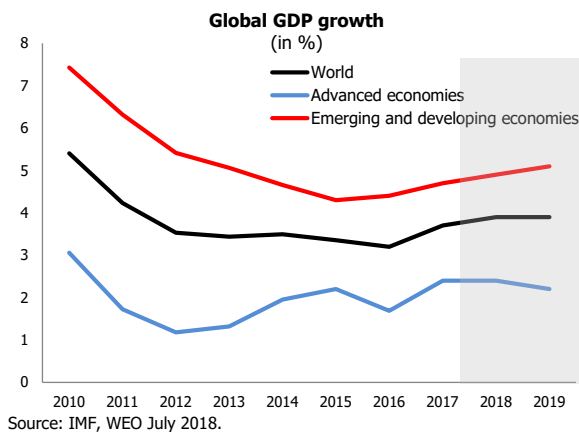
² Bank Lending Survey, July 2018



I. Macroeconomic developments

1.1. International economic surrounding³

Global economy's growth continued in the first quarter of 2018, supported by favorable performance in both developed and developing countries. Acceleration of economic activity is observed in the United States and it is expected that the announced expansionary fiscal policy will further stimulate the US economy in the coming period. In the euro area, a solid growth rate of 2.5% was registered, which is still a slight slowdown in the dynamics compared to the previous quarter. However, a gradual slowdown in global economic activity is expected in the medium term, and risks remain generally unfavorable and are related to the growing trade protectionism, the possible tightening of global financial conditions, the reforms in China, and the possible consequences of the Brexit. In the first quarter, there was some slowdown in inflation at global level, largely due to lower inflation rates in the emerging economies. In contrast, the rise in oil prices in the coming period and the growing utilization of economic capacities in most countries are expected to accelerate global inflation.



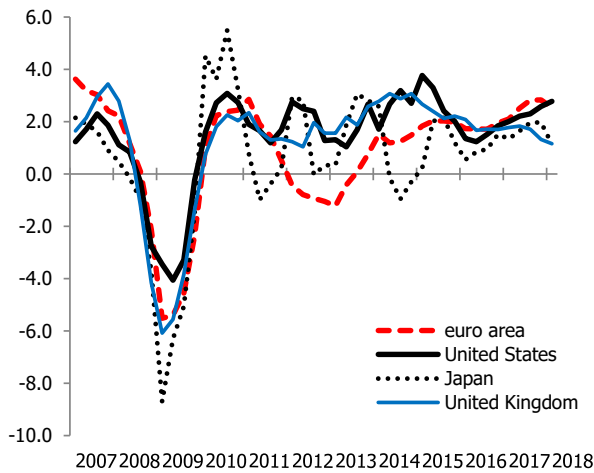
The global economy registered solid performance in the first quarter of 2018.

Solid growth rates were observed in both developed and developing countries. In the first quarter of 2018, within the euro area, the annual real GDP growth rate was 2.5%, which is a slight slowdown compared to the growth of 2.8% in the fourth quarter of 2017. Main drivers of growth are solid private consumption and investments, with favorable shifts in the labor market, favorable financing conditions and stimulating monetary policy of the ECB. The real GDP growth rate in the US was 2.8% on an annual basis (2.6% in the fourth quarter of 2017), which is a slight acceleration mainly due to the fiscal stimulus in the US economy. On the other hand, a further slowdown in economic activity is registered in the UK, related to the uncertainty about the consequences of the Brexit. In developing countries, the relatively high growth rates were also maintained in the first quarter of the year, with growth accelerating in India and Russia, while in China the economy continued to grow at the same pace as in the previous quarter. On the other hand, a slowdown in economic growth in the first quarter was registered in Brazil, which indicates a relatively slow recovery after the long economic crisis present in this country.

³ The analysis is based on the IMF World Economic Outlook, updated July 2015; ECB Economic Bulletin; announcements by Markt Economics; World Bank Global Economic Outlook; Bloomberg; the reports of Roubini Global Economics and Capital Economics, the monthly reports of the International Energy Agency and the weekly reports of the Bank of Greece.

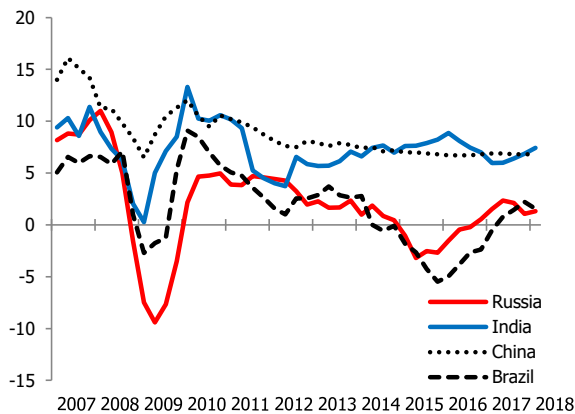


Real GDP growth in advanced economies (year-on-year percentage changes; quarterly data)



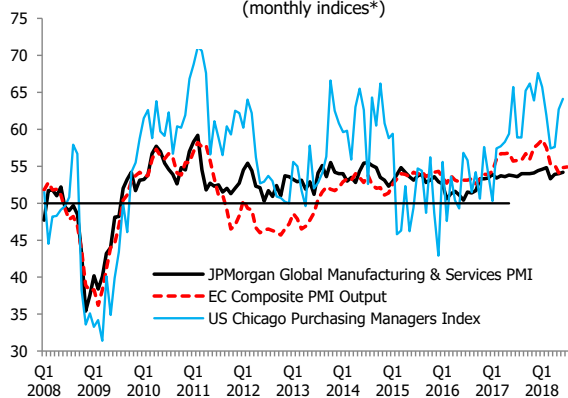
Source: OECD.

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



Source: OECD and IMF.

Global economic activity indicators (monthly indices*)

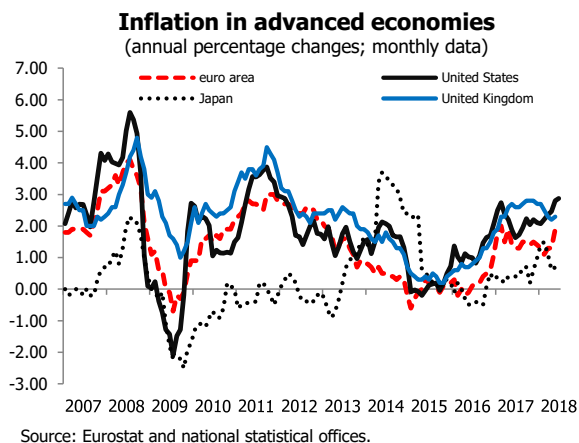
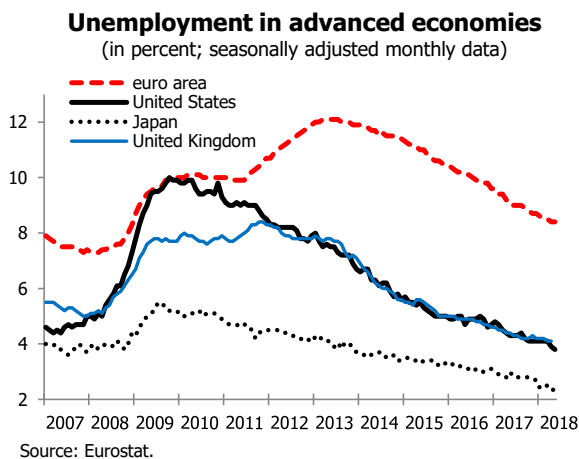
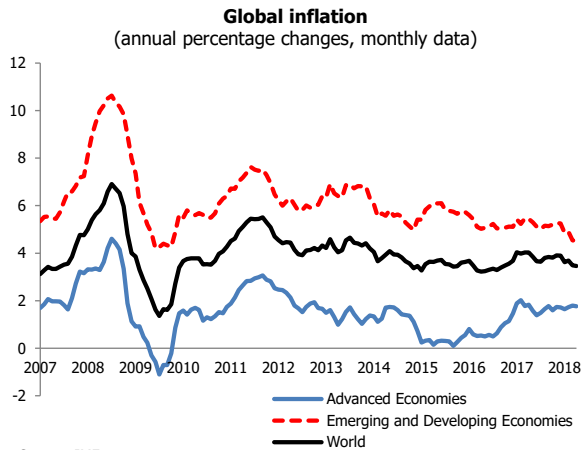


*The PMI index reflects the percentage of respondents that reported better business conditions compared to the previous month and it can take values between 0 and 100. PMI=50 is considered as a reference value, indicating unchanged economic conditions. A PMI value over 50 is taken to indicate that the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

High frequency survey indicators - PMI indicate continuation of solid economic performance worldwide. The average value of the PMI index for the period April-June 2018 is 54 points, which is identical to the average of the first quarter of 2018.

In the short run, the solid performance of the global economy is expected to continue, but in the medium run, the growth is expected to slow down. Positive short-term performance is expected to be largely driven by the fiscal stimulus in the US economy, as well as the generally favorable financial conditions and the stimulating monetary policy. **Regarding the expectations and risks in the medium run,** in conditions of approximation of the real GDP to its potential in most of the developed economies, as well as more intensive use of economic capacities in the developing countries, the current expectations point to a slowdown in the economic activity. Additionally, in the balance of risks around the global growth in the medium run, the unfavorable risks prevail. The most pronounced unfavorable risks are the growing trade protectionism and the geopolitical tensions. Furthermore, the possible tightening of the global financial conditions, the process of implementation of reforms in China, as well as the uncertainty arising as a result of the Brexit are considered as more significant risks.

In the first quarter of 2018, a lower inflation rate was observed worldwide compared to the previous quarter. The average inflation rate in the period January-March on annual basis was 3.6% (3.9% in the fourth quarter of 2017), whereby the slowdown is due to lower inflation rates observed in the developing countries (4.8% vs. 5.2% in the previous quarter). On the other hand, the inflation rate in the developed countries in the first quarter of 2018 remained unchanged compared to the previous quarter and it was 1.7%. However, in the coming period, inflation is expected to accelerate driven by the sharp rise in oil prices. A factor that is expected to act towards increasing the inflation rate globally is the increasing utilization of production capacities.



Despite the slight slowdown compared to the last quarter, the positive economic performance in the euro area continued in the first quarter of 2018.

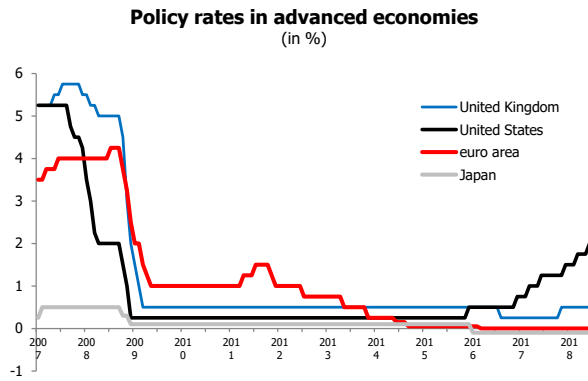
Economic growth in the euro area in the first quarter, on an annual basis, was 2.5% (2.8% in the fourth quarter of 2017), while on a quarterly basis the growth was 0.4% (0.7% in the fourth quarter of 2017). Moreover, the economic performance in the euro area is characterized by synchronization and relatively wide distribution by sectors and countries. Despite the slowdown, economic growth rates in the euro area are relatively solid, with private consumption as the main driver, given the relatively favorable labor market conditions and stimulating monetary policy by the ECB. Furthermore, investments also have a positive impact on the economic growth in the euro area, in conditions of favorable financial conditions and increased profitability of companies. According to the latest forecasts of the ECB, the real GDP growth rate for 2018 has been adjusted downwards, so now it is expected to be 2.1% in 2018, while for 2019 and 2020 the forecasts of 1.9% and 1.7%, respectively, are maintained.⁴

In the second quarter of 2018, there is a certain acceleration of inflation in the euro area compared to the first quarter. Thus, the average annual inflation rate in the period April-June was 1.7% (1.2% in the first quarter of 2018), which is largely due to the increase in prices of energy, food and services. Furthermore, the high level of utilization of production capacities and the growth of wages also have an impact on the increase of the inflation rate. According to the latest forecasts of the ECB, inflation rates are forecasted to be 1.7% in 2018, 2019 and 2020, which is an upward revision compared to the March forecasts.⁵ The upward revisions for 2018 and 2019 mainly reflect the higher oil prices.

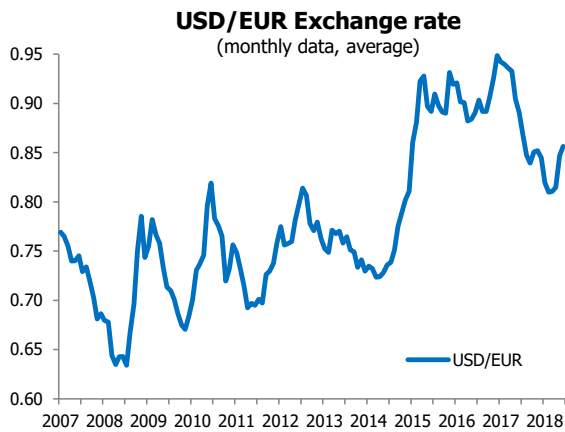
The divergent monetary policy setup in the developed countries continued in the second quarter of 2018. Thus, in conditions of solid economic growth, supported by the good

⁴ In June, the ECB revised its March forecasts, according to which real GDP growth in the euro area was forecasted to be 2.4% in 2018, 1.9% in 2019 and 1.7% in 2020.

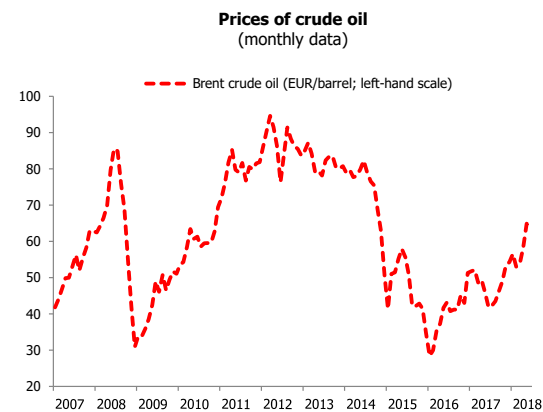
⁵ In June, the ECB revised its March forecasts, according to which the euro area inflation rate was forecasted to be 1.4% in 2018, 1.4% in 2019 and 1.7% in 2020.



Source: Central banks.



Source: Bundesbank



Source: WB monthly database.

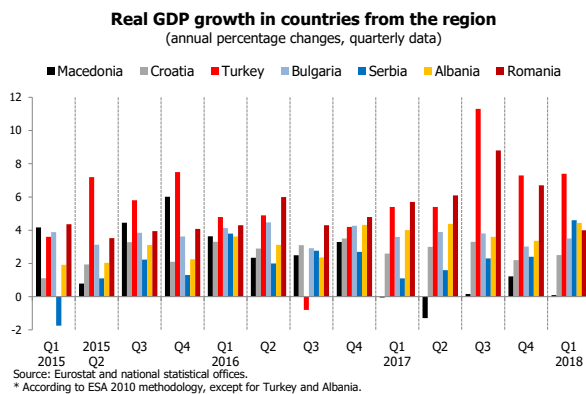
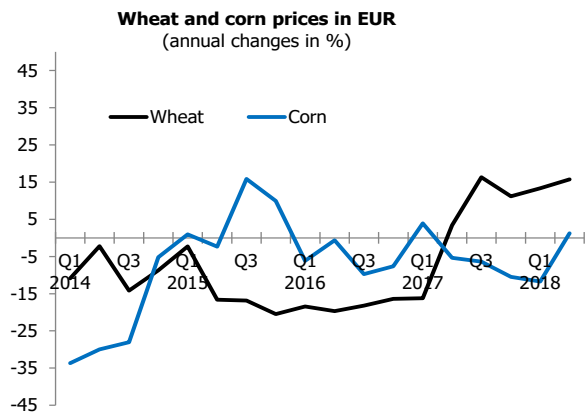
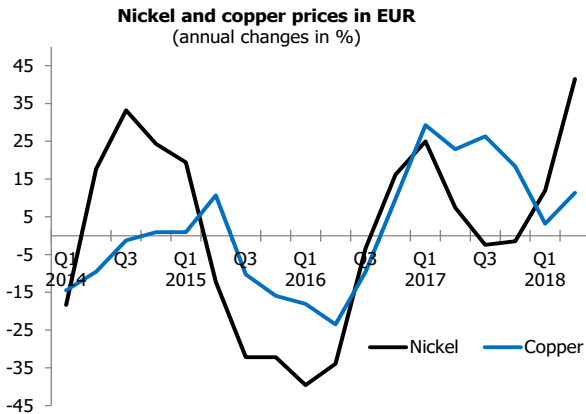
performances on the labor market and inflation, the Fed, for the second time this year, decided to increase the target interest rate interval by 0.25 percentage points, i.e. to 1.75% - 2%. On the other hand, at its regular meeting in June, the ECB decided to keep the interest rate unchanged, at least until the end of the next year's summer. Special emphasis at the meeting was placed on the signal for completion of the purchase of securities by the end of 2018⁶. On the other hand, although the market expectations were directed towards possible increase of interest rates, at the meeting in June, the Bank of England decided not to change the interest rate until the next meeting in August, and changes in the monetary policy setup were not made by the Bank of Japan either.

In the second quarter of 2018, the US currency appreciated against the euro by 3.2%, on average, compared to the first quarter of 2018. Such movements are mainly due to rising political tensions in the euro area and solid demand for the US dollar. On the other hand, on an annual basis, in the second quarter, the value of the US dollar against the euro decreased by 7.7%, whereby in June 2018, one US dollar was exchanged for an average of Euro 0.86.

In the second quarter of 2018, the price of oil increased significantly compared to the price in the first quarter of 2018. Thus, in the second quarter, the average price of oil expressed in euros was Euro 62.2 per barrel, which is an increase of 14.2% on a quarterly basis. The rise in oil prices is largely a reflection of high global oil demand, geopolitical tensions between the United States and Iran, and political and economic instability in Venezuela. In terms of oil supply, despite the agreement between OPEC and Russia to reduce oil production⁷, no significant changes are observed mainly due to increased oil production in

⁶ Regarding the non-standard monetary policy measure, the ECB will continue to conduct net purchase under the quantitative easing programme with the current amount of Euro 30 billion by September 2018 and if the economic performance confirms the ECB's medium-term inflation outlook, the net amount from October would be reduced to Euro 15 billion per month and would last until December 2018 when the entire programme would end.

⁷ On 30 November 2017, OPEC Member-States and Russia decided to extend the measure for reduction of oil production for additional nine months, i.e. until the end of 2018, aimed at reducing the inventories of this fuel globally. Also, other non-OPEC oil-producing countries, including Russia, have supported the extension of the agreement, whereby 1.8 million barrels less per day until December 2018 will be produced. Additionally, Nigeria and Libya, countries that were not previously part of the agreement, joined the measure.



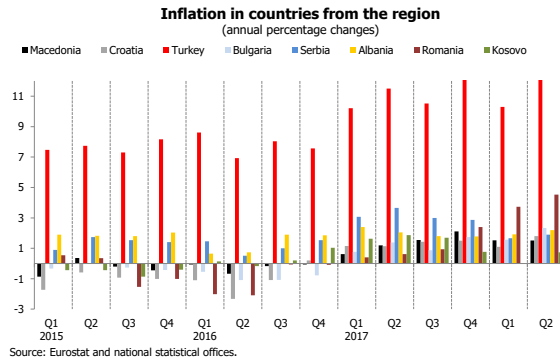
the United States. On annual basis, the price of oil expressed in euros increased by 36.1%.

Prices of non-energy primary products in the second quarter increased on an annual and quarterly basis. The increase in metal prices is mainly due to the expectations for reduced supply⁸, and an additional contribution is also made by the increased demand for certain metals, primarily for nickel and copper. The increase in food prices, especially of corn and wheat, is associated with higher demand for these products worldwide, as well as with the unfavorable weather conditions in the United States, Europe and China.

In the first quarter of the year, the growth of economic activity in the countries of the region continued with positive economic performance observed in all countries. The highest growth in the region in this quarter was observed in Turkey (7.4%), driven by private consumption and investments. Acceleration of growth was also observed in Serbia, Albania, Bulgaria and Croatia, and in most of these countries the domestic demand was the driver of the growth. Of the countries in the region, only Romania (4.0%) and Macedonia (0.1%) registered a slowdown in growth, which is associated with the lower consumption and investments in Romania, and with the decline in the investment activity in Macedonia.

In the second quarter of 2018, there was a further acceleration of the annual inflation rate in all countries in the region. Such shifts in consumer prices in most countries are mainly explained by the rising prices of the core inflation components, while in some countries higher food prices were observed. Observed by countries, in the second quarter of 2018, the largest acceleration of the annual inflation rate was registered in Turkey, Romania, Bulgaria and Albania, while in other countries the acceleration was relatively lower.

⁸ Expectations to reduce the production in China, as well as closure of one of the larger smelters in India, as a result of the measure to reduce environmental pollution (<https://www.reuters.com/article/us-vedanta-smelter/indian-court-denies-vedantas-interim-request-to-reopen-copper-smelter-lawyer-idUSKBN1JV155>)



1.2. Domestic supply

In the first quarter of 2018, the Macedonian economy almost stagnated, i.e. it has registered a minimum annual growth of 0.1%. Analyzing the supply, the reasons for such poor performance are concentrated in construction. Namely, in this sector, the activity continued to decrease at an intensified pace, mainly reflecting the temporary suspension of the announced public projects in the field of road infrastructure. On the other hand, most of the other activities, including trade, industry and agriculture made a positive contribution, but yet insufficient to significantly overcome the adverse effect of the construction activity. Regarding the movements in the second quarter of 2018, most of the available data for the period of April-May, for certain economic sectors, point to more favorable movements compared to the first quarter.

In the first quarter of 2018, the domestic economy experienced a decline of 2.6%, on a quarterly basis (seasonally adjusted), while on an annual basis, a minimal growth of 0.1% was registered. Although annual growth of the value added⁹ was observed in several activities, the unfavorable movements in the construction, coupled with the decline in value added in several activities of the services sector¹⁰, offset the positive effects and resulted in a low growth rate.

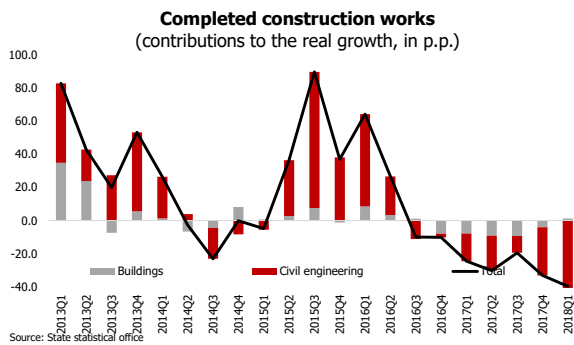
⁹ Growth of value added in the first quarter of the year was registered in the activities: Agriculture, Forestry and Fishery, Mining and Quarrying; Manufacturing Industry; Electricity, Gas, Steam and Air Conditioning Supply; Water Supply; Wastewater Disposal, Waste Management and Environmental Remediation Activities, Wholesale and Retail Trade; Repair of Motor Vehicles and Motorcycles; Transport and Storage; Accommodation and Food Service Activities, Professional, Scientific and Technical Activities; Administrative and Support Service Activities and Arts, Entertainment and Recreation; Other Service Activities; Activities of households as employers; activities of households that produce various goods and provide various services for their own needs.

¹⁰ In the first quarter, there was a decline in value added in construction, in information and communications, collectively in the activities of public administration and defence, compulsory social insurance, education and activities of health and social care, in financial activities and activities of insurance, as well as in real estate activities.

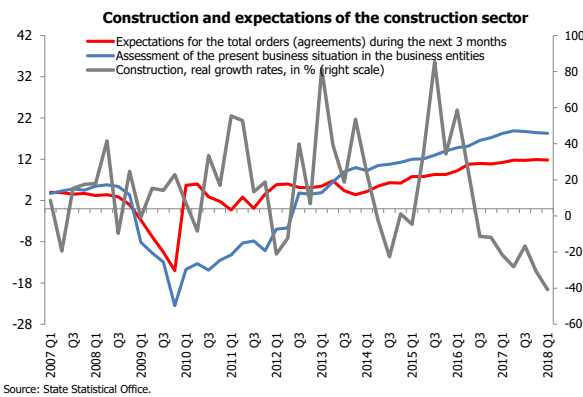


	annual growth rates, in %						contribution in GDP growth, in p.p.					
	2013	2014	2015	2016	2017	Q1 2018	2013	2014	2015	2016	2017	Q1 2018
Agriculture	8.6	3.1	1.9	2.8	4.1	6.6	0.8	0.3	0.2	0.3	0.4	0.5
Industry	3.7	11.5	4.9	1.4	-2.5	1.4	0.6	1.7	0.8	0.2	-0.4	0.2
Manufacturing	9.6	21.5	5.0	4.1	-4.0	5.5	1.0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

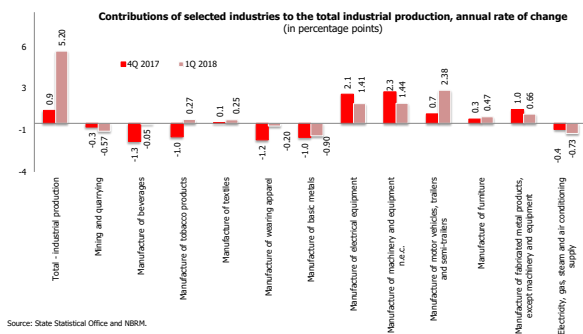
Source: State Statistical Office and NBRM calculations.



Source: State statistical office



Source: State Statistical Office.

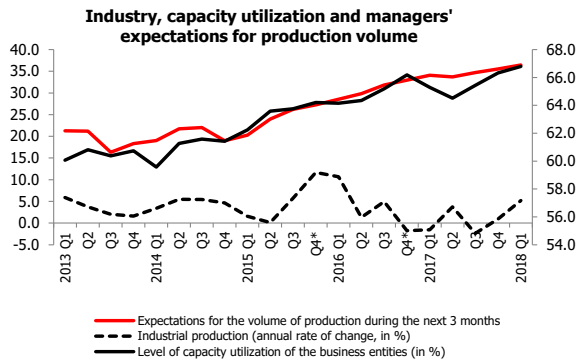


Source: State Statistical Office and NBRM

In the first quarter of 2018, the decline in activity in the construction sector intensified. Structurally speaking, the downward shift in the first quarter is entirely due to the decline in civil engineering associated with the temporary suspension of the planned public infrastructure projects. On the other hand, after five quarters of constant decline, for the first time since the third quarter of 2016, a positive contribution is again observed in building construction. Currently available data for April indicate small improvements in the sector in the second quarter of the year, amid deceleration in the decline in the value of completed construction works, and somewhat more favorable are also the expectations of corporate managers in the construction sector in terms of employment and orders¹¹ compared to the same period last year.

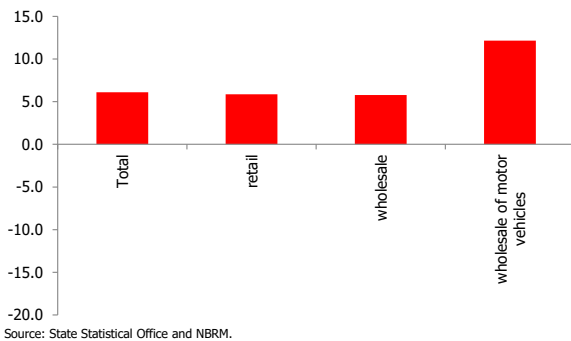
On the other hand, the favorable movements in the industry present from the end of 2017, continued at a stronger pace in the first quarter of 2018, when there was an increase in average utilization of the capacities of the business entities and higher industrial production by 5.2% on an annual basis. This growth is fully explained by the growth of production in the manufacturing industry, where, as before, the highest contribution is made by the activities in which the larger export facilities in foreign ownership (machinery and devices, motor vehicles and electrical equipment) are present. On the other hand, in most of the traditional activities, the production continued to decrease in the first

¹¹ The expectations of the corporate managers in construction, retail trade and manufacturing industry for the second quarter are taken from the Business Tendency Surveys for the respective sector conducted in the first quarter of 2018.



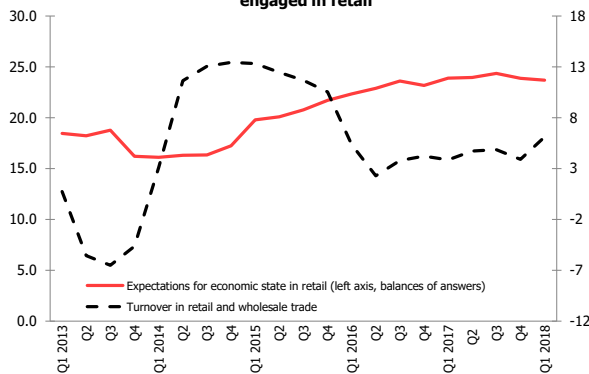
quarter, but with reduced intensity (production of beverages, clothing and metals). In the second quarter, the growth of the industry is expected to continue, viewed according to the favorable expectations of the managers of this sector in connection with production, prices and employment. Also, the data for the period April - May point to a growth of industrial production which, as before, is a reflection of the performances in the manufacturing industry. However, the growth in these two months is slower than the growth in the first quarter of the year.

Trade 2018 - Q1
(real annual growth rates, in %)



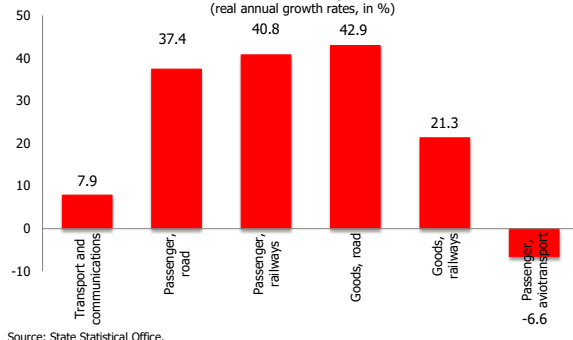
In the first quarter of 2018, trade is among the activities with the highest positive contribution to the growth of the Macedonian economy. In light of the high-frequency¹² indicators, all types of trade made a positive contribution, including the retail trade, which in 2017 made a negative contribution. The same movements continued in the period April-May, which indicates a probable growth of the activity in the sector in the second quarter of the year. Additionally, the corporate managers in the retail trade sector maintain the favorable perceptions regarding the number of employees and the business situation of the enterprises in the second quarter, which is also in line with the assessments of favorable movements during the second quarter.

Trade and expectations of managers of business entities engaged in retail



Regarding the movements in the sector of "transport and communications", the positive movements registered at the end of 2017 continued in the first quarter of 2018 as well. Thus, high-frequency data show positive movements in all types of traffic, with the exception of air cargo traffic.

Transports in 2018 - Q1
(real annual growth rates, in %)

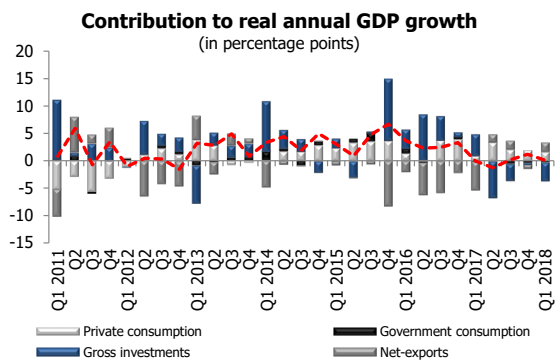


¹² The analysis of trade movements is made on the basis of trade turnover data.



1.3. Aggregate demand

Observing demand, the minimum GDP growth of 0.1% on an annual basis registered in the first quarter of 2018 is due to the positive contribution of the net export, in conditions of a decline in domestic demand. In terms of individual components, exports continue to grow significantly, hence the highest positive contribution, which is mainly related to the activity of foreign export capacities. Private consumption continued to grow, supported by the growth of disposable income and lending. However, their positive contribution was almost completely offset by declining gross investments, coupled with the fall in public spending and import pressures.



Source: State Statistical Office and NBRM calculations.

In the first quarter of 2018, exports were the component with the highest individual positive contribution to the growth of the economy, representing a feature of the growth structure for a longer period of time. From the components of domestic demand, private consumption continued to grow at a similar pace as in the previous two quarters. In conditions of a strong decline in the construction activity at the beginning of the year, mainly due to the delay in the implementation of some infrastructure projects, gross investments continued to decline at an accelerated pace. Such investment movements, coupled with the decline in public spending, led to a negative contribution of domestic demand to growth in the first quarter.

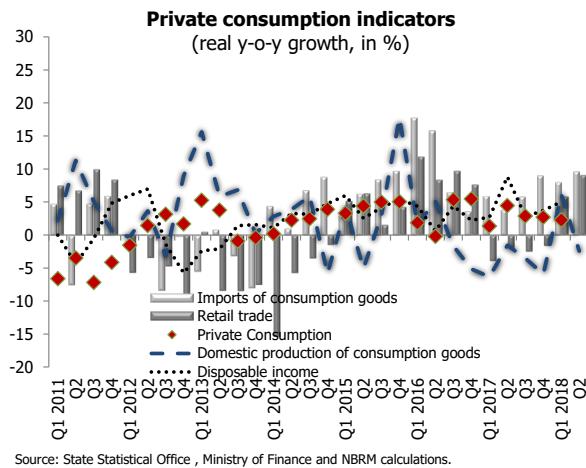
	Real annual growth rates (%)										Contributions to real annual growth (in p.p.)									
	2013	2014	2015	2016	2017	2017-Q1	2017-Q2	2017-Q3	2017-Q4	2018-Q1	2013	2014	2015	2016	2017	2017-Q1	2017-Q2	2017-Q3	2017-Q4	2018-Q1
Private consumption	1.9	2.2	4.4	3.1	2.9	1.3	4.4	2.9	2.7	2.3	1.4	1.6	3.1	2.1	1.9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

*decrease represents lower deficit

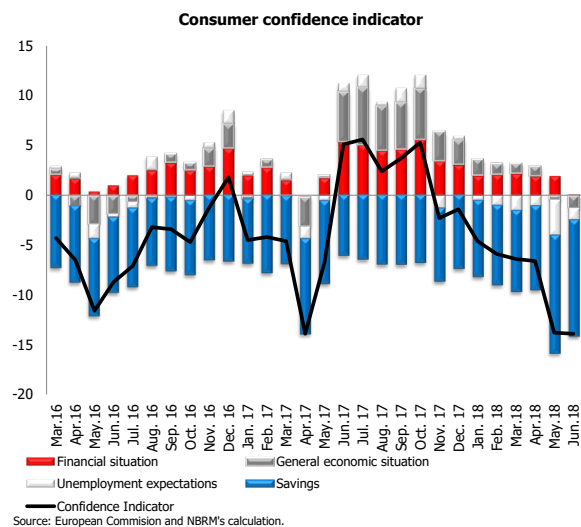
Source: SSO and NBRM calculations.



1.3.1. Private consumption



At the beginning of 2018, private consumption registered a solid growth of 2.3% on an annual basis, while on a quarterly basis it dropped by 2.7%. In terms of sources of funding, they are somewhat more favorable on an annual basis and are aimed at supporting the consumption. Thus, the short-term indicators for the first quarter of the year point to higher growth of disposable income (in conditions of intensified growth of wages and private transfers, and growth of pensions, although with lower intensity). At the same time, the pace of lending to households by banks is accelerating. On the other hand, according to the results of the consumer confidence surveys¹³ in the first quarter, consumer perceptions are unfavorable, with further deterioration of expectations related to opportunities to reduce unemployment and increase savings.



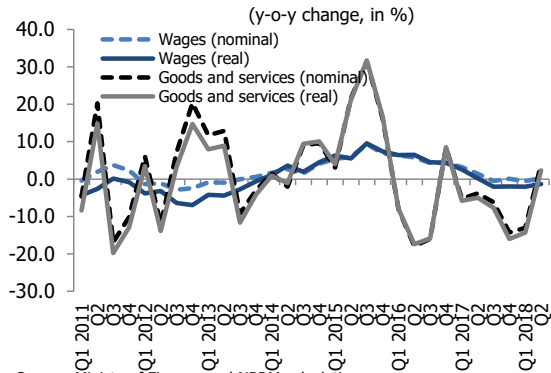
The signals from the available high-frequency data, for the most part, point to growth¹⁴ of private consumption in the second quarter of 2018. Thus, in the period April-May, growth was registered in the retail trade, the real wages and the pension bill, and lending to households grew solidly, which partially corresponds to the results of the Bank Lending Survey, which indicate easing of overall lending conditions, but also a net decrease in the demand for household loans in this period. In April, net private transfers also increased. On the other hand, the signals from the consumer confidence surveys conducted in the second quarter remain unfavorable.

¹³ European Commission's Consumer Optimism Survey as of May 2018. The graph shows the consumer confidence index as a net percentage of responses. This index is an integral component of the overall index of economic confidence.

¹⁴ From the private consumption indicators, only the domestic production of consumer goods and the import of consumer goods registered a decline in the period May-April 2018.



Expenditures for Wages and salaries and Goods and services



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

1.3.2. Public consumption

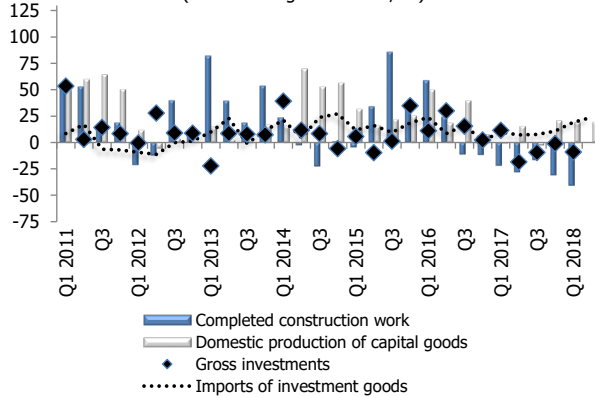
In the first quarter of 2018, public consumption registered quarterly and annual decline of 1.3% and 1.4%, respectively. The annual decline in public spending is mainly due to lower expenditures on goods and services.

The data for April and May 2018 indicate an annual growth of public consumption mainly as a result of higher transfers for health care¹⁵.

1.3.3. Investment consumption

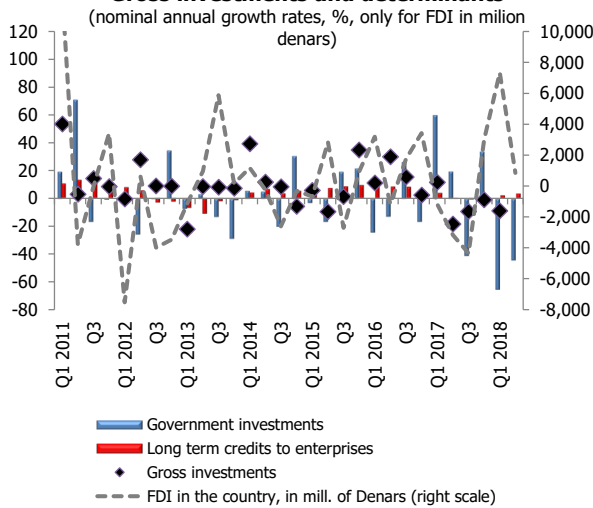
Unfavorable movements in gross investments continued in the first quarter of 2018, with annual and quarterly decline of 9.0% and 0.6%, respectively. Such movements correspond to the decline in construction activity in the first quarter, which is mainly related to the temporary suspension of some public projects in the field of road infrastructure. There was also a decline in the government capital investments. Other gross investments indicators are generally favorable (growth of import of investment products and domestic production of capital goods), and growth of foreign direct investment and long-term lending to enterprises by domestic banks was additionally registered.

Gross investment and indicative series



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

Gross investments and determinants



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

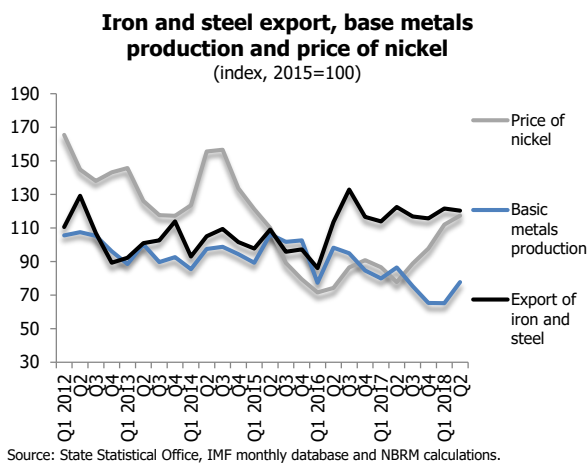
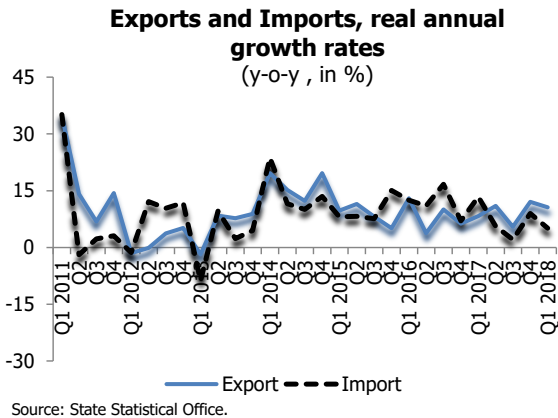
Regarding the movement of investments in the second quarter of 2018, some of the high-frequency data point to more favorable movements. Namely, annual growth of short-term investment indicators is observed in the domestic production of capital goods, as well as in foreign direct investments. At the same time, corporate lending for the period April - May continued to grow, with moderately increased demand for loans and net easing of lending conditions in this period, according to the results of bank surveys. On the other hand, the data on government capital investments still point to their decrease on an annual basis, but at a slower pace compared to the first quarter. Also, despite the generally favorable perceptions of construction managers about the situation in the sector during the second quarter, in April, the several-month decline in the construction activity continued, but with a significant slowdown in the

¹⁵ Most of these funds relate to expenditures on goods and services of the Health Fund.



decline compared to the previous period. A decline was also registered in the import of investment products.

1.3.4. Net external demand



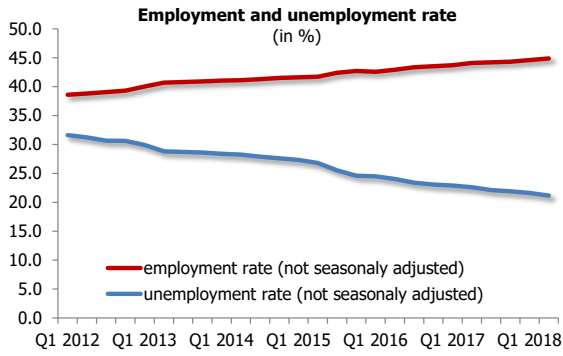
The positive contribution of net exports, characteristic for the last three quarters of 2017, continued in the first quarter of 2018, with higher growth of exports than imports of goods and services. Exports of goods and services registered quarterly and annual growth of 2.7% and 10.6%, respectively, whereby also in this quarter it remains the component with the highest positive contribution to GDP growth. Analyzed according to the high-frequency foreign trade statistics, the growth of nominal export was mostly supported by the solid performances of the new export-oriented capacities, and favorable trends are observed in the metal processing industry and in part of the other export sector. In the first quarter imports grew, but at a slower pace compared to exports (quarterly and annual growth of 1.5% and 5.1%, respectively).

In the second quarter of 2018, the trade deficit is expected to narrow, which is indicated by the nominal data on foreign trade for April - May 2018, in conditions of higher growth in the export than the import of goods.

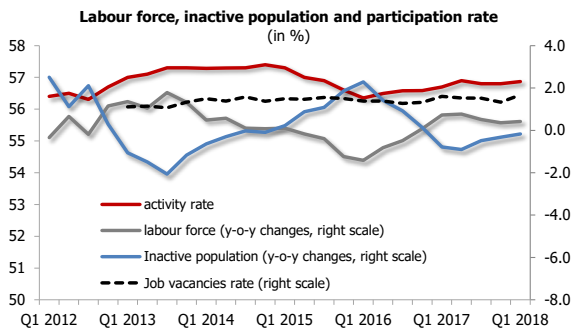
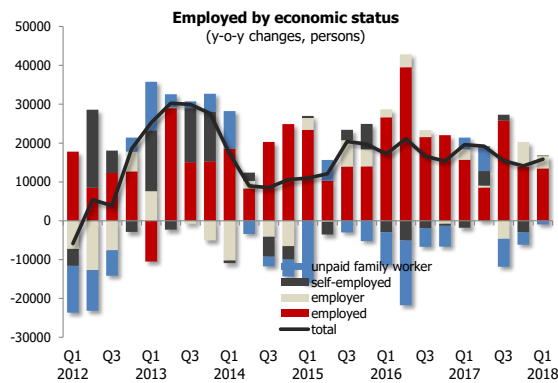
1.4. Employment and wages

Some of the labor market indicators in the first quarter of 2018 point to further improvements in this market segment. Thus, the number of employees is increasing with a similar intensity as in the previous quarter. At the same time, the unemployment rate reduced to 21.6%. Business tendency surveys indicate increased optimism regarding the employment in the next three months. On the supply side, the annual growth of the active population that started in the last quarter of 2016, continued. However, competitiveness indicators continue to point to unfavorable movements. Thus, there was an annual decline in labor productivity, while unit labor costs increased.

Employment growth continued in the first quarter of 2018, with a similar intensity as in the previous quarter. Thus, the number of employed persons increased by 2.2%, on annual basis, while on quarterly basis, growth of 0.6% was



Source: State Statistical Office, Labour Force Survey.



Source: State Statistical Office,.

registered¹⁶. Observed by individual activities, the movements are divergent. Industries with the greatest contribution to the increase of the number of employees are the manufacturing industry, construction and accommodation and food service activities. On the other hand, one third of the activities registered a decrease in employment, and activities with a stronger decline in employment are the wholesale and retail trade; repair of motor vehicles and motorcycles, transport and storage and information and communications. In terms of economic status¹⁷, the category of employees registered the highest growth.

The employment rate in the first quarter of 2018 is 44.6%, which is an annual increase of 0.9 percentage points. At the same time, the **aggregated signals from the business tendency¹⁸ surveys indicate increased optimism** among the managers of the business entities regarding the employment for the next quarter. In the first quarter, **the rate of vacancies¹⁹ was 1.7%** (1.6% in the same quarter of 2017). Despite the small upward or downward shifts, analyzed on a longer-term basis, the rate of vacancies is relatively stable, which, in conditions of declining unemployment, indicates a possible improvement of the process of matching the supply with demand for skills on the labor market. Observed comparatively, by sectors of activities, the highest rate of vacancies was registered in the administrative and support service activities (4.2%), as well as in the accommodation and food service activities (3.2%).

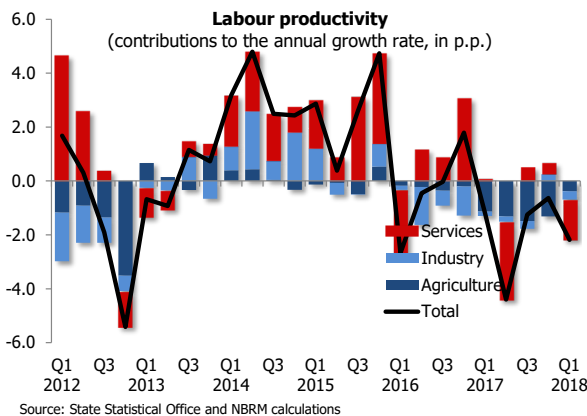
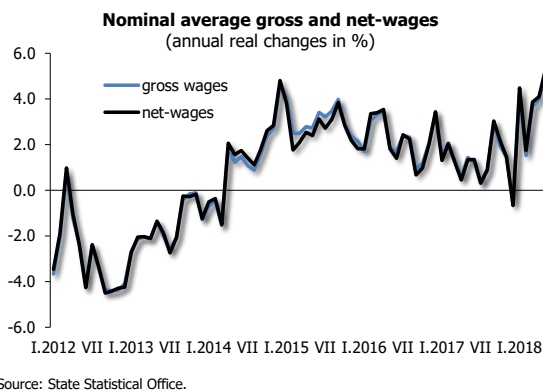
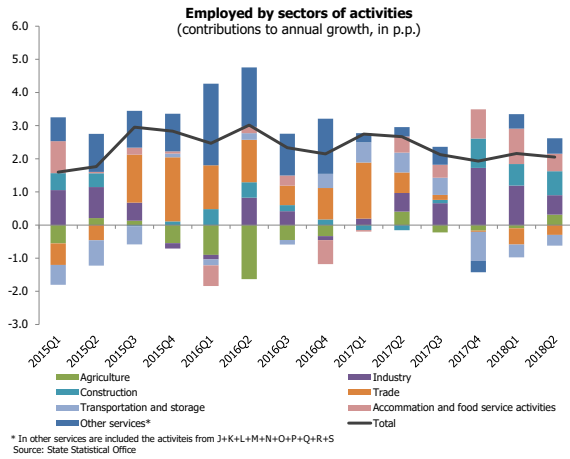
Regarding the shifts in the labor supply, the trend of moderate growth observed since the last quarter of 2016

¹⁶ The analysis of the quarterly dynamics of employment, unemployment and the total active population is made on the basis of seasonally adjusted data.

¹⁷ 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).

¹⁸ Source: State Statistical Office, business trends surveys in manufacturing (April and May 2018), construction (first quarter of 2018) and trade (first quarter of 2018).

¹⁹ The rate of vacancies is the ratio between the number of vacancies and the total number of job positions. Normally, the job vacancy rate is considered together with the unemployment rate (relation known as the Beveridge curve). The position of these two indicators provides information on the efficiency of the labor market in terms of potential mismatches between the required profiles and those that are available in the labor market at a given time. (skill mismatches). Specifically, if the two indicators move at the same time, these are temporary, cyclical fluctuations, while in case when the unemployment rate decreases amid a stable vacancy rate, these are structural changes, i.e. improvement of the labor market efficiency.



continued in the first quarter. Thus, the total active population in the first quarter increased by 0.4%, on annual basis, while the activity rate was 56.9%.

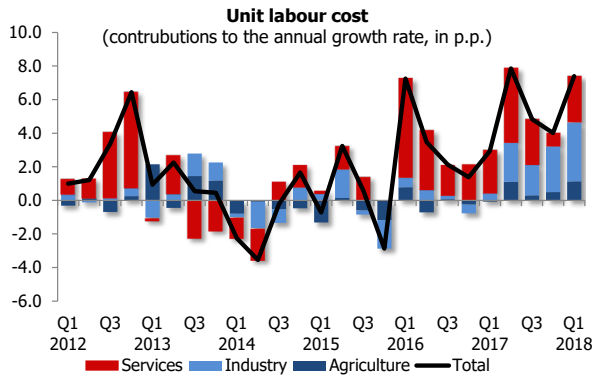
Stronger growth of demand in relation to labor supply in the first quarter of the year led to a further decline in unemployment. The number of unemployed persons in the first quarter decreased by 5.4% on annual basis, which is a slightly stronger dynamics compared to the previous quarter, while the unemployment rate reduced to 21.6% (annual and quarterly decrease by 1.3 and 0.3 percentage points, respectively).

Average net and gross wages paid in the first quarter registered an annual growth of 4.9% and 4.7%, respectively, which is an acceleration of the annual growth dynamics, in part reflecting the September growth of the legally established minimum net wage²⁰. Wage growth was registered in most of the sectors of activities, among which the following activities stand out by the amount of increase: agriculture, manufacturing industry, mining, accommodation and service activities, information and communications and arts, entertainment and recreation. On a quarterly basis, nominal net and gross wages increased by 0.7% and 0.6%, respectively, which is relatively modest growth compared to the previous quarter. **In the first quarter, in conditions of rising consumer prices, real annual wage growth was around 3% (net and gross wages).**

Unfavorable shifts in labor productivity observed in 2017 were present in the first quarter of 2018 when, in conditions of slower growth of value added, labor productivity²¹ decreased by 4.4% (compared to an annual decline of 2.1% in the fourth quarter of 2017). From sector point of view, the downward trend in overall productivity remains largely related to the services sector. **Wage growth, amid further decline in productivity, led to an**

²⁰ On 19 September 2017, the Assembly of the Republic of Macedonia approved the amendments to the Law on Minimum Wage of the Republic of Macedonia. Pursuant to the amendments, the minimum wage in the Republic of Macedonia, starting with the payment of wages for September 2017, for all sectors in the economy, was set at a gross amount of 17,300 denars or 12,000 denars net.

²¹ Total productivity is calculated as a weighted sum of the calculated productivity at a level of an individual sector. Within each sector, productivity is calculated as the ratio between the value added in that sector and the number of employees.

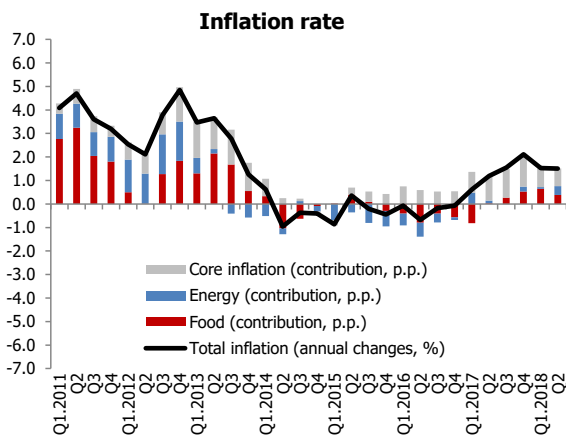


Source: State Statistical Office and NBRM Calculations

increase in unit labor costs of 9.9% (compared to 5.6% in the last quarter of 2017). Most of the growth is explained by the growth of unit labor costs in the services sector and in industry, and agriculture also makes a positive contribution.

1.5. Inflation

In the second quarter of the year, domestic prices continued to grow on an annual basis, with the same dynamics as in the first quarter of 2018. In terms of structure, this quarter experienced rapid growth in energy prices, influenced by the price of crude oil and derivatives on the world market, while food prices and core inflation grew at a slower pace. Indicators for the future short-term dynamics of consumer prices do not mainly indicate significant upward pressures on the price level, with the exception of labor costs whose growth accelerated. Regarding the expectations for the inflation rate in the next two-year period, according to the NBRM Survey, economic analysts expect it to be moderate and range around 2%, similarly to the NBRM forecast and the forecasts of some international institutions.



Source: State statistical office and NBRM calculations.

1.5.1. Current inflation

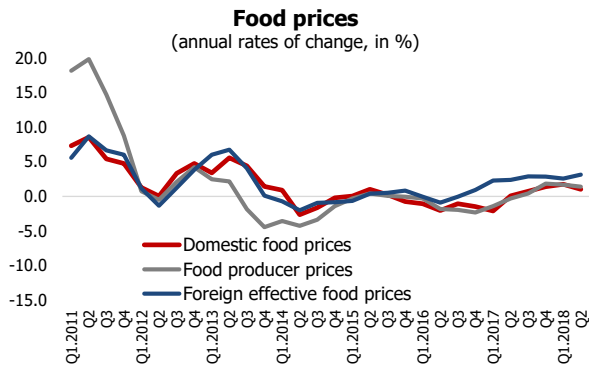
In the second quarter of 2018, domestic consumer prices grew at the same pace as the previous quarter (annual inflation rate of 1.5% in the first and second quarters of the year)²². During this period, the annual growth of energy prices accelerated, while the growth of food prices, as well as core inflation slowed down in the second quarter.

The core inflation rate in the second quarter was 1.6% (compared to 1.7% in the previous quarter). In terms of the structure, the highest positive contribution is still made by the prices of air traffic, but with a significant slowdown of the growth rate. At the same time, tobacco prices also made a more significant positive

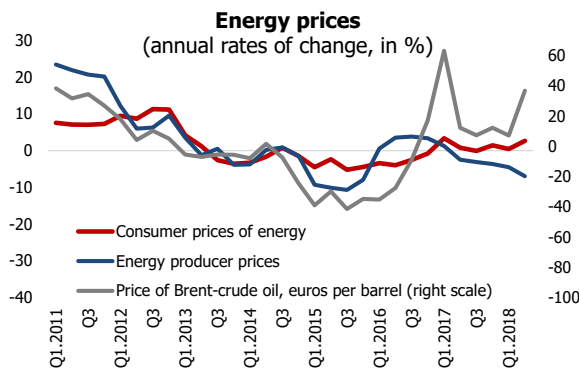
	(annual changes, in %)								(contribution to annual changes, in p.p.)							
	2017				2018				2017				2018			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Consumer price index - all items	0.6	1.2	1.5	2.1	1.4	1.5	1.5	1.5	0.6	1.2	1.5	2.1	1.4	1.5	1.5	1.5
Food	-2.1	0.1	0.7	1.4	0.0	1.7	1.0	-0.8	0.0	0.3	0.3	0.5	0.0	0.7	0.4	0.4
Energy	3.4	0.8	-0.1	1.5	1.4	0.5	2.7	0.5	0.1	0.0	0.2	0.2	0.2	0.1	0.4	0.4
Electricity	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Heat energy	-10.8	-10.8	-5.5	-2.9	-7.6	-2.5	-2.5	-0.1	-0.1	0.0	0.0	-0.1	0.0	0.0	0.0	0.0
Fuels and lubricants	16.4	5.5	0.4	5.0	6.7	2.0	11.1	0.5	0.2	0.0	0.2	0.2	0.2	0.1	0.4	0.4
Food and energy (volatile prices)	-0.7	0.3	0.5	1.4	0.4	1.4	1.5	-0.3	0.1	0.3	0.7	0.7	0.2	0.7	0.8	0.8
Core inflation calculated by the NBRM (total index - food and energy (categories 01.1, 04.5, 07.2.2))	1.9	2.1	2.6	2.8	2.3	1.7	1.6		0.9	1.0	1.2	1.3	1.1	0.8	0.7	
Overall index excluding energy, liquid fuels and lubricants and unprocessed food (SSO)	0.8	1.3	1.6	2.3	1.5	1.3	1.1									
Overall index excluding energy, liquid fuels and lubricants, unprocessed food, tobacco and alcoholic beverages (SSO)	0.5	1.0	1.4	2.0	1.2	1.0	0.7									

Source: State Statistical Office and NBRM calculations.

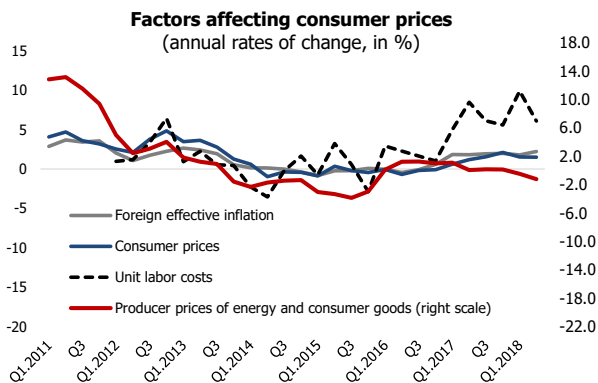
²² On a quarterly basis, consumer prices were higher by 1.0%, while on a seasonally adjusted basis they were higher by 0.4%.



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



Source: State statistical office and NBRM calculations.



Source: State statistical office and NBRM

contribution to the growth of core inflation²³. Similarly to the core inflation rate, the other sub-indices of inflation slowed down, excluding the most volatile prices. Thus, the total index, with energy²⁴, liquid fuels and lubricants (for transport) and unprocessed food excluded, registers an annual growth of 1.1% (1.3% in the previous quarter), while the total index, with energy, liquid fuels and lubricants (for transport), unprocessed food, tobacco and alcoholic beverages excluded, indicates an annual growth of 0.7% (1% in the previous quarter).

In the second quarter of the year, **food prices** registered a slowdown in the annual growth compared to the previous quarter, reflecting the lower growth of fruit and vegetable prices. The growth of consumer food prices is in line with the dynamics of prices of domestic food producers, as well as with the shifts in foreign effective food prices. **Energy prices** in the second quarter increased as well, but with stronger dynamics than the previous quarter, which is mainly explained by the movement of domestic prices of oil derivatives. This shift in domestic consumer energy prices is in line with the movement of the price of crude oil and derivatives on the world market, whose growth significantly accelerated during the second quarter.

Producer prices for industrial products on the domestic market, as one of the factors influencing the dynamics of consumer prices, continued to grow in the second quarter²⁵, but with a further slowdown in the growth dynamics (0.1%, compared to 0.8% in the previous quarter). On the other hand, producer prices of energy and consumer goods decreased by 0.9% (in the previous quarter the decrease was 0.5%).

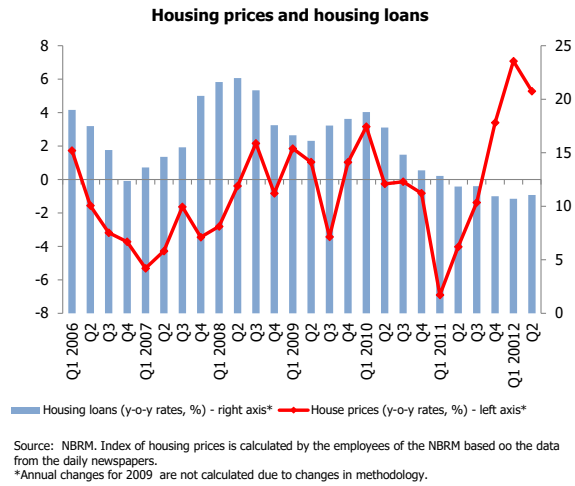
Foreign effective inflation²⁶, as an indicator of imported inflation, in the second

²³In April and May 2018, the prices of certain type of cigarettes increased, probably as a reflection of the expected increase in the excise duties on cigarettes from the beginning of July 2018. The increase of excises by 0.20 denars/piece is planned to be made every year, as of 1 July 2023.

²⁴“Energy” category refers to electricity, gas, liquid and solid fuels for heating and central heating.

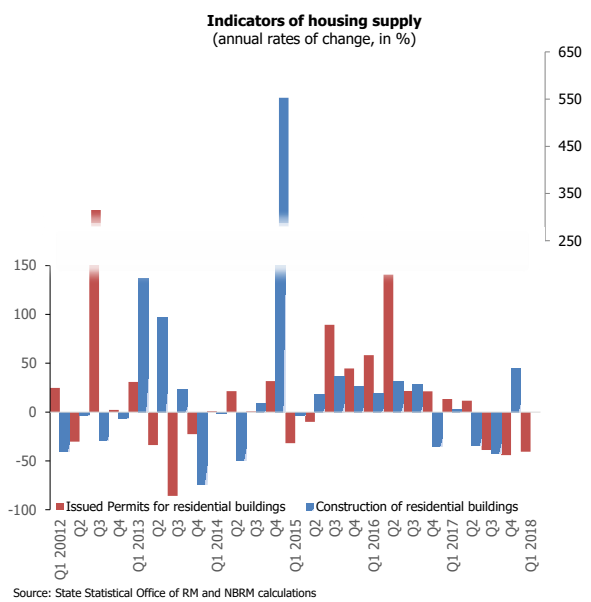
²⁵ The analysis refers to the first two months of the quarter.

²⁶ The calculation of the foreign effective inflation is made from the weighted sum of the consumer price indices of the countries, the most important partners of the Republic of Macedonia in the field of import of consumer goods. The weighting structure is based on



quarter of the year continued to grow with almost unchanged dynamics (annual growth of 2%, compared to 1.8% in the previous quarter).

Despite the absence of potential pressures on domestic prices through the channel of foreign prices and producer prices, **unit labor costs** continued to increase (in conditions of wage growth and further decline in productivity), with intensified dynamics compared to the first quarter of 2018 (9.9%, compared to 5.6% in the fourth quarter of 2017). The continued growth of labor costs could contribute to an increase in the prices of final products in the upcoming period.



Apartment prices, measured by the hedonic index²⁷, continue to grow, albeit at a slightly slower pace than before (annual growth of 5.3%, compared to 7.1% in the previous quarter), taking into account the low comparison base of the same period last year. Demand in the second²⁸ quarter of 2018 was also supported by the solid growth of housing loans. In terms of supply, the value of the constructed residential buildings in the first quarter of 2018 increased (for the second consecutive quarter), in conditions of further reduction of the value of the issued approvals for construction of residential buildings. Given that the rise in apartment prices²⁹ is preceded by a long period of decline, it is still too early to assess whether these shifts indicate a change in trend or are of a temporary character.

the normalized shares of the nominal import from each of the countries in the total nominal import in the period 2010 - 2012. Bulgaria, Germany, Greece, France, Italy, Austria, Slovenia, Croatia and Serbia are included in the calculation of this indicator. The analysis refers to the first two months of the quarter.

²⁷ Hedonic index of housing prices, prepared by the NBRM on the basis of the notices of sale in the capital city, and published by the agencies dealing with trade in real estate. The price of the apartment is a function arising from the size of the apartment, the neighborhood in which it is located, the floor, whether the apartment has central heating and whether the apartment is new.

²⁸ Available data for the first two months of the quarter.

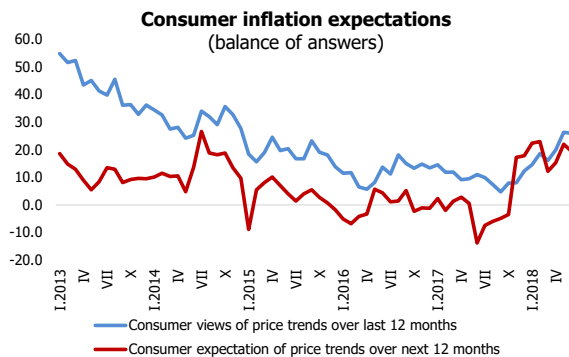
²⁹ In June 2018, the Ministry of Finance amended the Law on Value Added Tax, which extended the application of a preferential VAT rate of 5% for the sale of new apartments for 5 years, i.e. until the end of 2023.

1.5.2. Inflation expectations

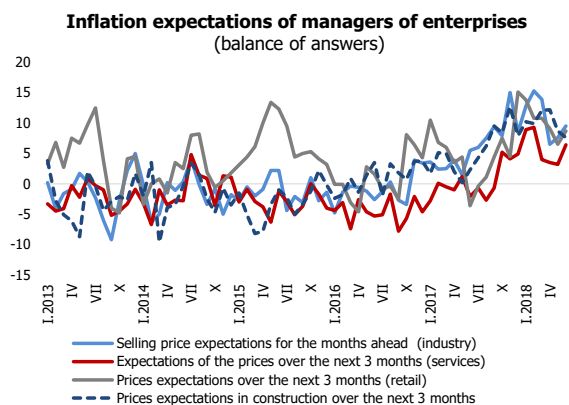
Forecasts and expectations for the inflation rate

	2018	2019
Economic analysts	1.8	2.0
IMF	1.8	2.0
Consensus Forecast	2.0	2.2
Ministry of Finance of the R. of Macedonia	1.7	2.0
National Bank of the R. of Macedonia	2.0	2.0

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



Source: European Commission



Source: European Commission

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

Economic analysts expect moderate inflation that would follow a path of minimal acceleration in the next two years. According to the research from the **Survey on Inflation Expectations and Expectations for the Movement of the Real GDP**³⁰ conducted in June, the economic analysts expect that the inflation in 2018 will be 1.8%. According to economic analysts, over the next two years the inflation rate will accelerate minimally to 2.0% and 2.1% in 2019 and 2020, respectively. Other institutions in the domestic economy also predict similar dynamics of prices.

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

Thus, the indicator of **consumer expectations for price changes in the next 12 months**³¹ indicates that the expectations for price growth remain the same, i.e. a larger number of persons believe that prices will increase in the next 12-month period, compared to the number of respondents who expect unchanged or reduced prices.

As for the **short-term expectations of the corporate sector**³², among the corporate managers in industry, construction, retail trade and services sector, the expectations of growth of their prices in the following few months prevail.

1.6. Balance of Payments³³

In the first quarter of 2018, the deficit in the current account of the balance of payments is almost unchanged compared to the same period last year. In terms

³⁰ Starting from October 2017, the NBRM made a change in the current Inflation Expectations Survey. The new Survey on Inflation Expectations and Expectations for the Movement of the Real GDP is conducted on a sample of economic analysts, and the subject of the Survey has also been expanded, in accordance with the practice of the European Central Bank (ECB).

³¹ European Commission's Consumer Optimism Survey as of March 2018.

³² European Commission's Business Tendencies Surveys in industry, retail trade, construction and services sector as of November 2017.

³³ Starting from the Quarterly Report, October 2014, the analysis of the movements in the balance of payments is based on data compiled under the Manual on the *Balance of Payments and International Investment Position, sixth edition (IMF, 2009) (IMF, 1993)*.

For more detailed information on the methodological changes, visit the NBRM website

([http://nbrm.mk/WBStorage/Files/Statistika Informacija za promenite vo platniot bilans megunarodnata investiciska pozicija i nadvoresniot dolg koisto proizlequvaat od primenata na novite megunarodni statisticki standardi.pdf](http://nbrm.mk/WBStorage/Files/Statistika%20Informacija%20za%20promenite%20vo%20platniot%20bilans%20megunarodnata%20investiciska%20pozicija%20i%20nadvoresniot%20dolg%20koisto%20proizlequvaat%20od%20primenata%20na%20novite%20megunarodni%20statisticki%20standardi.pdf)).

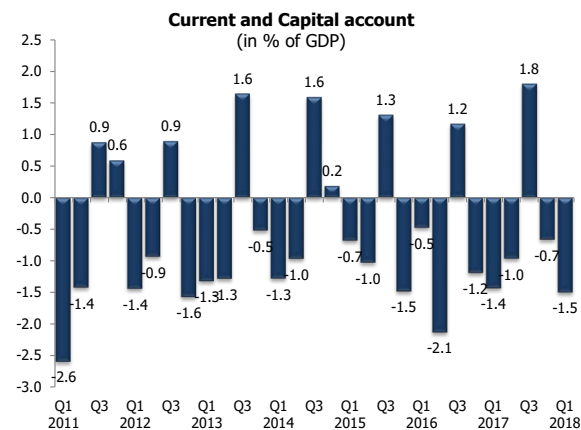


of components, a slight deterioration was observed in the balance of trade in goods and services and primary income, which was partially offset by higher inflows in secondary income. The financial account, during the first quarter, registered high net inflows, which fully arises from the net inflows in the country's portfolio investments (as a result of the issuance of the sixth Eurobond) and inflows based on foreign direct investments. Other categories of the financial account registered moderate net outflows in the first quarter of the year. Total performances of the balance of payments' individual components contributed to the growth of foreign reserves in the first quarter of 2018.

	2016		2017					2018	2016		2017					2018
	Q1	I-XII	Q1	Q2	Q3	Q4	I-XII	Q1	Q1	I-XII	Q1	Q2	Q3	Q4	I-XII	Q1
	EUR mil								% of GDP							
I. Current account	-48.2	-265.0	-145.2	-99.4	180.5	-69.6	-133.7	-157.9	-0.5	-2.7	-1.4	-1.0	1.8	-0.7	-1.3	-1.5
Goods and services	-295.4	-1461.7	-364.1	-373.9	-220.3	-442.0	-1400.3	-377.6	-3.0	-15.0	-3.6	-3.7	-2.2	-4.4	-13.9	-3.6
Credit	1109.0	4865.6	1251.5	1352.4	1463.7	1457.1	5524.7	1387.6	11.4	50.0	12.4	13.4	14.6	14.5	54.9	13.2
Debit	1404.4	6327.3	1615.6	1726.3	1684.0	1899.1	6925.0	1765.2	14.4	65.1	16.1	17.2	16.7	18.9	68.9	16.7
Goods	-404.3	-1808.9	-464.0	-418.4	-412.2	-505.4	-1800.0	-474.4	-4.2	-18.6	-4.6	-4.2	-4.1	-5.0	-17.9	-4.5
Services	108.9	347.2	99.9	44.5	191.9	63.4	399.7	96.8	1.1	3.6	1.0	0.4	1.9	0.6	4.0	0.9
Primary income	-97.2	-383.9	-104.7	-107.7	-108.6	-103.0	-424.0	-109.7	-1.0	-3.9	-1.0	-1.1	-1.1	-1.0	-4.2	-1.0
Secondary income	344.4	1580.5	323.6	382.2	509.3	475.5	1690.6	329.4	3.5	16.3	3.2	3.8	5.1	4.7	16.8	3.1
II. Capital account	2.3	10.7	1.4	2.6	0.4	2.9	7.3	0.3	0.0	0.1	0.0	0.0	0.0	0.0	0.1	0.0
Net lending (+) / net borrowing (-) (balance from current and capital account)	-45.9	-254.3	-143.8	-96.8	180.8	-66.7	-126.4	-157.6	-0.5	-2.6	-1.4	-1.0	1.8	-0.7	-1.3	-1.5
III. Financial account	-69.8	-604.3	-70.5	-50.9	275.8	-157.0	-2.6	-426.4	-0.7	-6.2	-0.7	-0.5	2.7	-1.6	0.0	-4.0
Direct investment	-129.3	-316.9	-111.4	10.0	50.5	-178.1	-229.1	-233.3	-1.3	-3.3	-1.1	0.1	0.5	-1.8	-2.3	-2.2
Portfolio investment	6.7	-429.2	-20.3	5.9	39.6	-8.0	17.3	-368.7	0.1	-4.4	-0.2	0.1	0.4	-0.1	0.2	-3.5
Currency and deposits	59.7	279.0	34.5	19.8	158.2	36.5	248.9	80.3	0.6	2.9	0.3	0.2	1.6	0.4	2.5	0.8
Loans	-55.7	-106.1	28.6	-24.4	43.4	-14.7	33.0	47.3	-0.6	-1.1	0.3	-0.2	0.4	-0.1	0.3	0.4
Trade credit and advances	49.0	-30.3	-1.9	-61.9	-15.9	7.4	-72.2	48.1	0.5	-0.3	0.0	-0.6	-0.2	0.1	-0.7	0.5
Other accounts receivable/payable	0.0	0.0	0.0	-0.1	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Special drawing rights (Net incurrence of liabilities)	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
IV. Net errors and omissions	-10.3	-11.8	6.8	-15.5	-5.6	-7.9	-22.2	-12.1	-0.1	-0.1	0.1	-0.2	-0.1	-0.1	-0.2	-0.1
V. Reserve assets	13.5	338.2	-66.5	-61.3	-100.6	82.4	-146.0	256.7	0.1	3.5	-0.7	-0.6	-1.0	0.8	-1.5	2.4

Source: NBRM.

1.6.1. Current Account



Source: NBRM.

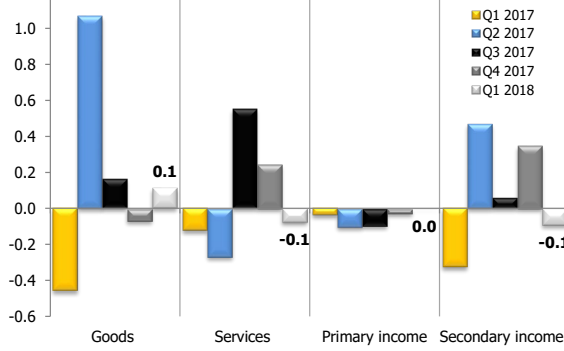
In the first quarter of 2018, the current account of the balance of payments registered a deficit of Euro 150.2 million, or 1.4% of GDP³⁴. Compared to the same period last year, the current account deficit remained almost unchanged³⁵. In relation to the individual components, a slightly higher deficit is registered in the trade of goods (due to the more intensive growth of the import in relation to the growth of the export activity), with small unfavorable shifts in the primary income. Such movements are partially offset by positive shifts in the secondary income balance and slightly higher service surplus. The annual growth in secondary income entirely results from the stronger net inflows of private transfers (mainly from the growth of foreign cash purchased on the currency exchange market, which is used as

³⁴ The calculations use the forecasted amount of the nominal GDP (from April 2018).

³⁵ In nominal amounts, the current account deficit widened by 3.4% on an annual basis.



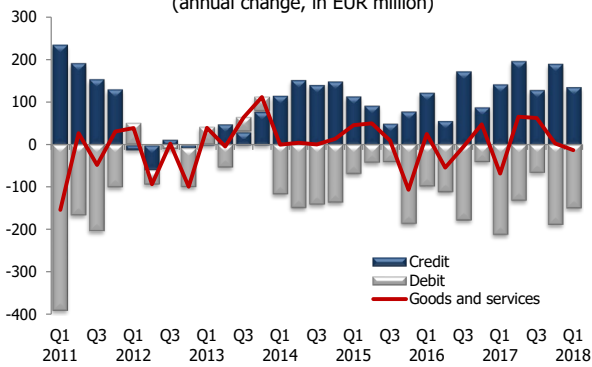
Contribution of current account components in its annual change
(in p.p. of GDP)



Source: NBRM.

an indicator of private cash transfers), with lower official transfers. In services, more favorable movements were registered in several categories, primarily in transport, telecommunications, computer and information services, in the category of repairs and maintenance and in processings, while construction and other business services registered weaker performance compared to the same period last year.

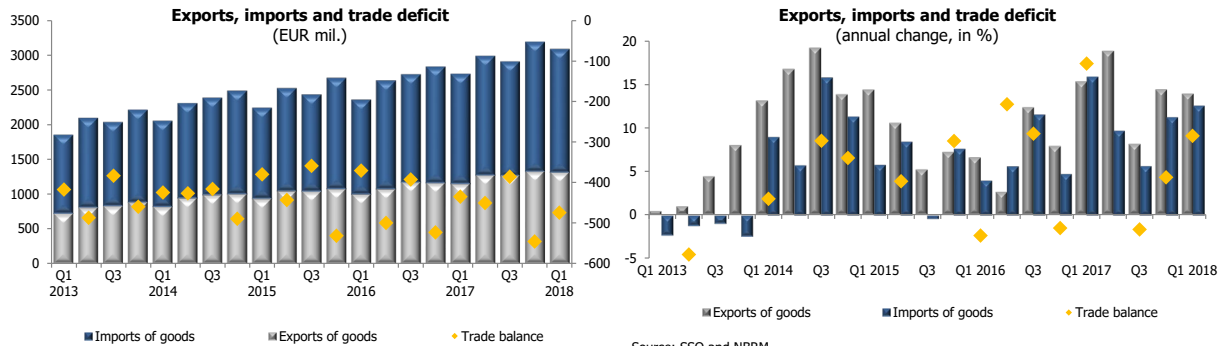
Balance of goods and services
(annual change, in EUR million)



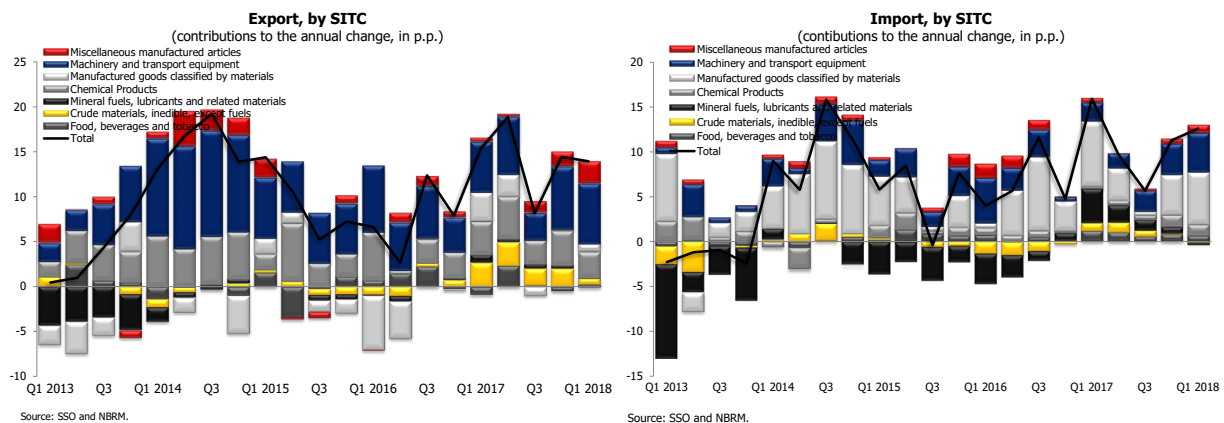
* Positive change in the import of goods means a decrease in imports.
Source: NBRM.

Box 1: Foreign trade of goods and movement of the Nominal and the Real Effective Exchange Rate (NEER and REER)³⁶

Foreign trade in the first quarter of 2018 amounted to Euro 3,092.1 million, i.e. 29.3% of GDP, which is an increase of 13.2% on an annual basis, as a combined effect of the growth of its two components, export and import of goods.



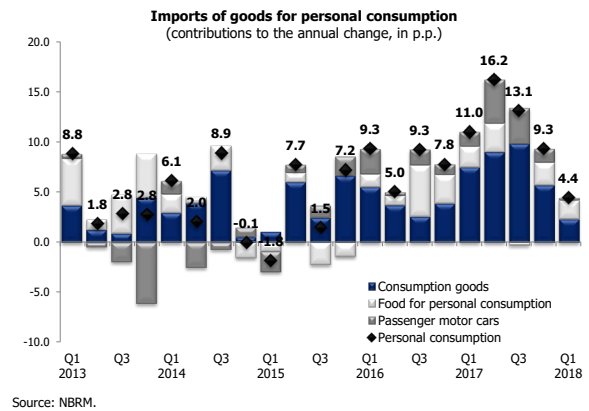
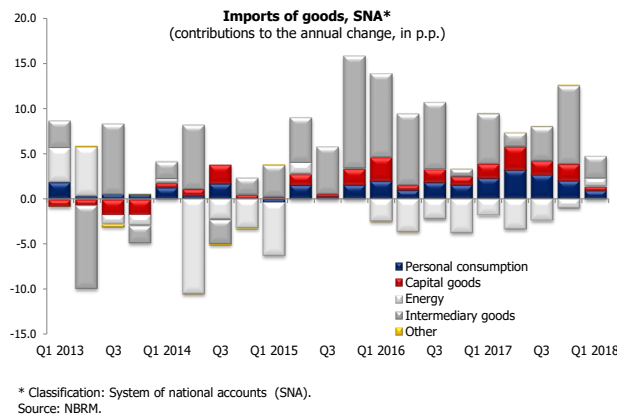
In the first quarter of 2018, export of goods continued to grow at a high annual growth rate of 13.9% (growth of 14.4% in the previous quarter). The activity of the new foreign capacities continues to be the main driver of the good export results, which is reflected in the increased placement of machines and transport devices, chemical products, as well as furniture on the foreign markets. Within the traditional export branches, a small, but positive annual change was registered by the export of metal ore, clothing and the export of food and beverages. On the other hand, the export of iron and steel registered a moderate annual decline, which was entirely due to the lower export prices, amid increased export volumes. **The import of goods registered slightly higher growth on annual basis of 12.6%, compared to the growth of 11.3% registered in the previous quarter.** Moreover, in accordance with the higher export performance in this category, the imports of raw materials for the new foreign companies makes the largest contribution to the annual growth of the total import of goods. The significant upward pressure on imports in the first quarter is that of the increased import of iron and steel, which according to the structure of imported quantities can be reflected in the export of iron and steel in the forthcoming period. **The more intensive growth of the import in relation to the growth of the export of goods, in absolute amounts, led to expansion of the foreign trade deficit by 9.1%**, amid increased deficit in the non-energy component, in conditions of slight narrowing of the energy deficit.



The analysis of the import of goods under the System of National Accounts (SNA) indicates that in the first quarter of 2018 the largest contribution to the annual growth of total import is made by the import

³⁶ According to the Foreign Trade Methodology, data on the export of goods are published on a f.o.b. basis, and on the import of goods, on a c.i.f. basis.

of intermediate products. Additionally, the import growth was also stimulated by the higher import of capital goods and products intended for private consumption, as opposed to the slightly lower import of energy. In terms of import intended for private consumption, it registered moderate annual growth, which reflects the increase in all components, but in the consumer goods above all. As a whole, the growth of import for private consumption in the first quarter of 2018 accelerated compared to the previous quarter, but the annual change remains moderate and does not indicate significant import pressures.

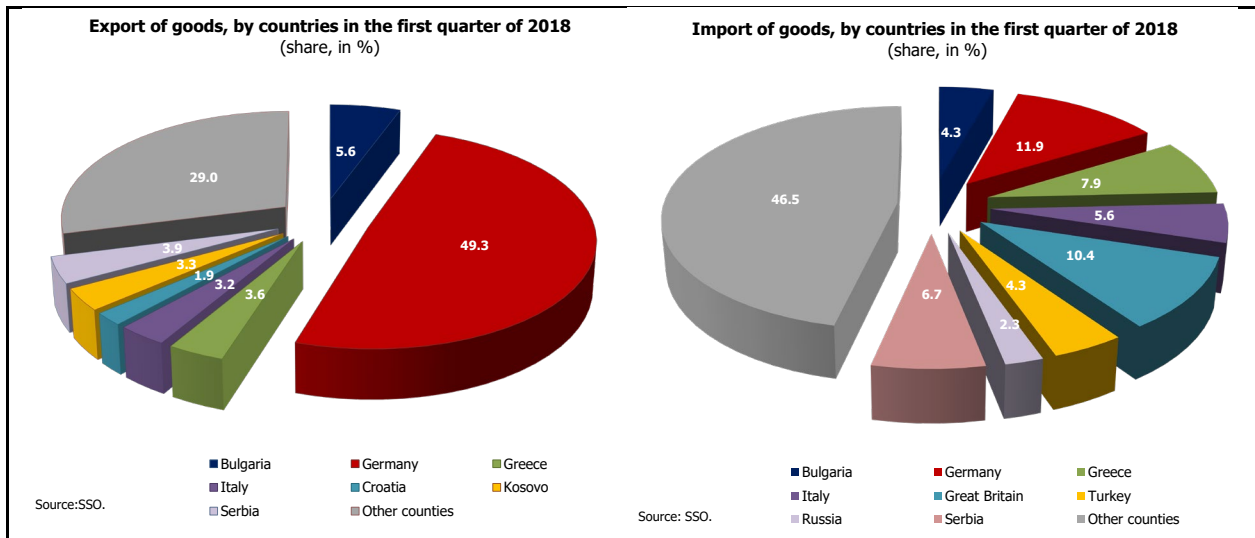


The latest available data on foreign trade during April and May 2018 indicate a more intensive annual growth of the export in relation to the import activity. Export of goods has increased by 14.5% on annual basis, which almost entirely reflects the favorable export performance of the new production facilities. The import of goods registered a more moderate annual growth of 5.3%, which was mostly due to the increase in import of equipment and machinery, coupled with slightly higher energy import. On an annual basis, import of metals registered declined.

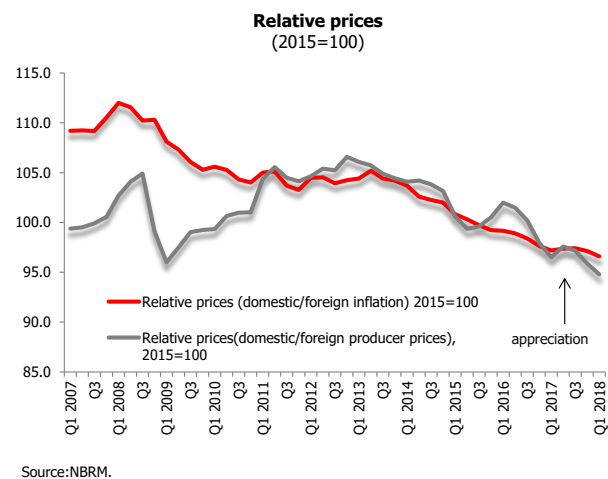
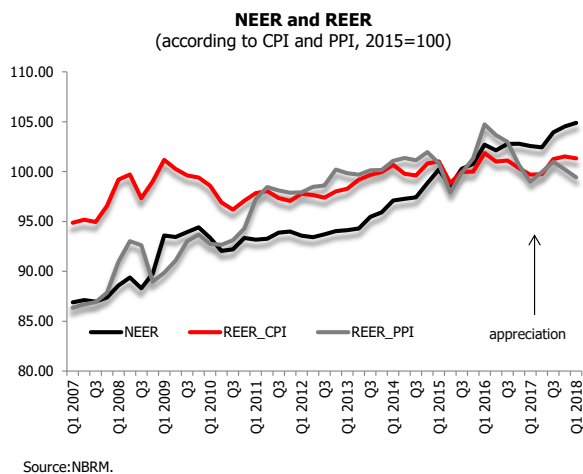
The analysis of foreign trade by trading partners shows that in the first quarter of 2018 the European Union remains our most important trading partner, registering the highest share in total trade of 72.6%. In terms of individual countries, the main driver of growth in export is the export to Germany, as a market to which the export activity of the new capacities in the economy is mostly directed. The export of equipment and machinery to Austria also makes a positive contribution to the export growth. Export of iron and steel to China registered a more pronounced decrease. In terms of import, the largest contribution was made by the higher import from Germany, Great Britain and Italy, which reflects the imports of raw materials for the needs of the new industrial capacities. Significant annual growth was also registered in the import of iron and steel from Greece, as well as in the import of natural gas from Kazakhstan. Analyzed in terms of balances, the expanded trade deficit is mostly due to the deepening of the negative balance in the trade with China, Great Britain, Kazakhstan and Ukraine³⁷. On the other hand, there was an increase in the trade surplus with Germany, as well as a reduction in the trade deficit with the Republic of South Africa³⁸.

³⁷ Reduced export of iron and steel to China, increased import of raw materials for new companies from Great Britain, increased import of energy (natural gas) from Kazakhstan.

³⁸ Reduced import of platinum from the Republic of South Africa.

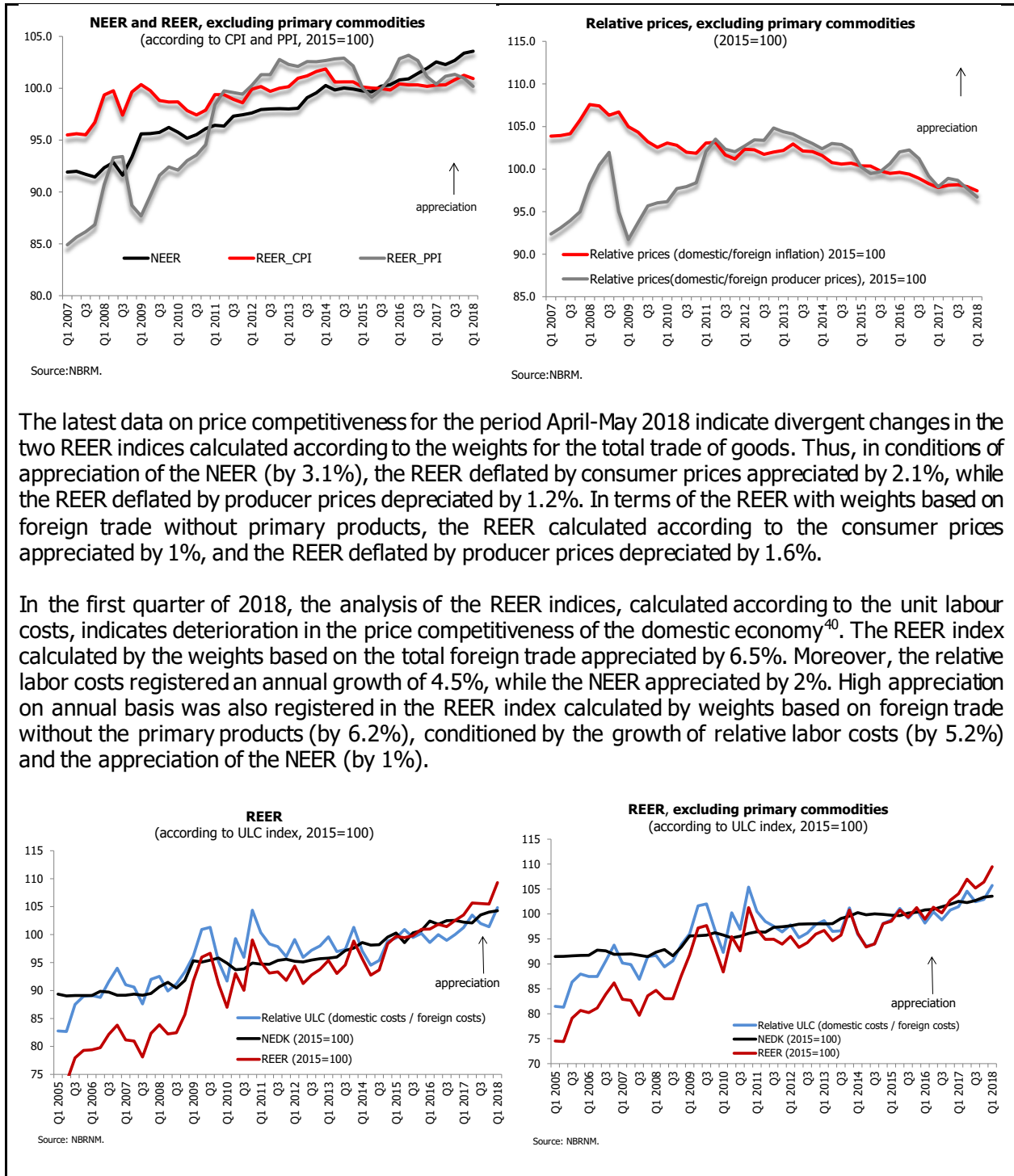


In the first quarter of 2018, the price competitiveness indicators of the Macedonian economy registered less favorable movements compared to the same period last year. The real effective exchange rate index deflated by consumer prices registered an annual appreciation of 1.6%, and the index deflated by producer prices appreciated by 0.4%. The upward pressures arise from the NEER index, which appreciated by 2.3% as a result of the appreciation of the denar against the Turkish lira and the Russian ruble. On the other hand, the relative prices decreased on an annual basis, with a decrease in the relative consumer prices and lower relative producer prices (by 0.6% and 1.8%, respectively).



The analysis of the REER indices calculated by weights based on the foreign trade without primary products³⁹ indicates divergent movements of the price competitiveness indicators. The REER, deflated by consumer prices moderately appreciated by 0.6%, while the REER calculated by the producer prices registered a small depreciation of 0.2% on annual basis. Namely, in conditions of appreciation of the NEER by 1%, the relative prices continue to register an annual decline (decline of 0.4% in the relative consumer prices and decline of 1.2% in the relative prices of industrial products).

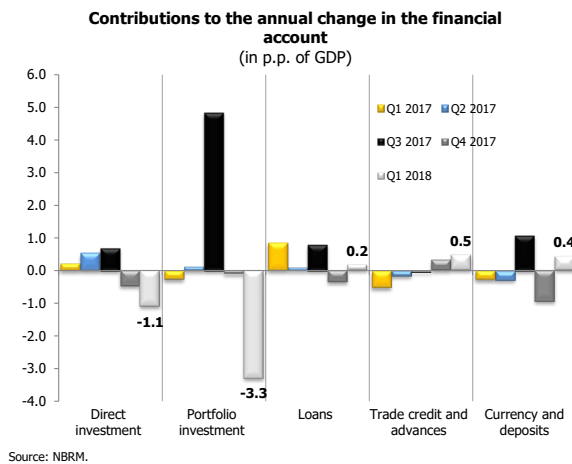
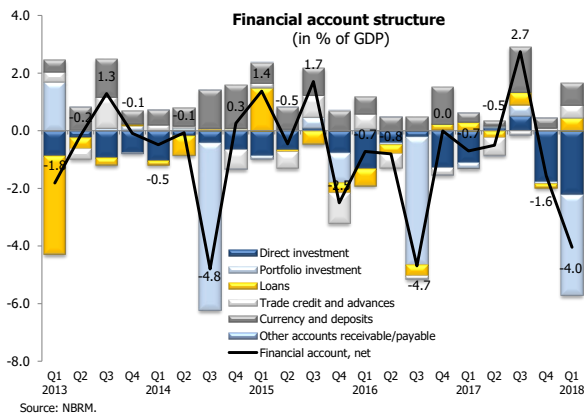
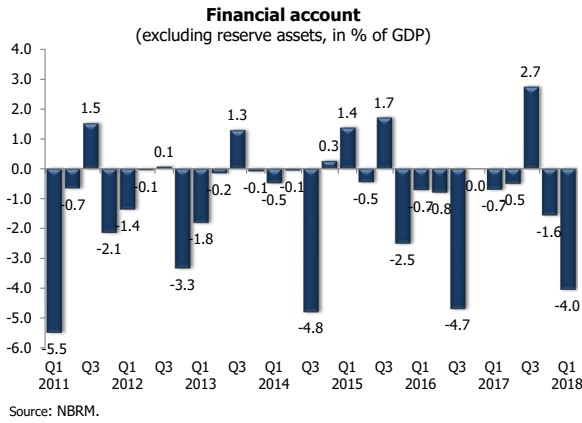
³⁹ Primary products not included in the calculation are: oil and oil derivatives, iron and steel, ores and imported raw materials for new industrial facilities in free economic zones. More detailed information on the methodology for calculating the real effective exchange rate is available on the following link: http://nbrm.mk/WBStorage/Files/Statistika_REDK_Informacija_za_promenite_na_metodologijata_za_presmetuvanje_na_realno_efektiven_devizen_kurs_na_denarot_mak.pdf



The latest data on price competitiveness for the period April-May 2018 indicate divergent changes in the two REER indices calculated according to the weights for the total trade of goods. Thus, in conditions of appreciation of the NEER (by 3.1%), the REER deflated by consumer prices appreciated by 2.1%, while the REER deflated by producer prices depreciated by 1.2%. In terms of the REER with weights based on foreign trade without primary products, the REER calculated according to the consumer prices appreciated by 1%, and the REER deflated by producer prices depreciated by 1.6%.

In the first quarter of 2018, the analysis of the REER indices, calculated according to the unit labour costs, indicates deterioration in the price competitiveness of the domestic economy⁴⁰. The REER index calculated by the weights based on the total foreign trade appreciated by 6.5%. Moreover, the relative labor costs registered an annual growth of 4.5%, while the NEER appreciated by 2%. High appreciation on annual basis was also registered in the REER index calculated by weights based on foreign trade without the primary products (by 6.2%), conditioned by the growth of relative labor costs (by 5.2%) and the appreciation of the NEER (by 1%).

⁴⁰ The REER indices are based on the indices of unit labor costs are internal calculations of the NBRM and do not represent a formal statistical survey. The calculation uses data on unit labor cost indices for the entire economy, published by the ECB and the US Bureau of Labour Statistics. Exceptions are data based on internal calculations, which is the case with the data for Switzerland, as well as for Turkey and Serbia, whereby the calculated indices refer to the industrial sector only.



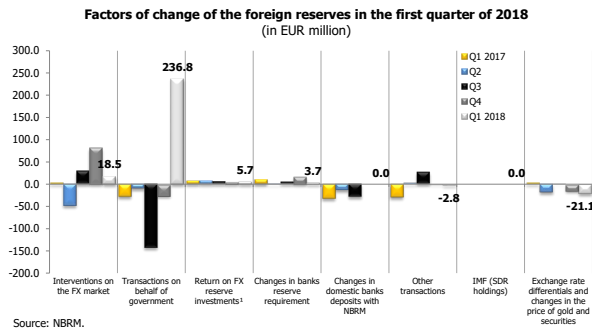
1.6.2. Financial Account

In the first quarter of 2018, the financial account of the balance of payments registered net inflows in the amount of Euro 418.8 million or 4% of GDP. Net inflows were registered in portfolio investments and foreign direct investments, while net outflows were registered in currencies and deposits, trade credits and loans. The inflows in the portfolio investments are almost entirely a result of the government borrowing on the international financial markets, through the issuance of the sixth Eurobond⁴¹. High net inflows were also registered in foreign direct investments as a result of the positive movements in all components, whereby over half of the growth achieved was due to foreign direct investments on the basis of debt instruments (intercompany debt). The other two components of direct investments, equity and reinvested profit, show more moderate positive flows. The negative trends in trade credits and advances, both in currencies and deposits continued in the first quarter of 2018, at a stronger pace. Moreover, the registered net outflows in currencies and deposits are mostly a reflection of the further net outflows in other sectors, with simultaneous net outflows in depository corporations. Net outflows in loans are entirely due to the long-term component, mainly as a result of the repayment of the second part of the loan to Deutsche Bank. Regarding the short-term loans, moderate net inflows were registered based on the short-term borrowing of other sectors.

The realized net inflows in the financial account during the first quarter of 2018 are higher compared to their performance in the same period of the previous year. The more favorable shifts in this period represent a combined effect of higher net inflows based on portfolio investments and higher direct investments. On the other hand, the performances in the other categories of the financial account registered deterioration on an annual basis.

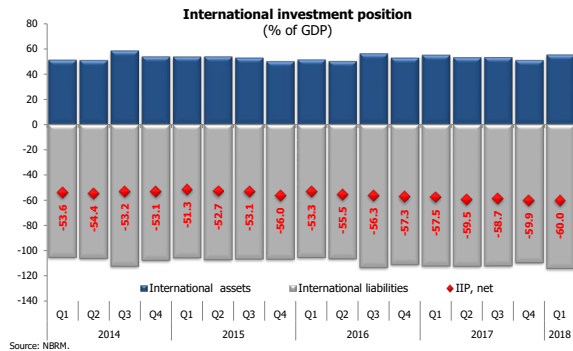
At the end of the first quarter of 2018, the gross foreign reserves amounted to Euro 2,577.1 million, representing a quarterly increase of Euro 240.8 million. The increase in foreign reserves is mainly due to the transactions on behalf of the government, as a result of the issuance of the sixth Eurobond on the international financial markets. Other flows had a

⁴¹ On 11 January 2018, the sixth Eurobond in the amount of Euro 500 million was issued on the international capital market with a maturity of 7 years and an interest rate of 2.75%. Part of the total amount of the sixth issued Eurobond was used for partial early purchase of the Eurobond issued in 2015 by the government.

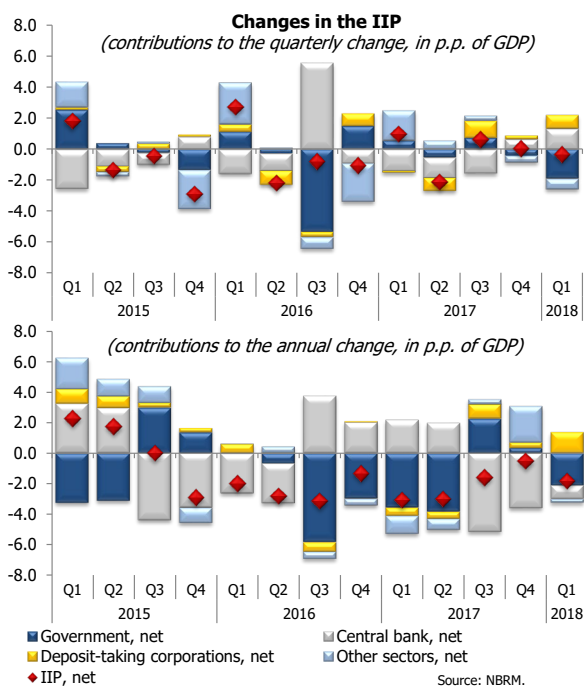


more moderate impact on the changes in foreign reserves in the analyzed period.

1.6.3. International Investment Position and Gross External Debt



The international investment position⁴² of the Republic of Macedonia at the end of the first quarter of 2018 was negative and amounted to Euro 6,324 million, or 60% of GDP. On a quarterly basis, the negative international investment position was higher, in conditions of faster growth in international liabilities relative to the growth of international assets. In terms of division by sectors, the change in the international investment position is largely due to the growth of net government liabilities (based on debt securities)⁴³ and other sectors⁴⁴ in the economy (increased net liabilities on the basis of foreign direct investments and long-term loans). On the other hand, the net position of the central bank acted towards improving the overall international investment position of the country (mostly as a result of the growth of foreign reserves), and the net liabilities of depository corporations acted in the same direction as well.

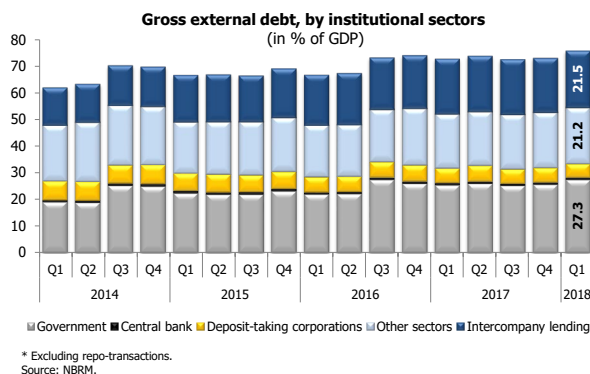
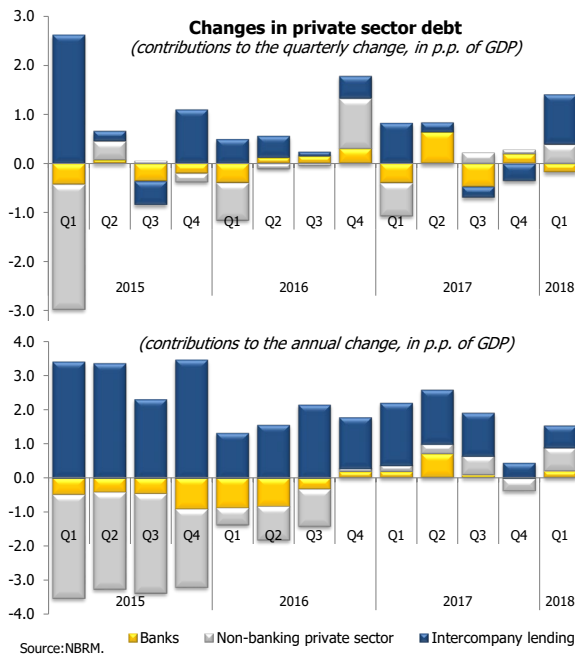
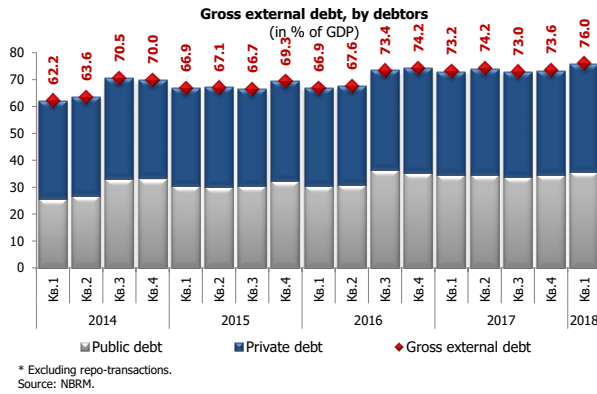


Compared to 31 March 2017, the negative IIP registered an additional deterioration of 2.6 percentage points of GDP. This change is a reflection of higher international liabilities (2.6 percentage points of GDP), in conditions of almost unchanged international assets. The sectoral analysis shows that this shift is largely due to the change in the net position of the government, as a result of higher net liabilities on the basis of debt securities. Net liabilities of other sectors also have their effect in the same direction (increased net liabilities on the basis of direct investments and long-term loans). These movements were partially mitigated by the shifts in the net position of

⁴² In the second quarter of 2011, the NBRM began concluding repo and reverse repo transactions. These transactions represent an investment opportunity to use portfolio securities to provide additional income. Conclusion of repo transactions incurs liabilities. At the same time, the claims created from entering into reverse repo agreements increase gross claims. The NBRM simultaneously carries out matched conclusion of repo and reverse repo agreements in nearly identical amounts. In general, as they are concluded concurrently, these transactions have a neutral net effect on net basis, i.e. they appear in almost identical amount on both liabilities and assets side, and therefore do not affect the total net IIP nor the total net external debt.

⁴³ On 11 January 2018, the sixth Eurobond in the amount of Euro 500 million was issued on the international capital market with a maturity of 7 years and an interest rate of 2.75%.

⁴⁴ It refers to other financial institutions, non-financial enterprises, households and non-profit institutions serving households.



depository corporations (reduced net liabilities based on currencies and deposits and long-term loans).

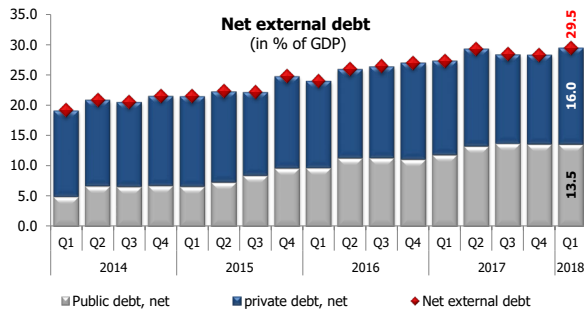
The gross external debt at the end of the first quarter of 2018 amounted to Euro 8,298 million, or 78.7% of GDP, which is an increase of 5.2 percentage points of GDP compared to the previous quarter. By excluding the effect of the NBRM's⁴⁵ repo-transactions, gross external debt (76% of GDP) registered a quarterly increase of 2.4 percentage points of GDP, which is a result of the growth of both public and private debt (1.3 and 1.1 percentage points, respectively). Within the public debt, the quarterly change was driven by higher long-term liabilities of the central government on the basis of debt securities, while the lower liabilities on long-term loans of public enterprises and public banks acted in the opposite direction. Within the private sector's debt position, the quarterly growth is driven by the realized increase in the intercompany debt, as well as the non-banking private sector's higher liabilities based on loans, in the short and long term.

On an annual basis, gross external debt increased by 2.8 percentage points of GDP, resulting from the higher private and public debt (by 1.6 and 1.2 percentage points, respectively). Moreover, the increase in the private sector's debt results from the increase of the non-banking private sector's liabilities and the growth of the intercompany debt, while the annual growth of the public sector's debt is driven by higher government liabilities based on debt securities.

At the end of the first quarter of 2018, net external debt amounted to Euro 3,105.6 million, or 29.5% of GDP, which is an increase of 0.8 percentage points compared to the previous quarter. The moderate increase is due to the increase in the private net debt, while the public debt registered a slight decline.

The review of the domestic economy's external debt indicators does not indicate significant changes. Namely, according to the indicator for the share of the gross external debt in GDP, we are still in the group of highly indebted countries, while all other indicators point to a low level of indebtedness of the economy. The analysis of the dynamics of external indebtedness indicates favorable annual shifts in some of the solvency indicators, i.e. in the indicator of the share of gross debt in the export of goods and services and other

⁴⁵ The overall further analysis refers to the gross external debt without central bank liabilities based on repo-transactions.



* Excluding repo-transactions.
Source: NBRM.

inflows, as well as in the indicator of the share of interest repayment in the export of goods and services and other inflows. Other solvency indicators show a moderate deterioration, while a slight annual deterioration is also observed in all individual liquidity indicators.

Indicators for external indebtedness	Solvency				Liquidity		
	Interest payments/ Export of goods and services and other inflows	Gross debt/ Export of goods and services and other inflows	Gross debt/ GDP	Debt servicing/ Export of goods and services and other inflows	Foreign reserves/ Short-term debt	Foreign reserves/ Short-term debt, with residual maturity**	Short-term debt/ Overall debt
	in %				ratio	ratio	in %
31.12.2004	2.41	129.3	47.3	12.4	1.14	0.89	30.3
31.12.2005	2.66	147.0	54.2	11.1	1.67	1.04	26.7
31.12.2006	3.44	131.3	49.8	21.7	1.95	1.34	29.0
31.12.2007	2.78	119.3	51.3	19.4	1.35	1.08	39.8
31.12.2008	2.66	116.9	54.1	10.2	1.29	0.95	35.2
31.12.2010	2.43	131.0	57.8	11.8	1.29	0.94	32.9
31.12.2011	3.22	140.4	59.7	13.9	1.49	0.99	27.9
31.12.2012	3.12	148.4	64.6	16.8	1.78	1.18	25.2
31.12.2013	2.92	142.1	67.6	13.1	1.64	1.03	26.7
31.12.2014	2.51	137.3	67.3	15.8	1.64	1.08	23.3
31.03.2015	3.01	149.1	74.0	17.2	1.82	1.13	22.3
30.06.2015	2.69	143.9	73.2	20.0	1.69	1.13	21.3
31.12.2015	2.38	135.26	71.38	14.95	1.51	1.05	23.05
31.03.2016	2.38	136.59	72.09	14.95	1.41	0.98	23.24
30.06.2016	2.38	148.28	78.25	14.95	1.74	1.16	21.72
30.09.2016	2.38	149.94	79.13	14.95	1.65	1.16	21.93
31.12.2016	2.69	139.37	76.53	12.70	1.46	1.00	23.51
31.03.2017	2.69	141.32	77.60	12.70	1.33	0.88	24.12
30.06.2017	2.69	138.91	76.28	12.70	1.26	0.86	24.51
31.12.2017	2.69	140.15	76.96	12.70	1.31	0.89	24.03
31.03.2018	2.52	137.21	79.19	16.77	1.28	0.92	25.08
<i>Moderate indebtedness criterion*</i>	<i>12 - 20%</i>	<i>165 - 275%</i>	<i>30 - 50%</i>	<i>18 - 30%</i>		<i>1.00</i>	

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

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

*According

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

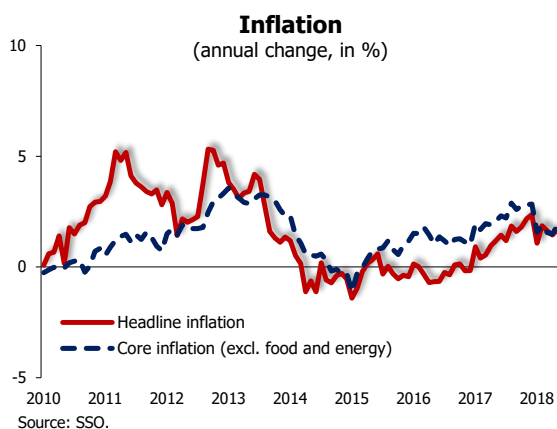
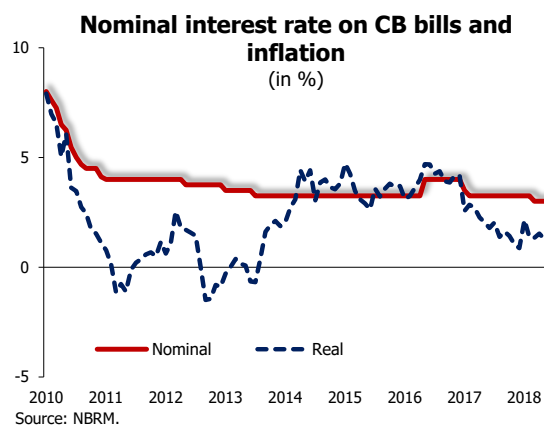
Short-term debt at remaining maturity is calculated by addition of the long-term external debt (original maturity), with final contractually scheduled payment of less than a year, to the short-term debt (original maturity).

Source: NBRM.



II. Monetary Policy

After easing the monetary policy at the end of the first quarter, the National Bank kept the key interest rate at 3.00% in the second quarter of 2018. The current monetary setup was assessed as appropriate, in conditions of further assessments of the stability of the economic fundamentals and the absence of imbalances in the economy. However, the risk assessment showed that they are still present at certain points, although less pronounced compared to the previous period. On the foreign exchange market, favorable movements are still registered, with the National Bank continuing to intervene with the purchase of foreign currency from market makers, and the foreign exchange position of the banks remained at a relatively high and stable level. Foreign reserves registered growth in the second quarter of the year, and according to their adequacy indicators, they are still maintained in the safe zone. Favorable movements were also registered in the deposit and credit flows, which in the period April-May exceeded the growth expectations in accordance with the April forecasts. The NBRM will continue to closely monitor the situation, in order to timely and adequately adjust monetary policy.



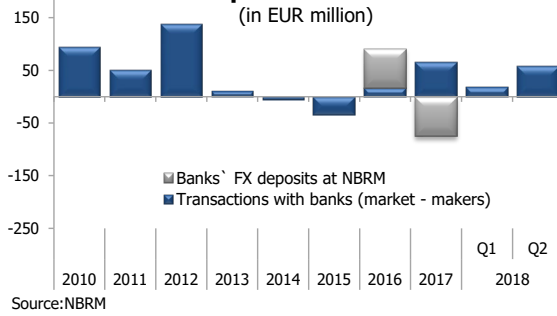
During the second quarter⁴⁶ of 2018, the NBRM did not change the monetary policy setup, i.e. the NBRM's key interest rate was kept at the level of 3.00%. During the regular review of the monetary setup adequacy, it was assessed that most of the macroeconomic indicators, which are important for the monetary policy setup, do not deviate significantly from the forecasts, and the fundamentals of the economy are still sound. Risk assessment showed that they are still present at certain points, but still less pronounced compared to the previous period. The NBRM will continue to closely monitor the situation in the forthcoming period, in order to timely and adequately adjust monetary policy.

The comparison of the performances of the basic macroeconomic indicators with their forecasted dynamics in the April forecasting round, indicated certain deviations in the individual segments of the economy. The inflation growth in the period April - May was moderate and averaged 1.6%, on an annual basis. Inflation performance was assessed as lower than forecasted in the April forecast, but given the upward adjustment in import prices, the risks around the forecast for the whole year were assessed as balanced. In terms of economic activity, according to the estimated GDP data for the first quarter, the economy registered a minimal growth of 0.1%, which is a performance below the estimates incorporated in the April forecasts. In the first quarter, the continuity of solid growth of export activity was maintained, as well as the growth of household consumption. Yet, in conditions of temporary interruption and

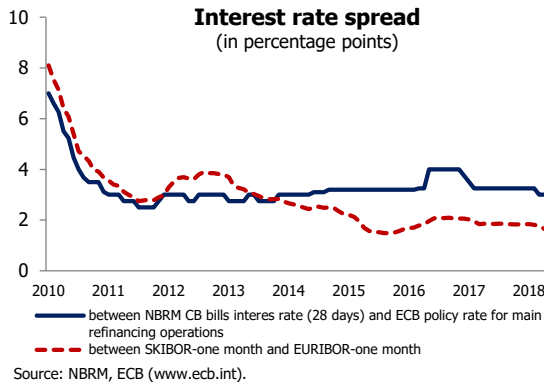
⁴⁶ It refers to the decisions of the OMPC sessions held in the period April-June.



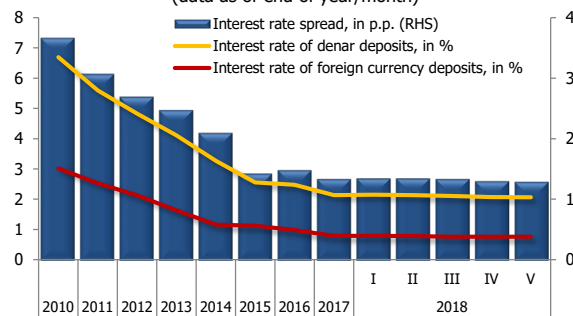
Interventions on the foreign exchange market by NBRM and banks` FX deposits at NBRM
(in EUR million)



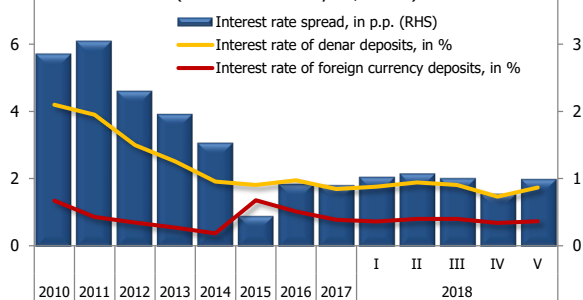
Interest rate spread
(in percentage points)



Spread between interest rates of denar and foreign currency deposits
(data as of end of year/month)



Spread between interest rates of denar and foreign currency deposits (new business)
(data as of end of year/month)



prolongation of some of the more significant infrastructure projects, the total investments declined, almost offsetting the positive performance of other GDP components. Foreign reserves in the second quarter of the year registered an increase, and the movements in the foreign exchange market, where the NBRM intervened with purchase of foreign currency, were also favorable. The foreign reserves adequacy indicators continuously showed that their level is appropriate and in the safe zone. Favorable shifts were also registered in the banks' deposit base, which continued to grow with accelerated dynamics in the period April-May, which is partly related to certain seasonal factors, and in part it reflects the further stabilization of the economic agents' confidence. Regarding the credit market, the growth of credit activity in the period April-May accelerated compared to the previous quarter. These performances were in line with the results of the Bank Lending Survey for the first quarter, in which banks expected further easing of the overall lending conditions and increase in the credit demand in both sectors for the second quarter of the year as well.

In general, the environment for conducting monetary policy in the second quarter of the year was assessed as relatively favorable. Risks related to the domestic environment were assessed as less pronounced compared to the previous period. From the external environment, the solid macroeconomic indicators in the Euro area indicated its further recovery. But, despite the favorable assessments, the risks from the external environment were assessed as less favorable compared to the previous period, and related to the increase of trade protectionism globally, the continuation of the upward trend of oil prices on world stock markets, the increased political and geopolitical risks in many regions of the world, as well as the effects of the pace of normalization of the central banks' monetary policies in developed countries.

At its session held in June, the European Central Bank announced gradual abandonment of the quantitative easing programme by the end of this year and keeping interest rates at the current level, at least until the end of 2019 summer.

In conditions of unchanged key interest rates of the NBRM and the ECB⁴⁷ in the second quarter of 2018, the spread between these interest rates remained unchanged. Regarding the indicative market interest rates, with a moderate decrease of 1m SKIBOR, the spread between the

⁴⁷ Main refinancing operations interest rate



interest rates in the Republic of Macedonia and in the Euro area (1m SKIBOR and 1m EURIBOR) registered a slight narrowing.

In the domestic economy, interest rates on total deposits (denar and foreign currency) in May did not change compared to the end of the previous quarter, whereby the interest rate spread is still 1.3 percentage points. Newly received deposits (denar and foreign currency) registered a moderate decrease in the interest rate compared to March, by 0.1 percentage point, respectively⁴⁸, whereby the interest rate spread at the end of May is still 1.0 percentage point.

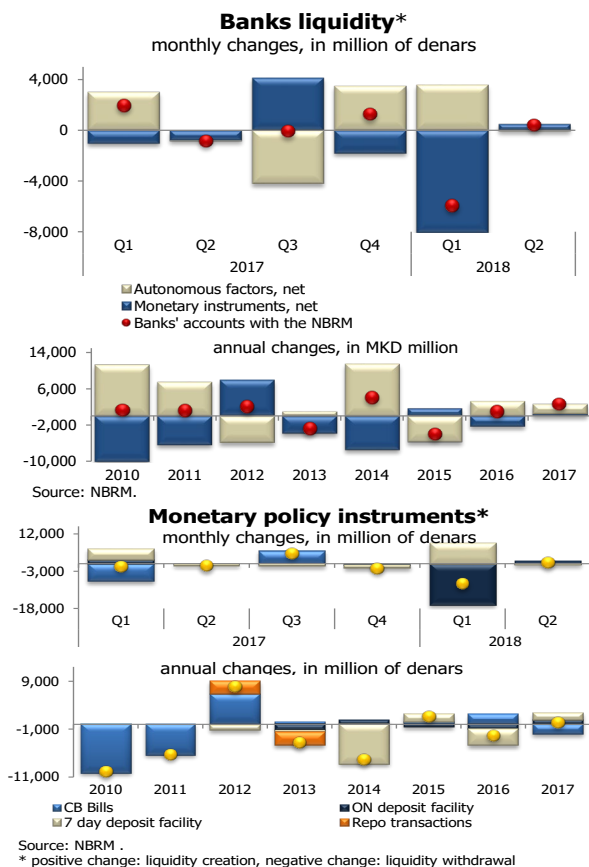
2.1. Banks' liquidity

In the second quarter of 2018, banks' liquid assets⁴⁹ on the NBRM accounts increased by Denar 441 million, compared to the decrease in the previous quarter.

The growth of banks' liquidity in the second quarter of the year was a reflection of the reduced interest of banks in placing free liquid assets in short-term deposits with the NBRM. Monetary instruments' stock in the second quarter decreased by Denar 492 million, which, in conditions of maintaining the stock of CB bills at the level of Denar 25,000 million⁵⁰, fully results from the decrease in the amount of overnight deposit facilities, amid a small increase in 7-day deposit facilities.

Net autonomous factors acted towards moderate withdrawal of liquidity from the banking system, in the amount of Denar 75 million. According to the analysis of the individual autonomous factors, the dominant flows that acted towards withdrawing liquid assets from the banking system were government transactions and currency in circulation. On the other hand, the foreign currency interventions of the NBRM with market makers acted towards increasing the liquidity of the banks, but to a lesser extent.

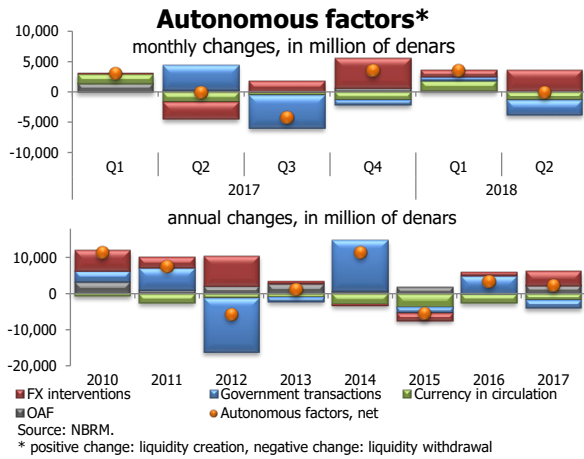
In the second quarter of 2018, the amount of liquid assets on the banks' accounts with the NBRM above the level of the reserve requirement was significantly higher compared to the previous quarter. The



⁴⁸ Interest rates on newly received deposits are characterized by variable movements, which can lead to frequent and temporary adjustments to the interest rate spread.

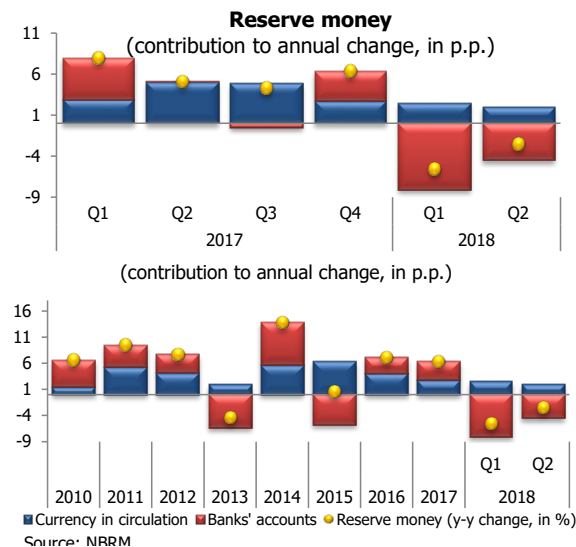
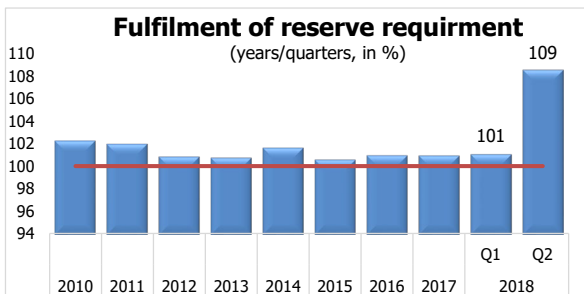
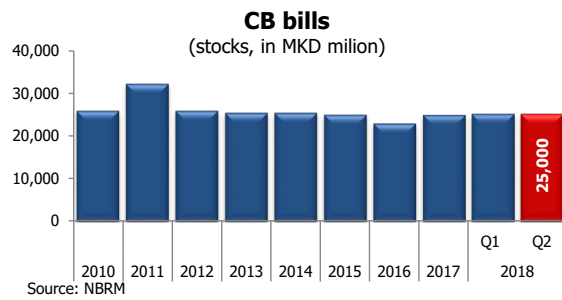
⁴⁹ It refers to the change in the balance of the bank accounts with the NBRM.

⁵⁰ In the second quarter of 2018, three auctions of CB bills were held, at which CB bills in the amount of Denar 25,000 million were offered and sold.



stock of banks' liquid assets on the accounts with the NBRM in the second quarter of the year was, on average, by 9.0% higher than the reserve requirement, which is significantly higher compared to the previous quarter (on average 1.0% above the reserve requirement). The growth of the excess liquid assets arises from the determination of the banks to maintain the excess liquid assets on accounts with the NBRM, in conditions of lower interest rates on the deposit facilities with the NBRM.

At the end of the second quarter of the year, reserve money⁵¹ was lower by 2.5% on annual basis, which is a moderately lower decline compared to the previous quarter (5.6% on annual basis).



⁵¹ Includes the reserve requirement in foreign currency.

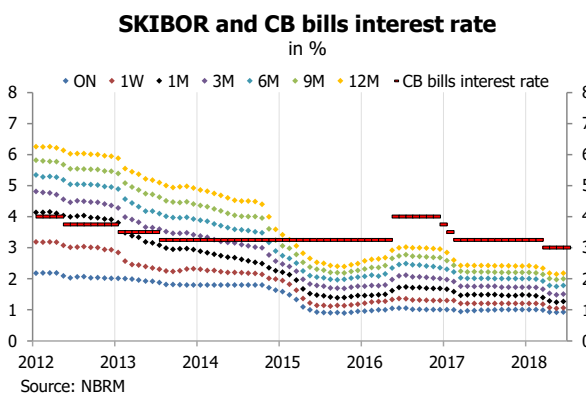
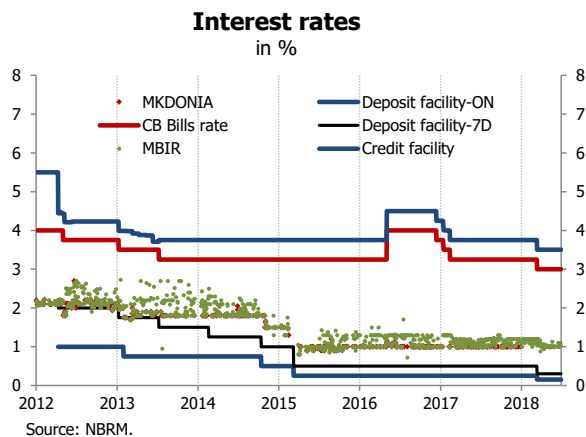
III. Financial market developments

In the second quarter of 2018, given the unchanged level of the key interest rate of the NBRM, the interest rates on the money market remained stable. On the primary government securities market, the trend of shifting the mature short-term securities to longer maturities continued, with favorable shifts in the government securities' currency structure. On the secondary securities market, there was an increase in the turnover, almost entirely a result of the increased volume of repo transactions, while the returns on realized transactions registered no significant changes. On the capital market, the value of MBI-10 on the Macedonian Stock Exchange continued to increase, amid rising prices of almost all shares that are part of the index, while regional indices moved in different directions. In the international financial markets, the volatility indices of the financial conditions during the quarter pointed to a certain increase of the uncertainty, which proved to be temporary. Yields on the Macedonian Eurobonds increased, which affected the expansion of the spreads in relation to the yields on the German government bonds.

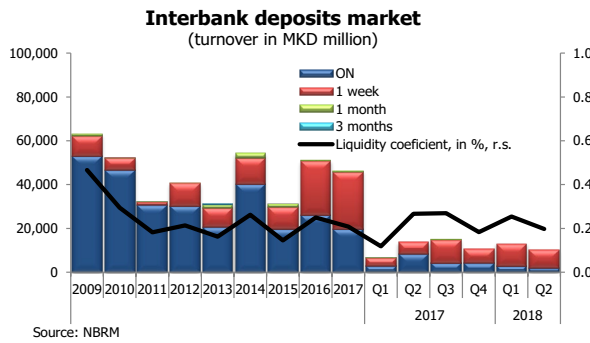
3.1. Interbank market with non-collateralized deposits

Amid unchanged level of the key interest rate of the NBRM, the interest rates on the money market remained stable. In the second quarter of the year, the NBRM kept the key interest rate unchanged (3.00%), whereby the interbank interest rate for overnight transactions (MKDONIA) remained at around 1.0%, and the interbank interest rate of all transactions (MBKS) decreased moderately (on average to 1.01% compared to 1.14% in the previous quarter). Minimal decrease was registered in all maturities of SKIBOR quotations⁵², compared to the previous period.

In the second quarter of the year, the interbank market with non-collateralized deposits registered a decreased trade activity compared to the previous quarter. The total realized turnover of this market segment in the second quarter of the year amounted to Denar 10,439 million, lower by 20.5% on a quarterly basis. Most of the transactions on the

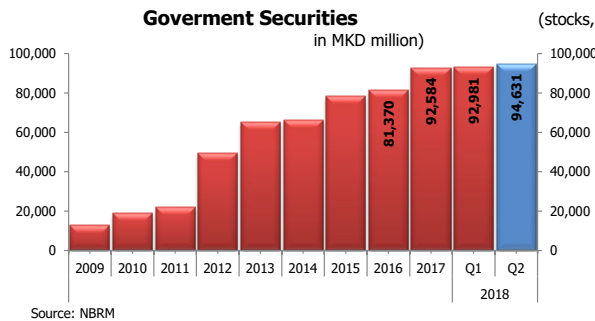


⁵² Indicative interest rates for selling denar deposits on the interbank market, with maturities overnight, 1 week, 1, 3, 6, 9 and 12 months, calculated from the quotations of the reference banks.

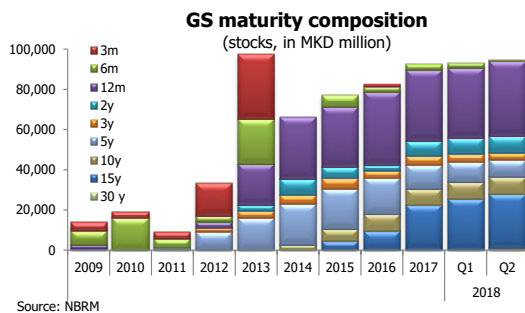


interbank market are still with a maturity of up to 7 days.

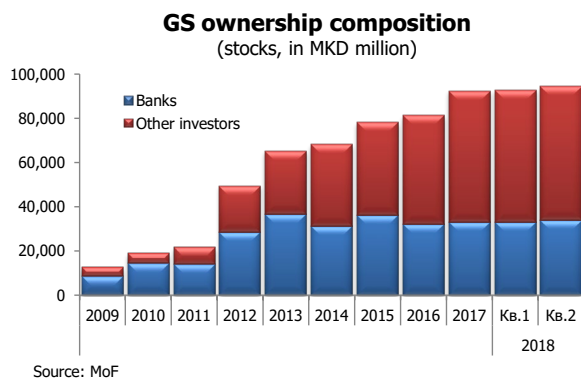
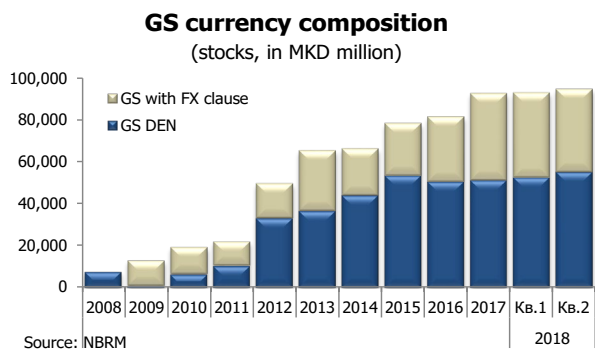
3.2. Government Securities Market



On the primary government securities market, the trend of shifting the mature short-term securities to longer maturities continued. The stock of government securities in the second quarter increased moderately, which is almost equally a result of the increase in the stock of treasury bills and government bonds.

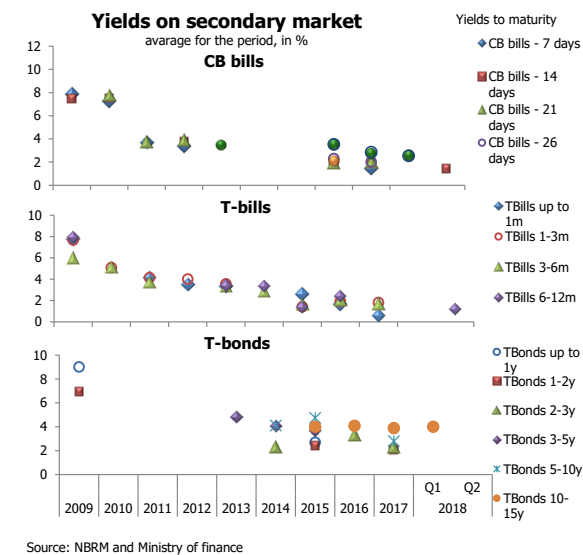
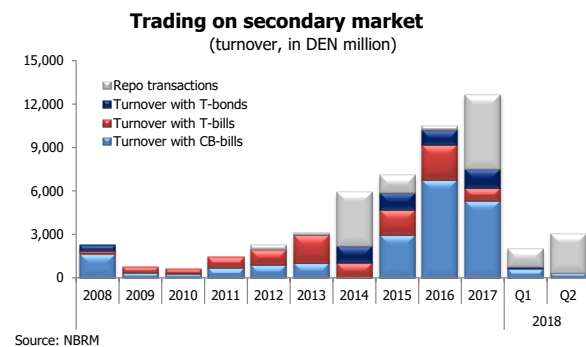
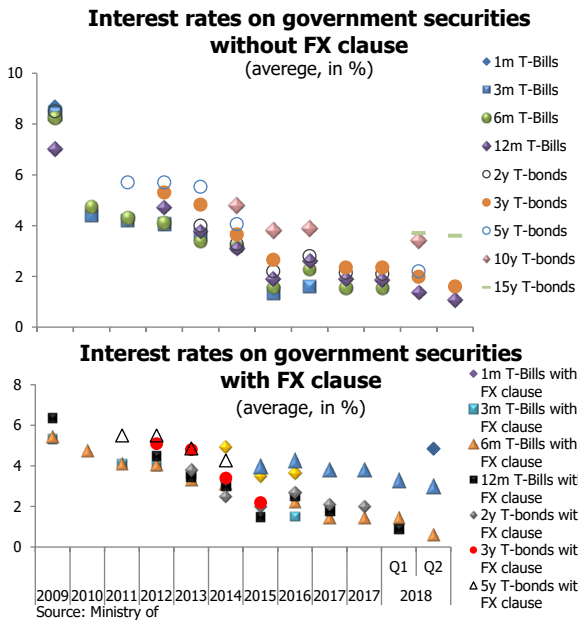


Analyzed by individual maturity categories, more significant growth in government bonds in the second quarter of the year was registered in the stock of the fifteen-year government bonds, and decrease in the five-year government bonds on a quarterly basis. In April, the Ministry of Finance issued a thirty-year government bond for the first time. Regarding the treasury bills, an increase was registered in the twelve-month treasury bills, with a quarterly decrease in the six-month treasury bills. Such changes contributed to the growth of the share of 12-month treasury bills in the total amount of government securities (from 37.5% to 39.5%), as well as of the 15-year government bonds (from 27.6% to 28.2%), with simultaneous reduction of the share of the 6-month treasury bills (from 2% to 1%), as well as of the 3-year and the 5-year government bonds (from 4% to 3% and from 11% to 9%, respectively).



The new issues of government securities in the second quarter of the year were mostly without foreign currency clause. The stock of the government securities without foreign currency clause in the second quarter increased by Denar 2,594 million, while the government securities with foreign currency clause decreased on a quarterly basis.

Consequently, in the second quarter, the share of government securities without foreign currency clause increased from 56.1% to 57.9%, while the share of securities with foreign currency



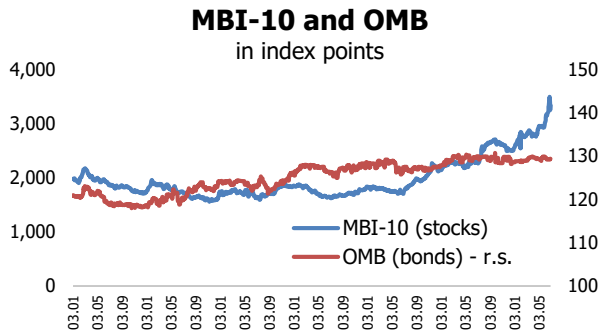
clause decreased from 43.9% to 42.1% on a quarterly basis.

In the second quarter of 2018, there is no significant change in the ownership structure of government securities. At the end of the second quarter of 2018, other investors still have a dominant share in the total issued government securities (with 64%), same as in the previous quarter, within which the pension funds continue to dominate, and the share of banks still accounts for 36%. **In the primary market, the Ministry of Finance reduced the interest rates on government securities⁵³ in the second quarter of the year.** With the interest rate on the newly issued 30-year bond (set at 4.85%), the yield curve was extended by another maturity.

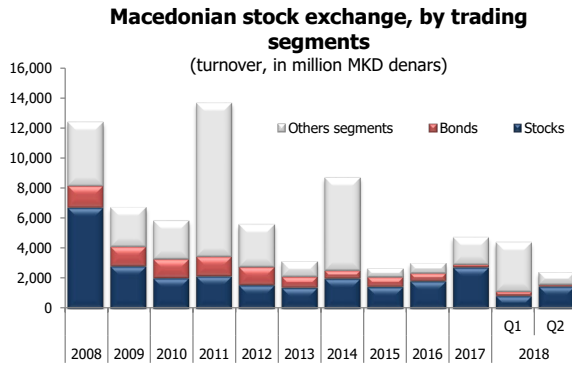
Increased trading activity was registered on the secondary securities market. In the second quarter of the year, the secondary securities market registered a turnover in the amount of Denar 3,052 million, which was by about 55% higher compared to the turnover registered in the previous quarter. The turnover structure continues to be dominated by repo-transactions (with a share of about 90%), with reduction in the share of outright transactions with CB bills (from 31% to 9.8%). **Yields on realized securities transactions on the secondary market in the second quarter registered no significant changes.**

On the Macedonian Stock Exchange, the value of the Macedonian Stock Exchange Index MBI-10 continued to increase, while the trading volume was lower, on a quarterly basis. The value of the MBI-10 continued to increase in the second quarter, and registered a growth of 20.5% on a quarterly basis (from 2,766 to 3,333). This shift of the MBI-10 during the quarter is related to the growth of the prices of all shares that constitute the MBI-10 index. In terms of trading, the total turnover in the second quarter was almost twice lower than in the previous quarter, which is a result of reduced turnover

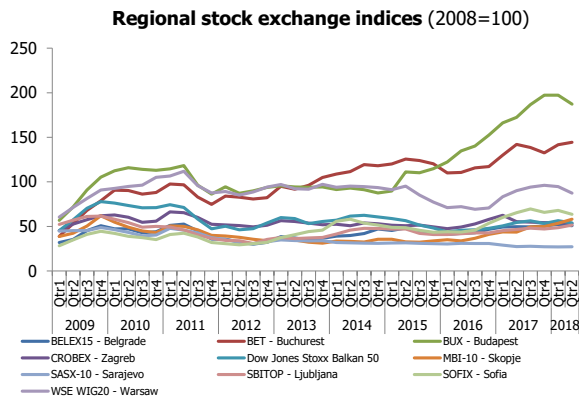
⁵³ In April, the Ministry of Finance reduced the interest rates on the 6-month treasury bills with foreign currency clause from 1.45% to 0.6%, while in May it reduced the interest rates on the 12-month treasury bills from 1.2% to 1%. In June, the interest rates on the 15-year government bonds without and with foreign currency clause were reduced from 3.7% to 3.5% and from 3.2% to 3%, respectively.



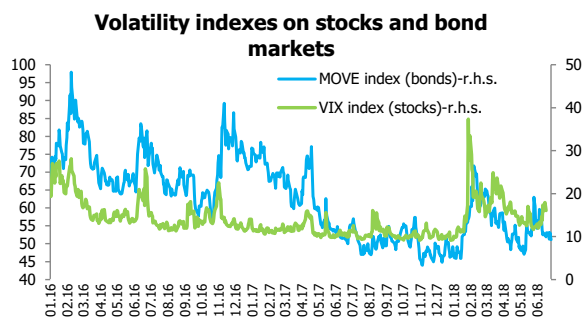
Source: Macedonian Stock Exchange



Source: Macedonian Stock Exchange



Source: Macedonian Stock Exchange and national stock exchanges.



Source: Chicago Board Options Exchange (CBOE)

through block transactions, in contrast to their faster growth in the previous period. The bond index (OMB) in the second quarter registered no significant changes and it was 129.3 at the end of the second quarter.

On the regional stock exchanges, the movements of the stock exchange indices were in different directions. The stock exchange index in Budapest is still the highest, which for the first time after a longer period registered a quarterly decline. Stock exchange indices in Belgrade, Sofia and Warsaw also registered a decline on a quarterly basis. On the other hand, the highest quarterly growth was registered in the stock exchange index in Skopje, while an upward shift was also registered in the stock exchange index in Ljubljana. Relatively lower growth was also observed in the stock exchange indices in Sarajevo and Bucharest.

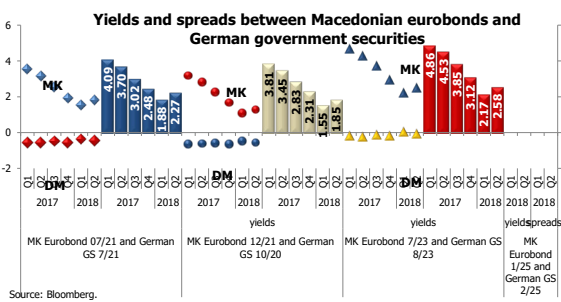
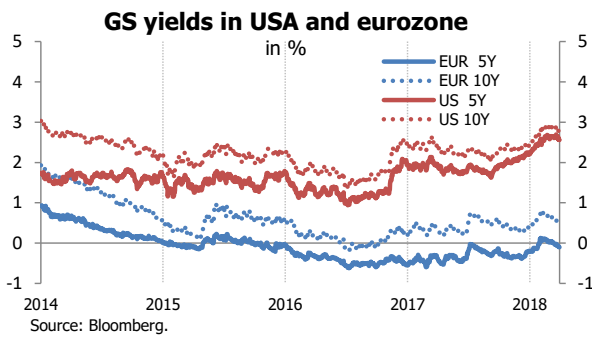
Bond and stock market volatility indices remained lower, on average, compared to the previous period. Despite the variable movement during the second quarter, both indices (VIX54 and MOVE), on average, remained at a lower level compared to the previous period. The movement of the indices during the quarter was mostly influenced by the positive performances in the US economy, but also by the uncertainty related to the possible effects of the announcements for increasing the trade protectionism on a global level.

Long-term government bond yields in the United States and the Euro area show divergent movements. In conditions of further normalization of the US monetary policy, the US 10-year government bond⁵⁵ yields continued to move upwards during the second quarter (on average from 2.75% to 2.92%). On the other hand, yields on the 10-year government securities in the Euro area decreased (on average from 0.62% to 0.49%)⁵⁶.

⁵⁴The MOVE Index (Merrill Lynch Option Volatility Estimate) shows the volatility on the US treasury bills markets. The VIX Index (Volatility Index) is constructed based on the implicit volatility of the S&P 500 index options. Investors use both indices as indicators of the situation and expectations regarding the instability of the financial markets. A downward path in the indices indicates a decrease in volatility.

⁵⁵These are generic yields derived from the US government bond yield curve.

⁵⁶These are generic government bonds derived from the government bonds yield curves of Germany and France.



The spread between Macedonian Eurobonds and German government bonds, compared to the previous period of continuous narrowing experienced widening in the second quarter. In the second quarter, the spread between the yields on the issued Macedonian Eurobonds⁵⁷ and the yields on the German government bonds averaged 2.27 percentage points, 1.85 percentage points and 2.58 percentage points respectively for the latest issues of Macedonian Eurobonds. The widening of the spread between domestic Eurobonds and foreign (German) bonds in the second quarter is a result of the increase in the yields on Macedonian Eurobonds, with simultaneous decrease in the yields on German bonds.

IV. Monetary and credit aggregates⁵⁸

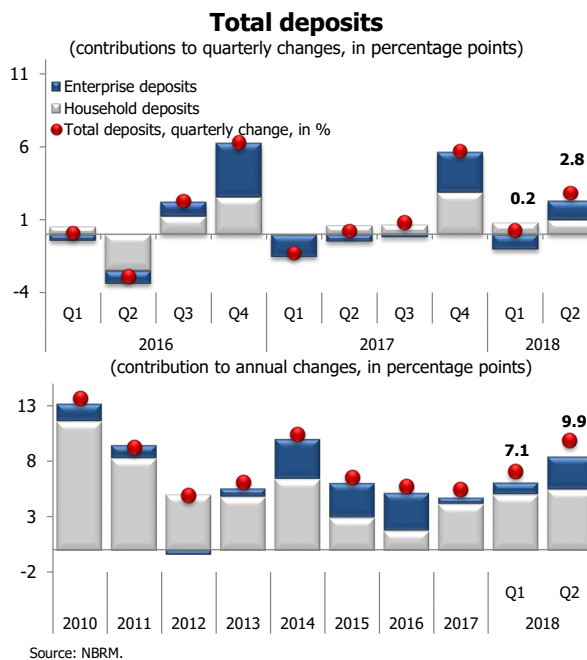
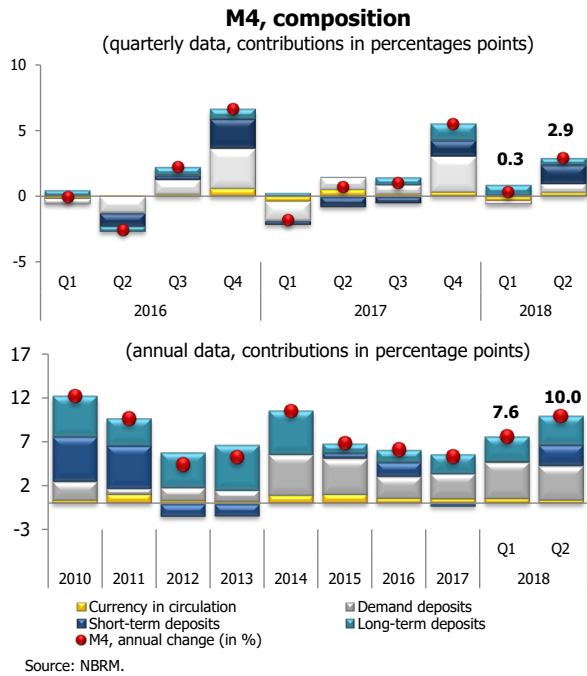
In the second quarter of 2018, favorable shifts were observed in the monetary and credit aggregates. Thus, after the stagnation in the first quarter, the broadest money supply in the second quarter registered a solid growth. This change in the dynamics is partly a seasonal effect, but it is also consistent with the signals for favorable shifts in terms of economic activity and the favorable position of the balance of payments in this period. From structural point of view, all components of the money supply experienced an increase. Similar trends are observed in the credit market as well. Namely, after the usual seasonal decline in the first quarter of the year, the credit activity in the second quarter accelerated under the influence of the strengthened credit support to the corporate sector, amid further growth of loans approved to households, as a sector that continues to be the growth driver of total credit placements of the banks. The results of the Bank Lending Survey for the second quarter of 2018, indicate further growth in the credit demand amid further easing of overall credit conditions.

4.1.1. Monetary aggregates

The broadest money supply M4, in the second quarter of 2018 registered a solid growth. The growth of money supply (of 2.9%, on a quarterly basis) is partly related to seasonal

⁵⁷Refers to the Macedonian Eurobonds issued in July 2014, in December 2015, in July 2016 and January 2018. Eurobonds are issued in a nominal amount of Euro 500 million, Euro 270 million, Euro 450 million and Euro 500 million, respectively, with maturities of 7, 5, 7 and 7 years, respectively, and annual interest rates of 3.975%, 4.875%, 5.625% and 2.75%, respectively.

⁵⁸ Within this quarterly report, the data on monetary and credit aggregates are analyzed based on the data based on the old monetary statistics methodology, which was applied as of the published data for May 2018. For more information about the methodological changes visit http://www.nbrm.mk/monetarna_statistika_i_statistika_na_kamatni_stapki.nsp.x.



	2016				2017				2018	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Total deposits	quarterly change, in %									
Total deposits	0.1	-2.9	2.3	6.3	-1.3	0.2	0.8	5.7	0.2	2.8
	contributions to quarterly growth, p.p.									
Deposit money	-0.4	-1.3	1.2	3.0	-1.3	1.0	0.7	3.0	-0.7	0.7
Denar deposits	0.01	-1.6	0.0	1.7	0.1	-0.4	-0.1	1.1	0.2	0.7
FX deposits	0.5	0.1	1.1	1.6	-0.1	-0.4	0.2	1.7	0.7	1.4
Short-term deposits	0.03	-1.0	0.4	2.5	-0.3	-0.9	-0.5	1.3	0.0	1.7
Long-term deposits	0.5	-0.5	0.7	0.8	0.3	0.1	0.7	1.5	1.0	0.4
Households	0.5	-2.5	1.2	2.5	0.0	0.6	0.6	2.9	0.8	1.0
Enterprises	-0.4	-0.9	1.0	3.7	-1.5	-0.5	-0.2	2.8	-1.0	1.3

Source: NBRM.

factors, but is also consistent with the favorable signals in terms of the economic activity and balance of payments. From structural aspect, the most liquid component (currency in circulation and demand deposits) accounted for about one third in the growth of the broadest money supply in the second quarter, despite its negative contribution in the first quarter of the year. However, the largest contribution to the growth of money supply is that of the increase in the short-term deposits, with further growth of the long-term deposits, as a reflection of the further stabilization of the confidence of economic agents. From currency aspect, growth was registered in both currency components, with a relatively higher contribution of the foreign currency component in relation to the denar component (denar deposits, without demand deposits). At the end of the second quarter, the share of foreign currency deposits in M4 (37.8%) was almost unchanged compared to the end of the previous quarter (37.7%). **On an annual basis**, the growth of the broadest money supply accelerated, reaching 10% in June, compared to 7.6% at the end of the first quarter.

The total deposit potential of banks in the second quarter of the year continued to grow with accelerated dynamics (acceleration of growth from 0.2% to 2.8% on a quarterly basis). Analyzed by sector, this performance largely arises from the increase in corporate deposits, after their seasonal decline in the first quarter. Household deposits continued to increase on a quarterly basis, with moderately stronger dynamics. The moderate growth of deposits of other financial institutions⁵⁹ also made a positive contribution to the quarterly growth of total deposits. The analysis of the currency structure indicates an equal contribution of denar (with demand deposits) and foreign currency deposits to the quarterly growth of total deposits. In terms of maturity structure, the growth is largely due to higher short-term deposits, amid slower growth of long-term deposits. **On an annual basis**, the growth of the total deposits of banks accelerated, reaching 9.9% in June (7.1% at the end of the first quarter).

Total household deposits in the second quarter continued to grow, with moderately stronger quarterly dynamics (from 1.2% in the first quarter to 1.4% in the second quarter). The growth of household deposits is due to higher deposits in foreign currency, while the contribution of denar deposits (with demand

⁵⁹ Other financial institutions include: investment funds, pension funds, insurance companies, investment fund management companies and pension fund management companies, financial companies and financial leasing companies.



Household deposits

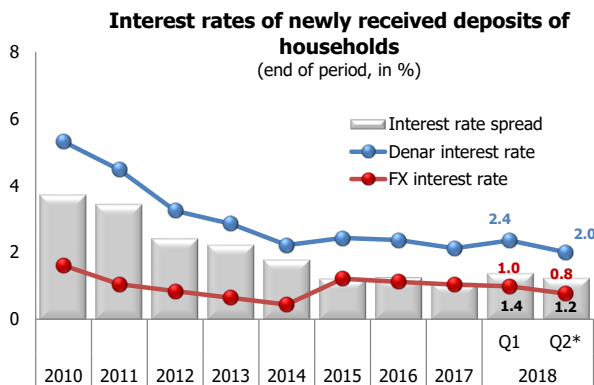
	2016				2017				2018	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
quarterly change, in %										
Total household deposits	0.8	-3.5	1.8	3.7	0.1	0.9	0.9	4.1	1.2	1.4
contribution to quarterly change of total deposits, in p.p.										
Deposit money	0.1	-0.9	0.6	2.1	-0.5	1.4	-0.1	2.5	-0.1	0.3
Denar deposits	0.3	-2.6	0.0	0.6	0.1	-0.4	0.2	0.5	0.5	0.1
FX deposits	0.4	0.0	1.1	0.9	0.5	-0.1	0.9	1.1	0.8	1.1
Short-term deposits	0.1	-1.8	0.6	0.6	0.2	-0.7	0.6	0.7	0.5	0.7
Long-term deposits	0.6	-0.8	0.5	0.9	0.4	0.2	0.4	1.0	0.8	0.5

Source: NBRM.

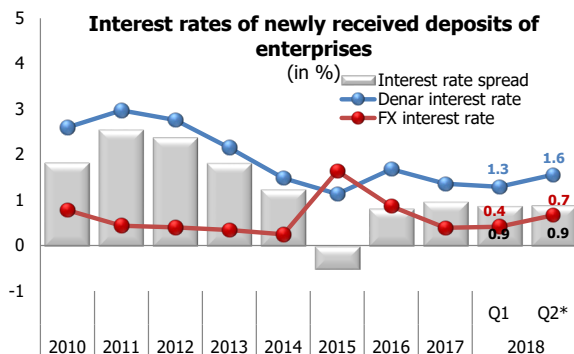
Household deposits

	2016				2017				2018	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
quarterly change, in %										
Total household deposits	0.8	-3.5	1.8	3.7	0.1	0.9	0.9	4.1	1.2	1.4
contribution to quarterly change of total deposits, in p.p.										
Deposit money	0.1	-0.9	0.6	2.1	-0.5	1.4	-0.1	2.5	-0.1	0.3
Denar deposits	0.3	-2.6	0.0	0.6	0.1	-0.4	0.2	0.5	0.5	0.1
FX deposits	0.4	0.0	1.1	0.9	0.5	-0.1	0.9	1.1	0.8	1.1
Short-term deposits	0.1	-1.8	0.6	0.6	0.2	-0.7	0.6	0.7	0.5	0.7
Long-term deposits	0.6	-0.8	0.5	0.9	0.4	0.2	0.4	1.0	0.8	0.5

Source: NBRM.



*end of May
Source: NBRM.



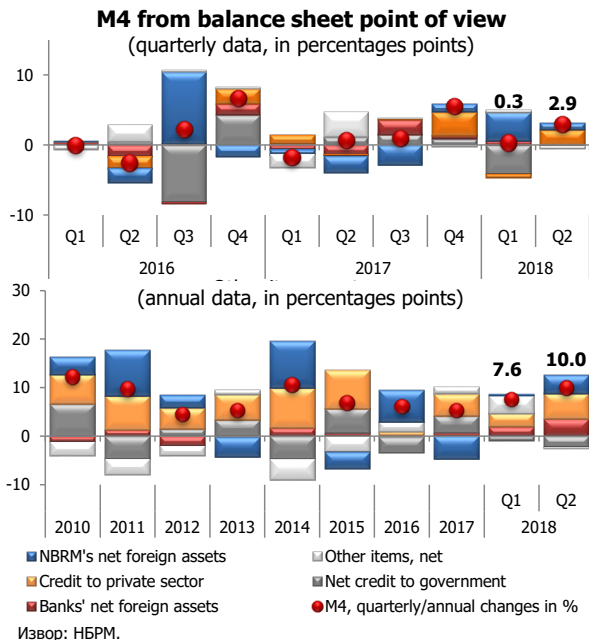
*end of May
Source: NBRM.

deposits) was positive, but moderately lower compared to the previous quarter. In the second quarter, a stronger positive contribution of short-term deposits was registered to the total quarterly growth compared to the realized growth of long-term deposits. **On annual basis**, the growth of total household deposits in June accelerated, reaching 7.9%, compared to 7.3% at the end of March 2018.

After the decline in the previous quarter (of 3.9%), the total corporate deposits in the second quarter of the year increased by 5.3%. According to the analysis of the currency structure, the growth largely stems from the growth of deposits with denar component (denar deposits with demand deposits), with more moderate growth of foreign currency deposits. In terms of maturity structure, the growth in the second quarter is entirely a result of short-term deposits, with a negative contribution of long-term deposits. **On annual basis**, corporate deposits at the end of June were higher by 11.6%, which is a significant acceleration of the annual growth compared to the end of March (growth of 4.1%).

The growth of the deposit base was achieved in conditions of reduction of the returns on the new savings and narrowing of the interest rate spreads in the household sector. Thus, in May, the interest rates⁶⁰ on the newly received household denar and foreign currency deposits (2.0% and 0.8%, respectively) were lower by 0.4 and 0.2 percentage points, respectively compared to March. In such conditions, the interest rate spread between the new denar and foreign currency household savings narrowed (from 1.4 percentage points in March to 1.2 percentage points in May). **In the corporate sector, interest rates on newly received denar and foreign currency deposits increased by 0.3 percentage points, respectively compared to March, amounting to 1.6% and 0.7%, respectively.** Amid simultaneous growth of both interest rates, the interest rate spread between the newly received denar and foreign currency corporate deposits in May remained at the level of 0.9 percentage points as in the previous quarter. Regarding the total received deposits, the interest rates on household and corporate deposits (denar and foreign currency) in May registered no changes compared to March, amounting to 1.4% and 1.7%, respectively.

⁶⁰ Starting from January 2015, data on interest rates of banks and savings houses are collected according to a new interest rate methodology. More detailed information is available in the Quarterly Report, May 2015, on page 53.



Total credits of private sector

	2016				2017				2018	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
quarterly change, in %										
Total credits of private sector	0.1	-2.0	0.2	2.7	-0.8	2.2	0.2	4.1	-0.7	2.7
Contribution in quarterly change of total credits (in p.p)										
Denar credits	0.6	-1.1	0.5	3.2	-0.6	2.2	0.6	4.0	-0.2	2.6
Foreign currency credits	-0.6	-0.9	-0.3	-0.5	-0.2	0.0	-0.5	0.1	-0.5	0.1
Short-term credits	-1.1	-0.3	-0.5	1.6	-1.4	0.5	-0.6	2.0	-0.9	0.6
Long-term credits	1.0	2.2	0.9	1.7	0.8	1.1	0.9	2.1	1.4	2.0
Households	1.1	0.1	0.8	1.0	1.0	1.4	1.0	0.8	1.1	1.6
Corporations	-1.0	-2.1	-0.6	1.6	-1.8	0.8	-0.8	3.3	-1.9	1.1

Source: NBRM.

The analysis of the money supply structure, from a balance sheet point of view, shows that the realized quarterly growth of the money supply in the second quarter of the year is mainly due to the loans to the private sector, as well as the growth of net foreign assets of the NBRM and net foreign assets of banks. The net government loans acted in the opposite direction.

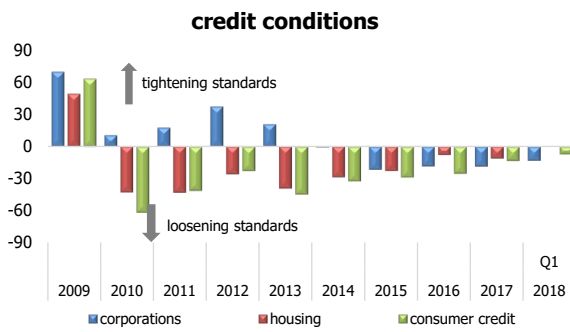
4.1.2. Lending activity

Lending activity in the second quarter increased, compared to the decrease in the previous quarter, with the quarterly growth rate of total loans at the end of June being 2.7%. This is a normal movement in this period, given the decline in the lending activity of banks in the first months of the year. The results of the latest Bank Lending Survey⁶¹ continue to show net easing of the credit conditions, with simultaneous increase in the credit demand, excluding the consumer credit demand.

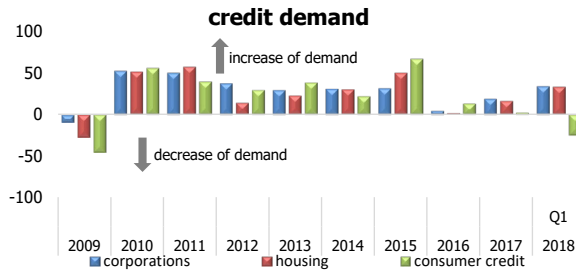
From sectoral aspect, the turning point in the dynamics of lending to the private sector on a quarterly basis is largely explained by the credit support of the corporate sector⁶², which grew in the second quarter, as opposed to the decline in the previous quarter. Household loans in the second quarter continued to grow, with moderately stronger dynamics compared to the first quarter, thus continuing to make a dominant contribution to the quarterly growth. In terms of currency structure, the growth of the total loans granted to the private sector in the second quarter almost entirely arises from the growth of the loans with denar component, with a small growth of the foreign currency loans. According to the analysis of the maturity structure, the quarterly growth of total

⁶¹ More detailed information is available in the Bank Lending Survey on the following link: <http://nbrm.mk/?ItemID=F7AC78DEE498764FBAF39049F726CE3C>.

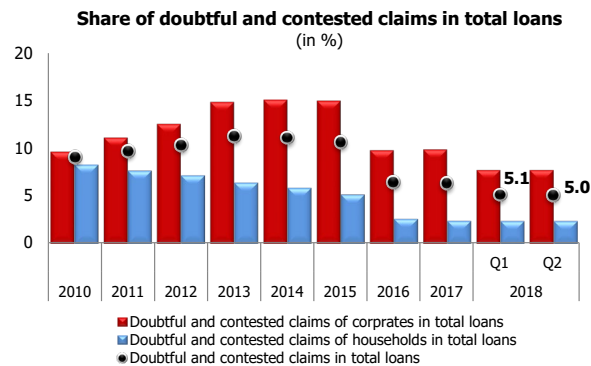
⁶² Also partly due to the lower base effect at the end of the first quarter, when a larger amount of doubtful and contested claims was collected from the corporate sector.



Source: Bank lending Survey, NBRM.



Source: Bank lending Survey, NBRM.



Source: NBRM.

Total credits of households

	2016				2017				2018	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
quarterly change, in %	2.5	0.2	1.9	2.2	2.1	3.0	2.1	1.6	2.3	3.3
Contribution in quarterly change of household credits (in p.p)										
Denar credits	2.5	0.1	1.7	2.1	2.0	2.6	1.8	1.6	2.2	3.1
Foreign currency credits	0.1	0.2	0.1	0.1	0.1	0.4	0.3	0.1	0.1	0.2
Short-term credits	0.2	0.2	0.1	-0.4	0.2	0.0	0.1	-0.5	0.1	0.2
Long-term credits	2.4	3.1	1.8	2.7	1.9	2.8	1.9	2.3	2.1	3.0

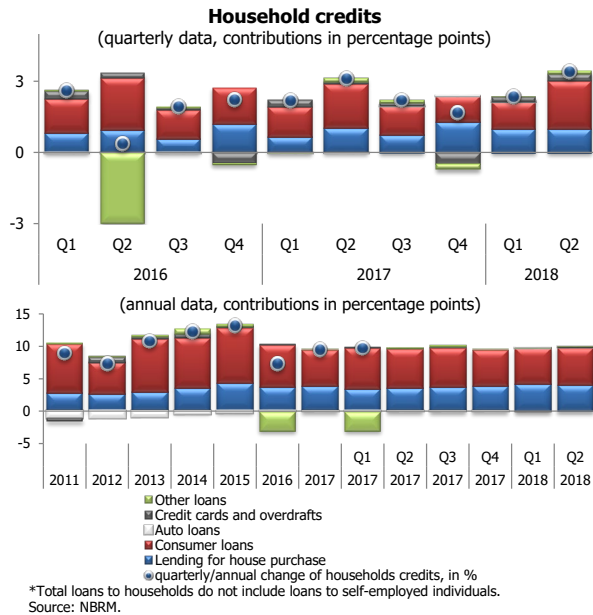
Source: NBRM.

loans is primarily due to higher long-term loans, with moderate growth of the short-term loans. The share of doubtful and contested claims in total loans at the end of June was almost unchanged compared to the previous quarter and amounted to 5% (5.1% in March).

On annual basis, total loans in June increased by 6.3%, which was higher compared to March (5.8%). During the second quarter, amid simultaneous increase of the deposit base and lending activity, the indicator of the share of total loans in total deposits remained at a stable level of around 87%.

The acceleration of the quarterly growth of loans granted to the household sector in the second quarter of 2018 (from 2.3% to 3.3%) is largely explained by the growth of consumer loans, with further stable and positive contribution of the housing loans. According to the Bank Lending Survey, in the second quarter there was a slight net increase in the demand for housing loans, amid a decrease in the demand for consumer loans, but at a slower pace compared to the previous quarter. In terms of currency structure, the growth of household loans mostly stems from denar loans, with a small growth of foreign currency loans. In terms of maturity structure, the growth is mostly a result of higher long-term loans, with a moderate positive contribution of short-term loans. **On annual basis**, total household loans at the end of June were higher by 9.7%, which is a moderately higher performance compared to the end of March (9.4%).

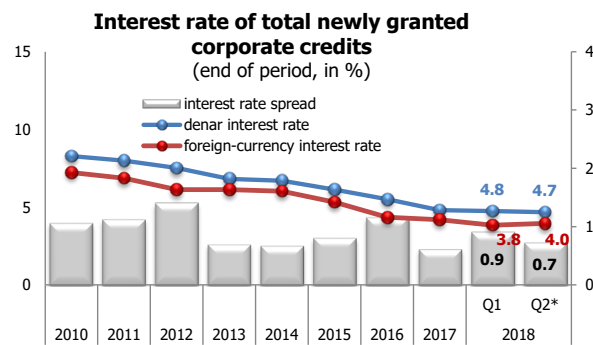
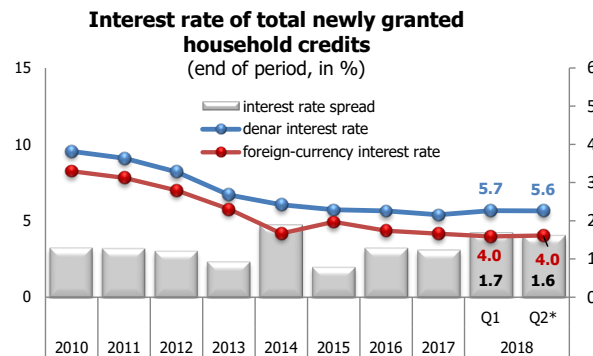
Total loans granted to the corporate sector during the second quarter of 2018, registered quarterly growth, compared to the decline in the previous quarter. Such movements were also confirmed by the results of the Bank Lending Survey for the second quarter, according to which there is a further, albeit moderately lower demand for loans by large enterprises, with unchanged credit demand by small and medium enterprises. According to the currency structure, the increase in loans granted to the corporate sector in the second quarter was entirely due to denar loans, with foreign currency loans remaining at the level registered at the end of the first quarter. From maturity aspect, the growth of corporate loans is largely a result of higher long-term loans, with a solid positive contribution of short-term loans. **On annual basis**, total corporate loans at the end of June were higher by 3.1%, which is a moderately higher



Total credits of corporations

	2016				2017				2018	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
quarterly change, in %										
Total credits of corporations	-1.8	-3.8	-1.1	3.0	-3.3	1.6	-1.6	6.4	-3.6	2.2
Contribution in quarterly change of corporation credits (in p.p)										
Denar credits	-0.7	-2.0	-0.4	4.0	-2.8	2.0	-0.4	6.2	-2.5	2.2
Foreign currency credits	-1.1	-1.8	-0.7	-1.0	-0.5	-0.4	-1.2	0.2	-1.1	0.0
Short-term credits	-2.0	-0.8	-0.9	3.3	-2.8	0.9	-1.3	4.5	-1.9	0.9
Long-term credits	0.0	1.4	0.2	0.8	-0.1	-0.4	0.1	1.8	0.7	1.2

Source: NBRM.



performance compared to the end of March (2.5%).

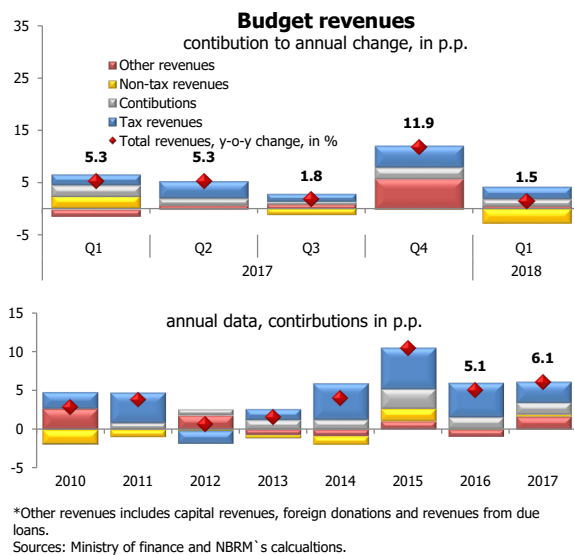
According to the data on interest rates on newly approved loans⁶³, in May, the interest rate on household denar loans dropped by 0.1 percentage point compared to March, and amounted to 5.6%, while the interest rate on foreign currency loans remained unchanged and amounted to 4%. In such conditions, the interest rate spread between the new denar and foreign currency lending narrowed slightly (from 1.7 to 1.6 percentage points).

In corporate loans, the interest rate on newly approved denar loans dropped by 0.1 percentage points compared to March, amounting to 4.7%, while the interest rate on newly approved foreign currency loans increased by 0.2 percentage points and amounted to 4%. In such conditions, the interest rate spread narrowed (from 0.9 to 0.7 percentage points). Regarding the total approved loans, the interest rates on household and corporate loans (denar and foreign currency) at the end of May registered a minimal decrease compared to March, amounting to 6.3% and 5.0%, respectively.

⁶³ Starting from January 2015, data on interest rates of banks and savings houses are collected according to a new interest rate methodology. More detailed information is available in the Quarterly Report, May 2015, on page 53.

V. Public finances

In the first quarter of 2018, the total revenues and expenditures in the Budget of the Republic of Macedonia (central budget and budgets of funds) increased by 1.5% and 0.4% on an annual basis, respectively. Taxes and contributions make the largest contribution to the growth of budget revenues, while higher budget expenditures are entirely due to the current expenditures. The budget deficit in the first quarter of 2018 amounted to 0.5% of GDP, and with the performances in April and May, it reached 0.7% of GDP. The budget deficit is moderately lower than the last year (0.9% of GDP) and represents 24.1% of the forecasted budget deficit for 2018. The budget deficit in the period January-May was mostly financed by government borrowing on the international financial markets, whereby part of the funds were accumulated as government deposits with the National Bank. The total public debt at the end of the first quarter of 2018 amounted to 48.2% of GDP and is by 0.6 percentage points higher than the previous quarter.



The total revenues in the Budget of the Republic of Macedonia⁶⁴ generated in the first quarter of 2018 are higher by 1.5% on an annual basis. Better performances are mostly a reflection of the higher inflows based on taxes and contributions, which contribute to the annual growth with 2.3 and 1.4 percentage points, respectively. "Other revenues"⁶⁵ also make a positive but relatively lower contribution (0.6 percentage points) (entirely influenced by the higher capital income), while the contribution of non-tax revenues is negative and amounts to 2.8 percentage points.

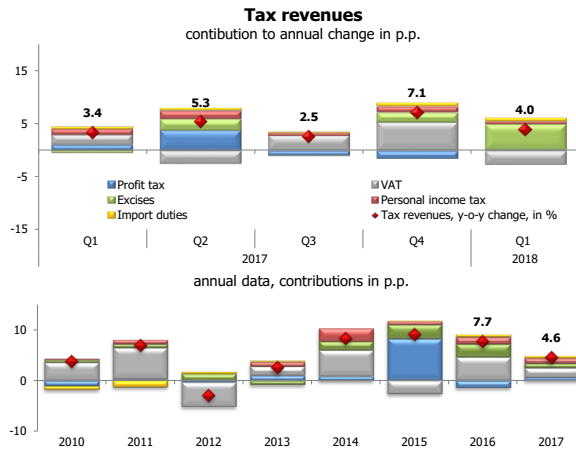
Total tax revenues⁶⁶ in the first quarter of 2018 are higher by 4.0% on an annual basis. Tax growth mainly resulted from higher performance in indirect taxes (with a contribution of 2.9 percentage points), while direct taxes made a lower positive contribution (0.6 percentage points). Within the indirect taxes, the generator of the growth are the excise-based revenues, with a contribution of 4.9 percentage points. Revenues based on import duties make a relatively lower positive contribution (0.6 percentage points), while the contribution of the income from VAT is negative and amounts 2.6 percentage points⁶⁷. Regarding direct taxes, the income from personal income tax and profit tax

⁶⁴ Central budget and budgets of funds.

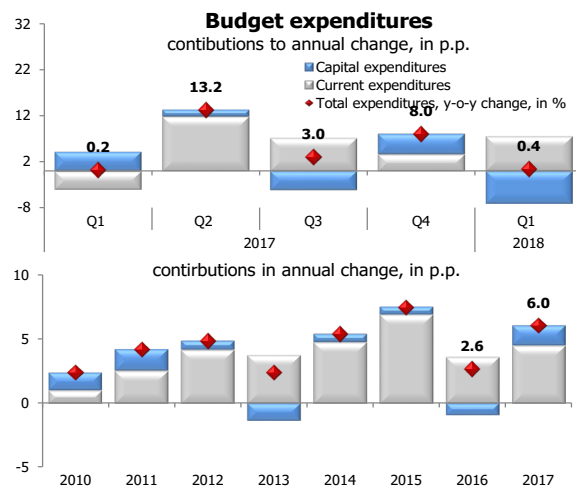
⁶⁵ Other revenue includes capital income, foreign donations and income from loans repaid.

⁶⁶ Includes the personal income accounts (PIA).

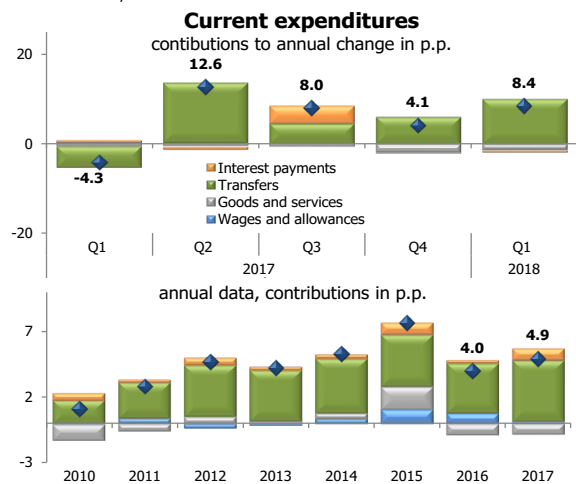
⁶⁷ On an annual basis, the lower net VAT revenues in the first quarter of 2018, are mostly explained by the higher payment of VAT refund, by 37.1%.



Source: Ministry of finance and NBRM's calculations



Source: Ministry of finance.



Source: Ministry of finance and NBRM's calculations.

make a positive contribution of 0.5 and 0.1 percentage points, respectively.

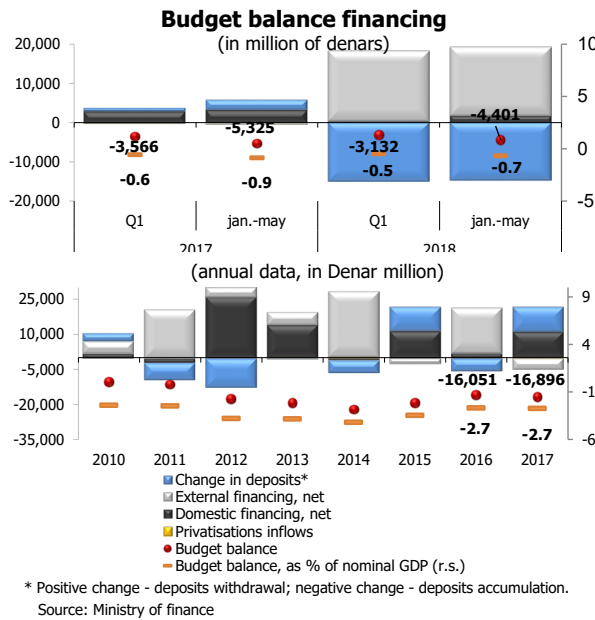
The total expenditures in the Budget of the Republic of Macedonia incurred in the first quarter of 2018 are higher by 0.4% on annual basis. The growth of budget expenditures in the first quarter of the year is due to higher current expenditures, with a contribution of 7.5 percentage points, while the contribution of capital expenditures in the first quarter of the year was negative and amounted to 7.0 percentage points. Analyzed structurally, higher current expenditures, by 8.4% on an annual basis, fully result from the expenditures in the category of transfers, which is related to the payment of subsidies, which is usual for this period of the year⁶⁸. Of the other budget expenditures, the categories of goods and services, interest payments and wages and allowances make a small negative contribution to the annual growth of current expenditures (of 1.2 percentage points, 0.4 percentage points and 0.1 percentage point, respectively).

During the first quarter of 2018, the Budget of the Republic of Macedonia registered a deficit of Denar 3,132 million, or 0.5% of GDP, which is moderately lower compared to the same period last year (0.6% of GDP). The deficit was financed by government borrowing on the international financial markets⁶⁹, whereby part of the funds were accumulated as deposits with the National Bank.

With the performances in April and May, the total budget revenues for the period January-May 2018 are higher by 3.5% compared to the same period last year. The growth of budget revenues is largely influenced by higher inflows based on taxes and contributions, with a contribution of 5.6 and 6.0 percentage points, respectively. On the other hand, **budget expenditures were higher by 2.1% compared to the same period last year.** Analyzed by categories, higher budget expenditures entirely resulted from higher expenditures for current costs, with a contribution of 8.6 percentage points, while the contribution of capital expenditures was negative and amounted to 57.0 percentage points. **In the period January - May 2018, the Budget of the Republic of**

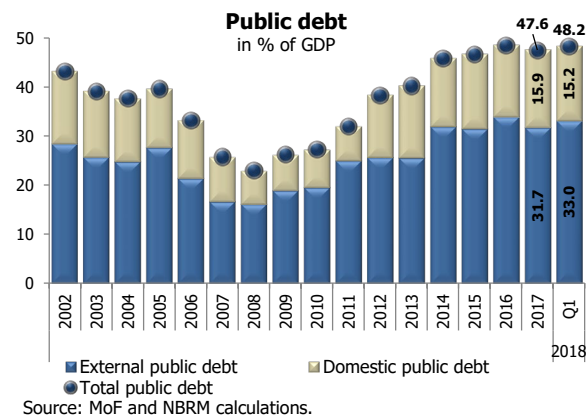
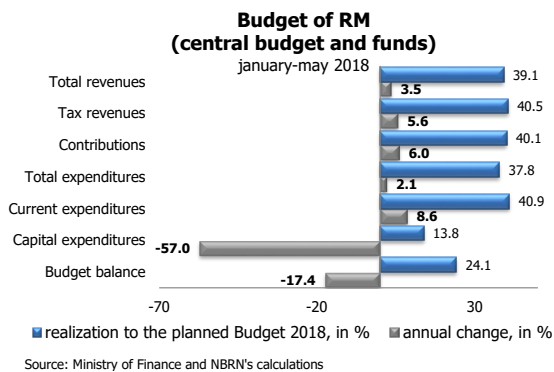
⁶⁸ In the first quarter of 2018, subsidies for agricultural production (including for capital investments in agriculture) in the amount of Denar 2,632 million were paid from the Budget of the Republic of Macedonia, which is 31% of the total annual amount planned in the Budget of the Republic of Macedonia.

⁶⁹ In January 2018, the sixth Macedonian Eurobond with a nominal amount of Euro 500 million was issued, with a maturity of 7 years and an annual interest rate of 2.75%. Moreover, a part of these foreign currency assets was used for early repayment of part of external liabilities that fall due in 2020.



Macedonia registered a deficit of Denar 4,401 million, which is 0.7% of GDP, i.e. 24.1% of the deficit planned for 2018. The budget deficit in this period was mostly financed by external sources, through the issuance of a Eurobond, with part of the funds being retained as a deposit on the government account with the National Bank.

Total public debt⁷⁰ in the first quarter of 2018 amounted to 48.2% of GDP⁷¹, which is a slight increase of 0.6 percentage points on a quarterly basis. From a structural point of view, the increase was entirely due to the higher external borrowing (by 1.3 percentage points of GDP), amid a decline in domestic borrowing (by 0.7 percentage points of GDP). Thus, at the end of the first quarter, external public debt amounted to 33.0% of GDP, while domestic public debt amounted to 15.2% of GDP. In terms of the sector structure, total government debt⁷² in the first quarter of 2018 increased by 1.2 percentage points of GDP and at the end of the quarter it was 40.5% of GDP, while the debt of public enterprises⁷³ decreased by 0.5 percentage points of GDP and at the end of the first quarter of 2018 it was 7.7% of GDP. On an annual basis, the total public debt, at the end of the first quarter of 2018, was higher by 1.1 percentage point of GDP compared to the same period in 2017.



⁷⁰ The public debt is defined under the Law on Public Debt (Official Gazette of the Republic of Macedonia No.165/14), according to which it is the sum of the government debt and the debt of public enterprises established by the state or municipalities, municipalities within the city of Skopje and the city of Skopje, and companies that are wholly or predominantly owned by the state or by the municipalities, the municipalities within the city of Skopje and the city of Skopje, for which the Government has issued a state guarantee.

⁷¹ The analysis uses the National Bank's April forecast for the nominal GDP for 2018.

⁷² Government debt is defined as a sum of debts of the central and the local government.

⁷³ It refers to the guaranteed debt of the public enterprises and the state-owned joint stock companies, in accordance with the definition of public debt in the Law on Public Debt (Official Gazette of the Republic of Macedonia No. 165/14).



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

	Budget for 2018	Q1 2018	jan.-may	Annual changes, period in 2018 over the same period in the previous year, in %	Contributions in annual changes, period in 2017 over the same period in the previous year, in %	Annual changes, period in 2018 over the same period in the previous year, in %	Contributions in annual changes, period in 2018 over the same period in the previous year, in %
	Realization, in mil. denars			Q1 2018	Q1 2018	jan.-may	jan.-may
TOTAL REVENUES	193,512	43,376	75,709	1.5	1.5	3.5	3.5
Tax revenues and contributions	170,200	38,916	68,517	4.2	3.7	5.9	5.2
Taxes	112,828	25,529	45,676	3.8	2.2	5.6	3.3
Contributions	55,403	13,058	22,200	4.7	1.4	6.0	1.7
Non-tax revenues	17,201	3,204	5,068	-27.2	-2.8	-18.0	-1.5
Capital revenues	1,510	456	757	276.9	0.8	207.7	0.7
Foreign donations	4,201	788	1,344	-7.9	-0.2	-29.5	-0.8
Revenues from repayments of loans	400	12	23	0.0	0.0	-76.8	-0.1
TOTAL EXPENDITURES	211,745	46,508	80,110	0.4	0.4	2.1	2.1
Current expenditures	187,601	44,714	76,773	8.4	7.5	8.6	7.7
Capital expenditures	24,144	1,794	3,337	-64.5	-7.0	-57.0	-5.6
BUDGET DEFICIT/SURPLUS	-18,233	-3,132	-4,401	-12.2			
Financing	18,233	3,132					
Inflow	40,897	21,710					
Privatisation receipts	0	0					
Foreign loans	34,839	30,463					
Deposits	-11,642	-15,032					
Treasury bills	17,700	6,279					
Sale of shares	0	0					
Outflow	22,664	18,578					
Repayment of principal	22,664	18,578					
External debt	10,418	12,795					
Domestic debt	12,246	5,783					

Source: Ministry of Finance and NBRM calculations.