

National Bank of the Republic of Macedonia



**Quarterly Report
February 2018**



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Introduction

In the fourth quarter of 2017, the NBRM did not change the monetary policy position, and the policy rate was maintained at the level of 3.25%. The current monetary setup was assessed as adequate, amid further assessments for soundness of the economic fundamentals and absence of imbalances in the economy. The latest data does not indicate major deviations from the forecasts in the key monetary policy segments. Also, amid improved foreign currency liquidity of the banks, the developments on the foreign exchange market in the fourth quarter were favorable and the NBRM intervened with net purchase of foreign currency. All foreign reserves adequacy indicators were kept within safe zone. Household savings have been continuously increasing from August onwards, which pointed to further stabilization of the expectations and confidence. However, foreign currency deposits continued to create most of the growth of household savings in this period¹. Under such developments, but still present risks, primarily in terms of the currency preference of entities, the monetary policy remained unchanged.

The risks regarding the macroeconomic forecasts are not significantly changed compared to the October forecasts, although those that refer to the global environment are slightly more favorable. Namely, at the end of 2017, the global economic data were better than expected, especially in the euro area, which also conditioned an upward revision of the estimate for growth of this region, as our major trading partner. Also, the financial markets developments at the end of 2017 show increased optimism of investors, especially on the stock exchanges in the USA and Europe. However, despite the favorable global macroeconomic situation and the improved perceptions for the next period, risks are still present, related to the global protectionist tendencies, the effects of the Brexit, the tightening of the global financial conditions and the geopolitical tensions.

The comparison of the latest macroeconomic indicators for the domestic economy with their forecasted dynamics within the October forecast vintage do not indicate some major deviations. The published GDP data for the third quarter show an annual GDP growth of 0.2%, which is slightly lower than the forecasted rate of 0.7%, but the average GDP growth in the first three quarters is entirely within the October assessments, given the revision of the data for the first half of the year. The growth registered in the third quarter is driven by net export demand, while domestic demand made a negative contribution to the growth. Regarding the individual components, the highest individual contribution was made by the export of goods and services, whose growth as in the previous quarter is mostly associated with the activity of the industrial facilities with foreign capital. From the components of domestic demand, a positive contribution is still made by private consumption, although there is a slight slowdown in the pace of growth. Gross investments, influenced by the weaker performances of the construction sector, continued to decrease, but still, there is a more significant slowdown in the negative rate which is also in line with the current forecast. The currently available high-frequency data for the fourth quarter point to more favorable shifts in the economy, in terms of the movements in the third quarter, and the results of the business tendency surveys which indicate signals for maintenance of the confidence of economic agents are also in the same direction, which is in line with the forecasted movement for improvement of the situation in the last quarter of the year. Annually, the **October forecast² envisages economic growth of 0.5% in 2017 and growth acceleration to 3.2% in 2018 and 3.5% in 2019.** The exports are expected to be the main driver of growth, while within domestic demand components, a solid positive contribution is expected from the household consumption. Also, unlike 2017, in 2018 and 2019 the contribution of investments is expected to be in the positive zone.

In the fourth quarter of the year, the annual domestic price growth accelerated from 1.6% in the third quarter to 2.2% in the fourth quarter. Throughout 2017, the inflation rate was 1.4%, and generally moved within the October forecast (forecasted average inflation of 1.3%). The inflation in 2017 was almost entirely driven by the growth of the core component, amid neutral contribution of the food, and minimum positive contribution of the energy component. Amid performances

¹ Refers to monetary data as of November, as available data in the period of making monetary decision.

² In October 2017, the expected economic growth for 2017 was corrected downwards from 2.5% to 0.5%. The growth expectations in 2018 remained unchanged (3.2% annually).



generally in line with the forecast, the risks regarding the expected inflation for 2018 and 2019 (moderate acceleration to 2%) remain associated with the uncertainty about the expected movement of the prices of primary products.

The external sector data seen through the balance of payments position show moderately improved performances than the current account forecasts, while the financial account position is less favorable than expected. In the third quarter, the current account recorded a surplus of Euro 183.1 million (1.8% of GDP) which is higher compared to the October forecast, reflecting the higher than expected surplus in the balance of goods and services. On the other hand, the financial account registered net outflows of Euro 278 million (2.7% of GDP), which is a weaker performance compared to the October expectations, amid significant negative deviations in foreign direct investments and trade credits. Analyzed dynamically, the current account balance in the third quarter recorded an annual improvement, amid higher surplus in services and in secondary income. The financial account registered net outflows, despite the high net inflows in the third quarter of 2016 when the fifth Eurobond was issued. The latest **gross foreign reserves** data for the fourth quarter point to quarterly growth, which is better than expected in the October forecasts. The available external sector data for the fourth quarter are still insufficient to make conclusions about the reasons for such deviations. Foreign trade data, as of November, indicate better performance than expected, while the latest data on the net purchased foreign currency on the currency exchange market indicate movements within the expectations in October. **According to October forecast for the period 2018 - 2019, the foreign reserves will moderately increase on a cumulative basis, and the adequacy indicators will hover in a safe zone.**

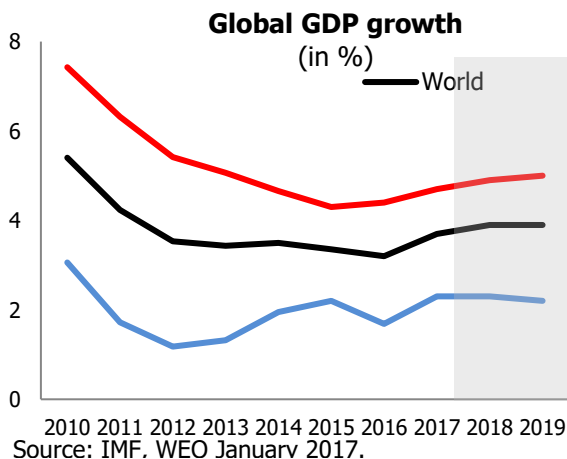
In the fourth quarter of the year, the **lending activity of the banking sector accelerated**, typical for the credit market at the end of the year, especially during December. Sector-by-sector analysis shows that the accelerated credit growth stems from the increased credit support to the corporate sector, accounting for most of the new lending in the last quarter, typical for this time of year. The household loans continued to increase also in the fourth quarter, at a slightly slower pace compared to the previous period, with the housing loans, besides consumer loans, making larger positive contribution to the growth. On an annual basis, the credit growth exceeded the expectations in October (of 4.6%), with the total loans being higher by 5.8%. Analyzing the drivers of credit market, surveys show positive movements on both the demand side and the supply side of credits. Thus, against the background of restrained growth of economic activity and favorable terms of lending by the banking sector, the private sector continued to increase the demand for loans. Sound solvency and liquidity position of banks and increased competition in the banking sector are factors that continue to have a stimulating effect on the supply of loans. Analyzing the sources of funding, **the last quarter has seen an intense growth in total deposits**, therewith the annual growth rate of total deposits in December reached 5.2% which is above the forecast for the end of the year (3.6%). The growth of total deposits in the last quarter stems from the simultaneous increase in household and corporate deposits. Bank deposit base is expected to continue increasing in the period ahead, ensuring stable sources of financing of credit growth, which, according to the October forecast, will range between 6-7% in the next two years.

In summary, the performances do not indicate significant deviations from the baseline scenario in the segments that are crucial to the monetary policy, whereby there are still assessments for soundness of the economic fundamentals. At the same time, the current risk balance has been assessed as more favorable compared to that highlighted in the October forecasts. Economic activity data for the third quarter and available data for the fourth quarter indicate a gradual economic improvement. Also, the inflation rate for 2017 is generally in line with the forecast. In the last quarter, the economy is more intensively supported by the banking sector, whereby the growth of the lending to the private sector in 2017 exceeded the October expectations, in circumstances when the deposit base exceeded the forecasts. Such movements send signals for further stabilization of expectations and confidence of domestic economic agents. The external position of the economy has still been assessed as stable, with favorable foreign reserves movements, while foreign reserves adequacy indicators continue to move in the safe zone. Yet, given the risks surrounding the forecast, in the period ahead, the NBRM will continue to monitor closely the situation for timely and appropriate adjustment of the monetary policy.

I. Macroeconomic developments

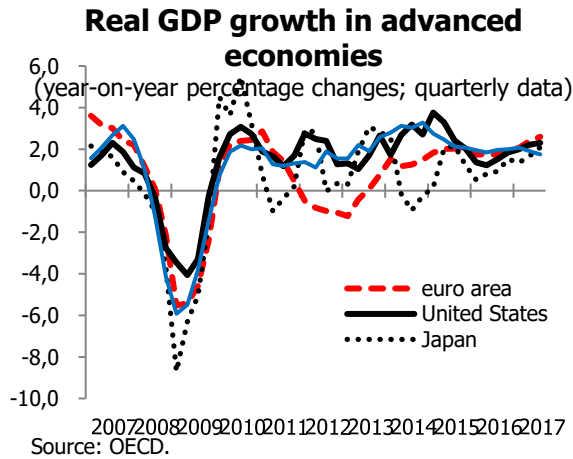
1.1. International economic surrounding³

The global economy continued to register solid growth in the third quarter of 2017. Growth of the economic activity is registered in both developed and developing countries. Moreover, within the developed economies, more significant recovery was recorded in the euro area, where in the third quarter of 2017 the real GDP increased by 2.6% on an annual basis. This is the highest growth rate in the last, almost seven years. The current estimates of the international financial institutions point to further recovery of the global economy, but the still present unfavorable risks around the forecasts have been simultaneously highlighted. These risks are medium-term and are mainly associated with the possibility for growing protectionism in trade, tightening of the global financial conditions, but they also refer to the political uncertainty arising from the Brexit. In the third quarter of 2017, the inflation rate on a global level was lower compared to the second quarter. However, at the beginning of the fourth quarter of 2017, there was certain acceleration in inflation on a global level, driven by the growth of oil prices. Global inflation for the next two years is expected to moderately accelerate, amid growth of the prices of primary products, but also further recovery of demand.



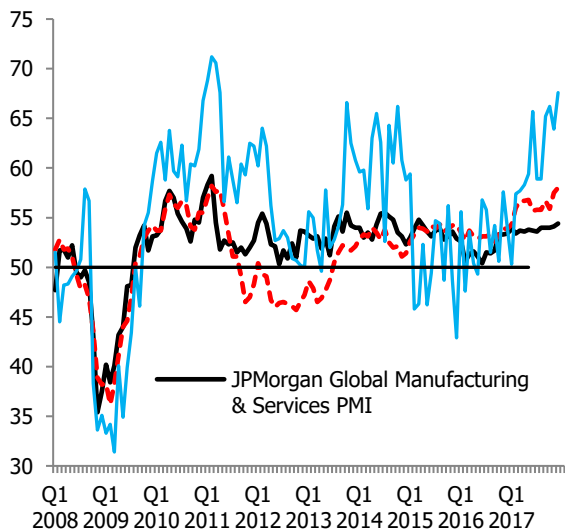
The global economic activity was characterized by solid performances in the third quarter of 2017. Moreover, relative dispersion of the global recovery is characteristic. In the euro area, the growth in the third quarter amounted to 2.6%, partially driven by the stimulating monetary policy of the ECB. This is the highest growth rate, after that measured in the first quarter of 2011 when it was 2.9%. Solid growth rate in this period was also registered in the US economy, which in the third quarter of 2017 amounted to 2.3% on an annual basis, supported by domestic demand. On the other hand, the British economy continued to slow down despite the increased competitiveness due to the depreciation of the exchange rate and the stimulus from the growth of the euro area. Thus, the growth of the real GDP in the UK in the third quarter amounted to 1.7% on an annual basis, which is lower than the growth rate of 1.9% in the second quarter. These performances are partially a consequence of the reduction of private consumption, amid depreciation of the British pound, growth in inflation and thus reduction of real household income. Regarding the emerging economies, in the third quarter this group of countries also recorded a moderate improvement of the economic performances, whereby, in addition to the solid growth in the Chinese economy and India, Brazil's economy has been increasing for the second consecutive quarter, and

³ The analysis is based on the IMF's *World Economic Outlook* of January 2018; the ECB's *Economic Bulletin*, the announcements of *Markit Economics*, the World Bank's *Global Economic Prospects*, the reports of *Bloomberg*, *Roubini Global Economics*, *Capital Economics*, *Reuters and Trading Economics*, the monthly reports of the International Energy Agency and the weekly reports of the Bank of Greece.



an acceleration in the economic growth was also registered in Russia.

The high-frequency survey indicators - PMI correspond to the increased economic activity at global level. The average PMI value in the fourth quarter of 2017 amounted to 54.2 index points, which is higher than the average value in the third quarter when it was 53.9 points. The increased average PMI value in the fourth quarter suggests favorable expectations of market entities for the forthcoming developments in the economy.

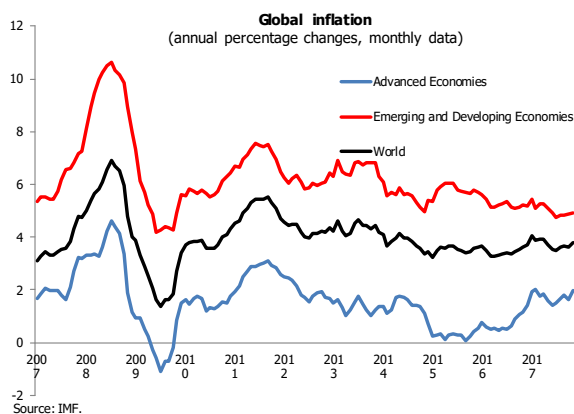


*The PMI index reflects the percentage of respondents that reported better business conditions compared to the previous month and it can take values between 0 and 100. PMI=50 is considered as a reference value, indicating unchanged economic conditions. A PMI value over 50 is taken to indicate that the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

According to the latest IMF perceptions from January 2018, the global growth for 2017 is estimated at 3.7% in 2017, while for 2018 and 2019 its acceleration to 3.9%, respectively is expected. The further recovery globally, is expected to be supported by the favorable financial conditions and the positive expectations, which will be an additional stimulus of the growing demand. The forecasts for the growth have been revised upwards compared to October⁴, primarily as a result of the revisions of the expected growth for developed economies.

Risks to the global economic activity remain unfavorable in the medium term. Major unfavorable risks include the increase in protectionism in trade, sharp tightening in the global financial conditions, turbulences related to the processes of liberalization and the reforms in China, as well as the overall political instability which partially stems from the negotiations for the future relations between the UK and the European Union.

In the first two months of the fourth quarter of 2017, the global inflation registered minimal acceleration. Acceleration in inflation in the first two months of the fourth quarter of 2017 was registered in developed, but also in emerging economies. Namely, the average inflation rate in the period October-November amounted to 1.8% in the developed countries (1.7% in the third quarter), while in the emerging economies it equaled 4.9% (4.8% in the third quarter). On a global level, the annual inflation rate at the beginning of the fourth quarter was 3.7% (3.6% in the third quarter). The increase in oil prices is cited as one of the main reasons for the acceleration in inflation. On the other hand, in the recent period,



⁴ October 2017 forecasts pointed to growth of the real GDP on a global level from 3.6% in 2017 and 3.7 in 2018 and 2019.

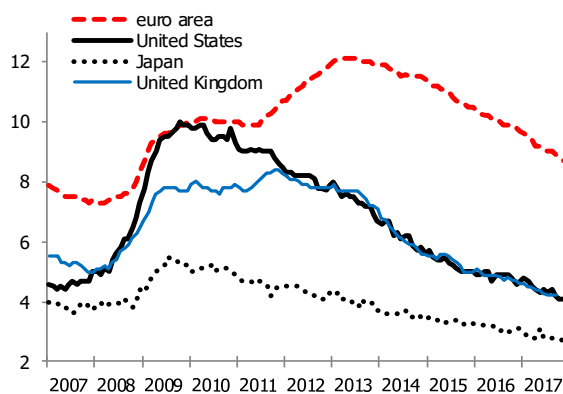
the prices of non-energy products minimally declined.

The economic growth of the euro area continued in the third quarter of 2017 as well.

The growth of the real GDP in the euro area in the third quarter of 2017 amounted to 0.6% on a quarterly basis, which is an insignificant slowdown compared to the growth of the second quarter which equaled 0.7%. In terms of the largest countries in the euro area, there was an acceleration in the economic activity in Germany and Italy, while certain deceleration in the growth was registered in France and Spain. On an annual basis, in the euro area, in the third quarter of 2017, the real GDP increased by 2.6%, which is higher by 2.4% registered in the second quarter and is also the highest growth rate in the past almost seven years. The growth of private consumption is one of the main drivers of the total growth of the economic activity in the euro area, supported by the favorable labor market developments. Namely, in September the unemployment rate in the euro area decreased to 8.9% from 9% registered in August. A significant contribution to the total growth of the economic activity was also made by the investment activity, and to a lesser extent by net exports, amid improved global environment. The solid economic performances in the euro area are also due to the stimulating monetary policy of the ECB. According to the latest December ECB forecasts, in the following years, the economic activity in the euro area is expected to gradually decelerate, whereby the growth of the real GDP in the euro area is expected to amount to 2.4% in 2017, 2.3% in 2018, 1.9% in 2019 and 1.7% in 2020.⁵

Unemployment in advanced economies

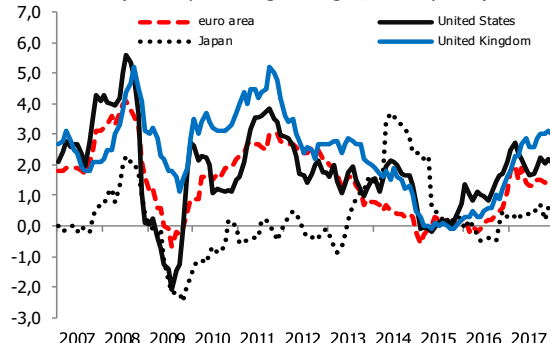
(in percent; seasonally adjusted monthly data)



Source: Eurostat.

Inflation in advanced economies

(annual percentage changes; monthly data)

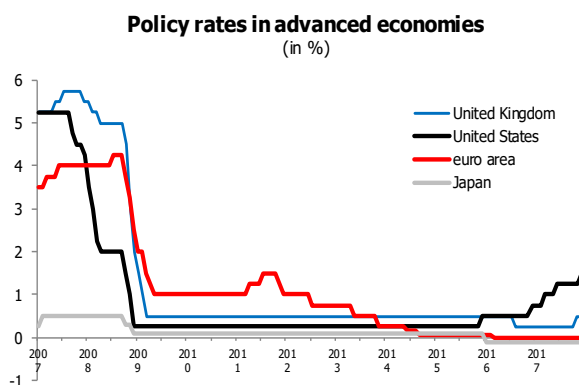


Source: Eurostat and national statistical offices.

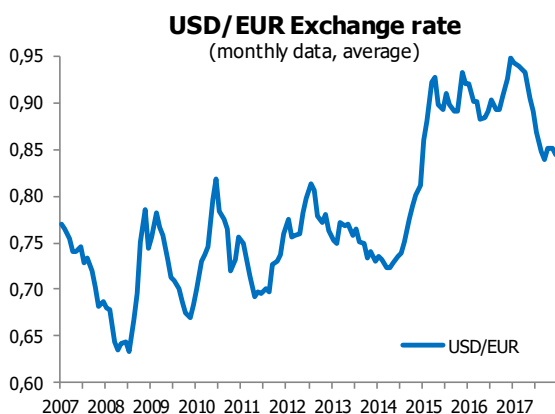
The annual inflation rate in the euro area registered no changes in the fourth quarter of 2017 and it equaled 1.4%.

In the medium run, inflation is expected to grow gradually, so according to the latest December ECB forecasts, it is expected to amount to 1.5% in 2017, 1.4% in 2018, 1.5% in 2019 and 1.7% in 2020. Compared to the September 2017 forecasts, inflation has been revised upwards due to the higher prices of oil and food.

⁵ In December, the ECB made upward revision to the September forecasts, according to which the real GDP growth in the euro area was forecasted to be 2.2% in 2017, 1.8% in 2018 and 1.7% in 2019.



Source: Central banks.

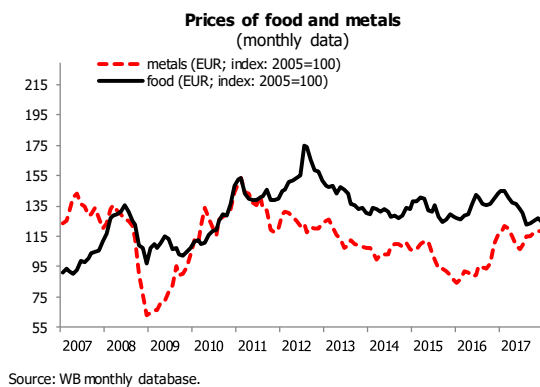
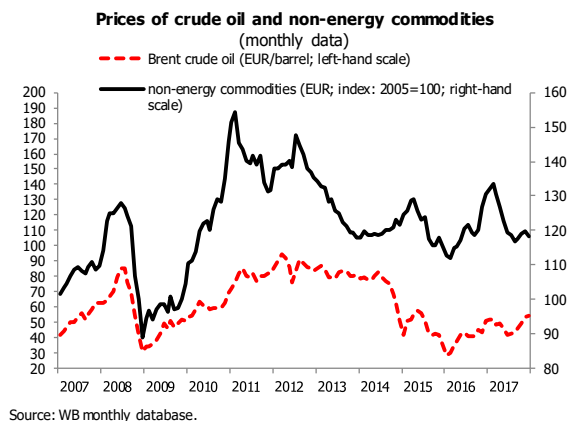


Source: Bundesbank

In the last quarter, some of the central banks of the developed countries, made changes to the monetary policy, aimed at its "normalization". Thus, after the increase in the interest rate in June, at the regular meeting held in December, the Fed adopted a decision on a new increase in the policy rate by 0.25 percentage points. As a result, the nominal interest rate of FED ranges from 1.25 to 1.5%. The increase in the interest rate is largely due to the Fed's estimates for improved labor market conditions and moderate growth of the economy. Bank of England also made changes to the monetary policy in the fourth quarter. Namely, the Bank of England at the November meeting raised the policy rate by 0.25 percentage points for the first time since July 2007, and it now amounts to 0.5%. The increase in the interest rate reflects the Bank of England's assessments for an increase in inflation above the target of 2%. On the other hand, the ECB decided to keep the current interest rate, amid simultaneous extension, but to a smaller extent (Euro 30 billion per month), of the quantitative easing program until September 2018. According to the ECB's communication, if necessary, the program can be extended after September 2018. The Bank of Japan did not shift the monetary policy setup, keeping the policy rate of -0.1%.

The fourth quarter of 2017 saw a slight depreciation of the US currency against the euro of 0.3%, on average, compared to the third quarter of 2017. Annually, in the fourth quarter, the US dollar against the euro depreciated by 8.4%, and in December 2017, one US dollar was exchanged for 0.849 euros on average. Moreover, the fall is largely due to the more favorable economic performances than expected in the euro area.

In the fourth quarter of 2017, the oil price increased significantly relative to the price in the third quarter of 2017. Thus in the fourth quarter, the average oil price in euros equaled Euro 52.2 per barrel, which is an increase of 18.5% on a quarterly basis. The increase in the oil price is



largely a reflection of the growing global demand, reduced level of inventory⁶ and extension of the OPEC and Russia agreement on oil production cuts⁷. On annual basis the oil price in euro currency increased by 12.3%.

Prices of non-energy primary products in the fourth quarter increased by 1.2% compared to prices in the third quarter. Analyzed by product, the growth of prices of non-energy primary products is mostly due to the growth of metal prices, which increased by 4.5% compared to the previous quarter. On the other hand, food prices remained at a similar level as in the previous quarter. The quarterly increase in metal prices expressed in euros is largely due to the increase in the prices of nickel, copper and lead, of 9.9%, 7.2% and 6.5%, respectively compared to the third quarter of 2017⁸. The price growth is largely a reflection of the expectations for an increased demand for these metals by the automotive industry⁹. On the other hand, on an annual basis, the prices of primary non-energy products expressed in euros decreased by 5.3%, while the prices expressed in US dollars increased by 3.4%, which is largely a result of the depreciation of the US dollar against the euro.

The trend of positive economic performance in the region continued in the third quarter of 2017. Thus all countries in the region registered growth acceleration in the third quarter of 2017. Turkey registered the highest growth in the region (11.1%). The economies of Romania, Bulgaria and Serbia registered a rapid growth of 8.7%, 3.9% and 2.1%, respectively. The growth in these countries was largely driven by domestic demand and investments. Croatia's economy also recorded solid growth of 3.4%, mainly driven by export demand.

In the fourth quarter of 2017, the inflation rate in the regional countries moved in different directions. Thus, Turkey,

⁶ In the first half of December, one of the major pipeline in the North Sea was shut down after defect identified. It is expected that the reparation will last around three weeks, consequently contributing to the disruption of the supply of about 10 millions of barrels of oil.

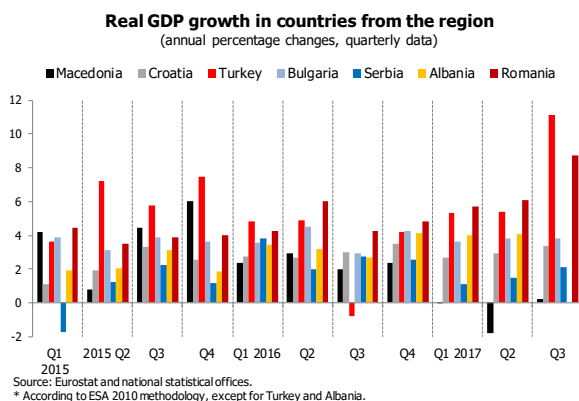
⁷ On 30 November 2017, the OPEC Member States and Russia agreed to extend the measure to cut oil production for nine additional months i.e. until the end of 2018, which aims to reduce the inventories of this fuel globally. Also, other non-OPEC oil producing countries, including Russia welcomed the extension of the agreement, by decreasing oil production by 1.8 million barrels per day until December 2018. Additionally, Nigeria and Libya also joined in the measure, countries that previously were not part of the agreement.

⁸ The increase in metal prices expressed in US dollars is largely due to the significant increase in the prices of copper, iron and nickel, of 12%, 13.3% and 14.1%, respectively, compared to the second quarter of 2017.

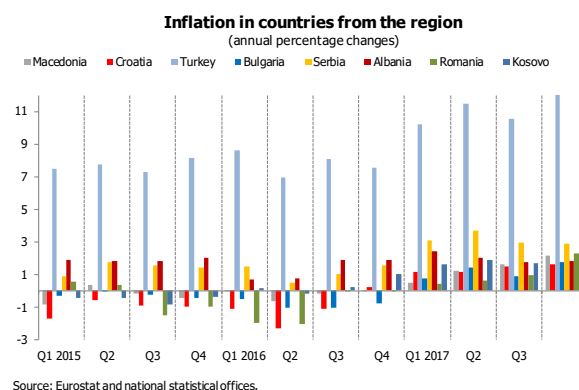
⁹ <http://www.scmp.com/business/commodities/article/2116772/goldman-lifts-copper-price-forecast-us7050-china-expected-drive>

<http://pubdocs.worldbank.org/en/743431507927822505/CMO-October-2017-Full-Report.pdf>

<http://www.kitco.com/news/2017-12-20/METALS-Lead-hits-2-month-peak-on-strong-winter-demand-deficit-worries.html>



Romania, Albania and Bulgaria registered a price level acceleration in the fourth quarter of 2017. The increase in inflation in these countries was largely due to the increase in food prices. On the other hand, Serbia registered a slight slowdown in inflation in the fourth quarter of 2017. The lower price growth in Serbia was largely due to the slower growth of food prices.



1.2. Domestic supply

After the fall in the economic activity in the first half of the year, the gross domestic product in the third quarter of 2017 recorded a slight growth of 0.2% on an annual basis. Analyzed from the supply side, the growth in the third quarter was driven by the sectors "trade, transport and communications and catering", with a small positive contribution of agriculture and activities related to real estate. On the other hand, the activity in the construction sector, after the fall in the first half of the year, continued to decrease in the third quarter as well. These movements in construction follow after a several-year continuous growth, driven by the cycle of public infrastructure investments, but also by the activity of the private sector. Lower value added in the third quarter was also registered in industry. Regarding the developments in the fourth quarter, most of the available data for certain economic sectors for the period October-November point to more favorable movements compared with the third quarter.



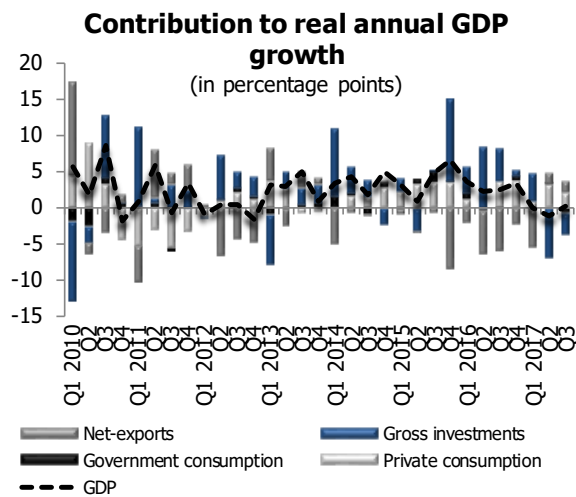
After the unfavorable movements in the first half of the year, the gross domestic product in the third quarter of 2017 increased by 2.0%, on a quarterly basis (seasonally adjusted) and by 0.2%, on an annual basis. Observed by activities, the largest contribution to the annual GDP growth was made by the activities: "trade, transport and communications and catering", and an increase in value added was also registered in agriculture and activities related to real estate. In the other activities, an annual drop in the value added was observed.

	annual growth rates, in %							contribution in GDP growth, in p.p.						
	2013	2014	2015	2016	Q1 2017	Q2 2017	Q3 2017	2013	2014	2015	2016	Q1 2017	Q2 2017	Q3 2017
Agriculture	8,6	3,1	1,9	2,8	1,5	6,7	3,8	0,8	0,3	0,2	0,3	0,2	0,6	0,3
Industry	3,7	11,5	4,9	1,4	-3,6	-3,8	-4,1	0,6	1,7	0,8	0,2	-0,6	-0,7	-0,7
Manufacturing	9,6	21,5	5,0	4,1	-8,1	-5,2	-5,8	1,0	2,1	0,5	0,5	-1,0	-0,6	-0,7
Construction	12,8	5,1	8,0	11,9	-6,5	-17,1	-11,6	0,7	0,4	0,6	0,8	-0,5	-1,2	-0,8
Trade and transport	11,1	3,1	1,4	4,2	6,3	4,4	9,8	1,9	0,6	0,3	0,8	1,1	0,9	1,9
Information and communication	4,8	3,4	13,4	6,5	7,1	3,9	-0,1	0,2	0,1	0,4	0,2	0,2	0,1	0,0
Financial and insurance activities	-1,4	13,5	8,7	0,9	-2,6	-0,7	-2,6	0,0	0,4	0,3	0,0	-0,1	0,0	-0,1
Real estate activities	-1,3	0,0	2,7	-0,5	0,7	-3,3	0,9	-0,2	0,0	0,3	-0,1	0,0	-0,4	0,1
Professional, scientific and technical activities	9,6	6,3	5,9	7,7	0,5	-4,2	-4,6	0,3	0,2	0,2	0,2	0,0	-0,1	-0,2
Public administration	-7,5	3,2	6,5	1,5	-2,0	-2,5	-2,1	-1,1	0,4	0,8	0,2	-0,3	-0,3	-0,2
Other service activities	12,7	11,5	4,5	0,0	-8,0	-9,1	-6,9	0,3	0,3	0,1	0,0	-0,2	-0,2	-0,2
Gross Domestic Product	2,9	3,6	3,9	2,9	0,0	-1,3	0,2	2,9	3,6	3,9	2,9	0,0	-1,3	0,2

Source: State Statistical Office and NBRM calculations.

1.3. Aggregate demand

In terms of demand, the annual GDP growth of 0.2% in the third quarter is mostly explained by the export of goods and services, whose growth, as in the previous quarter, is significantly associated with the operation of the export facilities with foreign capital, with a certain contribution of the traditional sectors. From the components of domestic demand, a positive contribution was made by private consumption, supported by the favorable labor market developments and the credit support. However, in the third quarter this component registered a slight slowdown in the growth pace. Gross investments, influenced by the weaker performances of the construction sector, continued to decrease, but there is a more significant slowdown in the pace of reduction. A slight decline was also registered in public consumption. In terms of the total domestic demand and net exports, as in the previous quarter, also in the third quarter, net exports made a positive contribution to the GDP growth, as opposed to the domestic demand whose contribution was negative.



Source: State Statistical Office and NBRM calculations.

As seen through the components of demand, the annual GDP growth of 0.2% in the third quarter of 2017 (quarterly growth¹⁰ of 2.0%) is explained by the positive contribution of net exports, with exports, as in the previous quarter, being the component with the highest individual positive contribution to the growth, while the negative contribution of imports is significantly reduced. Within domestic demand, the growth of private consumption continued, while gross investments and public consumption are in the negative zone. However, in gross investments, there was a more significant reduction of the negative annual rate than in the previous quarter, which also significantly reduced the negative cumulative contribution of domestic demand to growth.

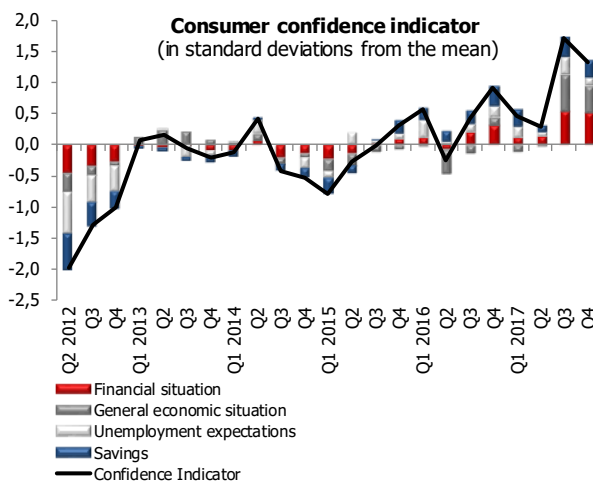
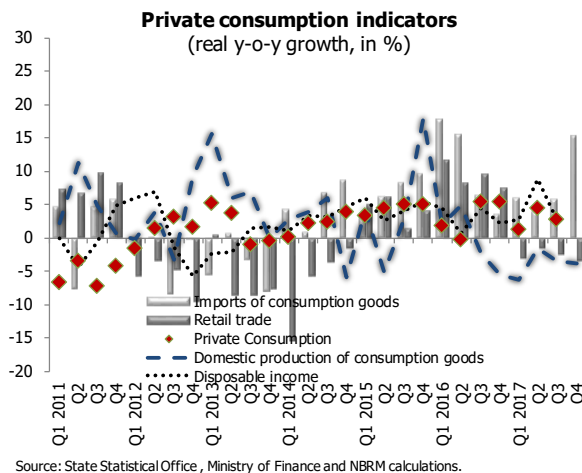
	2013	2014	2015	2016	2017-Q1	2017-Q2	2017-Q3	2013	2014	2015	2016	2017-Q1	2017-Q2	2017-Q3
Private consumption	1,9	2,2	4,4	3,1	1,3	4,4	2,9	1,4	1,6	3,1	2,1	0,9	2,9	1,9
Government consumption	0,5	3,0	3,9	1,9	-0,8	0,4	-3,6	0,1	0,5	0,7	0,3	-0,2	0,1	-0,5
Exports of goods and services	6,1	16,5	8,5	8,1	8,3	11,0	5,5	2,8	7,2	4,0	3,9	4,0	5,4	2,9
Imports of goods and services	2,2	14,1	9,9	11,6	13,4	5,6	2,1	-1,4	-8,7	-6,5	-7,5	-8,4	-3,6	-1,3
Gross capital formation	0,5	10,7	8,3	13,3	11,4	-18,6	-9,4	0,1	3,1	2,5	4,0	3,6	-6,1	-2,7
Domestic demand	1,3	4,4	5,4	5,7	4,0	-2,7	-1,3	1,6	5,2	6,3	6,5	4,4	-3,1	-1,3
Net exports*	-6,9	8,0	14,1	21,0	26,4	-5,9	-8,9	1,3	-1,5	-2,4	-3,6	-4,4	1,8	1,5
Statistical discrepancy								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	-1,3	0,2	2,9	3,6	3,9	2,9	0,0	-1,3	0,2

*decrease represents lower deficit

Source: SSO and NBRM calculations.

¹⁰ The quarterly changes of the GDP and its components are calculated using seasonally adjusted data.

1.3.1. Private consumption



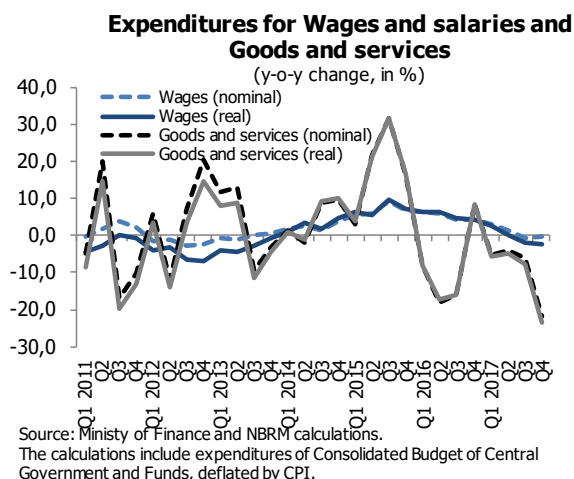
The solid growth of private consumption continued also in the third quarter of 2017, although the pace of growth is slightly slower compared to the previous quarter (quarterly growth of 2.8% and annual growth of 2.9%). The growth of household consumption is explained by the favorable movements in the wage and pension bill, and growth was also registered in private transfers¹¹. From the high-frequency indicators for the movement of private consumption in the third quarter of 2017, growth was registered in household loans and imports of consumer goods, while retail trade and domestic production of consumer goods registered a decline. In support of the performances of private consumption are the results of the consumer confidence surveys¹² conducted in the third quarter of 2017, which point to increased consumer optimism, amid more favorable expectations regarding the general economic situation, the unemployment, the expected financial situation, as well as the possibilities of generating savings.

The growth in private consumption is expected to continue in the fourth quarter of 2017. Thus, according to the October and November data, in the last quarter the disposable income components are expected to further increase, amid solid growth of lending to households. These movements correspond with the results from the Lending Survey¹³ which point to easing of the credit conditions and increased demand for loans in this period. At the same time, the signals from the consumer confidence surveys¹⁴, conducted in the fourth quarter, point to retention of the favorable consumers' expectations regarding the general economic situation, the savings possibilities, as well as the expected financial situation of consumers. From the short-term indicators for the movement of private consumption, growth was registered in the import of consumer goods, while retail trade and domestic production of consumer goods decreased, although at a slower pace compared to the previous period.

¹¹ The growth of private transfers in the third quarter is relatively small compared to the double-digit annual growth in the second quarter which is mostly a result of the low base effect from the second quarter last year when, amid escalation of the domestic political crisis, private transfers decreased significantly.

¹² European Commission's Consumer Survey as of September 2017.

¹³ NBRM's Lending Survey, January 2018.

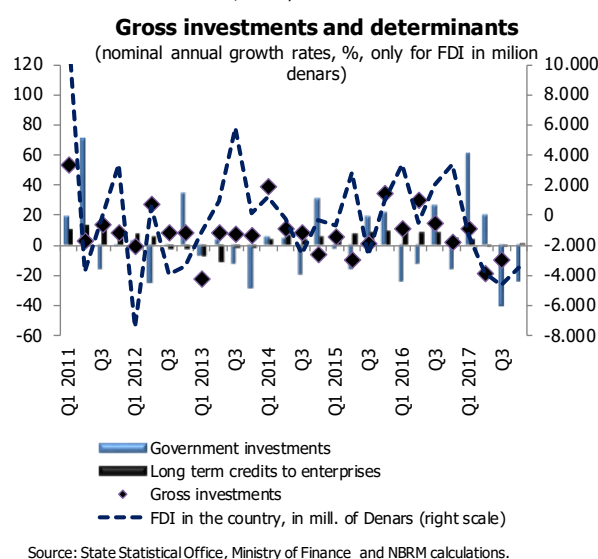
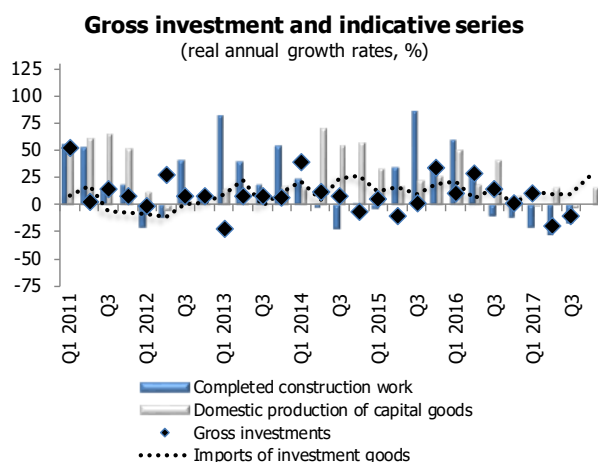


1.3.2. Public consumption

In the third quarter of 2017, public consumption recorded a quarterly decline of 2.3% and a real annual decline of 3.6%. The lower public consumption is mainly explained by the lower expenditures on goods and services. A slight downward adjustment was also registered in costs for wages of public sector employees, while health care transfers¹⁵ increased.

The data for October and November 2017 indicate an annual decline in public consumption in the fourth quarter, mainly due to the weaker performance in the expenditures on goods and services.

1.3.3. Investment consumption



After the relatively strong decline in the previous quarter, in the third quarter of 2017, investment consumption recorded a slight improvement. Thus, in the third quarter, gross investments registered a quarterly growth of 6.0% (as opposed to the quarterly decline of almost 20% in the previous quarter), which also decelerated the annual decline to 9.4% (annual decline of about 18.6% in the second quarter). This shift in gross investments corresponds to the changes in the construction sector where, dynamically speaking, there are also favorable developments. Namely, the annual decline in the value of completed construction works significantly slowed down in the third quarter, with a deceleration in the decline in the value added in the sector. However, generally speaking, on an annual basis, most of the high-frequency indicators for the movement of gross investments are in the zone of negative changes. Thus, in addition to the lower value of completed construction works, a decline was also registered in government capital investments, direct investments and in domestic production of capital goods. In addition, the credit support to companies decreased, i.e. the long-term lending to companies registered a slight decline, for the second consecutive quarter.

Regarding the movement of the gross investments in the last quarter, the available high frequency data indicate movements in different directions. Thus, the fall in the construction activity continued in October as well, with an annual decline in government capital

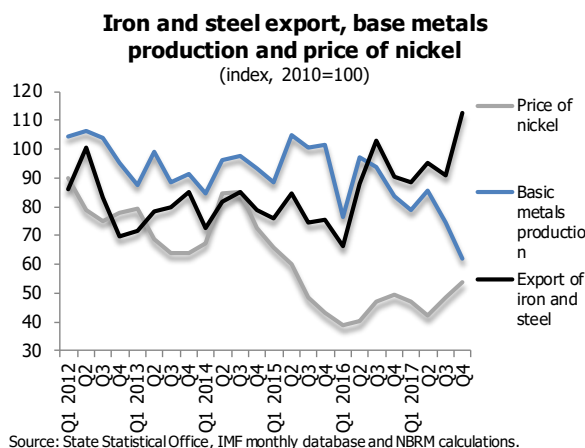
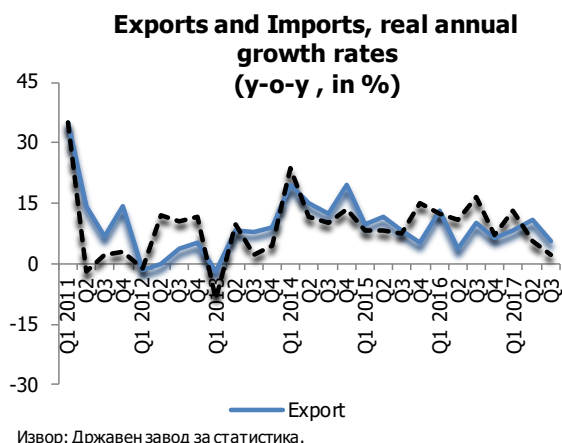
¹⁵ Most of these assets relate to expenditures on goods and services.



investments. On the other hand, managers' expectations regarding the total orders and the number of employees in the construction sector for the next three-month period are more favorable, on an annual basis. From the other indicators, growth was registered in imports of investment goods, domestic production of capital goods and foreign direct investments. Also, the terms of funding are more favorable amid small increase in long-term lending to companies which follows after two quarters of reduction. As shown in the survey, this is in line with the banks' assessments for increased demand for corporate loans amid eased credit standards in this period.¹⁶

1.3.4. Net external demand

In the third quarter of 2017, net exports made a positive contribution to the economic growth, with higher annual growth of the export than the import of goods and services. Real exports of goods and services registered small quarterly growth of 0.2% and real annual growth of 5.5%. Such movement of the real annual growth rate of export is a slight slowdown in the pace of its growth compared to the previous quarter, but still also in this quarter it is the component with the highest positive contribution to the GDP growth. Analyzed by high-frequency foreign trade statistics, the increase in nominal exports is mostly associated with the positive contribution from the new export-oriented industrial facilities, with a positive contribution of the exports of ores and energy. On the other hand, the export in part of the traditional sectors registered a moderate reduction (lower exports of metals, textile and food). The dynamics of export and domestic demand also affected the import of goods and services whose growth also decelerated in the third quarter of the year (annual growth of 2.1% and quarterly growth of 1.8%). **In the fourth quarter of 2017, the trade deficit is expected to widen,** as indicated by the nominal data on foreign trade for the period October-November 2017, in conditions of higher growth of the import than the export of goods.



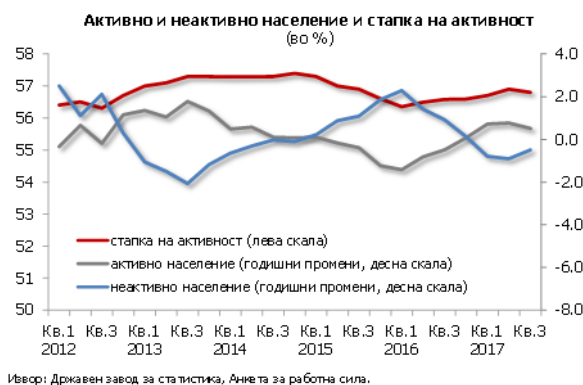
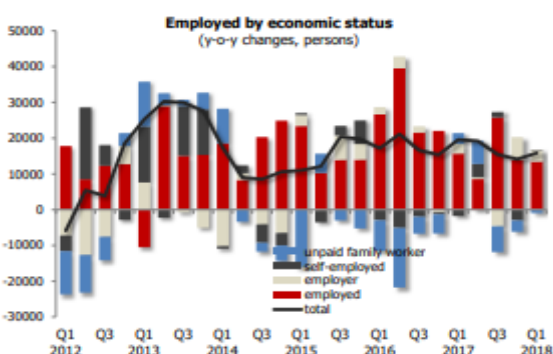
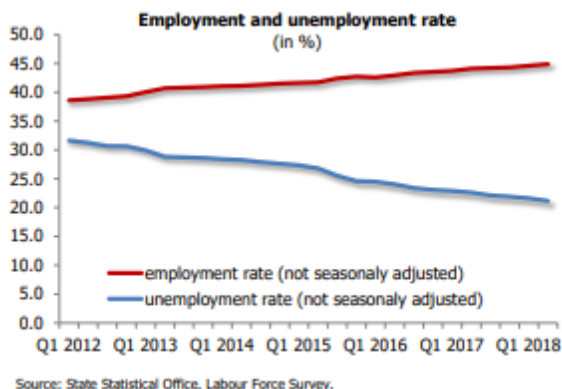
1.4. Employment and wages

In the third quarter, the labor market indicators point to further improvements of this market segment. Thus, the number of employees, although at a slightly slower pace, continued to increase also in the third quarter of 2017, a

¹⁶ NBRM's Lending Survey, January 2018.



tendency present for a longer period. At the same time, the unemployment rate amounted to 22.1%, which is a new historical minimum. The business tendency surveys point to stronger optimism about employment for the next three months. On the supply side, the annual growth of the active population, which began in the last quarter of the previous year, continued. On the other hand, competitiveness indicators suggest unfavorable trends, although with slightly lower intensity compared to the previous quarter, amid annual decline in labor productivity and growth of unit labor costs.



The employment growth, although with slightly lower intensity, continued in the third quarter of 2017 as well. Thus, the number of employees increased by 2.1%, annually, while quarterly, for the first time in three years, small decrease of 0.3% was registered¹⁷. The annual increase in the number of employees was registered in most of the activities, with the highest individual contribution to the growth of total employment being made by the manufacturing industry and "transport and storage". Activities with more intensive fall in employment include "electricity and water supply" and "agriculture". In terms of the economic status¹⁸, as in the previous quarter, most employments were registered in the category of employed population.

In the third quarter of 2017, the employment rate amounted to 44.2%, which is an annual growth of 0.8 percentage points. Simultaneously, the aggregated signals from business tendency surveys¹⁹ suggest strengthened optimism among managers of business entities regarding the employment for the next three months. In the third quarter, the job vacancy rate²⁰ equals 1.52% (1.27% in the same quarter of 2016). Despite the small upward or downward movements, analyzed on a longer-term basis, the job vacancy rate is relatively stable (especially from 2014 onwards), which, in conditions of a continuous decrease in the unemployment rate, suggests improved labor market efficiency. Observed by comparison, by sectors of activity, the highest job vacancy rate was registered in accommodation facilities and catering services (3.15%), as well as in administrative and auxiliary services (2.94%).

As for the movements on the side of labor supply, the moderate growth that started in the last quarter of 2016, continued in the third quarter, as well. Thus in the third

¹⁷ The analysis of quarterly dynamics of employment, unemployment and total economically active population was made using seasonally adjusted data.

¹⁸ 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).

¹⁹ Source: State Statistical Office, business tendency surveys in manufacturing industry (November 2017), construction (third quarter of 2017) and trade (third quarter of 2017).

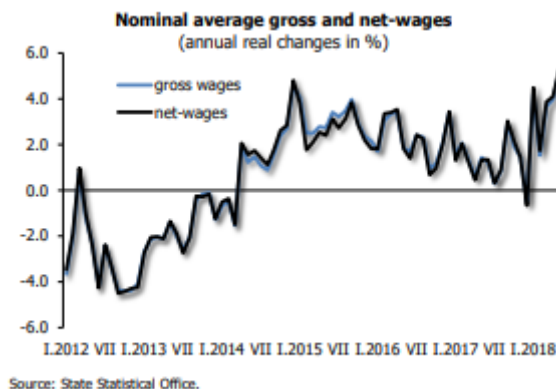
²⁰ The rate of vacancies is defined as the ratio between the number of job vacancies and the total number of jobs, i.e. both vacant and occupied jobs. So defined job vacancy rate shows the uncovered labor demand and as such it is an indicator of the labor market efficiency giving signals for the potential mismatches between the required profiles and those available on the labor market in a given moment (skill mismatches). However, this indicator should not be analyzed separately, but when interpreting it, the shifts in the unemployment rate (a relation known as the Beveridge curve) are also important.

quarter, the total labor force increased by 0.5% annually, while the activity rate equaled 56.8%.

The stronger rise in the demand relative to supply of labor force in the third quarter of the year resulted in further fall in unemployment. Thus, the number of unemployed in the third quarter decreased by 4.8% on an annual basis, which is a slightly slower pace compared to the previous quarter, while the unemployment rate amounted to 22.1% (annual and quarterly fall of 1.3 and 0.5 percentage points, respectively).

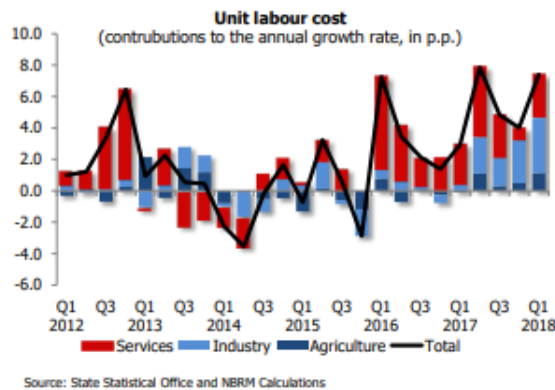
Average paid salaries in the third quarter registered annual growth of 3% and 2.9% (net and gross wages, respectively), a moderate acceleration of the annual dynamics, which is partly due to the September growth of the legally prescribed minimum net wage²¹. Wage growth was registered in most of the activities sectors, among which "mining", "arts, entertainment and recreation", as well as "accommodation facilities and catering services" are distinguished according to the increase volume. On a quarterly basis, nominal net and gross wages registered an increase of about 0.6% and 0.7%, respectively, intensity lower than that registered in the previous three-month period. **In the third quarter, in conditions of a rapid growth of consumer prices, the acceleration in the real annual wage rise** (growth of 1.4% and 1.3%, in net and gross wages, respectively, versus growth of 1% in both categories in the previous quarter) is entirely associated with the growth of nominal wages.

In the third quarter of 2017, the labor productivity²² registered decrease on annual basis, but with lower intensity than that registered in the second quarter. Negative performance evident since the beginning of the year, comes after the longer period this indicator has been maintained in the zone of positive annual changes. However, the annual decrease in productivity of 2.5% in the third quarter, as well as since the beginning of the year, relates to the services sector and industry, where there was an increase in employees and a decrease in value added. **The slight acceleration in the wage growth, amid major slowdown in the**



²¹ On 19 September 2017, the Assembly of the Republic of Macedonia adopted the amendments to the Law on the Minimum Wage of the Republic of Macedonia. According to the amendments, the minimum wage in the Republic of Macedonia, starting with the payment of the wage for September 2017, was determined for all sectors in the economy at a gross amount of Denar 17,300 or Denar 12,000 net.

²² Total productivity is a weighted sum of productivity of each sector. Within each sector, the productivity is calculated as a ratio between the value added in that sector and the number of employees.

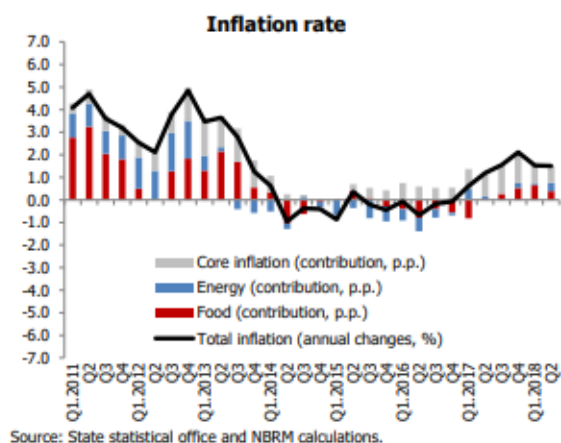


productivity fall, increased the unit labor costs, but at a slightly slower pace, which reduced to 6.1% on an annual basis. Moreover, the contribution from the growth of the unit labor costs in the services sector is the largest, followed by the slightly smaller contribution from industry, as well as the contribution from agriculture.

1.5. Inflation

In the fourth quarter of the year, there was an acceleration in the annual growth of domestic prices from 1.6% in the third quarter to 2.2% in the fourth quarter, amid strengthening of the price growth in all key categories (food, energy and core inflation). For the entire 2017, the inflation rate amounted to 1.4%, mostly as a result of the shifts in the core component, amid a neutral contribution from the food component and a minimal positive contribution from the energy component. Regarding the future dynamics of consumer prices, the current shifts in imported inflation and producer prices of domestic producers do not point to significant upward pressures through these channels. On the other hand, the possible risk in terms of the future movement of consumer prices is the increase in labor costs, which has been present for almost two years in a row and may spill over on final prices. Regarding the expectations for the future price growth, economic analysts expect moderate inflation rates and a trajectory of gradual strengthening of the growth in the next two-year period - a shift that corresponds to the NBRM forecast and the forecasts of some international institutions.

1.5.1. Current inflation



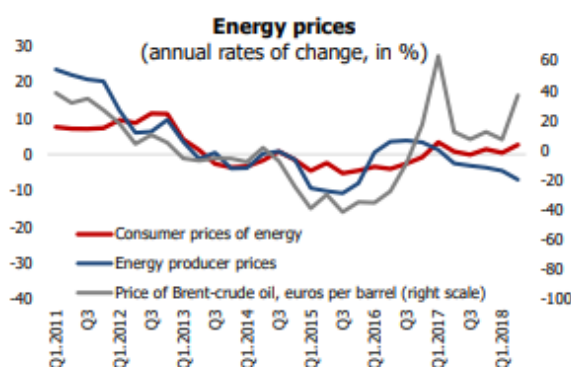
In the fourth quarter of 2017, the growth of domestic consumer prices continued to accelerate (annual inflation rate of 2.2% compared to 1.6% in the third quarter)²³ mostly due to food prices (whose growth accelerated in this quarter) and energy prices (growth despite the small decline in the previous quarter). A slightly more positive contribution was also made by core inflation, which in the last quarter of the year is slightly higher than in the previous quarter.

The annual rate of core inflation in the fourth quarter amounted to 2.9% (versus 2.7% in the previous quarter), whereby the growth largely reflects the upward adjustments in the

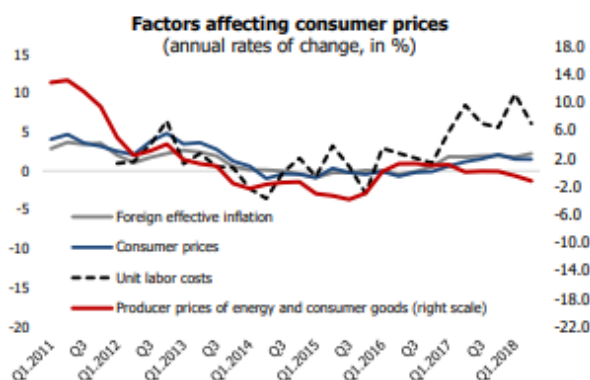
²³ On a quarterly basis, consumer prices are higher by 0.1% (seasonally unadjusted rate) and by 0.5% (seasonally adjusted rate).

	(annual changes, in %)										(contribution to annual changes, in p.p.)									
	Q1	Q2	Q3	Q4	2017	2018	Q1	Q2	Q3	Q4	2017	2018	Q1	Q2	Q3	Q4	2017	2018	Q1	Q2
Consumer price index - all items	0.8	1.1	1.3	2.0	1.9	1.3	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Food	-0.2	0.1	0.7	1.4	0.0	1.7	1.0	-0.8	0.0	0.3	0.0	0.0	0.0	0.7	0.4	0.0	0.7	0.4	0.0	0.0
Energy	1.4	0.8	-0.1	1.3	1.4	0.5	2.7	0.5	0.1	0.0	0.2	0.2	0.2	0.1	0.4	0.0	0.1	0.4	0.0	0.0
Alcohol	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Non-alcoholic beverages	-10.8	-10.8	-9.3	-10.1	-7.9	-2.5	-1.1	-1.1	-1.1	0.0	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Health and tobacco	10.4	9.0	0.4	1.0	0.1	2.0	11.2	0.5	0.2	0.0	0.2	0.2	0.2	0.1	0.4	0.0	0.1	0.4	0.0	0.0
Food and energy (excl. tobacco)	-0.7	0.0	0.3	1.4	0.4	1.4	1.0	-0.3	0.1	0.3	0.2	0.2	0.2	0.7	0.4	0.0	0.7	0.4	0.0	0.0
Core inflation (excl. tobacco)	1.9	2.1	2.6	2.0	2.2	1.7	1.8	0.8	1.0	1.2	1.2	1.2	1.0	0.8	0.2	0.0	0.8	0.2	0.0	0.0
Overall index excluding energy, liquid fuels and tobacco and unprocessed food (M2)	0.8	1.3	1.6	2.1	1.5	1.3	1.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall index excluding energy, liquid fuels and tobacco, unprocessed food, tobacco and alcoholic beverages (M3)	0.8	1.0	1.4	2.1	1.2	1.0	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Source: State Statistical Office and NBRM calculations.



Source: State statistical office and NBRM calculations.



Source: State statistical office and NBRM

prices of air traffic, with more significant growth being registered in the prices of tobacco, communications and catering services and accommodation. Other inflation sub-indices that exclude the most volatile prices also recorded more dynamic growth. Thus, the total index, excluding energy²⁴, liquid fuels and lubricants and unprocessed food, has an annual growth of 2.3% (1.6% in the third quarter), while the total index excluding energy, liquid fuels and lubricants, unprocessed food, tobacco and alcoholic beverages, indicates annual growth of 2% (1.4% in the third quarter).

In the fourth quarter of the year, there was significant increase in **food prices**, reflecting the higher prices of fruits and meat. The growth of consumer food prices is also consistent with the dynamics of foreign effective food prices, as well as with the price movements of domestic food producers. In addition, despite the small price decline in the previous quarter, in the fourth quarter **energy prices** also rose, which is mainly explained by the higher prices of oil derivatives. This shift in domestic consumer energy prices is in line with the movement in the price of crude oil and derivatives on the world market, whose growth accelerated significantly during the quarter.

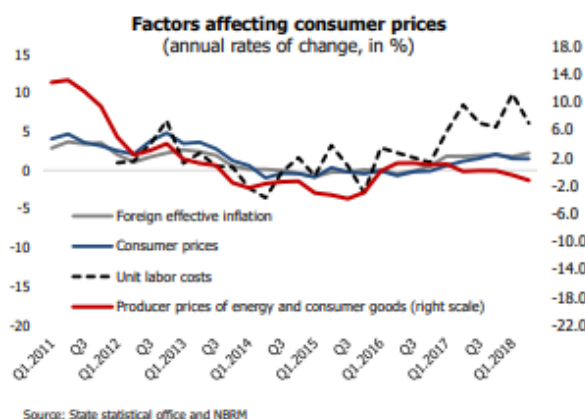
The prices of producers of industrial products on the domestic market, as one of the factors that influence the dynamics of consumer prices in the fourth quarter²⁵ register annual increase. Namely the total index increased by 1.3%, while the producer prices of energy and consumer goods increased by 0.4%. Although this shift represents growth acceleration compared to the previous quarter, however, given the historical data, it is still difficult to determine whether this movement will continue or the shift is only temporary. Also, this is a moderate price growth, so in the next period no significant pressures are expected on the total consumer prices through this channel.

Foreign effective inflation²⁶, as an indicator of imported inflation, in the fourth quarter, remained almost unchanged (annual growth of 1.9%, compared to 2% in the third quarter).

²⁴ The category energy refers to electricity and oil derivatives.

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

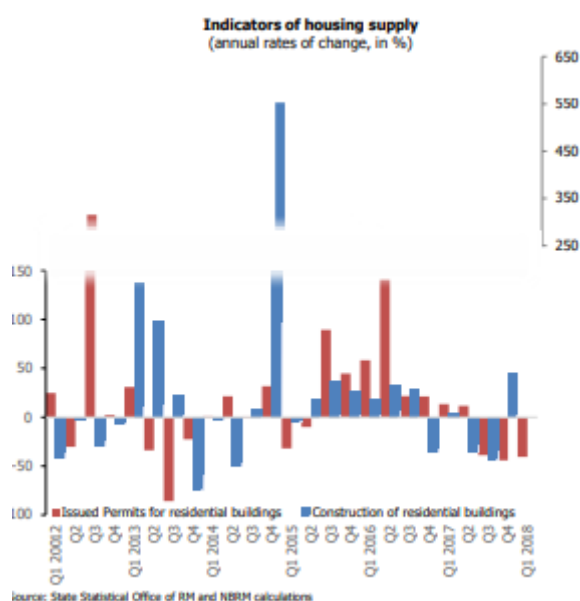
²⁶ The calculation of foreign effective inflation derives from the weighted sum of consumer price indices of the countries that are major partners of the Republic of Macedonia in the field of import of consumer goods. The weight structure is based on the normalized shares of nominal imports from each country in the total nominal imports in the period 2010-2012. The calculation of this indicator includes Bulgaria, Germany, Greece, France, Italy, Austria, Slovenia, Croatia and Serbia.



Despite the absence of potential pressures on domestic prices through the foreign prices and producer prices channel, in the third quarter of 2017, the **unit labor costs** continued to increase, although the growth is slightly lower compared to the second quarter (6.1% in the third quarter, versus 8.5% in the second quarter of the year). Given the estimates for small positive output gap²⁷, the continuous increase in labor costs could increase the prices of final products in the upcoming period.



In the fourth quarter of the year, apartment prices, as measured by the Hedonic index²⁸, registered an annual growth (3.5%) for the first time after a period of six quarters of consecutive fall. Despite the upward shift, the supply of and demand for apartments registered no significant changes that could explain this shift. Thus, after the significant increase in the supply of constructed apartments (high growth of the construction of residential buildings and the issued building permits) in the previous three years, in 2017 there was significant slowdown in the increase in new apartments (significant cumulative fall in the first three quarters of the year of the construction of residential buildings and the issued building permits). Namely, the real estate supply indicators still point to potential stabilization of the growth of the supply of real estate (substantial drop of the construction of residential buildings and the number of issued approvals for construction of residential buildings in the first three quarters of the year). On the demand side, the solid growth of housing loans continued in the fourth²⁹ quarter of 2017.



²⁷ According to the NBRM estimates, domestic production exceeds the potential level (positive output gap) from the second half of 2015 (an exception is the first half of 2017), as well as in the entire period of forecast (to 2019). However, it is estimated that the positive output gap throughout the period is relatively small and stable.

²⁸ 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.

²⁹ Available data for the first two months of the quarter.

1.5.2. Inflation expectations

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

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.



Economic analysts expect moderate inflation that would follow a path of slight acceleration in the next two-year period. According to the **Survey on Inflation Expectations and Expectations for the Movement of the Real GDP**³⁰ conducted in December, economic analysts expect that inflation in 2017 will equal 1.4%. During the next two years, according to economic analysts, the inflation rate will gradually accelerate to 1.8% in 2018 and to 2% in 2019. Other institutions also predict similar dynamics of the prices in the domestic economy.

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

In the fourth quarter of the year, after two quarters in the negative zone, the indicator **"consumers' expectations for the price changes in the next 12 months"**³¹ passed in the positive zone. Such setup points to a slightly larger number of persons who consider that prices in the next 12-month period will rise, compared to the number of respondents who expect unchanged or reduced prices. Regarding the price movements in the previous 12 months, most of the respondents estimate that prices rose which corresponds to the inflation rate for the period (the average annual inflation rate for the past 12 months amounts to 1.4%).

As for the **short-term expectations of the corporate sector**³², the managers of companies in industry, construction, retail trade and services sector, expect price growth in the next few months.

³⁰ Starting from October 2017, the NBRM changed the current Inflation Expectations Survey. The new Inflation and Real GDP Expectations Survey is conducted on a sample of economic analysts, extending the Survey subject in line with the practice of the European Central Bank (ECB).

³¹ European Commission's Consumer Survey as of December 2017.

³² European Commission's business tendency surveys in industry, retail trade, construction and services sector as of November 2017.

1.6. Balance of Payments³³

In accordance with the usual seasonal dynamics, in the third quarter of 2017, the current account balance recorded a surplus. On an annual basis, the current account surplus increased, largely due to the favorable developments in the balance in the trade in goods and services. Favorable developments in the current account were also registered on a cumulative basis during the first three quarters of the year, with a smaller current account deficit compared to the same period last year. This favorable shift is mainly driven by the reduction of the trade deficit in goods and services, while the other components registered no major changes. In the third quarter, the financial account recorded net outflows, mostly as a result of the further net outflows in currency and deposits. Also, long-term financial loans, direct investments and portfolio investments caused significant net outflows in this period. Negative balance in the financial account was also registered on a cumulative basis for the three quarters, as a result of the net outflows in currency and deposits, but also in the government, due to the net deleveraging, as opposed to the high net borrowing in the previous year. On the other hand, trade credits and foreign direct investments, on a cumulative basis affected positively the financial account. Given these movements in the individual components of the balance of payments, in the third quarter, as well as on a cumulative basis since the beginning of the year, the foreign reserves registered a decrease.

	2016		2017					2018	2016		2017					2018
	Q1	I-XII	Q1	Q2	Q3	Q4	I-XII		Q1	I-XII	Q1	Q2	Q3	Q4	I-XII	
	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 and capital account

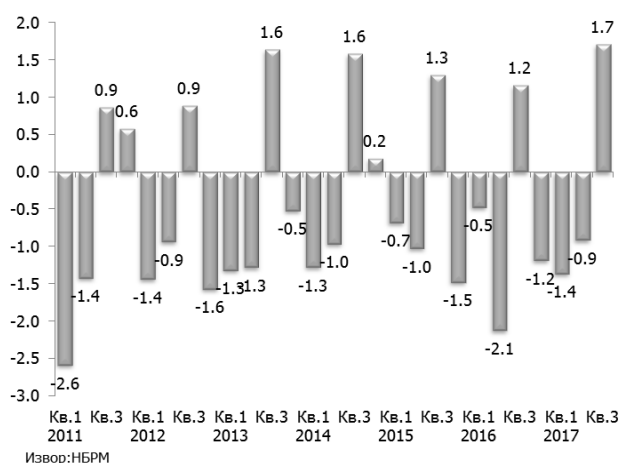
In the third quarter of 2017, the current account of the balance of payments recorded a surplus of Euro 174.9 million, or 1.7% of GDP³⁴, which is an improvement of 2.6 percentage points of GDP compared to the previous quarter, when the current account balance registered a deficit (of

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 information on the methodological changes, visit the NBRM website at

(http://nbrm.mk/WBStorage/Files/Statistika_Informacija_za_promenite_vo_platniot_bilans_megunarodnata_investiciska_pozicija_i_nadvoresniot_dolg_koisto_proizleguvaat_od_primenata_na_novite_megunarodni_statisticki_standardi.pdf).

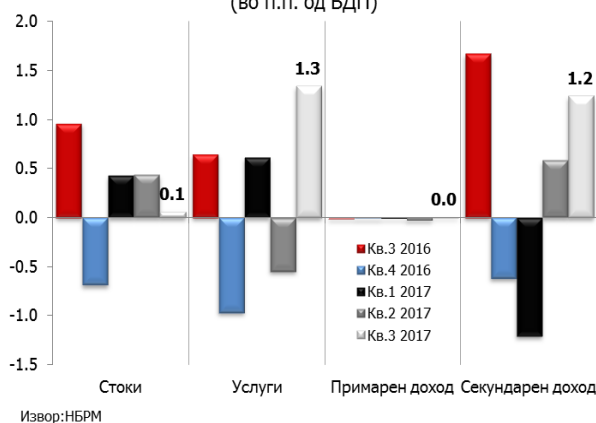
³⁴ The calculations use the nominal GDP forecast.

Тековна и капитална сметка
(како % од БДП)



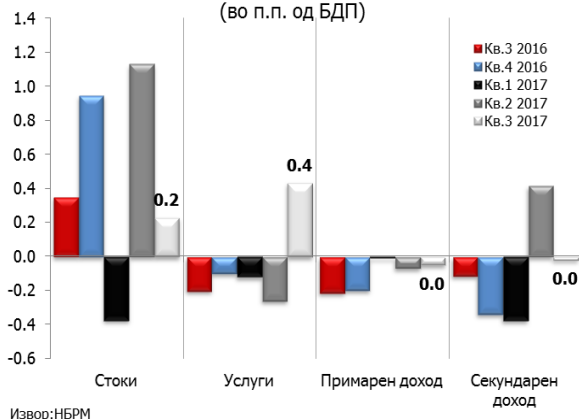
0.9% of GDP). The positive quarterly change largely reflects the increased surplus in the trade in services and the higher net inflows on the basis of secondary income. The favorable quarterly developments in services are distributed among several categories, largely reflecting the improved performances in manufacturing services on physical inputs owned by others, travel and intellectual services. The quarterly changes in secondary income result from the higher net inflows from private transfers, particularly from the growth of foreign cash purchased on the currency exchange market which is used as an indicator of private transfers in cash, which is a typical seasonal movement. A small positive contribution to the quarterly improvement of the current account was also made by the balance of goods, while the primary income registered no quarterly changes.

Придонес на одделните компоненти на тековната сметка во кварталната промена
(во п.п. од БДП)

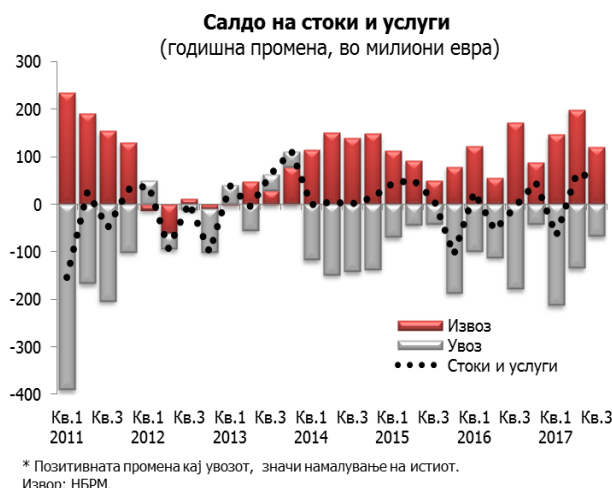


The annual analysis of the current account indicates a higher surplus in the third quarter of 2017 by 0.6 percentage points of GDP. As seen through the relative indicators, the improvement of the current account is a result of the favorable performances in the balance of goods and services, while the primary and secondary income registered no significant changes on an annual basis. The increased surplus in services (by 0.4 percentage points of GDP), as a pivotal factor of the annual growth, is mostly due to the favorable changes in the balance of construction services, travels, fees for intellectual property and other business services. The trade deficit decreased by 0.2 percentage points of GDP on an annual basis, amid more intensive growth of the export relative to the import of goods.

Придонес на одделните компоненти на тековната сметка во годишната промена
(во п.п. од БДП)



On a cumulative basis, the first nine months of the year recorded an improvement of the current account of 0.9 percentage points of GDP compared to the same period last year, influenced by the favorable movements in the balance of goods and services, amid unchanged secondary income and slight deterioration, i.e. higher net outflows in the primary income.



Box 2: Foreign trade of goods and movement of the Nominal and the Real Effective Exchange Rate (NEER and REER)³⁵



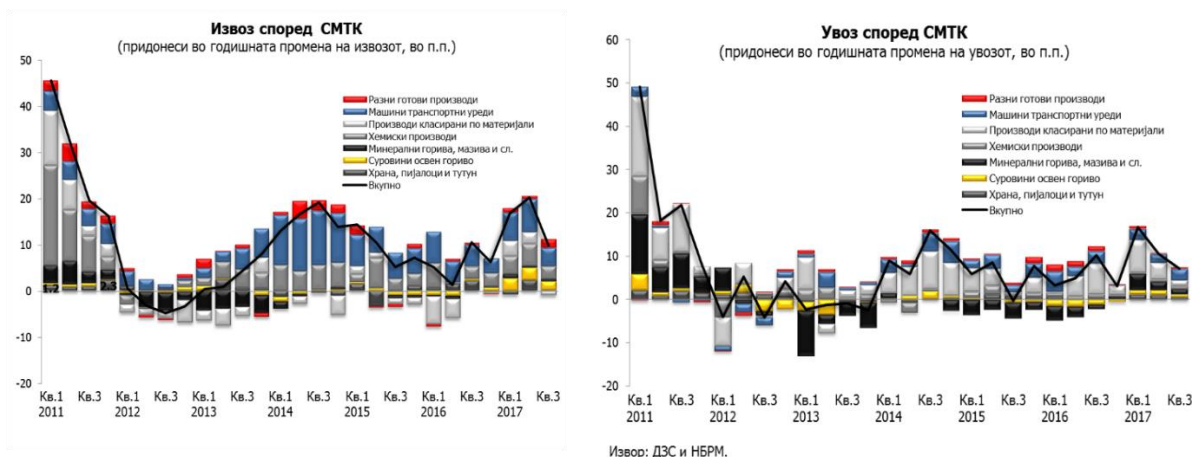
Foreign trade in the third quarter of 2017 amounted to Euro 2,911.8 million, or 28.5% of GDP. Compared to the third quarter of the previous year, there was an increase of 8.3%, amid simultaneous growth of both components. In the third quarter, the export of goods grew by 10%, which is a slowdown compared to the pace in the previous two quarters, but also a third quarter in a row at a double-digit growth rate of exports. The good export results are mostly driven by the new export-oriented facilities, whose export activity continued to grow also in the third quarter of 2017. A solid contribution to the export growth was also registered in the export of furniture

and metal ore, as well as in energy exports (electricity). On the other hand, the export of iron and steel in the third quarter registered a decrease, which is mostly due to specific factors³⁶. Moreover, the fall in the exports of the metal processing sector is a result of the reduced volumes exported, and in conditions of stable export prices. In the third quarter of 2017, the imports of goods increased by 7.1% on an annual basis, which is a moderate slowdown in the growth compared to the first two quarters of 2017 (16.7% in the first quarter and 10.5% in the second quarter). Driving factors for the growth are the import of equipment and machines and raw materials for part of the new foreign companies in the economy, as well as the energy imports. The increased energy imports is due to the growth of the oil imports and petroleum products, the gas imports, and partially to the higher imports of electricity. Moreover, the annual growth of oil imports entirely reflects the price effect, as a result of the increase in the price of oil on world markets, amid moderately reduced imported quantities. At the same time, a more significant positive contribution to the import growth was also made by the import of food, textile and metal ore. The annual changes in both foreign trade components moderately narrowed the trade

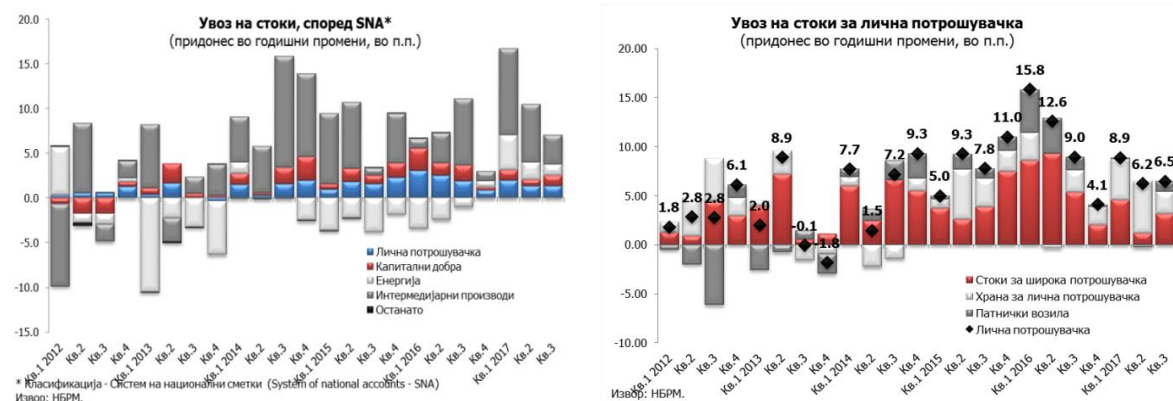
³⁵ According to the Foreign Trade Methodology, data on export of goods are published on an f.o.b. basis, and on import of goods, on a c.i.f. basis.

³⁶ The decrease in exports in the third quarter is a result of the non-operation and the fall in exports in two larger companies, while in most other exporters, the export trends in the third quarter are positive.

deficit in goods by 1.4%. This change resulted from the narrowing of the non-energy balance, and in conditions of moderate expansion of the energy balance.



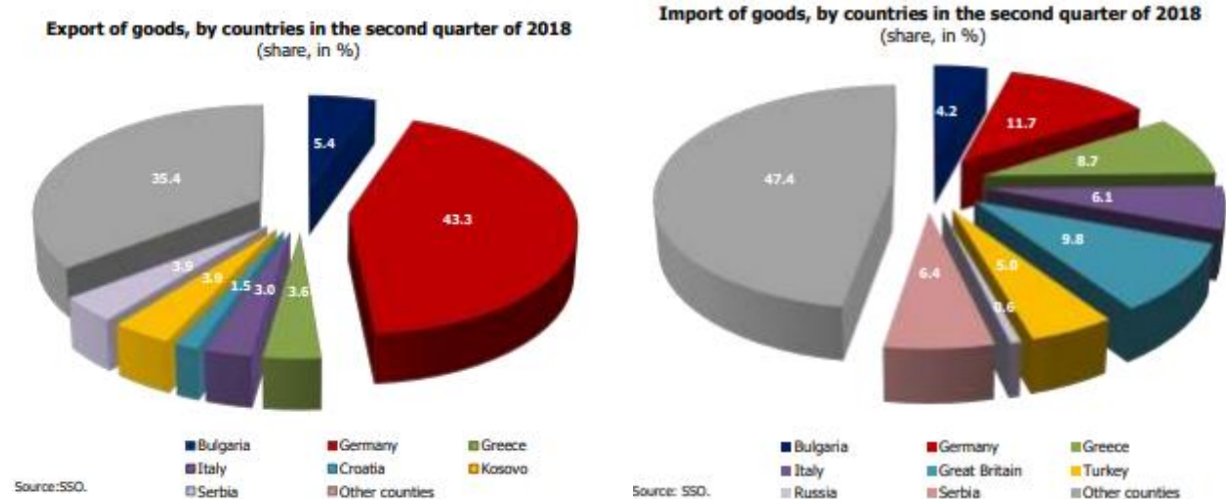
The analysis of the import of goods under the System of National Accounts (SNA) indicates that in the third quarter of 2017 all components acted towards increasing, with the largest contribution to the annual growth of total imports being made by the import of intermediate products. Imports for private consumption registered a moderate annual growth, which reflects the solid growth in all components. Overall, the growth in imports for private consumption in the third quarter of 2017 moderately accelerated compared to the second quarter, but the growth rate remains moderate and does not point to significant pressures on the imports from private consumption.



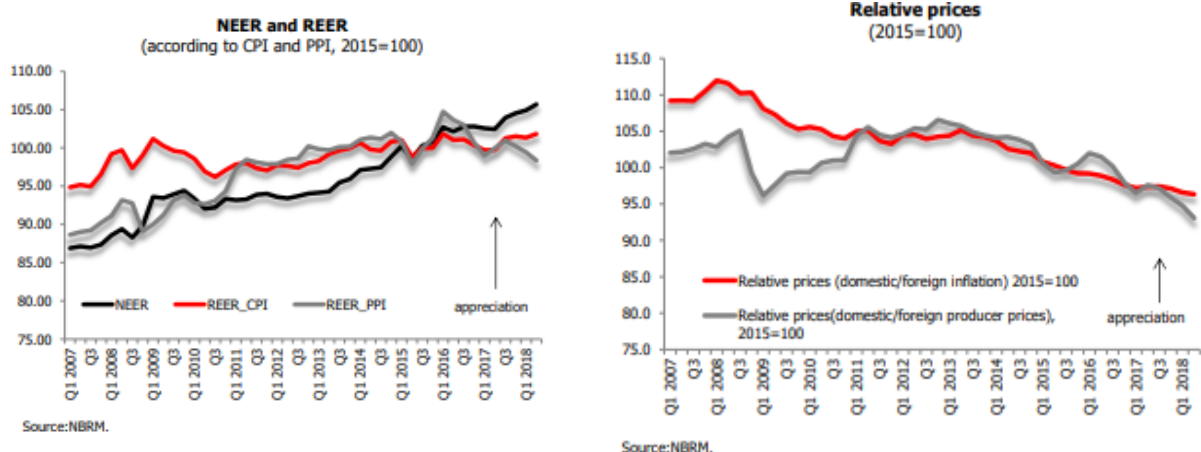
The latest available data on foreign trade as of October and November 2017 indicate solid annual growth of both the exports and the imports. The export of goods registered an annual growth of 22.4%, which is largely due to the favorable performances in the new export-oriented facilities, but a positive contribution to the growth is also made by almost all other export segments (with the exception of the export of food where there is a moderate decline). The import of goods increased by 17.3% on an annual basis, which results from the favorable developments in almost all components (primarily in the import of equipment and machinery and iron and steel), except for the import of ores that registered a moderate reduction.

The foreign trade analysis by country shows that in the third quarter of 2017, the European Union was the major trading partner of the domestic economy, making up 71.1% of total trade. In terms of individual countries on the export side, also in the third quarter, the largest contribution to the growth was made by the higher exports to Germany, as a market to which the export activity of the new foreign companies is largely targeted. Moreover, the higher placement to Germany reflects the export of machinery and equipment, as well as of the chemical industry products. At the same time, a more significant positive contribution to the export growth was also made by the export of ore to Bulgaria and the export of tobacco to Greece. The import analysis shows that the largest contribution to the growth

was made by the import of raw materials from Poland and Germany for the purposes of the new industrial facilities, and the import of oil derivatives from Greece. In terms of balances, the narrowing of the trade deficit is mostly due to the reduction of the trade deficit with the European Union expressed through the increased trade surplus with Germany, with an additional positive effect of the improvement of the balances in the trade with Bulgaria (surplus as opposed to the deficit in the same period last year), as well as the UK, Russia and Romania (smaller trade deficit). On the other hand, there was a greater deepening of the trade deficit with the Republic of South Africa, Greece and Taiwan, while for the first time (since 2008) in the third quarter of 2017, the Republic of Macedonia recorded a negative balance with the Republic of Albania - mostly due to the higher imports of the metal manufacturing industry.

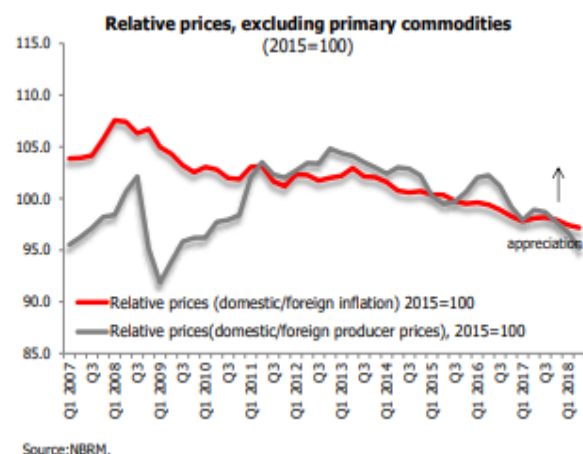
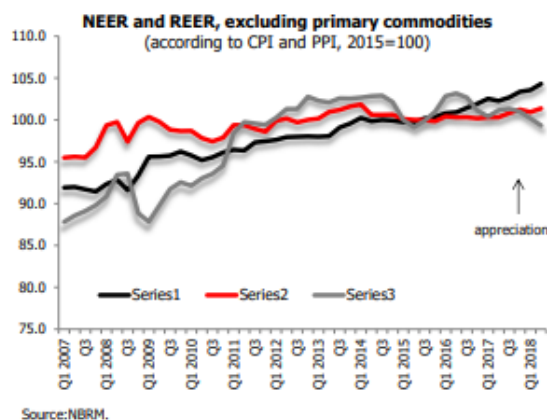


In the third quarter of 2017, price competitiveness indicators of the Macedonian economy point to divergent movements. Namely, the index of the real effective exchange rate according to the consumer prices slightly appreciated by 0.2%, while the index of the real exchange rate calculated according to the producer prices depreciated by 2.1% on an annual basis. The downward pressures result from the relative prices, whereby the relative consumer prices declined by 0.9% on an annual basis, while the drop in the relative producer prices was larger and amounted to 3.2%. At the same time, the NEER had an upward pressure on both indices, appreciating by 1.1%, due to the appreciation of the denar against the Turkish lira, the British pound and the US dollar.



The analysis of the REER indices, as measured using weights based on the foreign trade without primary products³⁷, also shows different movements of the price competitiveness indicators in the third quarter of 2017. The REER deflated by consumer prices moderately appreciated by 0.5%, while the REER deflated by producer prices depreciated by 1.8%. Moreover, there was a decrease in relative prices (annual fall of 0.7% in the relative consumer prices and 3% in the relative producer prices), while the NEER appreciated by 1.2% on an annual basis.

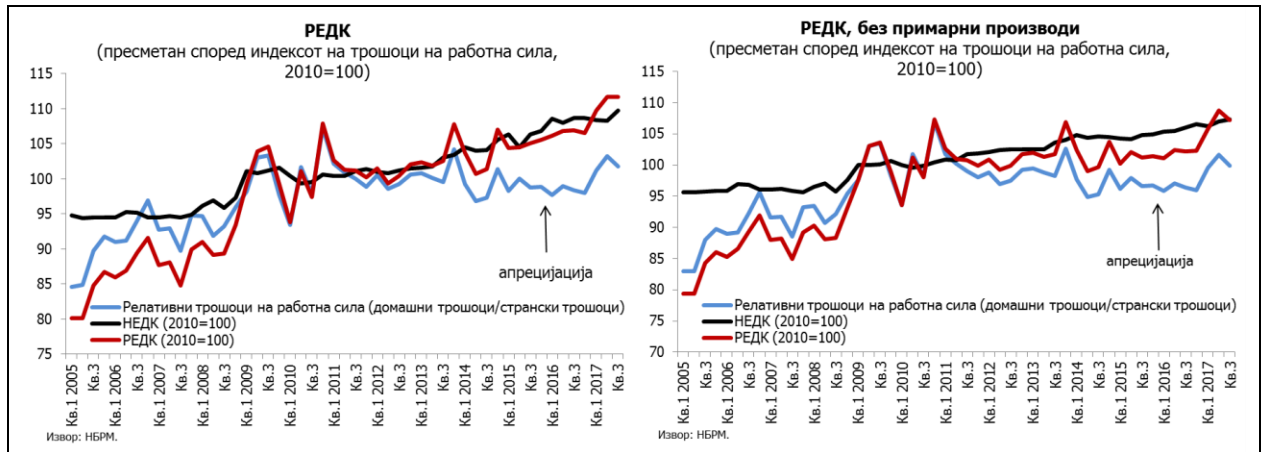
The latest data on price competitiveness for the period October - November 2017 indicate divergent movements of the REER as measured using weights of the total trade of goods. In circumstances of appreciation of the NEER, the REER deflated by consumer prices appreciated by 0.8%, while the REER deflated by producer prices depreciated by 1.5%. From the viewpoint of REER with weights based on the foreign trade without primary products, the REER calculated according to consumer prices appreciated by 1.0% and the REER deflated by producer prices depreciated by 1.1%.



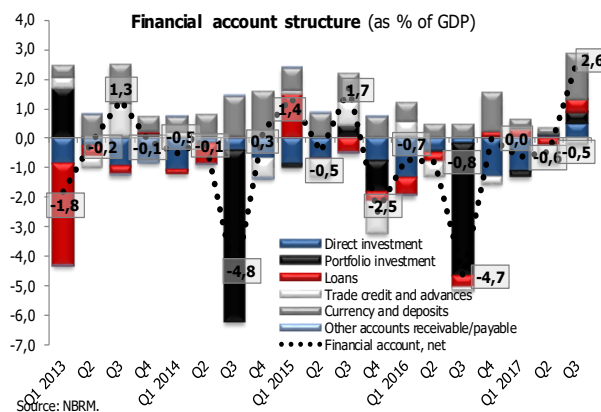
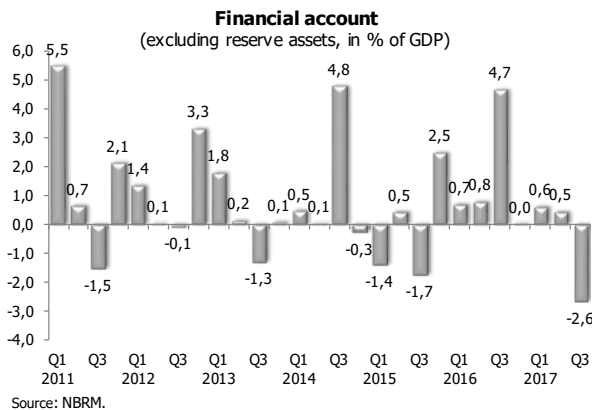
In the third quarter of 2017, the analysis of REER indices calculated using unit labor costs indicates deterioration of price competitiveness of the domestic economy³⁸. The REER index calculated by weights based on total foreign trade appreciated by 4.4%. The relative labor costs registered an annual growth of 3.4%, with more moderate upward pressures from the appreciation of the NEER of 1%. Annual appreciation was registered in the REER index calculated by using weights based on foreign trade without primary commodities (of 4.9%), determined by the growth of the relative labor costs (of 3.6%) and the appreciation of the NEER (of 1.2%).

³⁷ Primary products not included in the calculation are: oil and oil derivatives, iron and steel, ores and imported raw materials for the new industrial facilities in the free economic zones. For more detailed information on the methodology for calculating the real effective exchange rate visit: http://nbrm.mk/WBStorage/Files/Statistika_REDK_Informacija_za_promenite_na_metodologijata_za_presmetuvanje_na_realniot_efektiven_devizen_kurs_na_denarot_mak.pdf

³⁸ The REER indices based on the unit labor costs indices are NBRM internal calculations and do not represent a formal statistical survey. The calculation uses data on the unit labor costs indices for the entire economy, published by the ECB and the Bureau of Labor Statistics for the United States. Data based on internal calculations are exceptions, which is the case with the data for Switzerland, as well as in Turkey and Serbia, whereby the calculated indices refer only to the industrial sector.



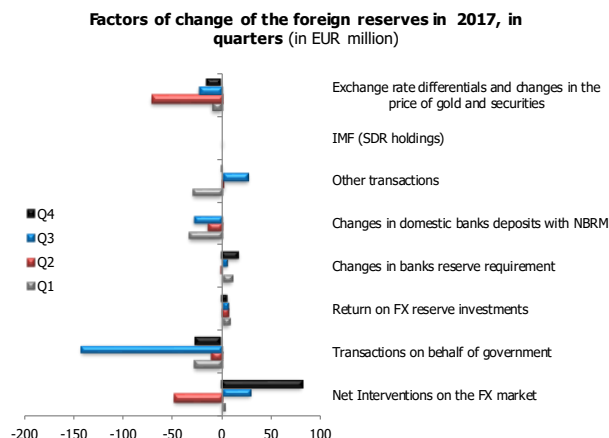
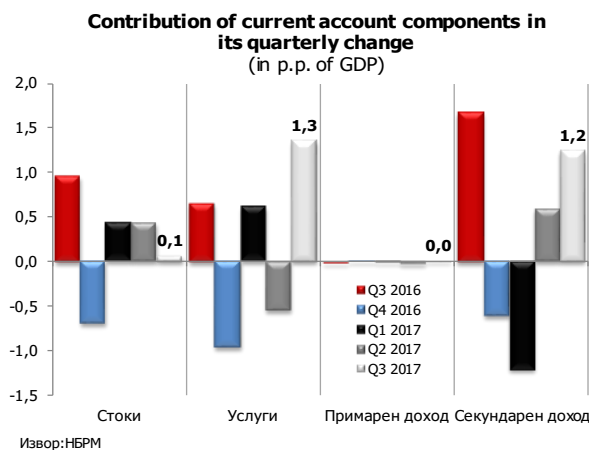
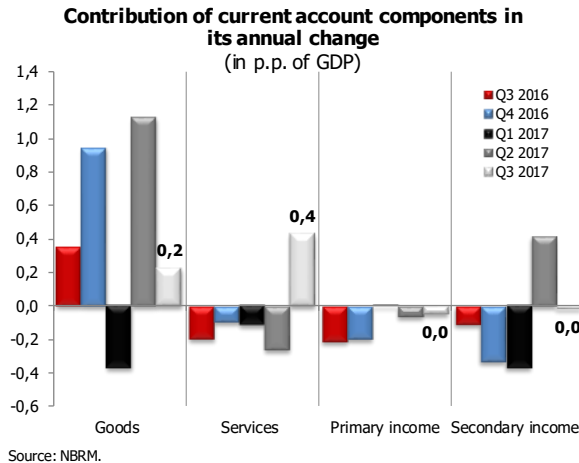
1.6.2. Financial account



In the third quarter of 2017, the financial account of the balance of payments registered net outflows of Euro 269.8 million or 2.6% of GDP. Net outflows were characteristic of most financial account components, and were especially pronounced in the category currency and deposits. The negative flows in currency and deposits in the third quarter were caused by the net outflows in depository institutions³⁹ and in the other sectors in the economy. In the third quarter, negative financial flows were also registered in long-term loans. Sector-by-sector analysis indicates deleveraging of the government, for repayment of the regular outstanding liabilities to foreign creditors⁴⁰, and reduction of the liabilities of depository institutions abroad. Direct investments registered net outflows, which is mostly due to the debt instruments, partially offset through the positive flows in reinvested earnings. Net outflows on the basis of portfolio investments also caused an additional negative effect on the position of the financial account. On the other hand, the outflows in the financial account were mitigated by the borrowing of the private sector through accumulation of trade credits and by the inflows in the short-term component of financial loans. *Quarterly analysis* indicates less favorable movements, amid net outflows contrary to the positive flows in the second quarter of 2017. Such changes are due to the deterioration in all financial account components, and especially to the increased net outflows in currency and deposits and the outflows on the basis of financial loans (as opposed to the net inflows registered in the second quarter).

³⁹ Increased net acquisition of assets of depository institutions with deposit accounts abroad.

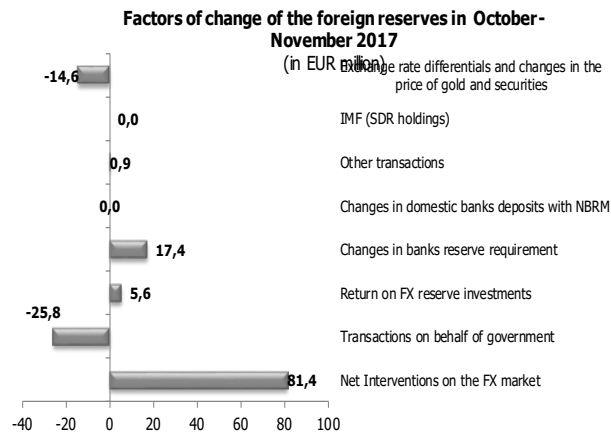
⁴⁰ In July, regular repayment of part of the borrowing from the Deutsche Bank in the amount of Euro 75 million was made.



The *annual analysis* indicates less favorable position compared to the third quarter of last year, when there were high net inflows in the financial account. The change mainly reflects the effect of the high base effect in portfolio investments, i.e. the high net inflows registered in the third quarter of 2016, as a result of the issuance of the fifth government Eurobond on foreign markets. In almost all other financial flows, the annual changes were unfavorable, but significantly more moderate.

Cumulatively for the period January - September, the financial account recorded net outflows, caused mainly by currency and deposits, and by the deleveraging of the government to abroad. The positive flows on the basis of trade credits and direct investments acted in the opposite direction.

At the end of the third quarter of 2017, the gross foreign reserves amounted to Euro 2,271.4 million, which is a quarterly fall of Euro 128.6 million. The reduction in foreign reserves largely results from transactions on behalf of the government, due to the settlement of regular liabilities to abroad, and in the absence of new borrowing. The reduction of foreign currency deposits of domestic banks with the NBRM and the currency changes and the change in the price of gold also have more moderate negative influence. On the other hand, the NBRM interventions aimed at purchase on the foreign exchange market had positive influence, as well as the transaction with a temporary effect, in particular the maturity of the swap transaction with gold. *According to the latest available data, as of 31 December 2017, the gross foreign reserves stood at Euro 2,336.3 million, down by Euro 277.2 million compared to the end of 2016.* The reduction is largely due to the transactions on behalf of the government, as a result of the repayments on the basis of liabilities to abroad, coupled with the negative currency and price changes and the reduction of foreign currency deposits of commercial banks with the NBRM. The interventions on the foreign exchange market, the banks' reserve requirement in foreign currency and the income from investment of foreign reserves, acted in the opposite direction.



Source: NBRM.

1.6.1. International investment position⁴¹ and gross external debt



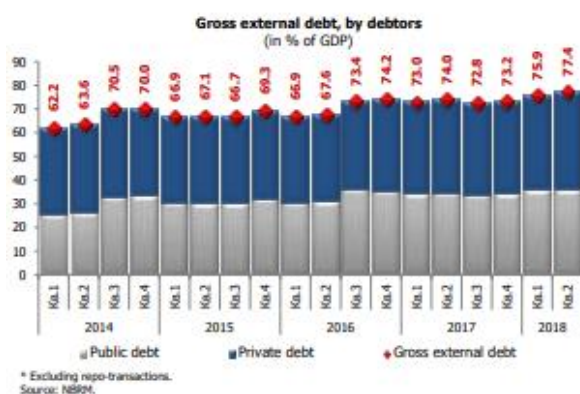
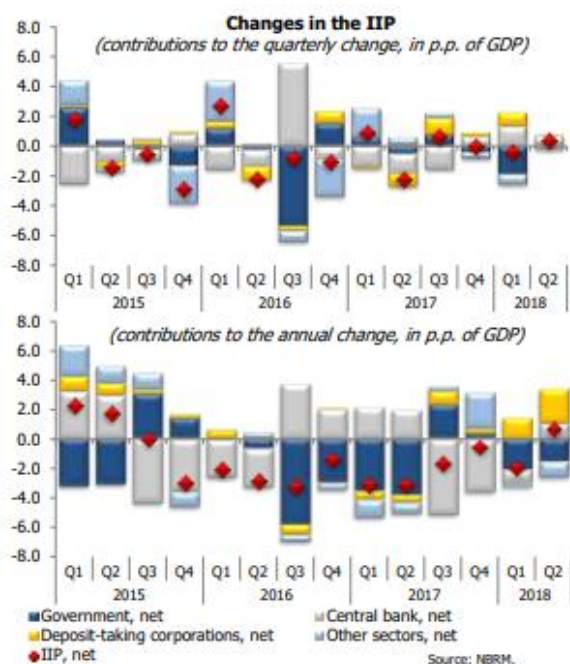
Source: NBRM.

The negative international investment position⁴² of the Republic of Macedonia at the end of the third quarter of 2017 equaled Euro 5,971 million, or 58.5% of GDP, which is a slight narrowing of 0.7 percentage points of GDP compared to the previous quarter. The quarterly change dominantly results from the lower international liabilities amid insignificant change of international assets. In terms of the division by sectors, the quarterly improvement of the international investment position is largely due to the movements in depository institutions and the reduced net liabilities of the government on the basis of other long-term loans (primarily due to repayment of the borrowing from the Deutsche Bank, in July 2017, in the amount of Euro 77.3 million). On the other hand, the net position of the central bank in the third quarter deteriorated the total international investment position of the country amid lower net assets (mainly on the basis of foreign reserves) and increased net liabilities).

On an annual basis, international assets and liabilities were lower by 3.8 percentage points of GDP and 1.7 percentage points of GDP, respectively, which further deepened the debt net position of the country by 2.2 percentage points of

⁴¹ The analysis in this section relies solely on IIP data compiled under the new methodology. Namely, since July 2014, the NBRM started disseminating data on the international investment position (IIP) and gross external debt of the Republic of Macedonia, according to the new international statistical standards defined by the Balance of Payments and International Investment Position Manual (BPM6) and External Debt Statistics (2013). For more information on the methodological changes, visit the NBRM website (http://nbrm.mk/WBStorage/Files/Statistika_Informacija_za_promenite_vo_platniot_bilans_megunarodnata_investicijska_pozicija_i_nadvoresniot_dolg_koisto_proizleguvaat_od_primenata_na_novite_megunarodni_statisticki_standardi.pdf).

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, claims created from reverse repo agreements tend to increase gross claims. The NBRM simultaneously carries out matched repo and reverse repo agreements in nearly identical amounts. In general, as they are concluded concurrently, these transactions have a neutral net effect, i.e. they appear in almost identical amount on both liabilities and assets side, and therefore do not affect the total net IIP nor the total net external debt.



GDP compared to the same period last year. Observing individual sectors, the annual decrease is mostly due to the change in the net position of the central bank as a result of the lower assets on the basis of foreign reserves. These developments were largely mitigated by the favorable movements in the net-position of the government (as a result of the lower liabilities on the basis of other long-term loans) and the depository institutions (due to the higher assets on the basis of currency and deposits).

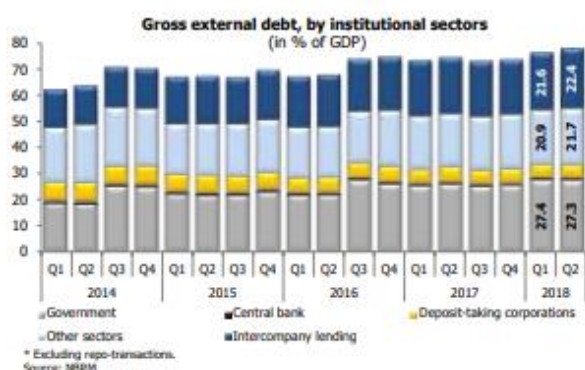
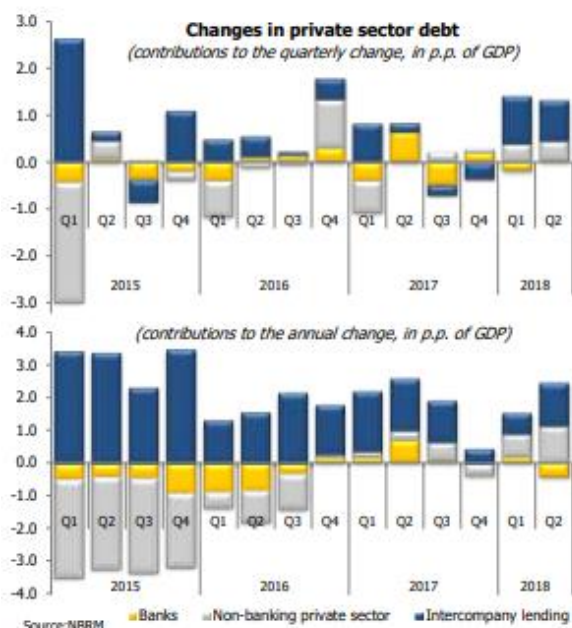
At the end of the third quarter of 2017, the gross external debt stood at Euro 7,710.2 million, or 75.5% of GDP, which is a decrease of 0.7 percentage points of GDP compared to the previous quarter. By excluding the effect of the repo transactions of the NBRM⁴³, the gross external debt accounts for 72.5% of GDP, which is a quarterly decline of 1.3 percentage points of GDP. The lower gross external debt largely results from the quarterly reduction of public debt, and to a lesser extent from the lower debt of the private sector. Moreover, within the public debt, the quarterly change is driven by the lower long-term loans of the central government (due to the repayment of the borrowing from the Deutsche Bank), while the change in the private debt largely stems from the lower short-term banks' liabilities on the basis of currency and deposits.

On an annual basis, the gross external debt decreased by 0.9 percentage points of GDP, which entirely results from the lower public debt, amid increased debt of the private sector. The reduction of the public debt is mostly a result of the lower government liabilities on the basis of long-term loans, while within the debt position of the private sector, the annual growth is driven by the increase in intercompany debt and in the debt of the non-banking private sector.

In general, the external indebtedness indicators of the national economy still indicate that the gross external debt is in the safe zone. According to the indicator for the share of gross external debt in GDP, the economy continues to be classified in the group of highly indebted countries, while the other indicators point to low indebtedness. The analysis of the external borrowing⁴⁴ dynamics indicates favorable annual

⁴³ The overall analysis below relates to gross external debt without the central bank liabilities based on repo transactions.

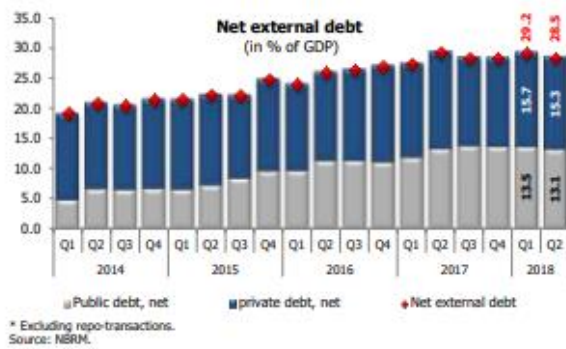
⁴⁴ The analysis of external indebtedness indicators uses the balance of payments data in accordance with the Balance of Payments and International Investment Position Manual (BPM6) and data on gross external debt according to the External Debt Statistics (2013). The methodological changes caused no changes in the overall level of external debt, but only affected the maturity and



movements in almost all solvency indicators, except the indicator for the interest repayment in the export of goods and services and other inflows which register moderate deterioration on an annual basis. Certain annual worsening is registered also in all individual liquidity indicators.

At the end of the third quarter, net external debt, as an additional indicator of the external position of the economy, amounted to Euro 2947.2 million, or 28.9% of GDP, which is a quarterly decrease of 0.9 percentage points of GDP. The lower net external debt entirely results from the fall in the net debt of the private sector, amid quarterly increase in the net debt of the public debt.

sector structure of the debt. Accordingly, under the new methodology, the level of short-term debt is lower at the expense of the increase in long-term debt component, which caused changes in the liquidity indicators, i.e. they have improved relative to the analyses based on data from the previous methodological framework. On the other hand, the methodological changes in the export of goods and services and other inflows caused deterioration of the indicators for the share of export of goods and services and other inflows in the gross external debt and debt service in relation to export of goods and services and other inflows, compared with the indicators relevant prior to the methodological changes.



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

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

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

*According

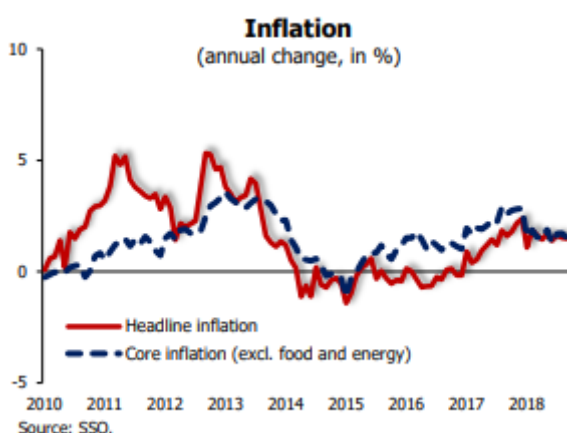
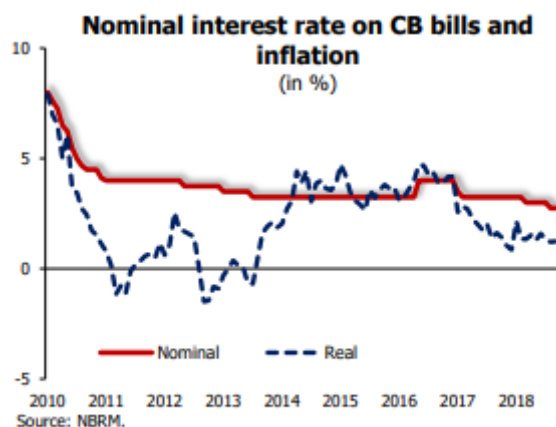
to the "Greenspan-Guidotti rule", a country should maintain full coverage of short-term debt at remaining maturity with gross foreign reserves.

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

Source: NBRM.

II. Monetary policy

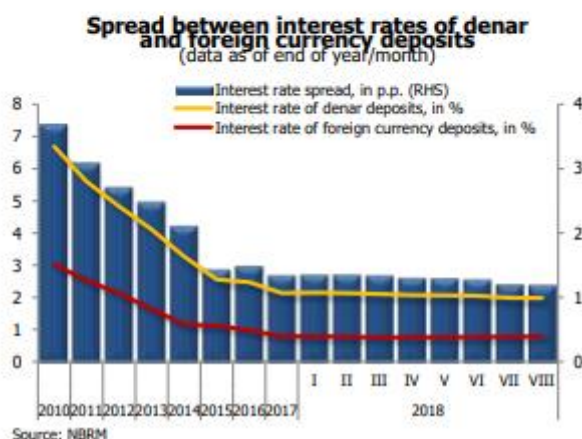
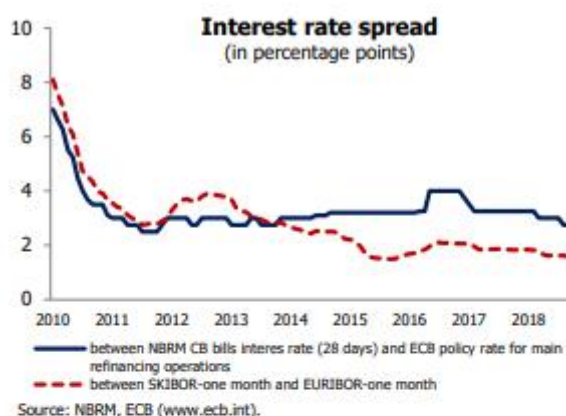
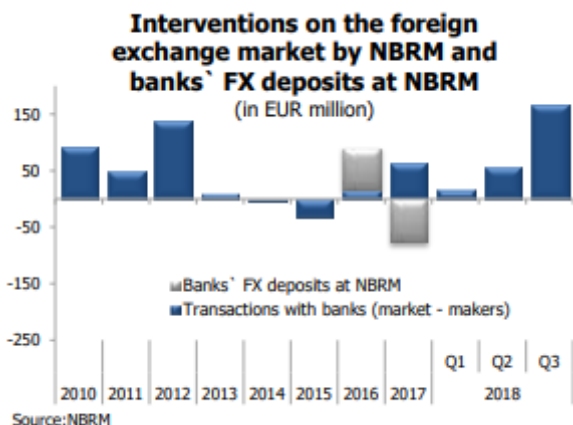
In the fourth quarter of the year, the NBRM did not change the monetary policy position, and the policy rate remained at the level of 3.25%. The current monetary setup was assessed as adequate, amid further assessments for soundness of the economic fundamentals and absence of imbalances in the economy. The latest data does not indicate major deviations from the forecasts in the key monetary policy segments. Also, amid improved foreign currency liquidity of the banks, the developments on the foreign exchange market in the fourth quarter were favorable and the NBRM intervened with net purchase of foreign currency. All foreign reserves adequacy indicators were kept within safe zone. Household savings have been continuously increasing from August onwards, which pointed to further stabilization of the expectations and confidence. However, foreign currency deposits continued to create most of the growth of household savings in this period. Under such developments, but still present risks, primarily in terms of the currency preference of entities, the monetary policy remained unchanged. In the period ahead, the NBRM will continue to monitor closely the situation, for the timely and appropriate adjustment of monetary policy.



In the fourth quarter of 2017, no changes⁴⁵ were made in the monetary policy setup, i.e. the policy rate of the NBRM remained unchanged at 3.25%. The NBRM regularly reexamined the monetary setup adequacy, and it was assessed that most of the macroeconomic indicators, which are important to the monetary policy setup, do not deviate significantly from the forecasts, while the economic fundamentals remain sound. However, the risks assessment showed that they are still present in certain points, and this primarily referred to the currency structure of savings. Namely, although there were certain changes in support of the savings in domestic currency, however the volatility and the slow shift in the structure pointed to the need for further vigilance in conducting monetary policy.

The performances in the key macroeconomic indicators during the quarter, did not suggest some major deviations from the forecasts, nor major changes in the environment for conducting monetary policy. Thus, the inflation growth in the period October-November registered an acceleration compared to the previous quarter, and these movements were in line with the forecast. Analyzed by components, inflation in the period October-November was mostly driven by core inflation, whose growth was also in line with the forecasted dynamics. The published data on the economic activity in the third quarter showed a modest recovery of the economy, after the fall in the first half of the year, and these movements in the real sector did not deviate significantly from the expectations. Changes in foreign reserves during the quarter were generally favorable, amid

⁴⁵ It refers to the decisions of the OMPC passed in the period October-December.



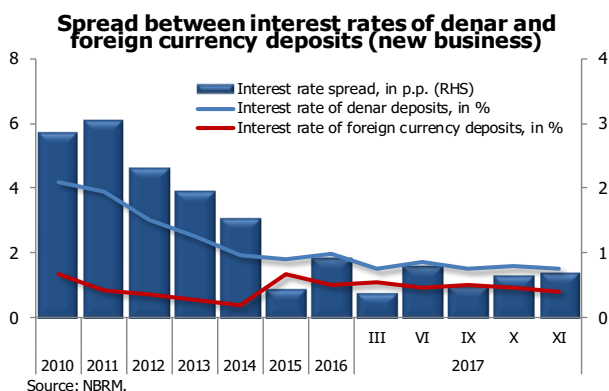
favorable developments on the foreign exchange market, which is why the NBRM intervened with net purchasing of foreign currency. The movements of foreign reserves were within the expectations, while the foreign reserves adequacy indicators were continuously maintained in a safe zone. Data on the banks' deposit base and the credit market for the period January-November showed a quarterly acceleration in the growth of deposits and loans in this period, with intensity that signaled realization of the forecasted dynamics of savings and loans until the end of the year. Moreover, the growth of lending activity in this period was still mostly a reflection of the relatively larger amount of approved household loans, amid relatively more moderate growth of corporate loans. In such a context, and amid assessments for current favorable effects and a need for further support to the lending to the corporate sector, at its meeting held on 21 December, the NBRM Council extended the application of the non-standard measure for reducing the reserve requirement base⁴⁶.

The risks related to the domestic and global environment were assessed as less pronounced compared to the previous period. In support of this conclusion were the latest information from the international environment which pointed to solid macroeconomic indicators for further recovery of the Euro area. Accordingly, the European Central Bank made a decision to reduce the monthly purchase of securities within the quantitative easing program, starting from 2018.

The interest rate spread between the policy rates (of the ECB and the NBRM) and the market indicative interest rates (in the RM and the euro area) remained at a stable level, in circumstances when the ECB and the NBRM policy rates remained unchanged in the fourth quarter. Regarding the short-term market interest rates on the European and the domestic financial market, the fourth quarter registered no changes in the average interest rate on the one-month SKIBOR and the average interest rate on the one-month EURIBOR. In such circumstances, the interest rate spread between these interest rates remained at a stable level.

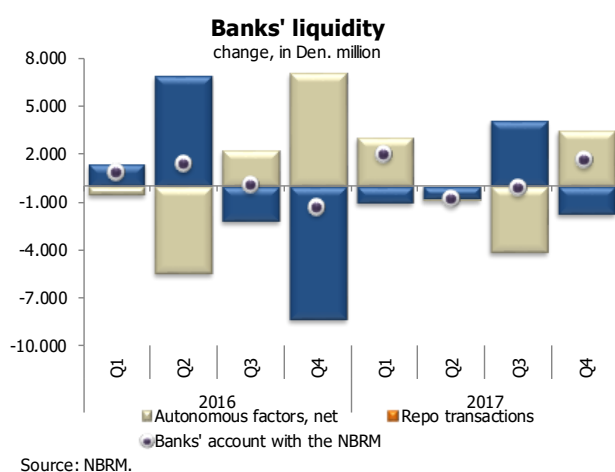
Regarding the interest rates of the banking sector in the domestic economy, in total deposits, the interest rate on denar deposits in November

⁴⁶ This measure reduces the denar reserve requirement base of banks for the amount of newly approved loans to net exporters and domestic producers of electricity and banks' investments in debt securities denominated in national currency without currency clause issued by net exporters and domestic producers of electricity. The measure was introduced in 2012, and has been applied since 2013. Since the introduction of the measure, this is the third extension of its application period for additional two years, that is, until the end of 2019.



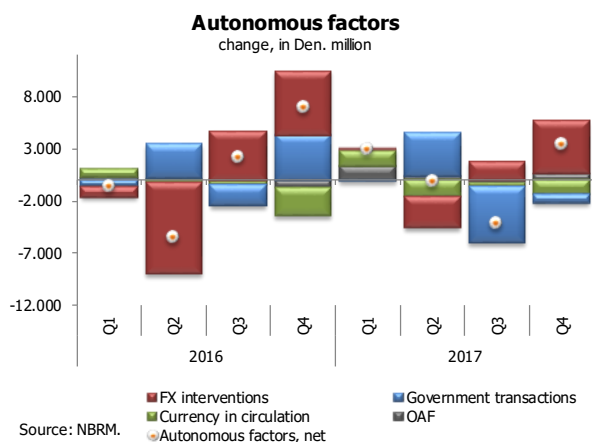
minimally increased compared to September, which, amid unchanged interest rate on foreign currency deposits, conditioned a slight increase (of 0.1 percentage points) in the interest rate spread to 1.4 percentage points. On the other hand, newly received deposits registered a moderate reduction of the interest rate on new foreign currency deposits compared to September, amid unchanged interest rate on new denar deposits. This increased the interest rate spread between the two interest rates to 0.7 percentage points, compared to the end of September (from 0.5 percentage points)⁴⁷.

2.1. Banks' liquidity



In the fourth quarter of 2017, bank liquidity⁴⁸ on the accounts with the NBRM increased by Denar 1,664 million.

Autonomous factors acted towards creating net liquidity in the banking system, totaling Denar 3,479 million. Analyzed by individual autonomous factors, the liquid assets in the banking system were mostly created through the foreign currency interventions of the NBRM with market-makers. Amid a relatively high currency position of banks and an increased supply of foreign currency on the foreign exchange market, the NBRM in the fourth quarter made a net purchase of foreign currency in the amount of Denar 5,002 million. On the other hand, government transactions and currency in circulation acted towards withdrawing liquidity from the banking system, in the amount of Denar 827 million and Denar 1,353 million, respectively.

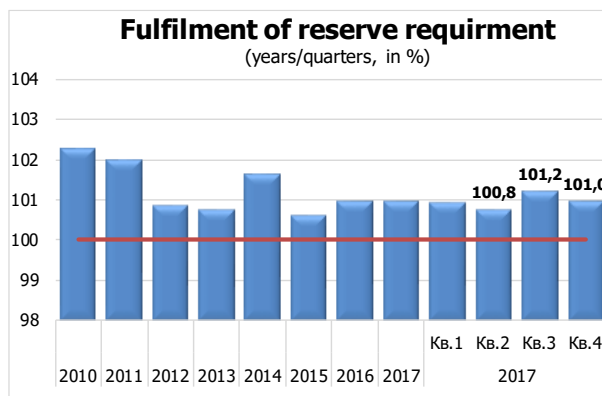
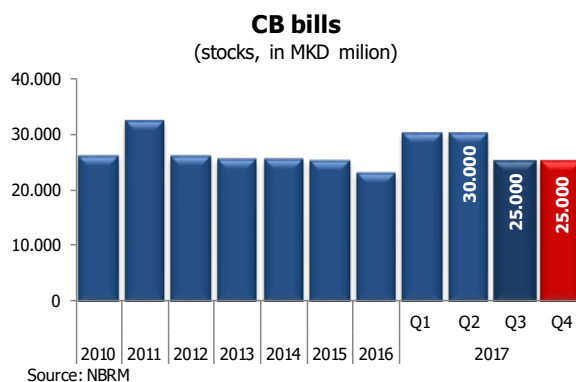
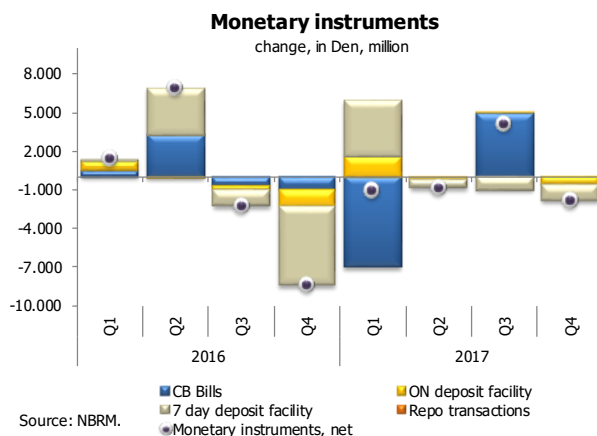


Liquid assets in the amount of Denar 1,815 million were withdrawn from the banking system on a net basis through the NBRM's monetary instruments. The change in the total monetary instruments in the fourth quarter entirely results from the changes in the deposit facilities with the NBRM. Namely, amid creation of liquid assets influenced by the autonomous factors and unchanged supply of CB bills⁴⁹ (of Denar 25,000

⁴⁷ The interest rates on newly received deposits are marked by volatility, which can result in frequent and temporary adjustments of the interest spread.

⁴⁸ Refers to changes in banks' account balances with the NBRM.

⁴⁹ In the fourth quarter, three CB bill volume tender auctions were held with fixed interest rate of 3.25%.

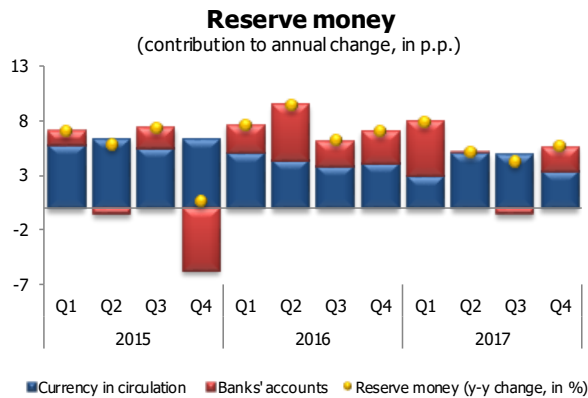


million), banks placed the short-term excess liquidity in deposit facilities with the NBRM (overnight and seven-day). Thus, the stock of these two instruments, that banks use for liquidity management within the period of reserve requirement, on a net basis, increased by Denar 610 million and Denar 1,205 million, respectively.

In the fourth quarter of 2017, the amount of liquid assets on the banks' accounts with the NBRM exceeding the level of the reserve requirement was moderately lower compared to the previous quarter. The stock of banks' liquid assets on the accounts with the NBRM in the fourth quarter of the year was higher by 1% on average than the reserve requirement. This performance is slightly lower compared to the previous quarter, when the stock of banks' liquid assets was higher by 1.2% on average than the reserve requirement.

In the fourth quarter of the year, reserve money⁵⁰ increased by 5.7% on annual basis, which is moderately higher growth compared to the growth in the previous quarter (4.3% on annual basis).

⁵⁰ Includes reserve requirement in foreign currency. Data are as of November.

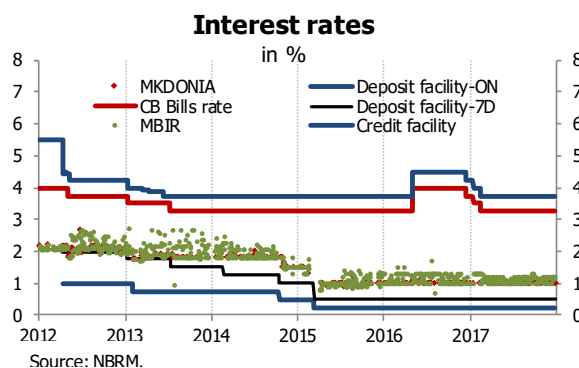


III. Financial market developments

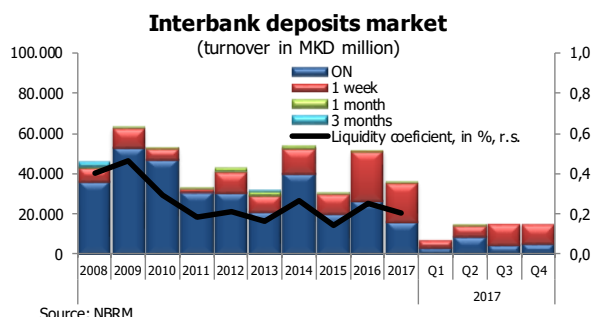
In the fourth quarter of 2017, amid unchanged level of the key interest rate of the NBRM, the interest rates on the money market remained at a stable level. On the primary government securities market, the trend of redirecting due short-term securities to longer maturities continued, whereby the new issues of government securities were largely with a currency clause and were purchased by institutional investors. The secondary securities market registered growth in turnover, mostly due to the increased volume of repo transactions, while yields on the executed transactions registered no significant changes. On the capital market, the value of the MBI-10 on the Macedonian Stock Exchange continued to decrease, amid a decline in the prices of almost all shares included in the index, while the regional indices moved in a different direction. On the international financial markets, the financial conditions volatility indices indicated stability, mainly reflecting the positive performances of the US economy. Macedonian Eurobond yields continued to decline, further narrowing the spreads relative to yields on German government bonds.

3.1. Unsecured interbank deposit market

Amid unchanged level of the key interest rate of the NBRM, the interest rates on the money market remained at a stable level. In the last quarter of the year, the NBRM kept its policy rate unchanged (3.25%), whereby the interbank interest rate on the executed overnight transactions (MKDONIA) remained at 1.0%, while the interbank interest rate of all transactions (MBKS), similar to the previous quarter ranged from 1.00% to 1.20%, depending on the maturity of the concluded transactions (overnight/up to 7 days).



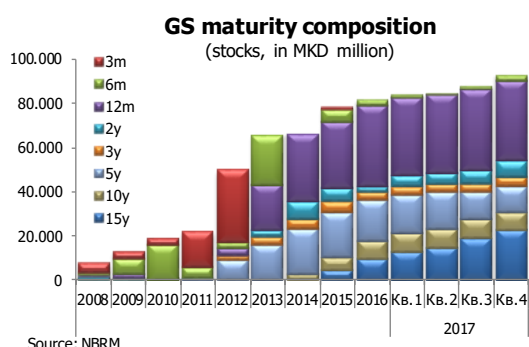
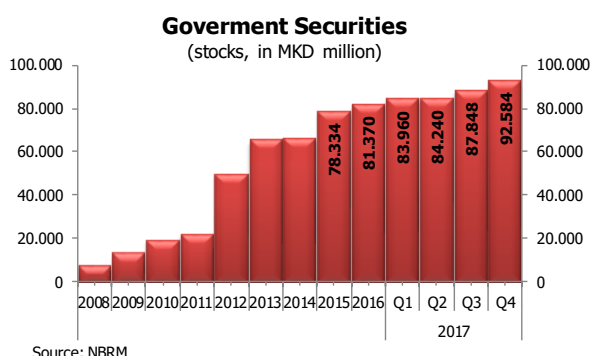
Trading in uncollateralized deposits was moderately lower compared to the previous quarter. The total turnover of this market segment in the fourth quarter of the year amounted to Denar 14,370 million and



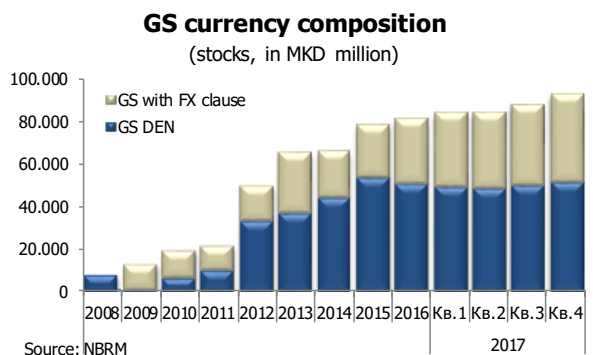
was moderately lower (by 3.1%) on a quarterly basis. Most of the transactions on the interbank market were with maturity up to 7 days.

3.2. Government securities market

On the primary government securities market, the trend of redirection of the due short-term securities to longer maturities, continued. In the fourth quarter, the stock of government securities increased⁵¹, which is almost entirely due to the increase in the stock of government bonds. Analyzed by individual maturity categories, a more significant growth in government bonds in the fourth quarter of the year was registered in the stock of the fifteen-year and the two-year government bonds, while in government securities with shorter maturities, growth was registered in the stock of the six-month treasury bills, amid simultaneous reduction in the stock of the twelve-month treasury bills. Such changes reduced the dominant share of the 12-month treasury bills in the total amount of government securities (from 42% to 39%), amid further growth of the share of the 15-year government bonds (from 22% to 24%).



The new issues of government securities were largely with a currency clause. In the fourth quarter, government securities with foreign currency clause increased by Denar 3,278 million, while the growth of government securities without foreign currency clause was slower and amounted to Denar 1,459 million. The performances in the fourth quarter increased the share of government securities with foreign currency clause, from 44% to 45%. However, securities with denar component continue to dominate in the total amount of issued government securities, with a share of 55% (56% at the end of the third quarter).

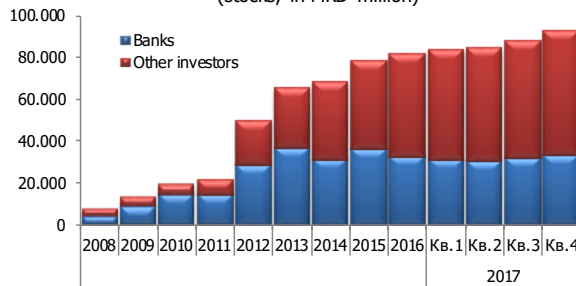


Institutional investors continued to increase their portfolio of government securities. In the fourth quarter of the year, institutional investors increased their portfolio of government securities, with a growing interest also being shown by banks and other investors. In terms of the ownership structure of government securities, banks and pension funds continue to have the largest share in the total issued government securities (36% and

⁵¹ In 2017, the stock of government securities increased by Denar 11,214 million, which is 97.8% of the amount planned for domestic government borrowing in accordance with the Budget Revision for 2017 from August 2017.

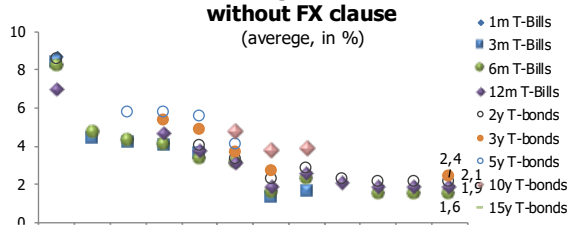


GS ownership composition
(stocks, in MKD million)

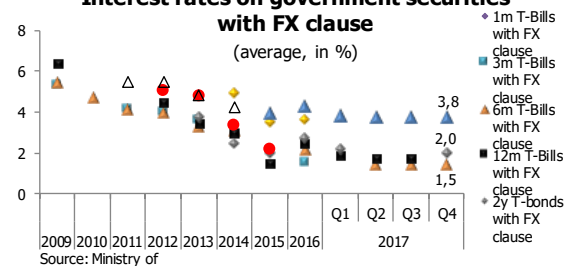


Source: MoF

Interest rates on government securities without FX clause
(average, in %)



Interest rates on government securities with FX clause
(average, in %)



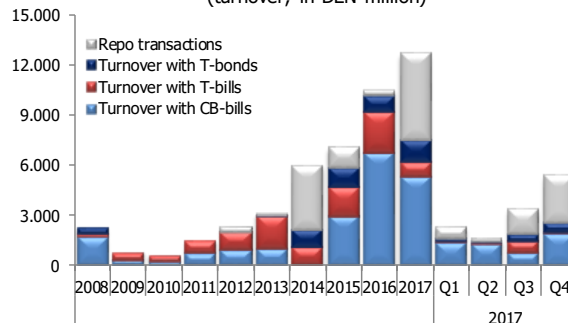
Source: Ministry of

Money and short-term securities market
(turnover, in MKD million)



Source: NBRM

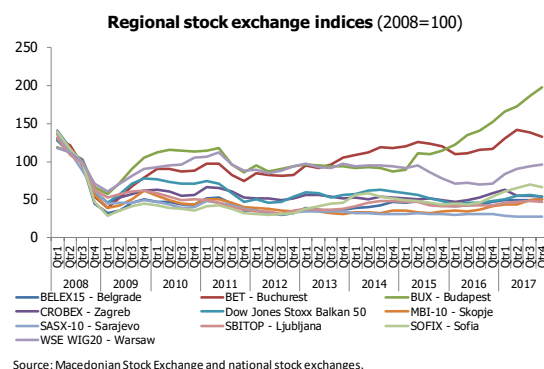
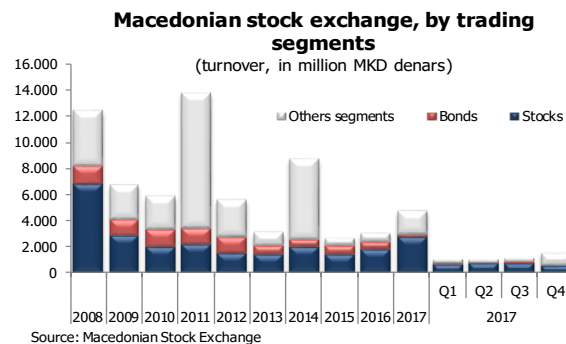
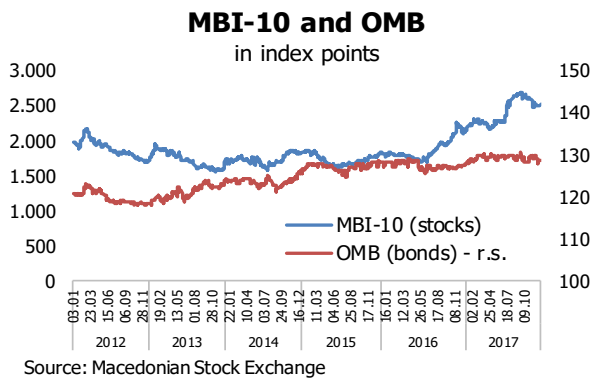
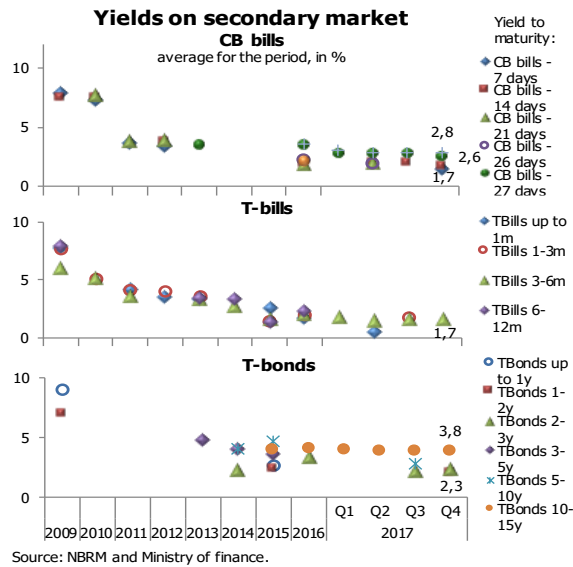
Trading on secondary market
(turnover, in DEN million)



Source: NBRM

37%, respectively). **In the fourth quarter of the year, the interest rates on the primary government securities market remained unchanged compared to the previous quarter.**

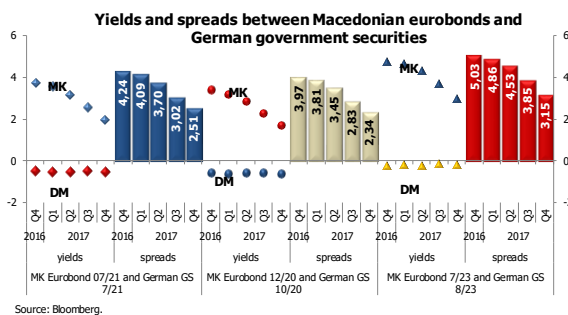
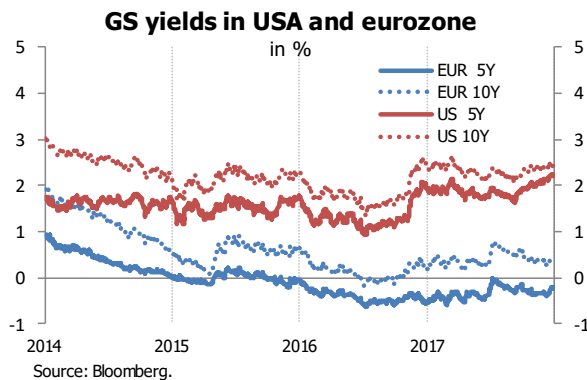
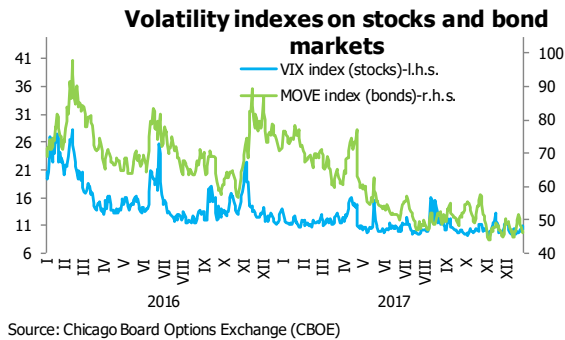
The secondary securities market registered an increased trading volume through repo transactions. In the fourth quarter of the year, the secondary securities market registered turnover in the amount of Denar 5,387 million, which was almost twice higher compared to the previous quarter. The structure of turnover was dominated by repo transactions and outright CB bill transactions (with a share of 52% and 36%, respectively), and government bonds were also traded. **In the fourth quarter, the yields for the securities transactions carried out on the secondary market remained at a relatively stable level.**



On the Macedonian Stock Exchange, the value of the Macedonian Stock Exchange Index MBI-10 continued to decrease, while the total turnover increased. At the end of 2017, the value of the MBI-10 amounted to 2,539.86 and was lower by 5.6% compared to the level at the end of the third quarter. This shift of the MBI-10 during the quarter is associated with the fall in the prices of almost all shares that make up the MBI-10 index. In terms of trading, in the last quarter, the total turnover was higher by 31% on a quarterly basis, whereby the growth was mostly influenced by the increased trading through block transactions⁵². Unlike the MBI-10, in the last quarter, the bond index (OMB) registered no significant changes and amounted to 128.57 at the end of the year. On an annual basis, the stock exchange index MBI-10 at the end of the year was higher by 18.9% compared to the end of the previous year, while the OMB index slightly increased by 0.9%.

The stock exchange indices on the regional stock exchanges moved in different directions. Dynamically speaking, over an extended period, after the fall in stock markets during the global financial crisis, the value of most regional stock indices, including

⁵² The increased trading through block transactions is mostly a reflection of one transaction that changed the ownership structure of one company in the field of mining.



the MBI-10, has still been below pre-crisis level. The stock exchange indices in Budapest and Bucharest are exceptions, which have been continuously increasing from 2015 onwards and are positioned above the level from before the onset of the global crisis.

The volatility indices of the bond and stock markets indicated stable financial conditions. The MOVE index, despite the volatile movement during the fourth quarter, remained at a lower level on average compared to the previous period, while the VIX index⁵³ registered no significant changes. These slight shifts are mostly a reflection of the positive performances in the US economy - strong economic growth and further decline in unemployment.

Yields on government bonds in the USA and the euro area moved in different directions. In the fourth quarter, the yields on the US 10-year government bonds⁵⁴ moved in an upward direction and averaged about 2.3%, (2.2% in the previous quarter), but are still around the level before the beginning of the normalization of the monetary policy by the Fed (in December 2015)⁵⁵. On the other hand, the yields on the 10-year government securities in the euro area, in the fourth quarter averaged 0.4%⁵⁶, which is a lower level compared to the previous quarter (0.5%).

The spreads between Macedonian Eurobonds and German government bonds continued to narrow. In the fourth quarter, the spread between the yields on the issued Macedonian Eurobonds⁵⁷ and the yields on the German government bonds averaged 2.51 percentage points, 2.34 percentage points and 3.15 percentage points, respectively. Analyzed dynamically, since the beginning of the year, the spread between the domestic Eurobonds and the foreign (German) bonds has been continuously narrowing, which almost entirely results from the growth of the

⁵³ The MOVE index (Merrill Lynch Option Volatility Estimate) shows the volatility of the US government bond markets. The VIX index (Volatility Index) is constructed based on the implied volatility of S&P500 index options. Investors use both indexes as indicators of the conditions and expectations for the financial markets volatility. Downward path in indexes indicates a decrease in volatility.

⁵⁴ Those are generic yields derived from the yield curve of government bonds of the United States.

⁵⁵ Since December 2015, the FED has increased the market interest rate target five times (from 0.00%-0.25% to 1.25%-1.50%), i.e. by 1.25 percentage points in total.

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

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



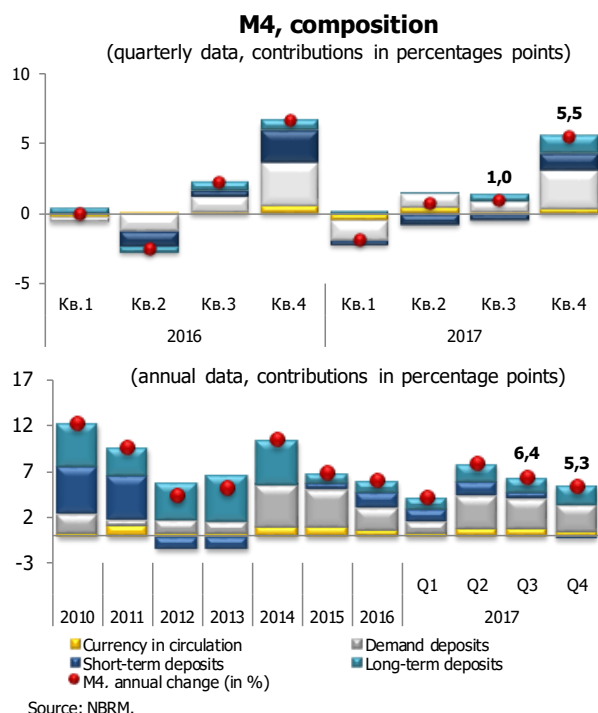
price i.e. the reduction of the yields on the Macedonian Eurobonds.

IV. Monetary and credit aggregates

The last quarter of 2017 witnessed significant acceleration in the quarterly growth of the broad money and total deposit potential of the banks. The higher money supply in the economy in this period is typical and is partly associated with certain seasonal factors, and is partially a reflection of the improved performances in the domestic economy. The analysis of the structure shows that the growth of the broad money largely results from the most liquid component M1, with significant positive contribution also being made by savings. Analyzed by sectors, the growth of the banks' deposit potential results from the simultaneous increase in the deposits in both sectors (households and companies). The higher level of deposits was additionally supported by the enhanced credit support of the banks during this period. Thus, the lending activity in the fourth quarter registered a rapid growth, given the significantly increased lending to the corporate sector, which is common for this time of year. Such performances correspond to the results of the fourth quarter Bank Lending Survey that indicate growth of loan demand and further net easing of total credit standards.

4.1.1. Monetary aggregates

The pace of growth of money supply during the last quarter of 2017 significantly accelerated (from 1.0% to 5.5%). The acceleration in the pace of growth in money supply in the last quarter of the year is typical and is partly associated with certain seasonal factors, and is partially a reflection of the performances in the domestic economy. Thus, the available high-frequency indicators point to more favorable developments in the real economy in the fourth quarter, as confirmed by the results of the surveys which show further strengthening of the confidence of economic agents. The labor market developments, i.e. the increase in nominal wages, as well as the credit market developments, i.e. the banks' solid credit support to the private sector, also acted in the same direction. The acceleration in the growth of money supply was further supported by the seasonal factors typical for the end of the year, on the eve of the New Year and Christmas holidays. In such circumstances, the growth of the broad money largely results from the most liquid component M1 (with a share of 54% in the



total growth), with significant positive contribution to the growth also being made by savings. The deposit analysis by maturity indicates a simultaneous solid increase in both long-term and short-term deposits. Observing the currency structure, the deposit growth in the fourth quarter is largely due to denar deposits, with a significant contribution of foreign currency deposits. Given the further denarization of deposit base, at the end of December, the share of foreign currency deposits in M4 moderately decreased to 37.1%, from 37.6% in September. **On an annual basis**, the growth of broad money slowed down to 5.3% in December, from 6.4% at the end of September.

Total banks' deposit potential in the last quarter of the year registered intensive growth, whereby its quarterly growth pace accelerated from 0.8% to 5.7%. The analysis of the currency structure indicates a more significant contribution of denar deposits to the total quarterly increase, amid solid growth in foreign currency deposits. Analyzing the maturity structure, the growth is largely due to the higher long-term deposits, with a significant contribution to the growth of short-term deposits. Observed by sector, the growth in the banks' deposit potential in the last quarter of 2017 is almost equally due to the higher household and corporate deposits. Thus, the **quarterly growth rate of total household deposits at the end of December equaled 4.1%**, which is a significant acceleration compared to the previous quarter (growth of 0.9%). The solid quarterly growth is associated with several fundamental and seasonal factors typical for the end of the year. Thus, the higher household deposits in the last quarter reflect the favorable developments in the labor market (through the higher nominal wages, which is partly due to the increase in the minimum wage in September), the early pension payments⁵⁸ and part of the wages in the private sector, the bonus payments typical for the year-end, as well as the payments of subsidies by the government in this period. Additional contribution was made by the further banks' solid credit support for households. In terms of currency structure, most of the quarterly growth is due to the higher denar deposits, amid more moderate growth of foreign currency deposits, which is contrary to the performances in the previous quarter, when foreign currency deposits were the driver of the

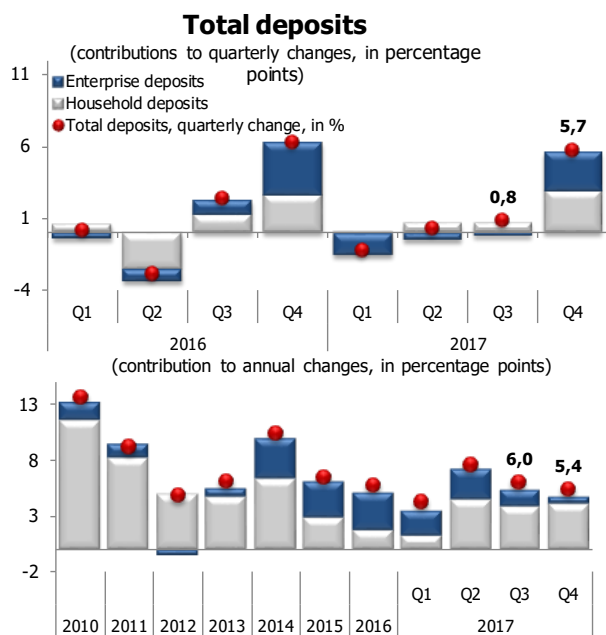
⁵⁸ Some banks paid the December pension at the end of December.



Total deposits

	2016				2017			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
quarterly change, in %								
Total deposits	0,1	-2,9	2,3	6,3	-1,3	0,2	0,8	5,7
contributions to quarterly growth, p.p.								
Deposit money	-0,4	-1,3	1,2	3,0	-1,3	1,0	0,7	3,0
Denar deposits	0,01	-1,6	0,0	1,7	0,1	-0,4	-0,1	1,1
FX deposits	0,5	0,1	1,1	1,6	-0,1	-0,4	0,2	1,7
Short-term deposits	0,03	-1,0	0,4	2,5	-0,3	-0,9	-0,5	1,3
Long-term deposits	0,5	-0,5	0,7	0,8	0,3	0,1	0,7	1,5
Households	0,5	-2,5	1,2	2,5	0,0	0,6	0,6	2,9
Enterprises	-0,4	-0,9	1,0	3,7	-1,5	-0,5	-0,2	2,8

Source: NBRM.



Enterprise deposits

	2016				2017			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
quarterly change, in %								
Total household deposits	-1,7	-3,6	4,2	14,9	-5,7	-1,9	-0,7	11,1
contribution to quarterly change of total deposits, in p.p.								
Deposit money	-2,3	-3,4	2,9	6,5	-3,6	-0,2	2,3	5,8
Denar deposits	-0,1	0,0	-0,7	4,5	-0,5	-1,1	-1,5	2,0
FX deposits	0,6	-0,3	1,9	3,8	-1,6	-0,5	-1,5	3,3
Short-term deposits	-0,2	0,7	0,5	7,9	-2,2	-2,0	-3,4	3,7
Long-term deposits	0,8	-0,9	0,8	0,4	0,1	0,3	0,4	1,6

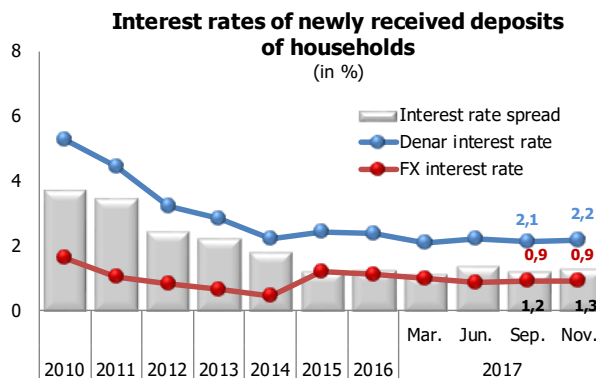
Source: NBRM.

growth. Along with the favorable developments in the currency structure of household deposits, the last quarter registered a positive change in the maturity structure of total savings. Namely, the fourth quarter registered a stronger positive contribution of long-term deposits to the total quarterly growth compared to the increase in short-term deposits. **On an annual basis**, the growth pace of total household deposits accelerated to 6.1% in December, from 5.6% at the end of September.

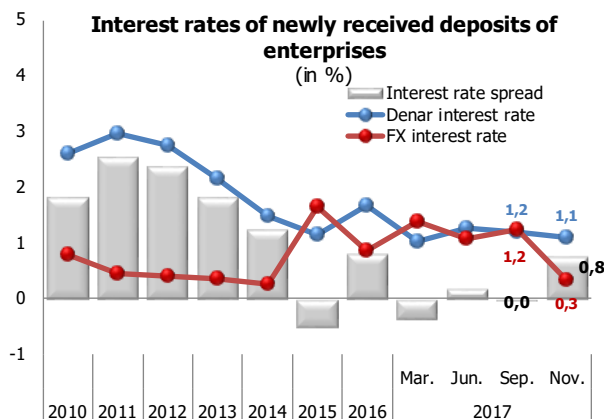
In the last quarter of the year, total corporate deposits registered a significant quarterly growth of 11.1%, unlike the fall in the previous quarter (of 0.7%). Besides the favorable real sector developments (the moderate growth of the economy in the third quarter and the relatively favorable high-frequency indicators for the fourth quarter), additional factor for the stronger deposit growth of companies may also include the increased banks' credit support to this sector in the last quarter, increasing the multiplicative effect of lending on corporate deposits. The analysis of the currency structure shows that the quarterly increase largely results from the higher denar deposits, with quarterly growth, but to a lesser extent, also being observed in foreign currency deposits (unlike the fall in the previous quarter). Analyzing the maturity structure, the growth in the fourth quarter is largely due to the higher short-term deposits (unlike the fall in the previous quarter) amid simultaneous increase in the positive contribution of long-term deposits. **On an annual basis**, corporate deposits increased by 2.1% at the end of December, which is a slower increase than that at the end of September (of 5.6%).

According to the analysis of the yields from new savings, in November, the interest rates⁵⁹ on the newly received Denar household deposits registered minimal growth of 0.1 percentage point compared to September, while the interest rate on the foreign currency deposits remained unchanged. In such conditions, there is a minimal expansion of the interest rate spread between the new Denar and foreign exchange household savings. Regarding the corporate sector, the changes in the interest

⁵⁹ As of January 2015, interest rate data of banks and savings houses have been collected under the new interest rate methodology, while data for the previous period were collected under the old methodology. For more information see Quarterly Report, May 2015, p 53.



Source: NBRM.

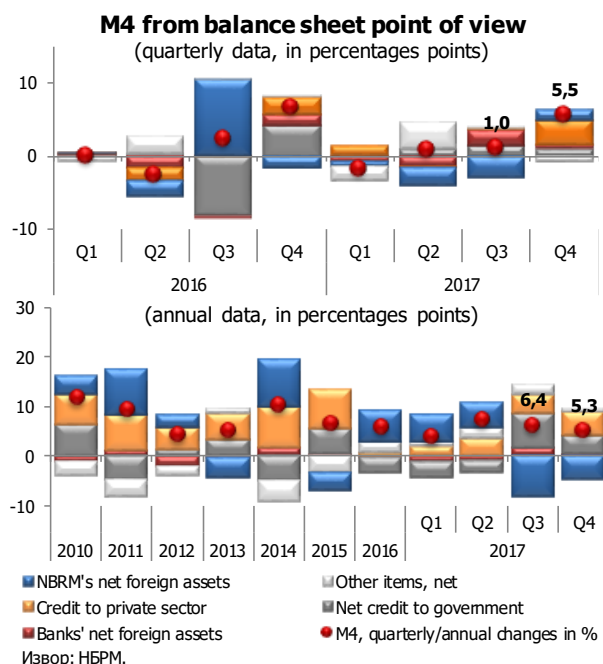


Source: NBRM.

rates on deposits are more pronounced⁶⁰, whereby the newly received foreign currency deposits in November registered significant reduction of 0.9 percentage points compared to the end of September, while the denar deposits registered minor decline of 0.1 percentage points. As a result of these developments, the interest rate spread between the newly received Denar and foreign currency corporate deposits expanded by 0.8 percentage points in November. Regarding the total deposits, the interest rates on Denar and foreign currency household deposits in November registered no significant changes compared to September and equaled 2.2% and 0.8%, respectively. The interest rates on denar corporate deposits remained at the same level as in September (2.2%), while the interest rate on foreign currency corporate deposits decreased by 0.1 percentage points and equaled 1%. In such circumstances, the interest rate spread between the Denar and foreign currency household savings remained stable at 1.4 percentage points, while in companies it minimally expanded and amounted to 1.2 percentage points.

The analysis of the structure of money supply, from balance sheet perspective, shows that the quarterly money supply growth in the last quarter of the year is mainly due to the loans to the private sector and the NBRM net foreign assets. An additional moderate contribution to expanding the money supply was also made by net government loans and net foreign assets of the banks.

⁶⁰ Volatility of interest rate on newly accepted corporate deposits results from the fact that they are driven by the volume of newly accepted deposits (which can vary from month to month) and their interest rate.

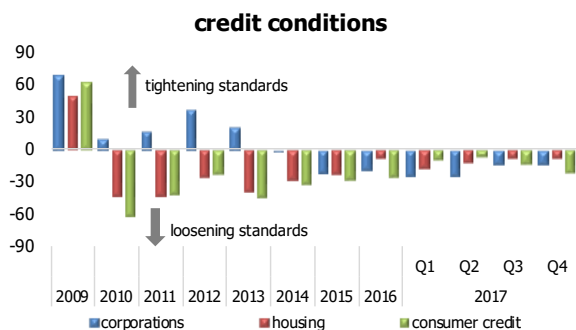


4.1.1. Lending activity

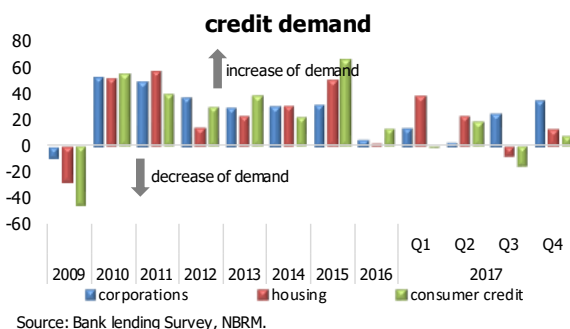
In the last quarter of 2017, the banking sector significantly strengthened its credit support to the private sector. The quarterly growth rate of total loans at the end of December equaled 4.1%, which is a significant acceleration compared to the third quarter (growth of 0.2%). Such intensification of the lending activity in the last quarter of the year is common (it has been registered in the last five years) and is mainly explained by the significant increase in the total corporate credits in this period. The increase in the fourth quarter of 2017 explains 72% of the overall annual growth, which is a higher share compared to the average contribution in the previous four years (share of about 46%). According to the results of the latest Bank Lending Survey⁶¹, the acceleration in the credit growth in this period corresponds to the favorable conditions on the side of supply of and demand for corporate and household loans.

	2016				2017			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
quarterly change, in %								
Total credits of private sector	0,1	-2,0	0,2	2,7	-0,8	2,2	0,2	4,1
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
Foreign currency credits	-0,6	-0,9	-0,3	-0,5	-0,2	0,0	-0,5	0,1
Short-term credits	-1,1	-0,3	-0,5	1,6	-1,4	0,5	-0,6	2,0
Long-term credits	1,0	2,2	0,9	1,7	0,8	1,1	0,9	2,1
Households	1,1	0,1	0,8	1,0	1,0	1,4	1,0	0,8
Corporations	-1,0	-2,1	-0,6	1,6	-1,8	0,8	-0,8	3,3

Source: NBRM.



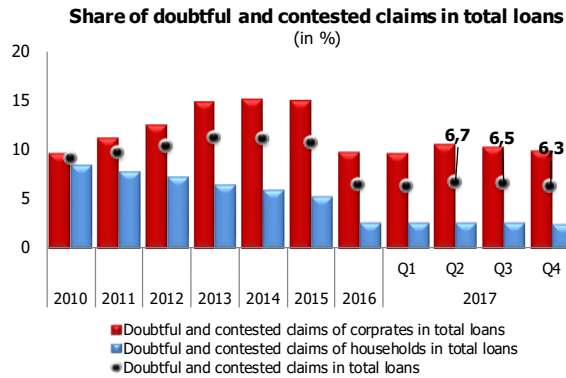
Source: Bank lending Survey, NBRM.



Source: Bank lending Survey, NBRM.

Observed by sector, credit flows in the last quarter are mostly due to the increased lending to enterprises, with a contribution of 80% to the total quarterly growth. Such performance differs compared to the previous three quarters, when household loans were the main driver of the growth. Analyzing the currency structure, the increase in credit activity in this period is dominantly due to the increase in denar loans, with a small positive contribution of foreign currency loans. According to the analysis of the maturity structure, the quarterly growth of total loans is

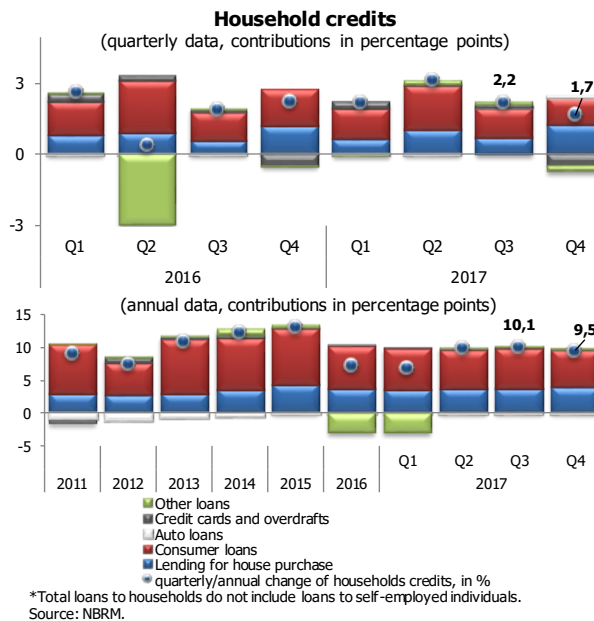
⁶¹ For more information, also see Bank Lending Survey at <http://nbrm.mk/?ItemID=F7AC78DEE498764FBAF39049F726CE3C>.



Total credits of households

	2016				2017			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
quarterly change, in %								
Total credits of households	2,5	0,2	1,9	2,2	2,1	3,0	2,1	1,6
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
Foreign currency credits	0,1	0,2	0,1	0,1	0,1	0,4	0,3	0,1
Short-term credits	0,2	0,2	0,1	-0,4	0,2	0,0	0,1	-0,5
Long-term credits	2,4	3,1	1,8	2,7	1,9	2,8	1,9	2,3

Source: NBRM.



almost equally due to the higher long-term and short-term loans. The share of doubtful and contested loans in total loans at the end of December decreased by 0.3 percentage points compared to September and equaled 6.3%. Such changes are the result of the simultaneous improvement of the quality of the credit portfolio of both companies and the household sector.

Annually, in December, total loans registered an increase of 5.7%, which was higher compared to September (by 4.3%). The fourth quarter registered significant expansion of the deposit base, which was partially used for new lending. In such circumstances, the loan to deposit ratio decreased by 1.4 percentage points on a quarterly basis, and equaled 88% at the end of December.

In the fourth quarter of 2017, the lending to the households sector continued to grow, but at a moderately slower pace compared to the previous quarter (1.6% at the end of December compared to 2.1% in September). The quarterly growth largely results from the increase in housing loans, with a significant positive contribution of consumer loans. Credit cards and overdrafts registered a quarterly decline as a result of seasonal factors typical for the end of the year. The further favorable developments in lending to households in the last quarter correspond to the results of the Bank Lending Survey that indicate a further moderate net easing of the total credit conditions, amid simultaneous net increase in the demand for housing and consumer loans (as opposed to the net reduction in the third quarter). Analyzing the currency structure, the growth predominantly resulted from denar loans, amid a small increase in foreign currency loans. Analyzing the maturity structure, the growth was entirely due to the higher long-term loans, amid moderate reduction of short-term loans. **Annually,** at the end of December, total household loans increased by 9.2%, versus 9.8% at the end of September.

In the last quarter of 2017, total loans extended to the corporate sector registered a strong quarterly growth of 6.4%, compared to the decline of 1.6% in the previous quarter. The increase contributes with 80% to the total credit growth in the last quarter of the year, which is a growth structure typical for the end of the year. According to the Bank Lending Survey, the favorable developments in lending to companies are largely due to the growth of the demand for corporate loans, with a



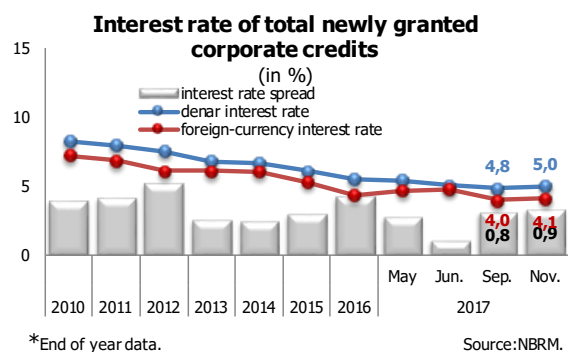
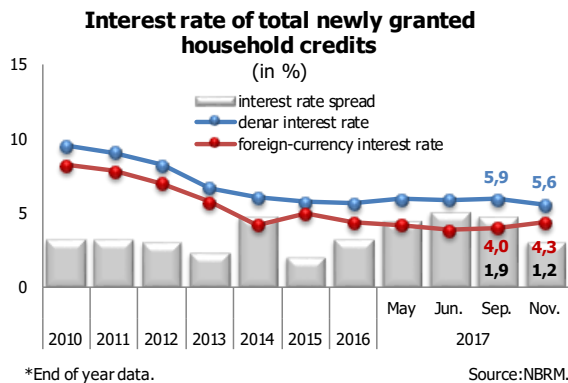
Total credits of corporations

	2016				2017			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
quarterly change, in %								
Total credits of corporations	-1,8	-3,8	-1,1	3,0	-3,3	1,6	-1,6	6,4
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
Foreign currency credits	-1,1	-1,8	-0,7	-1,0	-0,5	-0,4	-1,2	0,2
Short-term credits	-2,0	-0,8	-0,9	3,3	-2,8	0,9	-1,3	4,5
Long-term credits	0,0	1,4	0,2	0,8	-0,1	-0,4	0,1	1,8

Source: NBRM.

positive contribution of the retention of net eased credit conditions by banks. Currency structure data indicate a significant contribution of denar loans to the total quarterly growth, amid moderate increase in foreign currency loans. Analyzing the maturity, the increase in corporate loans largely derived from the higher short-term loans, with the long-term loans acting in the same direction. **Annually**, at the end of December, total corporate loans increased by 2.8%, despite the fall of 0.5% at the end of September.

According to the data on the interest rates on newly approved loans⁶², in November, the changes in denar and foreign currency household loans are in a different direction. Namely, the interest rate on denar loans decreased by 0.4 percentage points compared to September and equaled 5.6%, while the interest rate on foreign currency loans increased by 0.3 percentage points and equaled 4.3%. In such conditions, the interest rate spread between the new Denar and foreign exchange lending amounted to 1.2 percentage points and narrowed by 0.7 percentage points. Interest rates on newly approved denar and foreign currency corporate loans increased by 0.2 percentage points and 0.1 percentage points respectively, compared to September and equaled 5% and 4.1%, respectively. In such conditions, the interest rate spread minimally expanded (from 0.8% to 0.9%). The interest rates on the total household and corporate loans at the end of August minimally decreased compared to September and equaled 6.4% and 5.3%, respectively.

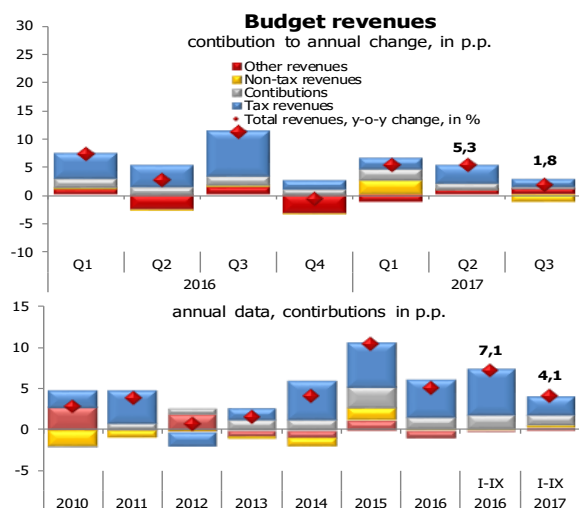


V. Public finance

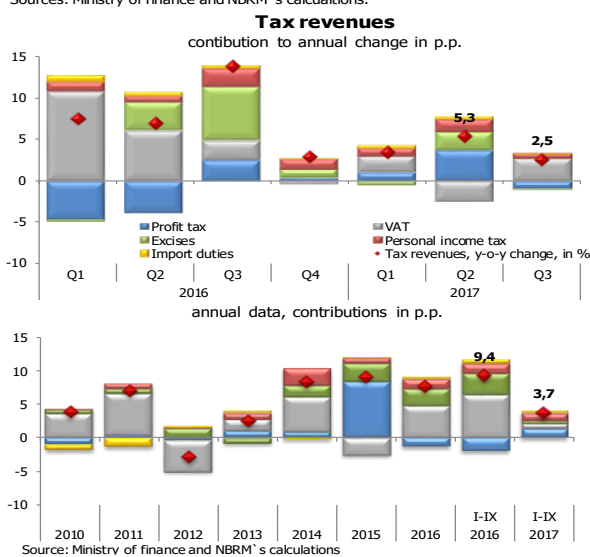
In the third quarter of 2017, the total revenues and expenditures in the Budget of the Republic of Macedonia (central budget and budgets of funds) were higher by 1.8% and 3.0%, respectively on an annual basis. The largest contribution to the growth of budget revenues was made by taxes, while the budget expenditures were entirely driven by current expenditures. The budget deficit in the third quarter of 2017 amounted to 0.4% of GDP, which is at the same level compared to the same

⁶² As of January 2015, data on interest rates of banks and savings houses have been collected under the new interest rate methodology. For more information see Quarterly Report, May 2015, p 53.

period last year. The deficit was funded through domestic borrowing and withdrawing funds from the government deposit account with the National Bank. The budget deficit in the period January-November was 2.1% of GDP, constituting 71.0% of the forecast budget deficit for 2017. At the end of the third quarter of 2017, total public debt equaled 45.9% of GDP, which is by 0.2 percentage points less compared to the end of the previous quarter.



*Other revenues includes capital revenues, foreign donations and revenues from due loans.
Sources: Ministry of finance and NBRM's calculations.



Source: Ministry of finance and NBRM's calculations

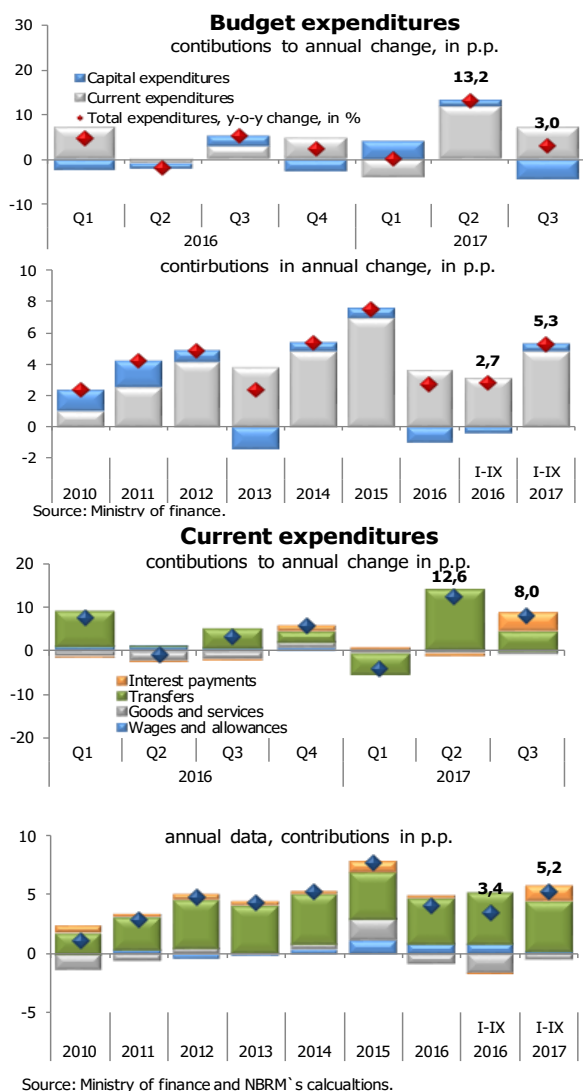
In the third quarter of 2017, the annual growth of total revenues in the Budget of the Republic of Macedonia⁶³ amounted to 1.8%. Structurally analyzed, the annual growth of budget revenues was mostly affected by the higher performance of taxes and other income⁶⁴, with a contribution to the annual growth of 1.5 and 1.0 percentage points, respectively. The revenues on the basis of contributions make a relatively smaller positive contribution (0.5 percentage points) to the annual growth, while the contribution of non-tax revenues in the Budget is negative and equals 1.2 percentage points. In the period January - September 2017, budget revenues grew by 4.1% on an annual basis, which mainly results from the positive contribution of taxes.

In the third quarter of 2017, total tax revenues⁶⁵ were higher by 2.5% on an annual basis. The growth of taxes mostly derives from the higher performances of indirect taxes, while the total contribution of direct taxes is small and negative. In terms of the individual tax categories, generator of the growth in indirect taxes are the revenues from value added tax, with a contribution of 2.8 percentage points. On the other hand, in the category direct taxes, the revenues on the basis of personal income tax made a positive contribution of 0.6 percentage points, while the contribution of income tax was negative and amounted to 0.9 percentage points. In the period January-September 2017, the inflows in the Budget on the basis of taxes are higher by 3.7% on an annual basis, with a positive contribution in almost all tax categories. Moreover, the contribution of income tax and personal income tax amounts to 1.3 and 1.1 percentage points, respectively and is relatively higher compared to the contribution of value added tax, excises and import duties (with a contribution of 0.8 percentage points, 0.6 percentage points and 0.3 percentage points, respectively).

⁶³ Central budget and budgets of funds.

⁶⁴ The growth of other income in the third quarter of the year is mainly driven by the inflows on the basis of donations from abroad.

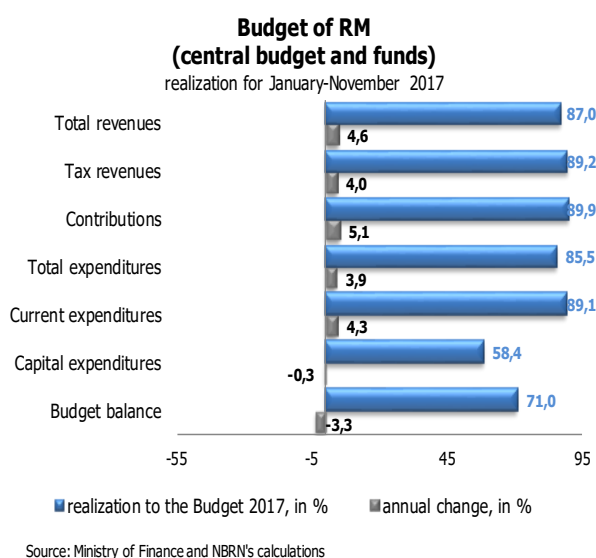
⁶⁵ Includes tax revenues (SSP).



Total expenses in the Budget of the Republic of Macedonia registered an annual growth of 3.0% in the third quarter of 2017.

The higher budget expenditures entirely result from the higher current expenditures (contribution of 7.1 percentage points to the annual growth), while capital expenditures make a negative contribution to the growth (of 4.1 percentage points). Analyzed by individual categories of current expenditures, their annual growth of 8.0% is almost equally driven by the higher transfers (with a contribution of 4.6 percentage points) and the higher expenditures on interest payments (with a contribution of 4.0 percentage points⁶⁶). Costs on the basis of the categories "wages and compensations" and "goods and services" make a small negative contribution to the annual growth of current expenditures of 0.1 and 0.5 percentage points, respectively. In the period January-September 2017, budget expenditures increased by 5.3% annually, mostly due to the higher expenditures for current expenses, with a small positive contribution of capital expenses.

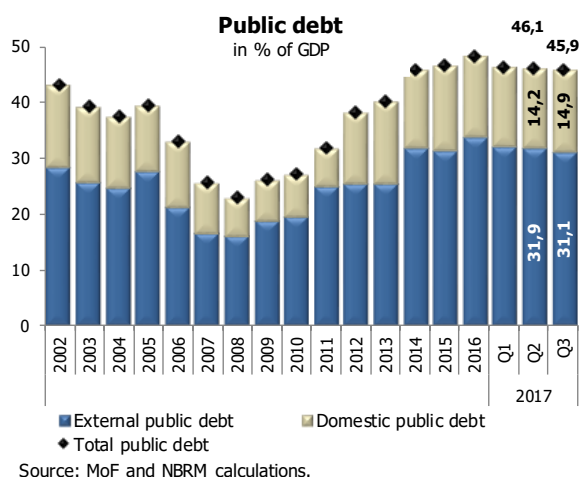
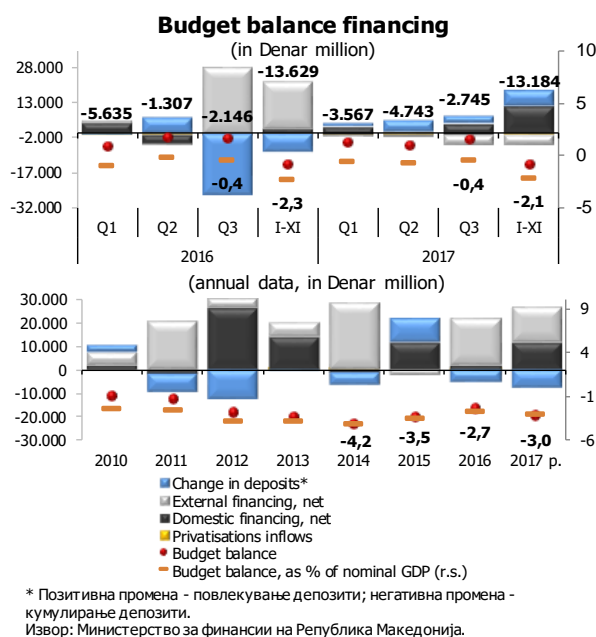
During the third quarter of 2017, the Budget of the Republic of Macedonia registered a deficit of Denar 2,745 million, or 0.4% of GDP⁶⁷, which is similar to the same period last year. The deficit was funded through government borrowing on the domestic financial market and by withdrawing funds from the government deposit account with the National Bank. On a cumulative basis, for the first nine months of the year, the budget deficit was Denar 11,055 million, or 1.8% of GDP, which is better realization compared to the same period last year (9,088 or 1.5% of GDP).



In the period January-November 2017, total budget revenues were higher compared to the same period last year (by 4.6%). Tax revenues registered an annual growth of 4.0%, while the annual growth of contributions was 5.1%. **Budget expenditures grew by 3.9%, on an annual basis.** Analyzed by category, the higher budget expenditures on an annual basis entirely derived from the higher current expenditures (with a contribution of 4.0 percentage points), while the contribution of capital expenditures was negative. In the period under observation, there was a budget deficit of Denar 13,184 million or 2.1% of GDP, which was lower compared to the same period last year (budget deficit of Denar 13,629 million or 2.3% of GDP). In the period January - November 2017, the

⁶⁶ As a result of the due government liabilities on the basis of external debt interest.

⁶⁷ The analysis of nominal GDP for 2017 uses the NBRM October forecasts.



budget deficit represented 71.0% of the deficit planned for 2017, which is better realization compared to the same period last year (58.9%).

In the period January - November 2017, the **budget deficit** was primarily funded from the net issue of government securities on the domestic market and less from withdrawing portion of the government deposits with the NBRM.

At the end of the third quarter of 2017, total public debt⁶⁸ equaled 45.9% of GDP, which is lower performance by 0.2 percentage points compared to the previous quarter. Thus, public debt has been decreasing on a quarterly basis, for four consecutive quarters. The analysis of its components indicates that the decrease is due to the lower external borrowing (by 0.8 percentage points), while domestic debt increased (by 0.6 percentage points). Thus, at the end of the third quarter, external debt equaled 31.1% of GDP, while domestic debt equaled 14.9% of GDP. Observing the debt structure, the total government debt⁶⁹ at the end of September was lower by 0.1 percentage points and equaled 37.9% of GDP, while the debt of public companies⁷⁰ was lower by 0.1 percentage points and equaled 8.0% of GDP. On a cumulative basis, in the first nine months of 2017, total public debt decreased by 2.5 percentage points of GDP.

⁶⁸ The public debt is defined under the Law on Public Debt (Official Gazette of the Republic of Macedonia No. 165/14), according to which it is the sum of the government debt and the debt of public enterprises established by the state or municipalities, municipalities within the city of Skopje and the city of Skopje, and companies that are entirely or predominantly owned by the state or by the municipalities, the municipalities within the city of Skopje and the city of Skopje, for which the Government has issued a state guarantee.

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

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



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

	Budget for 2017	Revised Budget for 2017	Q1 2017	Q2 2017	Q3 2017	Oct.-Noem. 2017	Annual changes, period in 2017 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 %			
	Realization, in mil. denars						Q1 2017	Q2 2017	Q3 2017	Oct.-Noem. 2017	Q1 2017	Q2 2017	Q3 2017	Oct.-Noem. 2017
TOTAL REVENUES	187.612	184.745	42.734	43.634	44.601	29.742	5,3	5,3	1,8	6,8	5,3	5,3	1,8	6,8
Tax revenues and contributions	160.746	159.497	37.346	39.421	39.563	26.125	4,8	5,0	2,2	5,3	4,2	4,5	2,0	4,7
Taxes	107.197	105.069	24.594	26.043	26.108	16.982	3,7	5,5	2,6	4,5	2,2	3,3	1,5	2,6
Contributions	51.879	52.742	12.472	12.994	13.043	8.907	7,7	4,3	1,6	7,8	2,2	1,3	0,5	2,3
Non-tax revenues	17.516	16.321	4.399	2.570	3.037	2.254	28,6	0,5	-14,6	2,5	2,4	0,0	-1,2	0,2
Capital revenues	2.613	1.941	121	238	741	136	-80,3	-13,5	-8,1	-28,4	-1,2	-0,1	-0,1	-0,2
Foreign donations	6.287	6.636	856	1.306	1.204	1.165	5,0	41,2	71,8	95,5	0,1	0,9	1,1	2,0
Revenues from repayments of loans	450	350	12	99	56	62	-85,9	-18,2	14,3	-7,5	-0,2	-0,1	0,0	0,0
TOTAL EXPENDITURES	206.219	203.312	46.301	48.377	47.346	31.871	0,2	13,2	3,0	-1,6	0,2	13,2	3,0	-1,6
Current expenditures	179.265	179.565	41.245	44.749	44.504	29.527	-4,3	12,6	8,0	0,6	-4,0	11,7	7,1	0,5
Capital expenditures	26.954	23.747	5.056	3.628	2.842	2.344	60,9	21,0	-39,9	-23,0	4,1	1,5	-4,1	-2,2
BUDGET DEFICIT/SURPLUS	-18.607	-18.567	-3.567	-4.743	-2.745	-2.129	-36,7	262,9	27,9	-53,1				
Financing	18.607	18.567	3.567	4.743	2.745	2.129								
Inflow	37.132	36.920	4.742	8.356	12.172	5.116								
Privatisation receipts	0	0	3	76	0	282								
Foreign loans	17.634	23.535	608	1.279	1.012	412								
Deposits	1.664	-7.421	899	4.900	3.293	-2.124								
Treasury bills	17.824	20.796	3.232	2.101	7.867	6.546								
Sale of shares	10	10	0	0	0	0								
Outflow	18.526	18.353	1.175	3.613	9.427	2.987								
Repayment of principal	18.526	18.353	1.175	3.613	9.427	2.987								
External debt	9.232	9.057	662	1.133	5.161	945								
Domestic debt	9.294	9.296	513	2.480	4.266	2.042								

Source: Ministry of Finance and NBRM cc

Annex 1: Alternative Beveridge curve

The conclusion of a possible improved labor market efficiency, given below within the Quarterly Report, results from the interpretation of the standard Beveridge curve. Namely, the Beveridge curve is a graphical representation of the relationship between unemployment and the job vacancy rate. Moreover, the analysts are interested in the direction of its shift which can be a consequence of the cyclical fluctuations of the economy, and in certain cases it can also indicate changes in the labor market efficiency. Theoretically, the expansion phases are characterized by low unemployment and high job vacancy rate, while the recessions are marked by higher unemployment and lower job vacancy rate. On the other hand, if the job vacancy rate is stable, while the unemployment decreases, as is the case in the Macedonian economy in recent period, such setup of the curve gives an indication of a possible improvement of the efficiency, i.e. a possible improvement of the process of connecting supply of to demand for skills in the labor market⁷¹.

Taking into account the relatively short series of data on the job vacancy rate in the Macedonian economy⁷², we are making efforts to check the conclusion of the changes in the labor market efficiency by constructing an alternative Beveridge curve. In constructing this alternative curve, **instead of the job vacancy rate** we are using the data on the **percentage of companies that stated that the lack of labor is one of the factors that limit the activity**, based on European Commission surveys conducted on a sample of companies from the manufacturing industry, construction and services sectors⁷³. Such manner of constructing the curve is generally applied in the countries where there is no data on the job vacancy rate.⁷⁴ We are constructing the curve for a longer period of time, i.e. from the second quarter of 2009 to the third quarter of 2017.

Chart 1

Beveridge curve

Chart 2

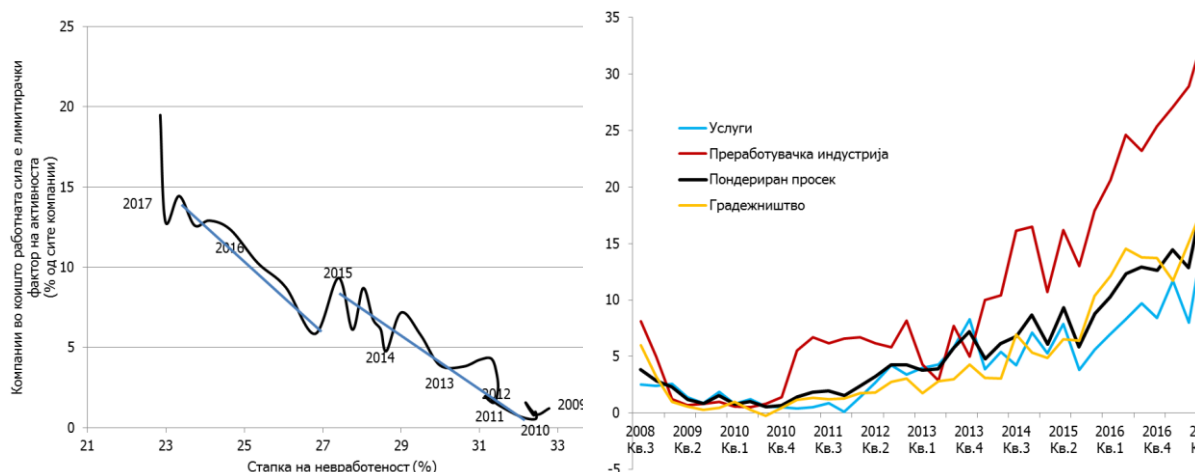
Labor as a limiting factor (% of companies)

⁷¹ For more information on this topic see the already existing research published within the Quarterly Report from May 2015 (Annex 2: Beveridge curve for Macedonia and comparative analysis with other European countries).

⁷² From 2012.

⁷³ Business climate indicators are based on European Commission surveys conducted on a sample of companies from the manufacturing industry, construction and services sector (excluding public sector). The results provide information about the percentage of respondents who stated that the lack of labor is one of the factors that limit the production compared to the previous three months. Also, the normalized shares in the nominal value added of each of these sectors are used as weights for calculation of the aggregate indicator, for each quarter respectively.

⁷⁴ For more information on this topic see "The Beveridge curve and the mismatching of professional skills in the euro area", FOCUS, Caixa Bank Research, November 2015



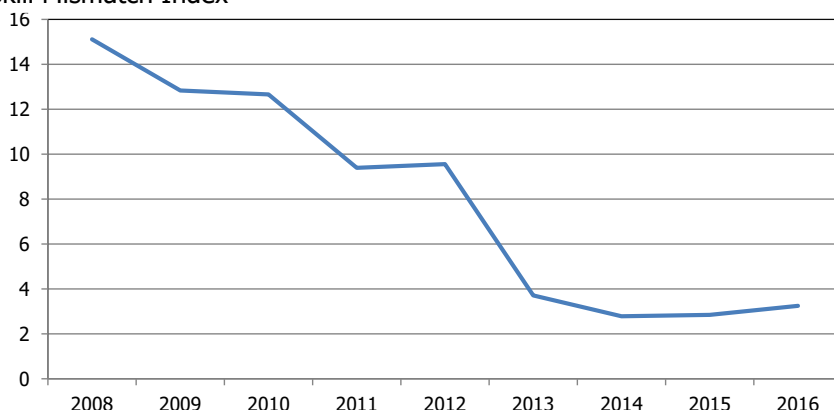
Source: European Commission, Business Climate Indicators in industry, construction and services sector, SSO's Labor Survey and NBRM calculations.

The monitoring of the shift of this alternative Beveridge curve, generally suggests that it is driven by the favorable fluctuations of the business cycle. Namely, in this entire period, there is a trend of reduction of unemployment, amid simultaneous increase in the vacancies, i.e. in this case an increase in the companies' perceptions for lack of labor. If we examine the movement of the alternative Beveridge curve in more details, we can notice both periods of improvement, but also periods of deterioration of the efficiency (i.e., shifts of the curve in the direction of approximation, i.e. moving away from the coordinate origin, respectively). However, what should be highlighted is the **existence of a specific turning point in the third quarter of 2015**, when a significant decrease in unemployment was observed, amid simultaneous significant improvement of the perceptions related to the lack of labor, indicating an improved labor market efficiency. Immediately afterwards, the decline in unemployment continues, but the managers' perceptions for labor deteriorate again, indicating that the business cycle continues to drive the shift in the labor market. **However, the key change is that from this quarter onwards the Beveridge curve has been continuously moving downwards** (Chart 1 - visible downward movement of the trend line), **indicating a steadier increase in the labor market efficiency, a conclusion from the analysis of the relationship between unemployment and the job vacancy rate.**

An additional alternative indicator of labor market efficiency/inefficiency in the literature is the (mis)match of professional skills required by firms and those offered by the labor force. One of the methods to assess the effect of such mismatch on the labor market efficiency is the construction of a **Skill Mismatch Index (SMI)**. This index compares the educational level of the labor force (as supply) with that of employees (labor demand)⁷⁵. In Macedonia, there is a downward trend in the index and its stabilization in the last three years, which also indicates a reduction of the mismatch between supply of and demand for skills, i.e. certain favorable changes in terms of labor market efficiency.

⁷⁵ $SMI_t = \sum_{i=1}^6 (A_{it} - E_{it})^2$, where A_{it} is the percentage of the labor force, while E_{it} , is the percentage of the employees with an educational level i , for the period t . A more detailed discussion about the index is available in "Euro Area Labour Markets and the Crisis", Occasional Paper Series 138 – 2012, ECB.

Chart 3
Skill Mismatch Index



Source: SSO and NBRM calculations

Of course, these conclusions should be interpreted carefully, as they are only an indication of certain favorable shifts, although amid still high unemployment, and especially high long-term unemployment it is difficult to accurately identify such changes. Actually, the fact itself, that amid still high unemployment, the companies' perceptions for lack of labor force have been increasing, and for example in the third quarter of 2017 they reach a historical maximum of about 20% (the average for the entire period is about 6%) indicates that despite the improvement, the structural problems in the labor market are still present. If the companies' perceptions continue to deteriorate, and it becomes increasingly difficult to find a suitable workforce, in that case there is a likelihood of restraint from growth of the existing firms, or restraint for creating new firms, which can certainly deepen the structural problems and lead to a so-called inherent inefficiency in the labor market, i.e. inefficiency that can hardly be eliminated with the phase of the business cycle⁷⁶.

Annex 2: Structural analysis of foreign direct investments in the countries of Central and Southeastern Europe - debt against non-debt component

Foreign direct investments are one of the important sources of financing of the economies of the CESEE countries after the commencement of the transition process⁷⁷ and they create almost half of the total international financial liabilities of these countries⁷⁸. Moreover, financial flows themselves had an important role in the region's transition process, helping the trade opening of the economies and the trade integration, especially with the EU countries. In addition, direct investments significantly contributed to the financial integration process, and also supported the process of real and nominal convergence of the region. **This analysis focuses on a specific aspect of FDIs, i.e. their structure in terms of debt and non-debt component, with emphasis on the countries of the CESE region.**

Dynamically speaking, the inflows through FDIs in the countries of the region⁷⁹ registered almost continuing growth, whose pace slowed down with the onset of the global financial and economic crisis. Moreover, in 2007 the average amount for all analyzed countries reached 8.9% of GDP, while the average share of FDIs in GDP for the period

⁷⁶ The conclusion corresponds to the findings elaborated in "Structural Unemployment in Bulgaria from 2007 onward", Y. Alexiev, Economic Policy Review, Institute for Market Economics, March 2015.

⁷⁷ The analysis focuses on the economies of Central, Eastern and Southeastern Europe and the Baltic states for the period 1998-2015 (CEE countries - Czech Republic, Poland, Hungary, Slovakia and Slovenia; SEE - Croatia, Bulgaria, Macedonia, Albania, Bosnia and Herzegovina, Serbia and Romania; Baltic states - Estonia, Latvia and Lithuania). Data on foreign direct investments refer to the category "liabilities" of balance of payments statistics, as an indicator of the inflows from non-residents based on foreign investments.

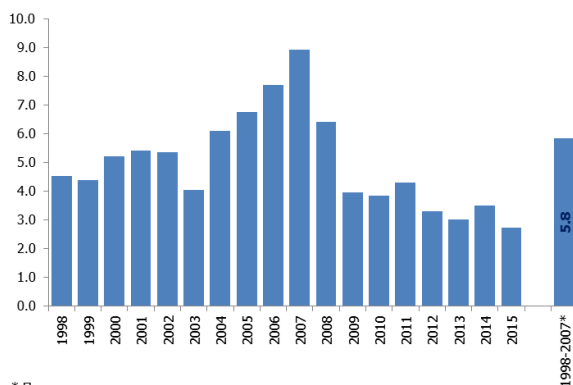
⁷⁸ 25 Years of Transition Post-Communist Europe and the IMF – IMF, 2014.

⁷⁹ With the exception of 2003.

1998-2007 was 5.8%. The global economic crisis also had consequences on the inflows based on direct investments in these economies, whose average share in GDP **in the period 2008-2015 decreased to 3.9% of GDP.** Analyzed by regions, the biggest change was registered in the Baltic and the CEE countries, as expected, if one has in mind the fact that these economies initiated the market reforms faster, started the accession to the EU and in parallel with that liberalized the financial account, opening up room for faster entry of direct investments into the domestic economy. After the strong growth of FDIs in the period until 2007, in the following years their pace slowed down, primarily as an effect of the global economic crisis, but probably due to the changes in the economies themselves⁸⁰. On the other hand, in the SEE countries, the effect of the crisis on the inflows from direct investments, although obvious, is significantly more moderate, which is partially a result of the more moderate inflows in this group of countries before the crisis. For illustration, in the period 1998-2007, the average FDIs in the CEE countries amounted to 5.4% of GDP, and in the Baltic states 6.4%, unlike the period after the crisis when their average share in GDP significantly reduced to 2.8% and 3.7%, respectively. On the other hand, the SEE countries registered no significant slowdown between the two periods, i.e. the average FDIs in GDP decreased from 5.9% to 4.7%. The moderate slowdown can partly be associated with the fact that despite the crisis, most of the countries in this group continued carrying out structural reforms. The EBRD's indicators for the SEE countries in the period after 2007 show further progress in the areas such as trade openness, price liberalization, progress in the process of market liberalization, by promoting competitiveness in the area of the rule of law. The positive changes, coupled with the policy to actively attract foreign direct investments from most of the countries of the region, increased the interest of foreign investors in the region despite the global economic crisis.

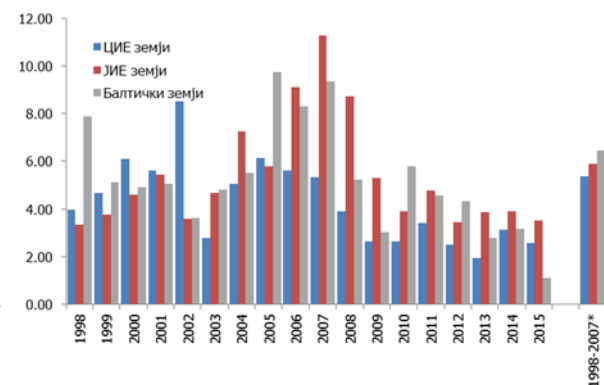
Chart 1 Average amount of FDIs in the analyzed countries, as % of GDP

Chart 2 Average share of FDIs in GDP by regions



* Просек за наведених периода.

Source: IMF, Eurostat and national central banks.



Source: IMF, Eurostat and national central banks.

There are several dimensions through which FDIs can be analyzed, and one aspect on which we rarely put emphasis in the economic literature and which will be subject to analysis in this Annex is their structure, in terms of non-debt versus debt component. Namely, FDIs consist of three main forms, **equity capital, reinvested earnings and intercompany financial and trade lending.** All these forms have special characteristics, with their own advantages, but also certain weaknesses. **Thus, the first two components are forms of non-debt capital** and accordingly do not affect the level of the external debt of the host country. In addition, equity capital and reinvested earnings are stable form of capital, with a significantly smaller risk of reversible movements in relation to other financial flows. However, the accumulation of profit increases the risk to transfer the profit to parent companies, through dividends, which can adversely affect the available capital in the domestic economy. **The debt component, i.e. intercompany financial and trade lending,** increase the external debt **of the host country,** and also impose expenditures on interest payments. However, the borrowing from parent companies (intercompany debt) is often used as an instrument to finance the operational and investment activities, given the easy access to this source of financing. In the literature, there are no many analyses that point to the key factors that determine the structure of financing in terms of the selection of debt versus non-debt sources of financing. However, in general, some important determinants of the structure of financing may include the characteristics

⁸⁰ One of the reasons is probably the process of real convergence, which can cause adverse changes in the competitiveness of these economies (see for example - "25 Years of Transition Post-Communist Europe and the IMF – IMF, 2014").

of the companies, the financial strategy of the parent company and the form of the FDI investment (greenfield versus brownfield investments), the activity in which the investment was made, as well as the appropriate regulatory requirements in the specific activities, the characteristics of the investors, their organizational form and development strategy, the development phase of the direct investment, i.e. from the cycle and manner of financing companies and their financing requirements, and the tax regulations of the host country and the country of origin of the investor. **Below, the analysis gives a review of the structure of FDIs in terms of the above-mentioned components, makes a comparison of the structure in the individual sub-regions, as well as a dynamic comparison of the trends in the period before and after the global crisis.**

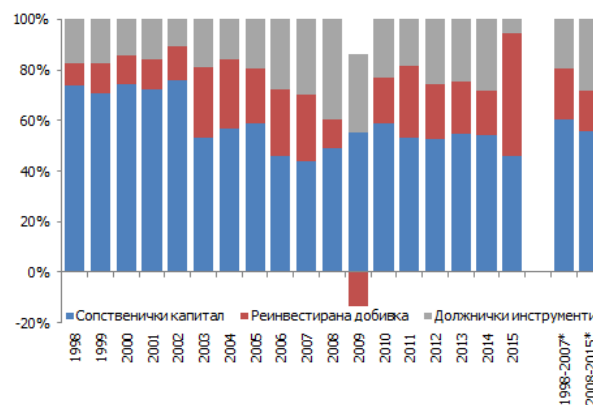
Chart 3 Structure of the average FDIs in the analyzed countries, as % of GDP



* Проксес за наведените периоди.

Source: IMF, Eurostat and national central banks.

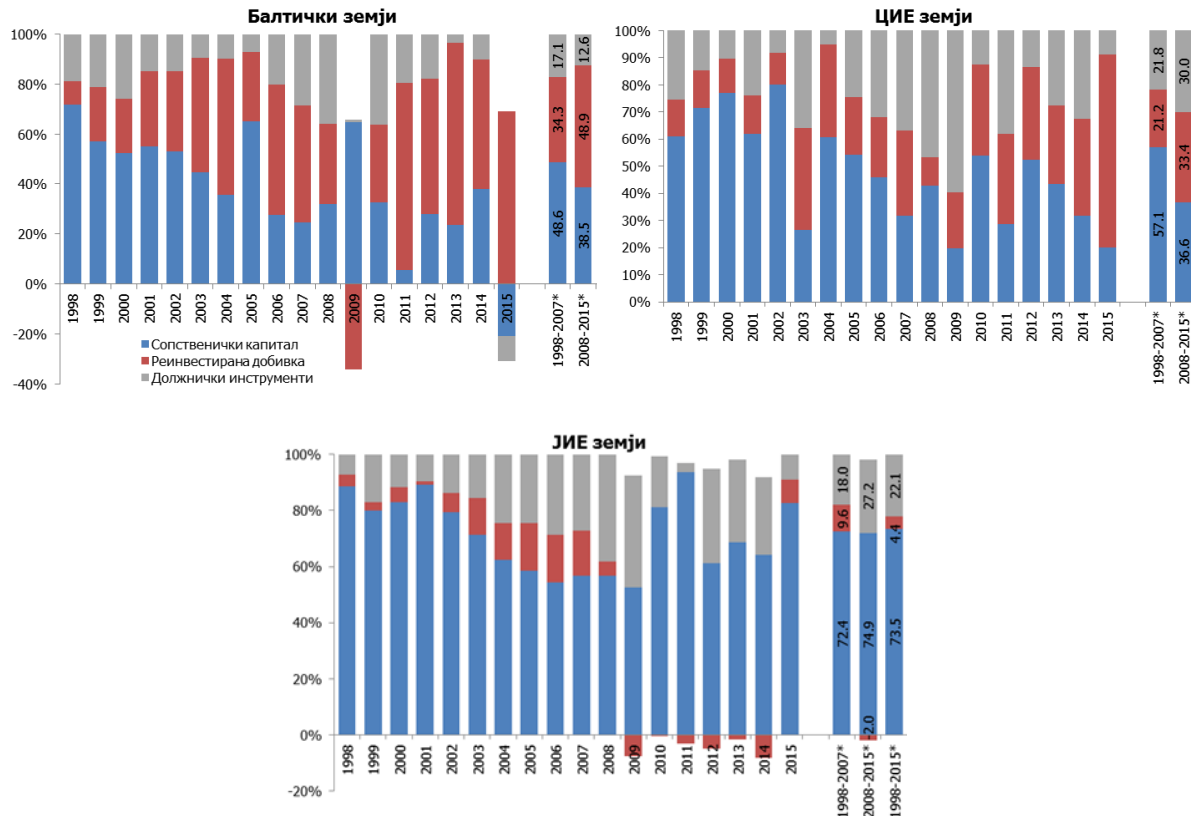
Chart 4 Structure of the cumulative FDIs in the analyzed countries, as % of the total FDIs



Source: IMF, Eurostat and national central banks.

The structural analysis indicates a dominant share of equity capital in the three sub-regions, but also certain differences in the relative importance for the total FDIs of the other two components. At a level of the entire region, the dominant share in the structure of FDIs is that of equity capital, which averages almost 60% for the period 1998-2015. One of the factors for such structure is also the process of privatization, which was especially pronounced in the initial stages of transition and which meant an inflow of private capital in equity form in these economies. The relative importance of reinvested earnings and the FDI debt component are rather close, with a share of 18.6% and 22.5%, respectively. However, the general picture does not show the specifics between the individual regions, as well as the dynamic changes in the structure of investments and for that very reason, below, we focus on these two aspects. Namely, if we analyze the individual regions, we notice that a common characteristic for all three regions is the high share of direct investments in the form of equity capital. Thus, for the entire period of analysis, in the Baltic states, most of the direct investments are in the form of equity capital (44%), but also in the form of reinvestment of profit (41%), which is an almost balanced share of these two components, while the debt component has minor importance for the total foreign investments. In the CEE countries, equity capital dominates with almost 50% during the analyzed period, while the remaining period is evenly distributed between reinvested earnings and intercompany borrowing. In contrast, the economies of the SEE region registered the highest share of equity capital of 73%, a share which has been stable over the years. What is additionally evident in these countries is the insignificant role of reinvested earnings (only 4% share) as a source of new foreign capital in this region, as opposed to the debt instruments, whose average share in the total direct investments is 22%.

Chart 5 FDI structure by region, as % of the total FDIs



Source: IMF, Eurostat and national central banks.

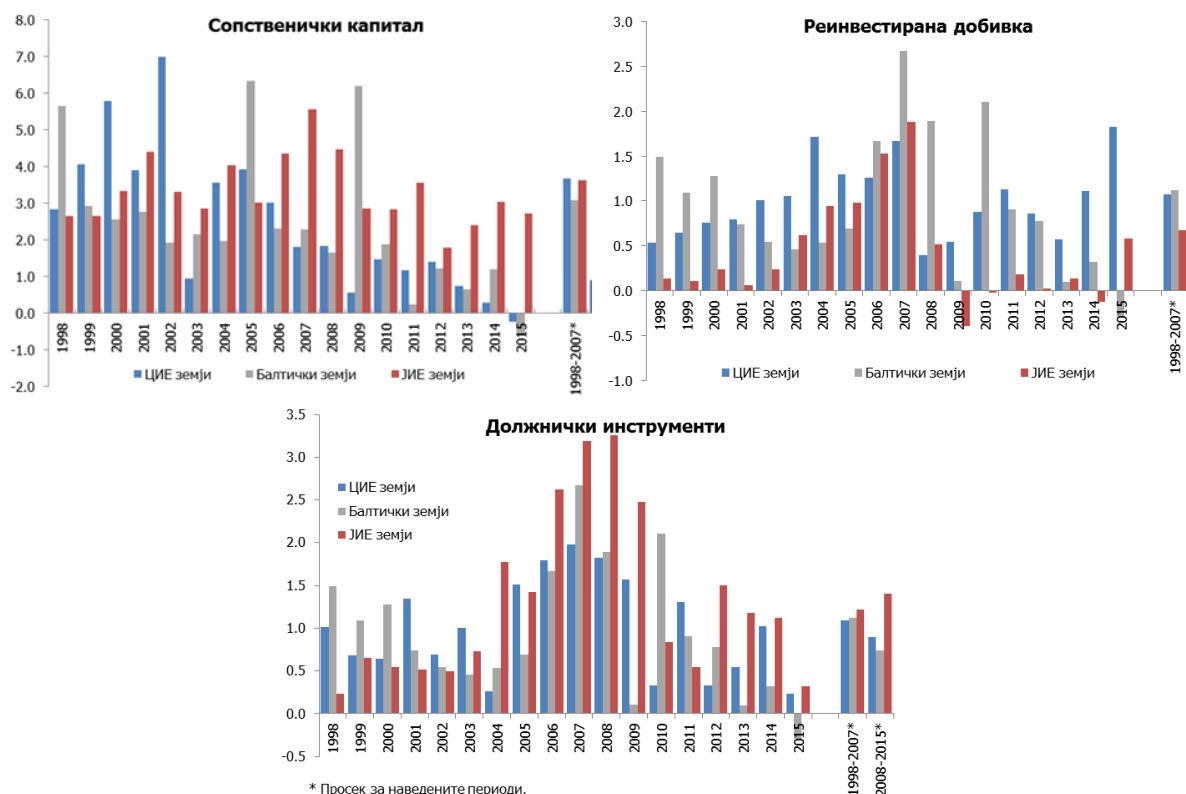
In line with the global slowdown in the financial flows in the period after the global financial crisis, there is also slowdown in the inflows from foreign direct investments in the region. In the past two decades, these countries have undergone a significant change in almost all economic and political aspects, which was also reflected on the perceptions of foreign investors of the individual countries and the perception of the region as a whole. If the period of the analysis is examined through two sub-periods, different conclusions are drawn. **The first period from 1998 to 2007**, is characterized as a period of liberalization of these markets, market reforms, activation of the process of accession to the EU and accession of some of the countries to the EU⁸¹, as well as a period of favorable international economic environment and increased investment activity. An additional factor for the high inflows of direct investments in the overall region is the active process of privatization in the period of the nineties and the beginning of the 2000s, where the privatization was carried out at a different pace in the individual countries. In general, the process itself started earlier in the Baltic and the CEE countries. In such conditions, the inflows on the basis of foreign direct investments significantly increased. **The second period from 2008 to 2015** is the period of the onset of the global economic crisis and when its consequences were felt, which meant less favorable external environment and general investment restraint. But, this was also the period when some of the analyzed countries (the CEE and the Baltic countries) became part of the EU. Data indicate a more significant reduction of the inflows from direct investments, analyzed as a share in GDP, in the period after 2008 in the entire region, with the slowdown being more pronounced in the Baltic economies and the CEE countries, compared to the countries from our neighborhood.

In terms of the FDI components that drive such performances, in the Baltic economies and the CEE countries, the reduction of direct investments in the period 2008-2015 compared to the period 1998-2007 is largely driven by equity capital, whose average share in GDP decreased from 3.6% to 1% in the CEE countries, i.e. from 3.1% to average 1.6% of GDP in the Baltic economies. On the

⁸¹ The countries from the analysis have different status in terms of the EU membership. The Baltic countries and the CEE countries have been EU members since the 2004 enlargement process, Bulgaria and Romania joined the EU in 2007, while Croatia joined in 2013. The remaining SEE countries have the status of candidate countries for membership, with the exception of Bosnia and Herzegovina, where the status is a potential candidate country.

other hand, the reduction of FDIs in the economies of Southeastern Europe, although with lower intensity, is driven by the two non-debt components simultaneously, and what is specific is the slightly higher intercompany borrowing between the two periods, with an average share in GDP of 1.2% in the period before the crisis and an increase to 1.4% after 2008⁸². Also, in this period, the average amount of FDIs is the highest in this region. There is no clear reason for these developments in the SEE countries, but potentially, the difference with the other two groups of economies may be due to the increased attractiveness of the region for investment of foreign investors, who, due to the great uncertainty in the world and European economy, placed the new capital in the region in the form of intercompany debt, as a form of FDIs that offers greater mobility in terms of equity capital.

Chart 6 FDI structure by region, as % of GDP



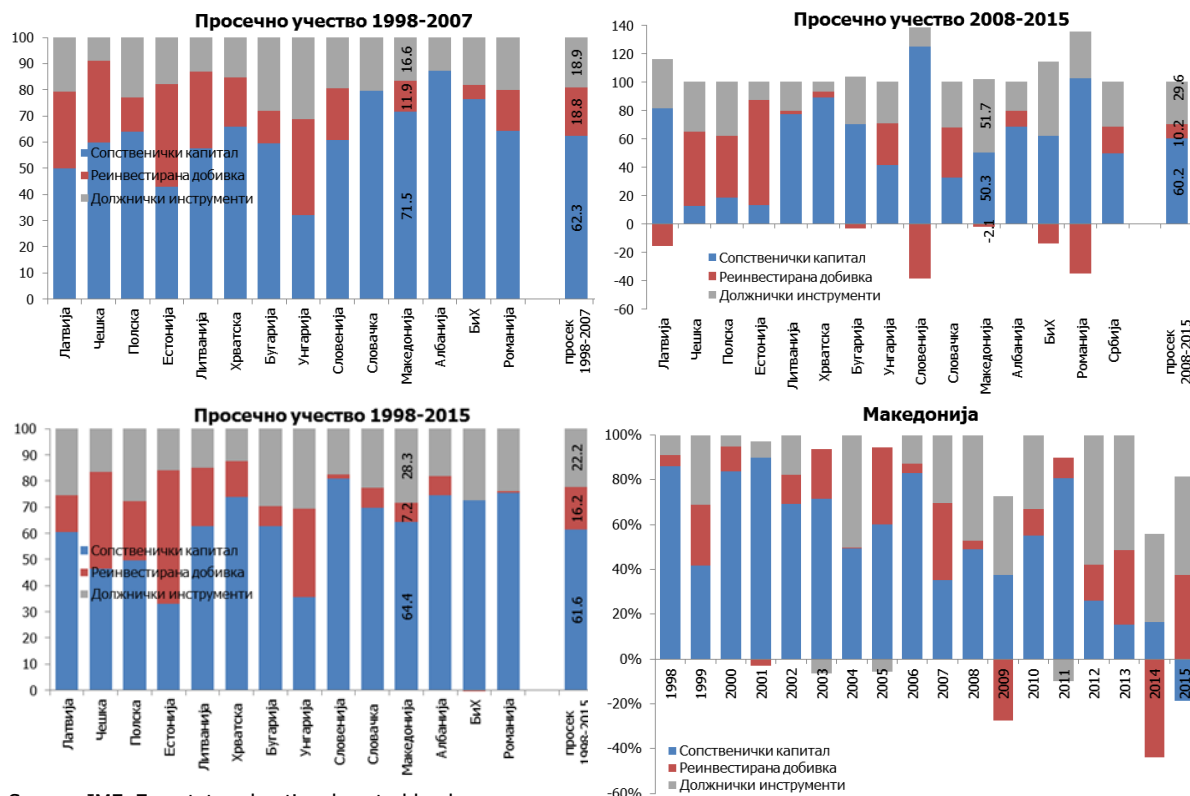
In the following section, the analysis focuses on the Macedonian economy. The analysis of the data for Macedonia indicates that the debt to non-debt FDI component ratio does not deviate significantly from the average of the SEE countries covered by the analysis. Namely, equity capital is the dominant form through which direct investments are entering the country. As with the average of the SEE countries, reinvested earnings have no important role in the creation of the new foreign investments in the country⁸³, with a significant share of FDIs in the form of intercompany borrowing in total foreign investments. Dynamically speaking, **in the period until 2007**, the share of equity capital in total FDIs averaged 72%, slightly higher than the average of the analyzed countries, while the debt component with a share of 17% is at a level of the average one. On the other hand, with reinvested earnings of only 12% of the total FDIs, we deviate significantly from the overall average. Only in Albania and Bosnia and Herzegovina, the relative importance of this component of direct investments is smaller in this period. **The next eight years after the crisis**

⁸² The exact reasons that would explain the FDI structure in the SEE countries cannot be identified for certain. However, possible reasons for such structure of FDIs in the SEE region, i.e. the insignificant share of reinvested earnings and the stability of intercompany flows, include the tax system, i.e. the taxation models, the investors' risk perceptions for these economies, the FDI structure by activity, the profitability of these companies, as well as the ratio of the dividends paid and the newly created value which in this region is high.

⁸³ According to the data from the balance of payments of the analyzed economies, the SEE countries had a higher ratio between the declared dividend and the income from FDIs, relative to the other two groups of countries, indicating a possibility for a higher outflow of the newly created value to the parent economies. This is especially pronounced in the period 2008-2015.

suggest a certain change in the structure of foreign investments in our economy. Namely, on average for 2008 until 2015, the inflows are balanced - intercompany loans have a share of 52% in total loans, compared to 50% share of equity capital. The relative share of reinvested earnings in this period is slightly negative, which is also the case in some of the other analyzed countries, such as Slovenia, Romania, Latvia and Bulgaria. However, the last two years registered a more significant growth in the share of reinvested earnings in total FDIs.

Chart 7 FDI structure by country, in %



Source: IMF, Eurostat and national central banks.

Source: NBRM and SSO.

In summary, this short review of the structure and dynamics of foreign direct investments in the region of CEE, SEE and the Baltic states (without going deeper into the reasons for the differences in the dynamics and structure of these flows by region), shows that the common characteristic of all three regions is the high share of direct investments in the form of equity capital, but there are differences in the relative importance for the total FDIs of the other two components. Thus, in the Baltic states, the relatively high share of reinvested earnings is characteristic, in the CEE countries there is a more equal distribution between reinvested earnings and debt component, while in the SEE economies, the importance of debt flows as opposed to the importance for the other groups of countries included in the analysis, is more pronounced. Dynamically speaking, the period before 2008 is a period in which the inflows from foreign direct investments reached the highest level in this region. Also, this period was characterized by greater stability in the FDI structure, both at the aggregate level and by individual countries, compared to the more recent history, where due to a series of global factors, as well as changes in the structure of economies themselves, there are significant shifts in the structure. The analysis of the structure and trends of FDIs in the Macedonian economy shows that the structure of direct investments does not deviate from the average for the region of Southeastern Europe although there is a slightly faster increase in the share of intercompany borrowing as a form of foreign investments in the economy. If the countries from the neighborhood, including Macedonia, follow the cycle of the Baltic economies and the CEE economies, reinvested earnings, as a source of capital for the current and investment needs of the companies in foreign ownership, are expected to have increasing importance in the future.

