

National Bank of the Republic of Macedonia



**Quarterly Report
May 2017**

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Introduction

The process of monetary policy normalization that started in December, continued during January and February 2017, when the key interest rate was additionally reduced for a total of 0.50 percentage points, reducing it to 3.25%. Thus, the key interest rate was reduced to the level prior to May 2016, when the monetary policy was tightened, in response to the pressures caused by the political crisis. The decrease of the key interest rate of the NBRM was the result of the further evident and continually present stabilization of the expectations of economic agents, after the measures taken by the NBRM, and in conditions of retaining the assessments for the soundness of the economic fundamentals. Stabilization signs were evident in both points where the political crisis hit the most in the previous year – propensity for managing foreign currency and household savings. In the first quarter of 2017, the exchange market was stable, whereby the NBRM intervened with a moderate net purchase of foreign currency. Household savings continued to increase in the first quarter of the year, although at a slower pace, mainly impacted by the performances in household deposits in March. The economic fundamentals continue to be assessed as favorable. However, the uncertainty arising from the domestic political situation is still present and additionally emphasized. Also, the unfavorable risks from the external environment are still current and in medium term are linked with fragile global recovery, global protectionist tendencies, Brexit and geopolitical tensions.

The latest cycle of macroeconomic forecasts for 2017 and 2018 points to certain changes in the macroeconomic picture compared to the October forecasts. Assessments for the soundness of the domestic fundamentals and characteristics of external environment remain favorable and unchanged. However, unlike the previous assessments for complete depletion of the effects from the political instability, performances show that it has a certain prolonged impact on individual segments. The economic growth in the second half of 2016 and the structure of growth in particular, the available indicators for the first quarter of 2017, as well as assessments for prolonged effects of the political crisis on the confidence and expectations of the economic agents during 2017, conditioned a downward revision of the expected economic growth in 2017 and 2018, and changes were also made in the structure of the expected growth. However, within the April macroeconomic scenario, assessments show retention of a relatively solid economic and credit growth, absence of price pressures and balance of payment position that ensures an adequate level of foreign reserves. These forecasts assume stabilization of the environment and depletion of the effects from the unfavorable political context by the end of 2017.

Changes occurred in the expected movements of the key indicators of external environment in the period between both forecasts. The foreign effective demand was revised in the upward direction in 2017, whereas a minor downward correction was conducted in 2018. Recent performances, as well as the expected economic growth and the increase of global primary product prices led to a significant upward correction of the **foreign effective inflation** in 2017, whereas expectations for 2018 remained unchanged. In terms of price developments of primary products, in 2017, higher growth in the prices of energy, food and most metals is expected compared to the October forecasts, whereas in 2018, further growth in the prices of food products and stabilization of other primary products prices, because for most primary products the expectations for 2018 are similar to those in October.

The latest forecasts show retention of the growth trend of the domestic economy during 2017 and 2018, but still at a slower pace compared to the expectations within the October cycle of forecasts. These changes are a reflection of the prolonged uncertainty due to the domestic political environment, which will have unfavorable effects on the behavior of the domestic investors and consumers. Certain effects were also evident through the performances during 2016. Despite the fact that the GDP growth of 2.4% in 2016 was in line with the previous expectations, its pace by the end of the year and the indicators for the first quarter show weaker performances compared to the October cycle of forecasts. Such initial positions, combined with the expected path of the key external and domestic factors as well as assumptions for prolonged effects of the domestic political crisis, indicate an economic growth of 2.5% in 2017 and



acceleration of the growth to 3.2% in 2018, which is a downward correction compared to the October forecasts (3.5% and 3.7%, respectively). Despite the downward correction of the expected overall growth of the economy, certain changes are made to the expected structure of the growth, primarily due to the performances towards the end of the previous year, as well as the assessments of recent influence channels of the political crisis. Cumulatively, and within this cycle of forecasts, in the period 2017-2018, export remains growth-driving factor of the economy, with a contribution which is more pronounced compared to the previous expectations. On the other hand, changes are conducted in the structure of the domestic demand, primarily for 2017, when it was expected that the economy was still stimulated by private consumption, whereas the investment activity will continue to decrease, but at a moderate pace, contrary to the previous expectations. The contribution of public consumption to the economic growth in 2017 and 2018 is expected to be neutral on an average. The relatively strong growth of private consumption points to a certain resilience of the political developments and relatively stable expectations of the households. However, in conditions of prolonged political uncertainty, the growth of private consumption is expected to decelerate, despite the assessments for retaining solid fundamentals of the consumption, evident through the further, although slower growth of wages, employment and credit support of the banks. On the other hand, official data for performances in 2016 and the available indicators for the first quarter show decline in investments, which probably reflects the effects from the political uncertainty on the inclination for investments in the domestic economy. This restraint is expected to be present in 2017 also, whereby despite foreign investments and the continuation of the cycle of public capital investments, a negative contribution from the investments is expected in 2017. In 2018, recovery of investments and their solid growth is expected, in conditions of a stable environment and prolonged positive action of the fundamental factors of investment activities. Export activity is expected to increase at a solid rate, and such assessments are based on the expectations for increasing activity of the new foreign export orientated facilities, further improvement of the global environment and recovery of part of the traditional export sectors. Thus, individually, as in the past four years, export is expected to be the most significant individual factor in the growth during 2017 and 2018. The growth of the components of the domestic demand and import will lead to moderate increase of the import, which will be more significant in 2018 as a result to the recovery of investments. However, the assessments are that the increase in import will be in accordance with the fundamentals and will not bring about disruption of the external balance.

The credit activity of the banking sector during 2017 and 2018 is expected to be a supporting factor of the economic growth. However, given the downward revision of economic growth and restraint of the domestic corporate sector from investments in 2017, **credit growth** of 5.6%¹ is expected this year (compared to the expected growth of 6.4% in October), whereas in 2018 an acceleration of the credit growth to 6.7% is anticipated, similar to the October forecasts. Assessments for acceleration of the credit growth in 2018 are based on the expectations for a more stable environment and growth of the deposit base, which in conditions of favorable capital and liquid positions of banks will create space for an increased credit funding. Given the dynamics of the deposit base at the beginning of 2017, assessments for prolonged uncertainty and weaker than previously expected economic growth, a growth of 4.2% is expected in the deposit base for 2017 (7.5% in the previous forecasts, whereby part of the revision of the forecasted growth is a consequence of the significantly higher base at the end of the previous year). In accordance with the assessments for stabilization of the expectations of the economic agents and increase of the economic activity, further increase of the inclination for savings in banks and acceleration of the deposit base growth to 6.5% is expected in 2018 (7.5% in the previous forecast).

After the moderate reduction of prices in the three previous year, in 2017 and 2018 a gradual acceleration of inflation to 1.3% and 2%, respectively, is expected, whereby

¹ Corrected for regulatory changes. Namely, on 17 December 2015, the National Bank Council adopted the Decision for amending the Decision on credit risk management, which requires from banks, for the period from 1 January 2016 through 30 June 2016, to write-off any claim that has been fully provisioned for more than two years, and where the bank identified and fully covered the credit risk of default at least two years before.



compared to the previous forecast cycle, no changes were done. Assessments for inflation growth reflect the current expectations for growth of global prices of food and energy and higher foreign effective inflation. Positive effect on inflation is also expected from the domestic demand, in conditions when the output gap being estimated as moderately positive during the entire forecast horizon.

The latest assessments on balance of payments point to a current account deficit for the period 2017-2018, which, on average is insignificantly more moderate compared to the expectations within the October forecast and amounts to 2.3% of GDP (2.5% in the previous forecast). However, changes were made in the assessments of both individual components of the current account between both forecasts. Thus, improvements were made in the goods and services deficit, reflecting the better expectations of the new export oriented facilities and part of the traditional export segments. On the other hand, in relation to the October forecast, assessments for future movements of primary income deficit are less favorable, as a result to the higher assessment of income from direct investments, and moderate downward correction was made in the secondary income deficit. A deficit of 2.4% of GDP is forecasted for 2017, whereby dynamically speaking a decline of the deficit compared to 2016 is expected, driven from percentages for better performances in the balance of goods and services, as well as moderate growth of net inflows from the secondary income, after the unfavorable developments in the previous year caused by the political crisis. On the other hand, the increase of the primary income deficit is expected to continue during 2017. **In 2018, further moderate narrowing of the current account deficit by 0.2 percentage points is expected in 2017, whereby it will amount to 2.2% of GDP, movement driven from the assessments for increasing the utilization of the potential of part of the new facilities, and smaller pressures through the energy balance.** The expected path of the current account deficit and its structure point to favorable external position and absence of imbalances in the economy. **In terms of the financial account, funding of the current account during this two-year period is expected to be provided through non-debt and debt long-term financial flows i.e. foreign direct investment and borrowing abroad.** In the period 2017-2018, the current account deficit is expected to be fully covered by financial flows, which will ensure additional increase in the foreign reserves. Thus, during the entire forecast horizon, foreign reserves adequacy indicators have ranged within the safe zone.

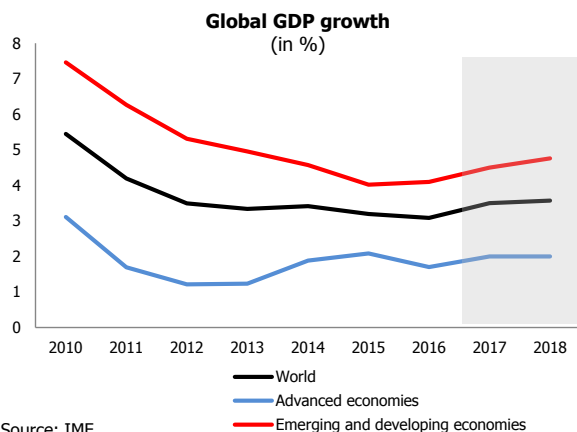
In summary, performances show that despite the increasing endogenous and exogenous risks in this period, the assessments for the domestic economy fundamentals remain solid. The economy further recovers without price pressures and in conditions of further maintaining an adequate level of foreign reserves. However, the risks for the economy are still assessed as unfavorable and are associated with the domestic political environment, and in this forecast cycle the same are additionally emphasized. At the same time, there are still unfavorable risks from the external environment. Hence, the NBRM will closely monitor the developments in the coming period, while the future changes to the monetary policy will largely depend on the further stabilization of the domestic political environment, as well as on materialization of external risks.



I. Macroeconomic developments

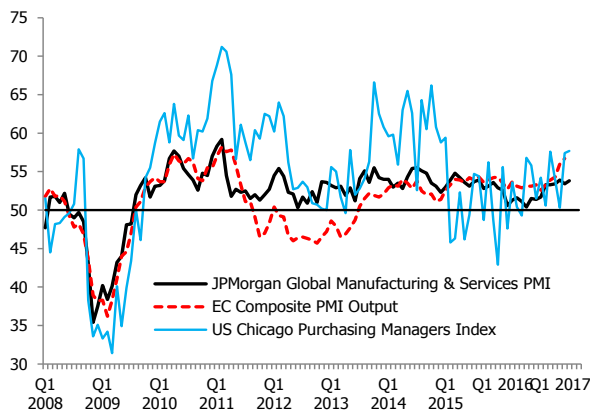
1.1. International economic surrounding²

The recovery of the global economy continued during the last quarter of 2016, driven by the good performances in both the developed countries and the group of fast-growing and developing countries. The global growth for 2016 is 3.1% which is still a moderate acceleration compared to the previous year. The latest IMF forecasts point to acceleration of the global growth during 2017 and 2018, to 3.5% and 3.6%, in 2017 and 2018, respectively. Growth acceleration is a reflection cyclical adjustment of the global economy after the global crisis and favorable conditions in the financial markets. In relation to the October forecasts, the global growth in 2017 is slightly corrected upwards as a reflection to the improved expectations for growth of the developed economies. There are no changes in the expectations for growth in foreign demand in 2018. Although, in the short term, the global growth risks are positive, however in medium term the same remain unfavorable and mainly refer to the possibility for increasing the global protectionism, uncertainty around the fiscal policy, and the possibility of financial deregulation of the USA, tightening the financial conditions for the fast growing economies, low demand and structural problems of Europe, as well as geopolitical risks. The available data for the global inflation for the first months of 2017 point to its further acceleration, mainly reflecting the higher crude oil and energy prices. Such shifts in prices make room for moderate inflation pressures in the upcoming period, and thus increase the uncertainty in the environment for conducting the monetary policy.



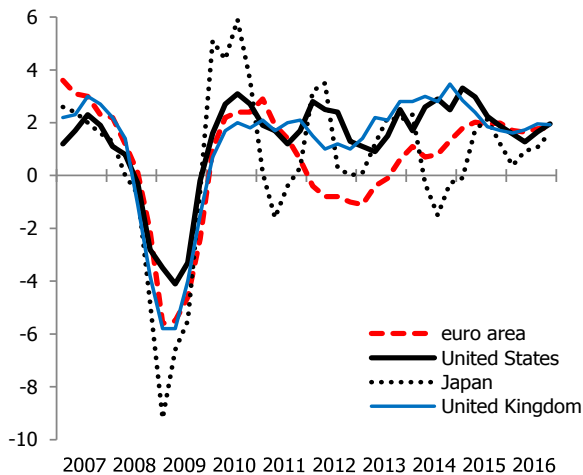
The stable growth of the global economy also continued in the last quarter of 2016, amid slightly improved performances both in the developed countries and the fast growing economies and developing countries. Regarding the most significant developed economies, an acceleration of the growth was registered in USA and Japan, whereas the euro area economies and Great Britain realized similar growth rates as in the third quarter of 2016. The American economy registered further acceleration of the GDP growth in the fourth quarter (from 1.7% to 2% on an annual basis), primarily as a result to the higher domestic demand. The growth of the economic activity in the euro area of 1.8% in the fourth quarter is mainly due to private consumption and export. Similarly to the previous period, the solid growth of 1.9% in Great Britain was mostly driven by the household consumption. The Japanese economy registered a growth of 1.6%, where the main driver is the net export supported by public consumption and investments. Positive

² The analysis is based on the IMF's *World Economic Outlook* of July 2015; the ECB's *Economic Bulletin*, the announcements of *Markit Economics*, the World Bank's *Global Economic Prospects*, Bloomberg, *Roubini Global Economics* and *Capital Economics* reports, the monthly reports of the International Energy Agency and the weekly reports of the Bank of Greece.



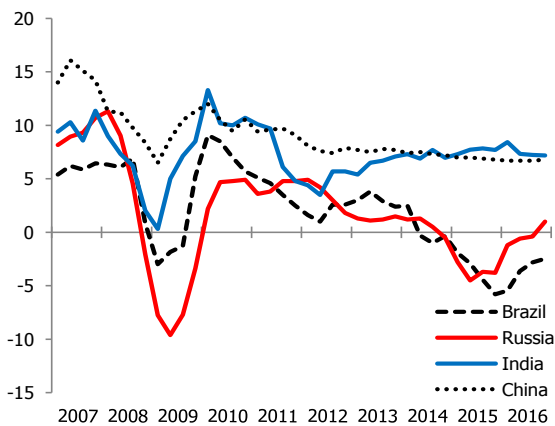
*The PMI index reflects the percentage of respondents that reported better business conditions compared to the previous month and it can take values between 0 and 100. PMI=50 is considered as a reference value, indicating unchanged economic conditions. A PMI value over 50 is taken to indicate that the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

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



Source: OECD.

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

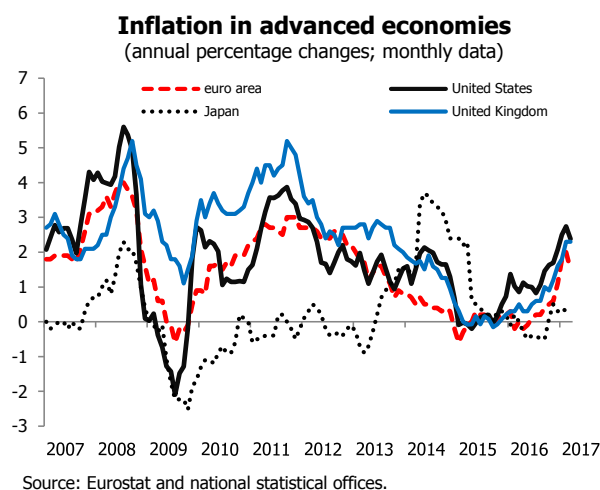
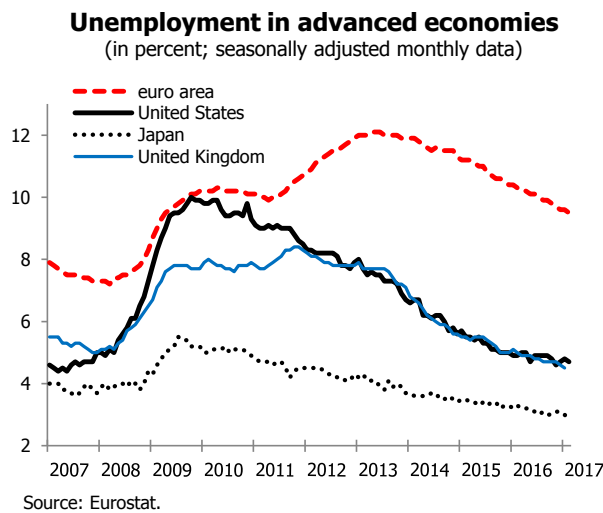
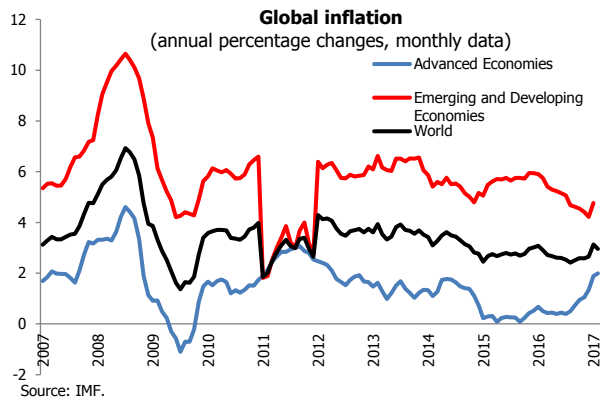


Source: OECD and IMF.

shifts are also registered in the fast growth in economies and developing countries. In the fourth quarter, a high growth with an intensity similar to the previous quarter is registered in China and India. Certain recovery signs are registered in the Russian economy (growth in the four quarter for the first time after a nine-year period of continuous decrease), whereas in Brazil continued to decrease at a slower pace.

Despite the improved performances in the second quarter of the year, on an average, the global economy decelerated in 2016, realizing the lower growth rate since 2008 onwards (3.1%). Such performance is mainly due to the more significant deceleration of the economic growth in the developed countries, primarily due to the reduced investment activity, whereas the growth in the developing countries remained almost the same as in 2015.

Dynamically speaking, the high-frequency survey indicators of the economic activity point to further improvement of the global economy condition in the beginning of the year. In the first quarter of 2017, the global composite PMI reached an average value of 53.7 index points, which expresses an increase of 0.7 percentage points compared to the previous quarter. The latest assessments indicate an acceleration of global growth in upcoming period. **Therefore, in the IMF's April cycle of forecasts, a slight upward revision of the assessments for global growth for 2017 was conducted, which is envisaged to amount to 3.5% (3.4% in the previous forecast), which is mainly due to the improved expectation for the growth of developed countries. On the other hand, the forecasts for global economy growth of 3.6% in 2018 were retained.** Global growth risks are dominantly downwards, although in the short term, positive effects from the potentially more positive segment in households and corporations, reforms and policies on the supply side, as well as the more stimulating policies in USA and China are possible. However, the risks of the global growth in the medium term continue to remain unfavorable, where the growth of protectionism and relaxation of the financial regulations, the more rapid increase of FED interest rates and the uncertainty about the monetary policy

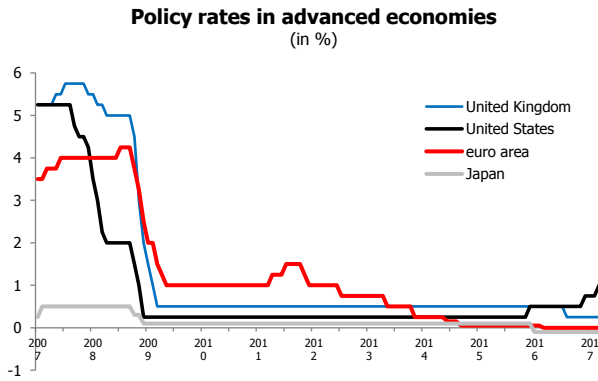


measures, the reforms in China and the process of liberalization stand out as more significant, as well as the uncertainty about the effects on the global economy from Brexit, and the geopolitical tensions might have an additional negative impact.

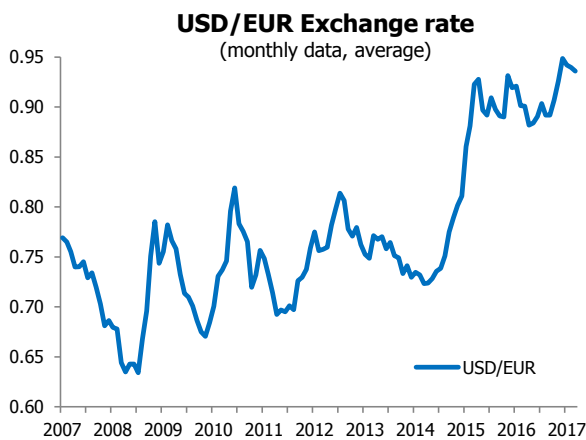
In 2016, global inflation was 2.8% which is the same as in the previous year. However, different shifts were registered in different groups of countries. Therefore, while a slight acceleration of the inflation was characteristic for the developed countries, a moderate deceleration was registered in the developing countries, compared to the stable developments of the prices in the previous years. Dynamically speaking, the available data on global inflation for the beginning of 2017 point to further acceleration of the growth of prices. In the first two months of 2017, the global inflation amounted to 3.0% on an annual basis (compared to 2.6% in the fourth quarter of 2016) and was mainly influenced by the higher oil prices. Analyzed by groups of countries, an accelerated increase is registered in most of the developed countries at the beginning of the year. On the other hand, a slight deceleration of inflation is registered in most of the greater fast growing economies and developing economies. The annual forecasts on global inflation point to its acceleration in 2017, in line with the expected movement of oil prices and primary products, and minimum deceleration in 2018. **Compared to the January forecasts, the global inflation in 2017 is slightly corrected upwards and is expected to amount 3.5%, whereas the forecast for 2018 remains unchanged (3.4%).**

The economic activity in the euro area continued to recover in the fourth quarter of 2016. GDP data show growth of 0.5% on a quarterly basis, whereas on an annual basis the growth amounts to 1.8% and is the same as in the previous quarter. The largest economies within the euro area register an acceleration of the growth on a quarterly basis (Germany, France and Spain), whereas a slight deceleration is registered in Italy. Regarding the labor market, the unemployment rate in the euro area continued to decline, and in February was 9.5%, hitting a record low since May 2009.

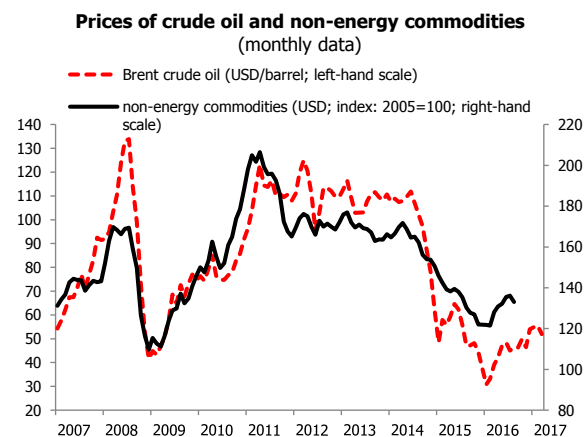
During the first quarter of 2017, the average annual inflation rate in the euro



Source: Central banks.



Source: Eurostat.



Source: IMF monthly database.

area registered an increase and it amounted to 1.8% which is close to the target level of 2.0%. The highest inflation growth was recorded in February, when it reached 2% on an annual basis, which is the highest inflation rate since January 2013. Same as globally, key factors are the energy prices, while food, alcohol and tobacco prices make an additional impact.

In the first quarter of 2017, the central banks of developed countries continued to implement divergent monetary policy, whereby FED made the greatest changes in the monetary setup. Namely, FED at the regular meeting in March decided to once again increase the targeted spread of the reference interest rate, after the increase in December. The targeted spread of the reference interest rate is higher by 25 base points i.e. amounts to 0.75-1.0%. This increase was a reflection of the FED's estimates for accelerating economic growth and the potential future inflationary pressures. On the other hand, ECB, Bank of England and Bank of Japan, made no changes in the monetary policy setup.

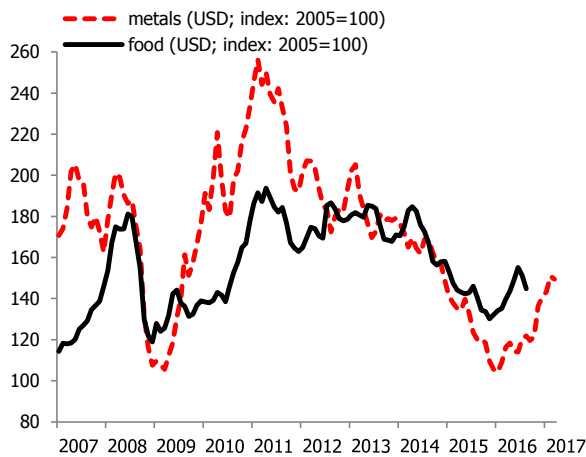
The nominal appreciation trend of the US dollar against the euro also continued in the first quarter of 2017. Thus, the US dollar appreciated by 1.3% compared to the fourth quarter of 2016. On an annual basis, in the first quarter, the value of the US dollar against the euro increased by 3.5%, and in March 2017, one US dollar was exchanged for 0.936 euros.

The increase of oil prices also continued in the first quarter of 2017 (expressed in euros and US dollars). Therefore, in the first quarter the oil price expressed in euros amounted to Euro 50.8 per barrel, which is an increase of 9.4% on a quarterly basis, mostly due to the price movements and to the appreciation of US dollar against the euro to a lesser extent. Annually, the oil price increased by 63%. Amid relatively stable demand, the upwards movement of the oil prices is mostly due to the reached agreement between OPEC members to decrease oil production by 1.2 million barrels per day. The readiness of Russia, which is not an OPEC member, to comply with the measures for decreasing its oil production made an additional effect on the increase of the prices.

The prices of non-energy primary

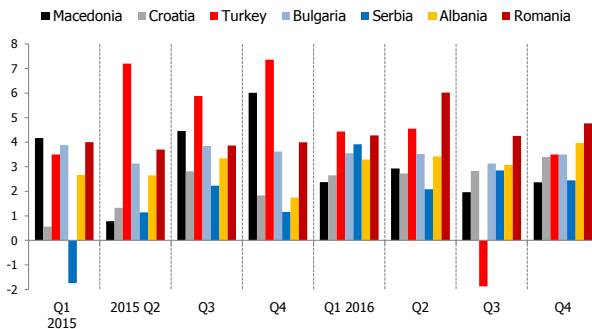


Prices of food and metals (monthly data)



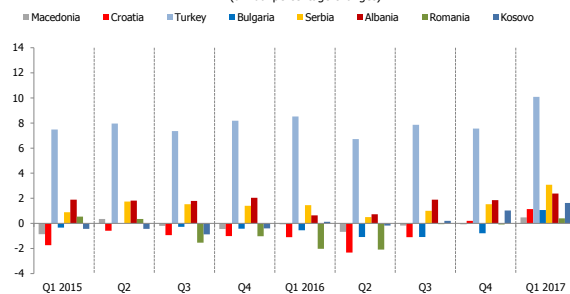
Source: IMF monthly database.

Real GDP growth in countries from the region (annual percentage changes, quarterly data)



Source: Eurostat and national statistical offices.
* According to ESA 2010 methodology, except for Turkey and Albania.

Inflation in countries from the region (annual percentage changes)



Source: Eurostat and national statistical offices.

products expressed in euros and US dollars continued to increase in the first quarter of 2017, registering a growth of 20.1% on an annual basis i.e. 7.1% on a quarterly basis (expressed in euros). Analyzed by group products, prices of metals and food expressed in euros increased by 12.6% and 6.0%, respectively (compared to the fourth quarter of the previous year). The relatively high increase of metal prices in the first quarter is mostly due to the growth of the prices of copper and iron (12% and 22.3%, respectively on a quarterly basis, expressed in euros). The factors which influenced the growth of copper prices were the decline of copper global stocks, possible interruptions in supply capacities and indications for increased demand from China and USA, whereas the main reason for the increase of the iron price was the higher demand by China. On the other hand, the increase of food prices is mostly due to the growth of the wheat and corn prices (quarterly growth of 7.0% and 18.8%, respectively, expressed in euros).

Countries in the region registered positive economic performances in the fourth quarter of 2016. As in the third quarter, the highest increase in the region was recorded in Romania (4.8% on an annual basis). After the decrease in the third quarter of 2016, in the last quarter, a high increase of 3.5% was also recorded in the Turkish economy, mostly due to private consumption. Regarding other economies, solid growth rates were recorded in Albania, Croatia and Bulgaria (4%, 3.5% and 3.4%), mainly as a reflection of private consumption and investments. Serbia also registered a solid growth of 2.4% which represents a deceleration compared to the third quarter of 2016 (2.9%).

In the first quarter of 2017, the inflation rate accelerated in all the countries in the region. Such shifts in consumer prices were expected and to a considerable extent are explained with the movements of energy prices in the global markets. observed by country, in the first quarter of 2017, the highest acceleration of the annual inflation rate was registered in Turkey, Albania and Kosovo, whereas the acceleration was relatively lower in Croatia, Bulgaria and Romania.

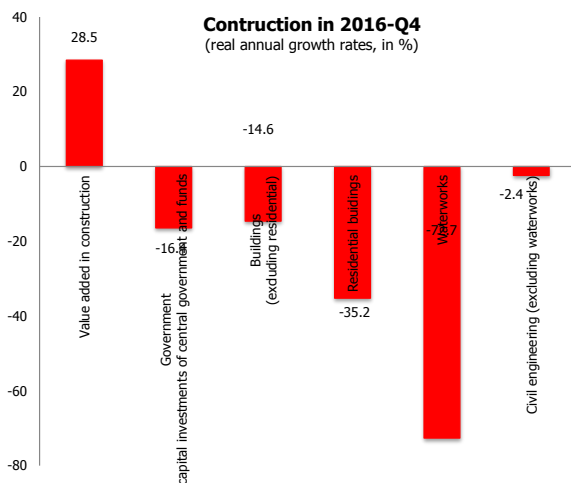


1.2. Domestic supply

The favorable developments in the economy also continued in the last quarter of 2016, when an annual GDP growth of 2.4% was recorded (compared to the growth of 2.0% in the third quarter). Thus, for the entire 2016, GDP growth equaled 2.4%. In terms of the structure of the growth in the fourth quarter, as well as throughout the year, the construction sector was once again the driving force. A moderate growth was also registered in most of the other economic sectors. Industry also registers an increase, which is one of the most significant sectors in terms of production and labor market, but significantly lower compared to the previous quarter. Regarding the movements in the first quarter, currently available data for January and February give different moving directions in part of the economic sectors, whereas the expectations of the managers of three key economic sectors - manufacturing industry, construction and retail trade - for the conditions in the first quarter remained favorable.

	2013	2014	2015	2016	Q1 2016	Q2 2016	Q3 2016	Q4 2016	2013	2014	2015	2016	Q1 2016	Q2 2016	Q3 2016	Q4 2016
Agriculture	8.6	3.1	2.3	2.8	5.0	4.1	1.2	1.8	0.6	0.2	0.2	0.2	0.3	0.3	0.1	0.2
Industry	3.7	11.5	6.9	-1.3	-6.3	-2.1	2.1	0.4	0.5	1.4	0.9	-0.2	-0.8	-0.3	0.3	0.1
Manufacturing	9.6	21.5	0.9	-2.2	-9.4	-0.8	1.1	-1.3	0.8	2.0	0.1	-0.2	-0.9	-0.1	0.1	-0.1
Construction	12.8	5.1	11.0	18.5	6.9	31.4	10.3	28.5	1.2	0.5	1.1	2.1	0.9	3.0	1.1	3.2
Trade and transport	11.1	3.1	2.9	1.3	3.7	1.2	0.3	0.2	1.8	0.5	0.5	0.2	0.6	0.2	0.1	0.0
Information and communication	4.8	3.4	18.0	5.6	10.5	6.7	5.6	0.3	0.3	0.2	1.0	0.3	0.6	0.4	0.3	0.0
Financial and insurance activities	-1.4	13.5	10.1	4.1	9.4	3.0	3.5	1.1	-0.1	0.5	0.4	0.2	0.4	0.1	0.1	0.0
Real estate activities	-1.3	0.0	1.0	-1.3	0.8	-2.2	-1.9	-2.0	-0.2	0.0	0.1	-0.1	0.1	-0.2	-0.2	-0.2
Professional, scientific and technical activities	9.6	6.3	5.5	9.3	7.5	8.9	10.9	9.8	0.3	0.2	0.2	0.3	0.3	0.3	0.4	0.3
Public administration	-7.5	3.2	4.0	1.0	4.5	1.0	-0.1	-1.4	-1.0	0.4	0.5	0.1	0.5	0.1	0.0	-0.2
Other service activities	12.7	11.5	4.6	1.9	6.0	2.9	1.0	-2.6	0.3	0.3	0.1	0.1	0.2	0.1	0.0	-0.1
Gross Domestic Product	2.9	3.6	3.8	2.4	2.4	2.9	2.0	2.4	2.9	3.6	3.8	2.4	2.4	2.9	2.0	2.4

Source: State Statistical Office and NBRM calculations.



Source: State Statistical Office and Ministry of finance.

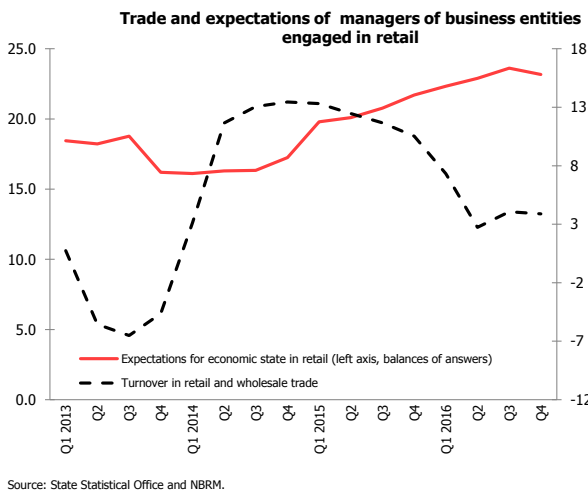
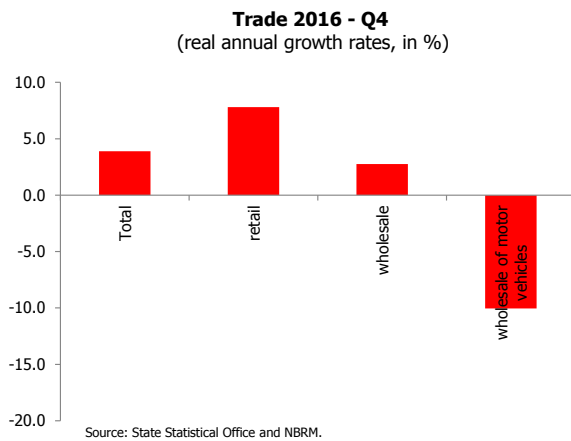
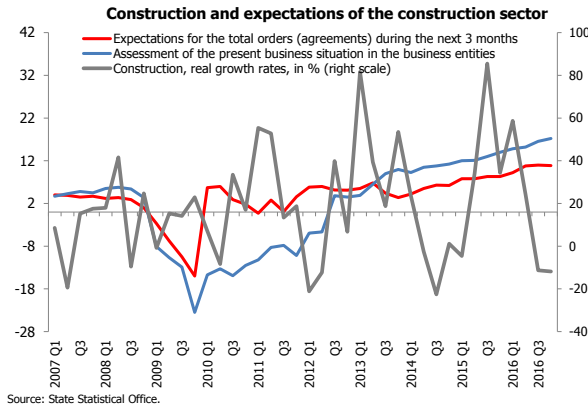
In the fourth quarter of 2016, GDP increased by 1.7% quarterly³, whereas on an annual basis the growth amounted to 2.4%, which is a slight acceleration of the growth compared to the third quarter of the year. Most of the economic sectors registered growth of value added, with the construction making the highest positive contribution. In terms of industry, a slight growth of value added is registered, most likely driven by the activities in the energy sector. On the other hand, in the manufacturing industry which is one of the more significant sectors for creating the GDP, the movements are unfavorable⁴.

The growth in the construction activity continued in the fourth quarter remaining the main driver of the GDP growth. The results of business tendency surveys in construction⁵ are in line with the performance of

³ The quarterly changes of GDP are calculated based on seasonally adjusted data.

⁴ In the fourth quarter, the value added has decreased in the manufacturing industry, activities related to real estate, cumulatively, in the activities public administration and defense, compulsory social security, education, health and social care, as well as in arts, entertainment and recreation, other services, activities of households as employers and activities of households that produce commodities and provide services for own purposes.

⁵ Refers to surveys conducted in the fourth quarter of 2016.



this sector. Namely, compared to the same period of the previous year, respondents have more favorable estimations for the current business and financial condition of the corporations. Also, managers suggest a more significant decrease of the limiting effect of the qualified staff deficiency factor and labor costs. On the other hand, factors with potential limiting effect in the fourth quarter are the insufficient demand and unfavorable weather conditions. Compared to the value added increase in construction, the movements in the high-frequency indicators in the fourth quarter point to a deterioration of the condition in the sector (decrease of the value of performed construction works and lower government capital investments). **In terms of the movements in the construction sector in the first quarter, it is difficult to form a more precise estimation.** Namely, in January, the value of the performed construction works decreased mainly reflecting the extremely bad weather conditions. On the other hand, the expectations of corporations' managers for the condition in the sector during the first quarter of 2017 are favorable.

The activity in the trade sector continues to grow in the fourth quarter, at a similar pace as in the previous quarter, amid growth of the retail and wholesale trade turnover. On the other hand, the motor vehicle trade registered a decrease. The good performances in the retail trade are also confirmed by the survey⁶ results which point to favorable estimations for the current business and financial condition of the corporations, and in terms of the factors which influenced the activity of this sector, the managers highlight the slight limiting effect of the labor costs and financial costs (interest) and lack of warehouse and selling space. On the other hand, managers single out increased offer as well as increased competition as factors whose limiting effect grew. The data for the first two months of the year point to an increase of the trade activity during the first quarter of 2017, amid growth of the turnover value in the total trade, although a slight acceleration is registered reflecting the lower turnover in the retail trade.

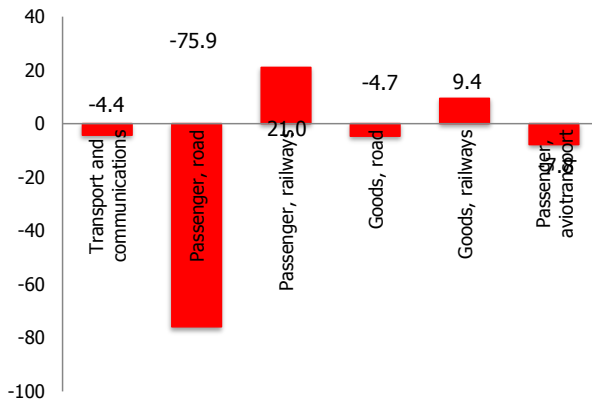
Analyzing the developments in the transport and communication sector, the

⁶ SSO's Business Tendency Survey in retail trade for the fourth quarter of 2016. The balance of responses is the difference between weighted positive and negative responses of corporate managers. The balance is designed to show the movement of the observed economic indicator rather than its true size i.e. it provides qualitative rather than quantitative (numerical) data from corporate managers.



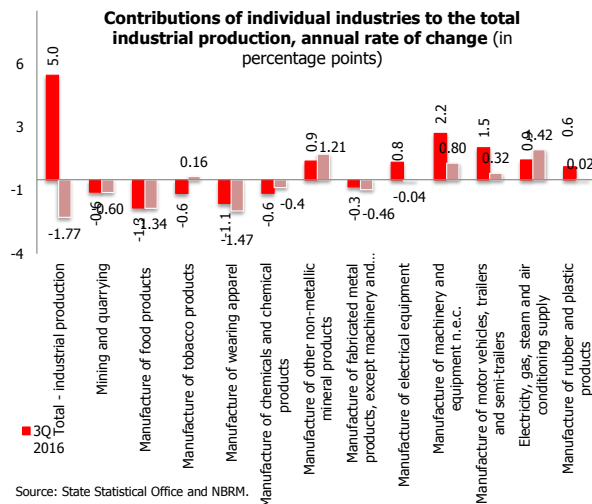
Transports and communications in 2016 - Q4

(real annual growth rates, in %)



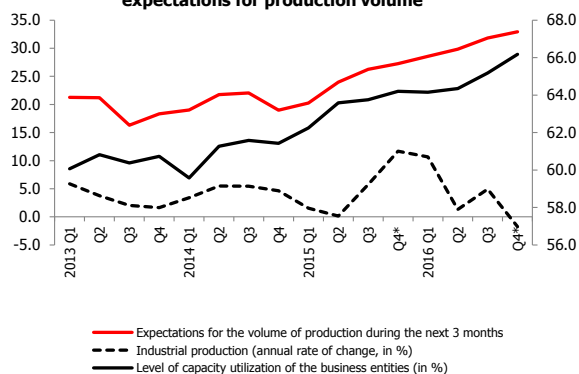
Source: State Statistical Office.

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



Source: State Statistical Office and NBRM.

Industry, capacity utilization and managers' expectations for production volume



Source: State Statistical Office.

* average of expectations for October and November of 2015.

indicators for the fourth quarter of the year point to a deterioration amid adverse movements in the rail traffic⁷. Traffic growth is only registered in the road freight and air transport. **The small number of high frequency indicators hinders any precise assessment in terms of developments in the transport and communications sector during the first quarter**, although the currently available data point to a decline in this activity, given the high annual decline in all types of rail traffic.

During the fourth quarter, a small annual growth of the value added in the industrial sector was registered, which most likely is driven by the energy sector, given the decrease in the mining and manufacturing industry⁸. Within the manufacturing industry, the decline reflects less favorable developments in traditional industries (production of food products, beverages, clothing, and metals). The decline was mitigated with the increased production of non-metal mineral products, machines and other equipment, pharmaceuticals and motor vehicle production. The weaker performances in some activities, according to the surveys⁹ could be linked to the more uncertain economic environment, a factor whose limiting effect in the fourth quarter is especially expressed. On the other hand, the survey results show maintaining favorable expectations in terms of the movements in this sector, as well as growth rate of the utilization of capacities which points to a possible improvement of the sector's condition in the upcoming period. Also, a reduction is registered in the limiting effect of part of the factors, as a lack of the qualified staff and the situation with the demand. **The data for the first two months of 2017 suggest a decrease of the industrial output** amid lower production in the manufacturing industry and mining, while the energy sector production registered an increase. On the other hand, the survey results in terms of the current situation in this sector and the expectations for future short-term movements remain favorable.

⁷ The relatively high decline in rail traffic is associated with the high base effect of last year, when in the second half of the year, the demand for this type of service increased as a result of the refugee crisis.

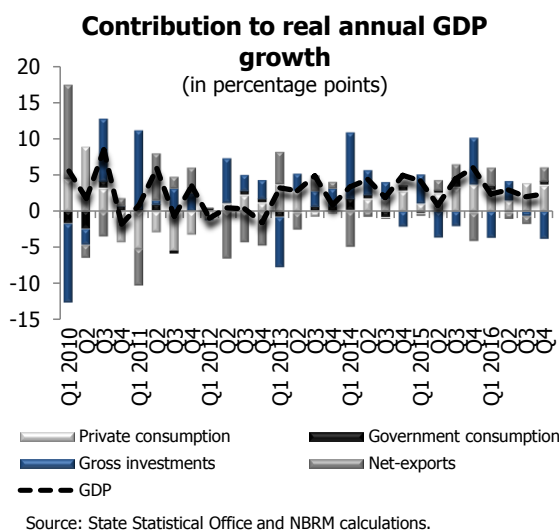
⁸ The analysis by activity is based on the data on the physical volume of industrial production because of the availability of data for individual industrial sectors.

⁹ Refers to the business tendency surveys in the manufacturing industry conducted during the fourth quarter of 2016.



1.3. Aggregate demand

Observing the demand components, the GDP growth of 2.4% in the fourth quarter is mostly due to the positive net export, and the positive contribution of the domestic demand. Observing individual components, as in the first three quarters of the year, export of goods and services is the component with the highest growth and most significant positive contribution. The export growth is mainly attributable to the activity of new industrial facilities, and higher growth is also registered in other sectors in accordance with the moderate growth of the foreign effective demand and improved conditions in the metals market. Among the domestic demand components, gross investments register a decline, whereas private and public consumption register an increase. Thus, the highest growth in private consumption in this quarter was also supported by the favorable labor market developments, the environment of low consumer prices and further lending support to households.



Gross domestic product (GDP) in the fourth quarter of 2016 increased by 1.7% on a quarterly basis¹⁰ and by 2.4% on an annual basis, which is a slight acceleration of the growth pace compared to the previous quarter. The structural analysis show that growth in the fourth quarter is mostly due to the net export, and the domestic demand also had a positive contribution. Analyzed by individual components, export is the component with the highest contribution to the growth in the last quarter of 2016, whereas the increased export activity is mostly attributable to the new export orientated production facilities. In the fourth quarter, the growth of private consumption continued supported by the favorable developments in the labor market and further lending support to households, and public consumption also increased. Among domestic demand components, decrease is registered only in gross investments. The higher consumption and export impacted the import, which continued to increase, but at a slower pace compared to the previous quarter.

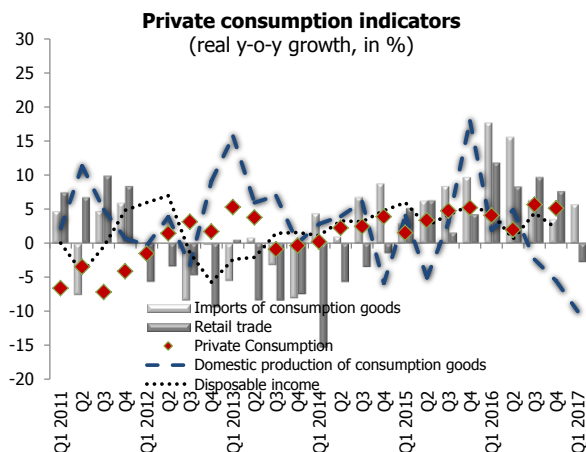
¹⁰ The quarterly GDP changes and its components are calculated based on seasonally adjusted data.



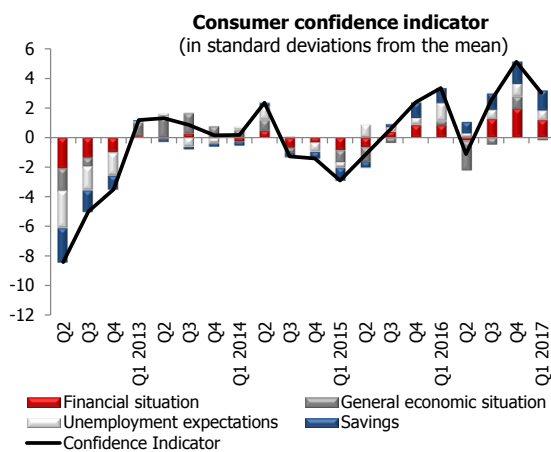
	Real annual growth rates (%)				Contributions to real annual growth (in p.p.)											
	2013	2014	2015	2016	2016-Q1	2016-Q2	2016-Q3	2016-Q4	2013	2014	2015	2016	2016-Q1	2016-Q2	2016-Q3	2016-Q4
Private consumption	1.9	2.2	3.7	4.2	4.1	2.0	5.6	5.1	1.4	1.6	2.6	2.8	2.7	1.3	3.8	3.5
Government consumption	0.5	3.0	2.1	1.6	4.7	-1.4	-0.4	3.4	0.1	0.5	0.4	0.3	0.8	-0.2	-0.1	0.6
Exports of goods and services	6.1	16.5	6.7	11.5	13.2	7.1	14.4	11.2	2.8	7.2	3.2	5.6	5.8	3.5	7.4	5.6
Imports of goods and services	2.2	14.1	5.2	7.6	5.5	6.4	13.7	5.3	-1.4	-8.7	-3.4	-5.0	-3.4	-4.2	-8.5	-3.7
Gross capital formation	0.5	10.7	3.6	-4.3	-10.7	9.6	-2.1	-10.4	0.1	3.1	1.1	-1.3	-3.5	2.6	-0.7	-3.6
Domestic demand	1.3	4.4	3.5	1.6	-0.1	3.3	3.0	0.2	1.6	5.2	4.1	1.8	-0.2	3.9	3.3	0.3
Net exports*	-6.9	8.0	1.0	-3.9	-14.3	4.3	10.3	-9.2	1.3	-1.3	-0.2	0.6	2.5	-0.8	-1.1	2.0
Statistical discrepancy									0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
GDP	2.9	3.6	3.8	2.4	2.4	2.9	2.0	2.4	2.9	3.6	3.8	2.4	2.4	2.9	2.0	2.4

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

1.3.1. Private consumption



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



Source: European Commission and NBRM's calculations.

In the fourth quarter of 2016, household consumption increased quarterly by 0.9% and annually by 5.1% in real terms. The growth in the fourth quarter is explained by the favorable movements in almost all indicative categories of household consumption. Thus, the fourth quarter of the year recorded an accelerated increase in the bill of wages and pensions, and a high growth is also registered in consumer loans. Also, export and import of consumer goods and retail trade register an increase, although at a slower growth pace compared to the previous quarter. Results of the consumer confidence surveys¹¹ which point to an increased consumer sentiment amid more favorable expectations in terms of the general economic landscape, as well as possibilities for savings.

According to high-frequency data, private consumption is expected to continue to increase in the first quarter of 2017¹². Namely, this is suggested by the growth of real wages and pensions, as components of disposable income and further growth of household lending, which according to the Bank Lending Survey¹³, corresponds to the further easing of the overall credit conditions to households in this period. Other high-frequency data on private consumption show additional positive signals from net private transfers, as well as from the imports of consumer goods, whereas retail trader registered a decrease. Additionally, the signals from the consumer confidence surveys¹⁴, conducted in the first quarter of 2017 suggest more favorable expectations in terms of the expected financial situation, as well as possibilities

¹¹ European Commission's Consumer Survey as of February 2017.

¹² The analysis of net private transfers and import of consumer goods was made using January data. Other factors have been analyzed as of February.

¹³ NBRM's Lending Survey, April 2017.

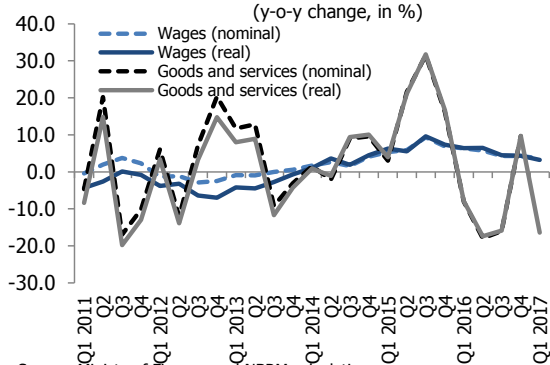
¹⁴ European Commission's Consumer Survey as of February 2017.



for savings.

1.3.2. Public consumption

Expenditures for Wages and salaries and Goods and services



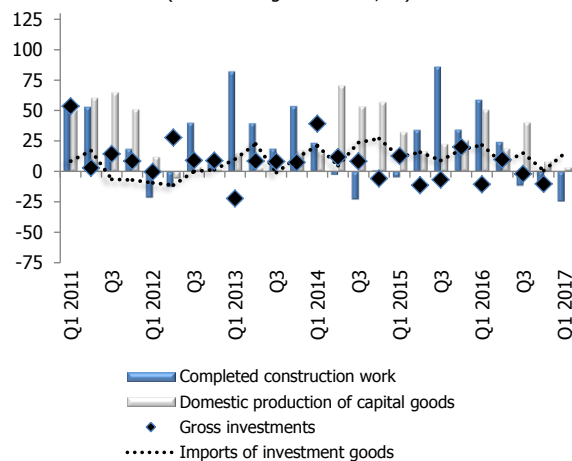
Source: Ministry of Finance and NBRM calculations. The calculations include expenditures of Consolidated Budget of Central Government and Funds, deflated by CPI.

In the fourth quarter of 2016, public consumption recorded a quarterly growth of 3.6% and an annual growth of 3.4%. The increase in public consumption is mainly due to the higher expenditures for goods and services, while wage expenses for the employees in the public sector and health care transfers¹⁵ increased.

The data for the period January-February 2017 indicate a slight increase in public consumption in the first quarter, given the increase of wages for the employees in the public sector, as well as health care transfers.

1.3.3. Investment consumption

Gross investment and indicative series



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

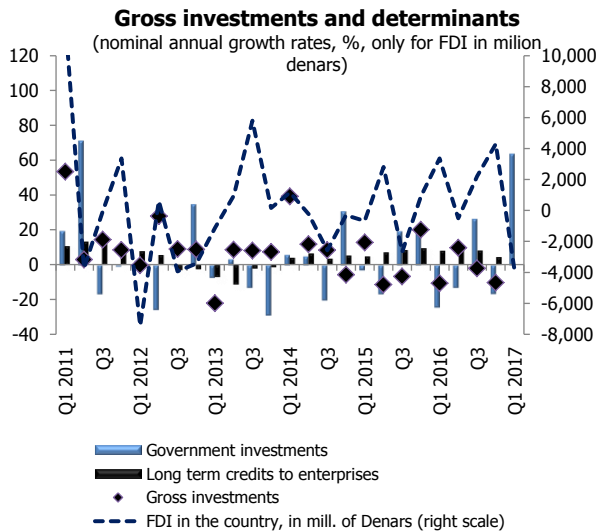
Unlike other domestic demand components, in the fourth quarter of 2016, gross investments registered a decline of 1.3% on a quarterly basis and 10.4% on an annual basis. Analyzing the high-frequency indicators, the decline in investment demand might be explained by the lower value of the completed construction works. Namely, the value of the completed construction works decreases for the second consecutive quarter, whereby, in the fourth quarter, the decrease is mainly due to the decline in the high-rise buildings domain (high comparative base from the previous year)¹⁶. Additionally, in the last quarter of the year, decrease of the government expenditures for capital investments also registers a decrease. On the other hand, regarding other indicators the movements are mainly favorable, amid growth of inflows from foreign direct investments, as well as higher import and domestic production of capital goods and growth of long-term lending to corporations, although at a slower pace compared to the previous quarter.

Available short-term indicators for gross investments in the first quarter of 2017 point to movements in different directions¹⁷. Thus, the growth of domestic

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

¹⁶ On the other hand, analyzed on the production side of GDP, construction registers a high increase of the value added and is the growth driver in the fourth quarter.

¹⁷ Data on completed construction works and import of investing assets have been analyzed as of January, while for the other indicative categories, the cut off date is February.

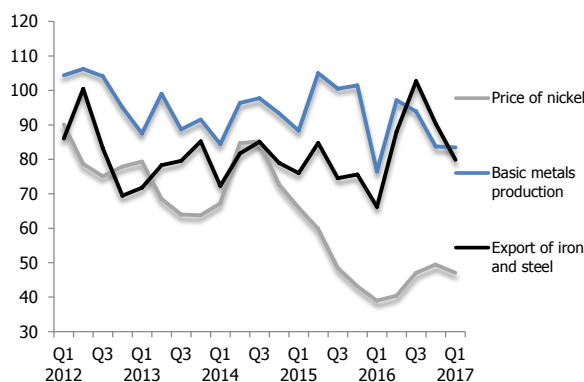


Source: State Statistical Office, Ministry of Finance and NBRM calculations.

1.3.4. Net external demand

production of capital goods, import of working assets and growth of government capital investments point to an increase of investments in the first quarter. The funding environment is also favorable given the solid growth in long-term corporate lending by banks. This is in line with the banks' expectations for increased demand for corporate loans amid eased credit standards in this period¹⁸. On the other hand, in January, foreign direct investments declined, and construction activity decrease continued partially due to the extreme bad weather conditions at the beginning of the year. However, the expectations of the managers in the construction sector relating the total orders during the first quarter onwards remain favorable¹⁹.

Iron and steel export, base metals production and price of nickel
(index, 2010=100)



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

Unlike the previous two quarters, net export in the fourth quarter of 2016 had a positive contribution towards the economic growth amid higher growth of export than import of goods and services. Thus, in the last quarter, the real export of goods and services registered a growth of 11.2% on an annual basis and a quarterly increase of 1%. Analyzing the structure, once again the export growth mostly arises from the increased export of new production facilities, and in accordance with the foreign demand recovery, export growth is also registered in other export components. Additionally, the gradual improvement of the conditions in the metal market had a positive reflection on the export activity of part of the companies in the metal industry, thereby the total export of iron and steel registers an increase. In the fourth quarter, **import of goods and services** in real indicators increased by 5.3% on an annual basis, which is a significant deceleration compared to the pace recorded in the previous quarter, whereas on a quarterly basis the import decreased by 0.9%.

Nominal foreign trade data for the period January-February 2017 indicate **a slight widening of the trade deficit in the first quarter of 2017**. The increased trade deficit is a result of the higher growth of imports than exports of goods.

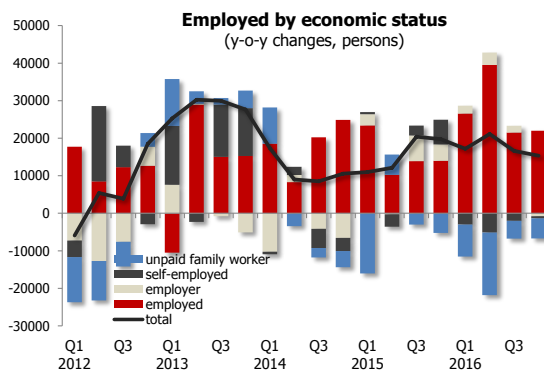
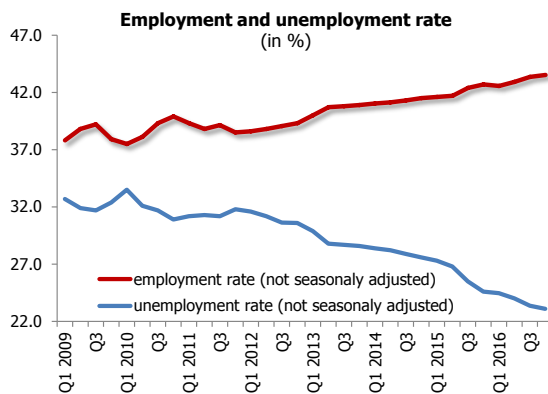
¹⁸ NBRM's Bank Lending Survey, April 2017.

¹⁹ Refers to surveys conducted in the fourth quarter of 2016.



1.4. Employment and wages

The increase of the number of employees also continued in the fourth quarter of the year, a tendency present for a longer period. Thus, the number of employees increased by 2.1%, while the unemployment rate was 23.1%, which a new record low. Also, the aggregated signals from business tendency surveys show stronger optimism about employment for the next three months. Additionally, a gradual decrease of the vacant posts continued in the fourth quarter, which viewed along with the above-mentioned positive signals from the employment surveys might point to a potential improvement of the labor market efficiency. On the supply side, for the first time after a year and a half continuous decline, a slight annual growth of the active population was registered. In the fourth quarter, competitiveness indicators also register an improvement i.e. the growth of labor productivity accelerated, whereas there was a deceleration of unit labor costs growth pace.



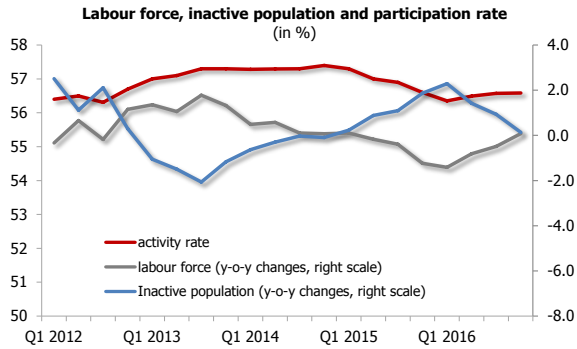
Employment continued growing in the fourth quarter of 2016, but at a slightly slower pace. Thus, the number of employees increased by 2.1% on an annual basis and 0.4%²⁰ on a quarterly basis (compared to an annual growth of 2.3% and a quarterly growth of 1% in the third quarter of 2016). An increase of employees, on an annual basis is registered in most activities, whereby trade, transport and health had the highest contribution to the overall growth of employment. Employment decrease is also registered in agriculture, mining, water supply, water waste removal, waste management and environment and accommodation facilities and catering services activities. In terms of the economic status²¹, same as in the previous quarter, most employments are in the employed population category.

In the fourth quarter of 2016, the employment rate was 43.5%, which is an annual growth of 0.8 percentage points. Considering the dynamics, the performance in the fourth quarter is a slight acceleration of the annual growth. Regarding the shifts in labor demand, in the first quarter of 2017, the aggregate signals from the business tendency surveys²² point to the continuation of the favorable trends given the strengthened optimism among company managers in the following

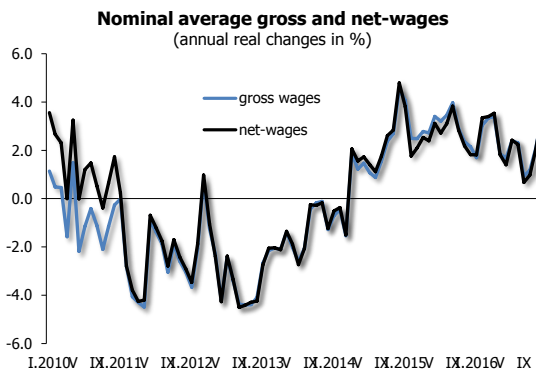
²⁰ The analysis of quarterly dynamics of employment, unemployment and total economically active population was made using seasonally adjusted data.

²¹ 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).

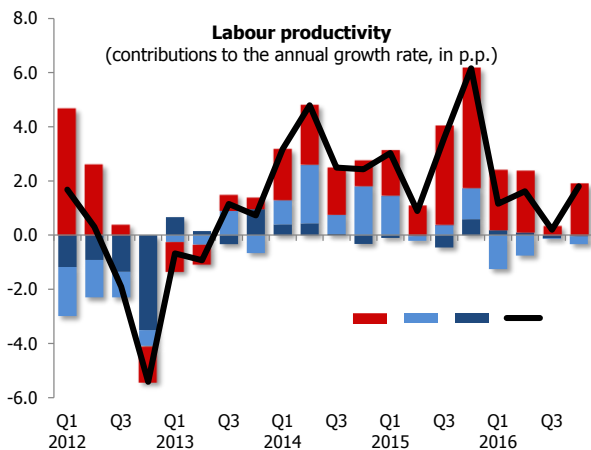
²² Source: State Statistical Office, business tendency surveys in manufacturing industry (November 2016), construction (third quarter of 2016) and trade (third quarter of 2016).



Source: State Statistical Office, Labor Force Survey.



Source: State Statistical Office.



Source: State Statistical Office and NBRM calculations

period. In the fourth quarter, the vacancy rate²³ decreased to 1.3% (compared to 1.5% in the fourth quarter of 2015). Given that the rate of vacancies is an indicator of the uncovered labor demand, as well as potential skill mismatches²⁴ between the demanded profiles and those available in the labor market at the given moment, the decrease of this indicator may result to an improvement of the labor market efficiency. However, given the labor market conditions as well as short time period²⁵, it is still early to give more precise estimations in this context.

Regarding the shifts on the labor supply side, a moderate growth was registered in the fourth quarter after six quarters of reduction in this indicator. Thus, the total active population in the fourth quarter increased by 0.1% on an annual basis, whereas the activity rate was 56.6% (same as in the third quarter).

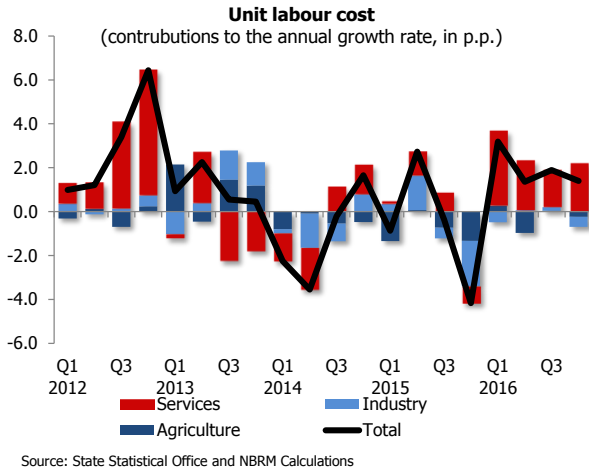
The demand growth in the fourth quarter of the year, amid almost unchanged labor supply let to further decline of unemployment. Thus, the number of unemployed in the fourth quarter decreased by 6.3% on an annual basis, which is a slower pace compared to the previous quarter, while the unemployment rate positioned itself at a level of 23.1% (annual and quarterly decline of 1.5 percentage points and 0.3 percentage points, respectively).

The average wages paid in the fourth quarter registered an annual growth of 2.1% (net and gross wages), which is a moderate acceleration of the annual growth pace compared to the registered in the previous three months. The growth is distributed in most economic activities, with construction, administrative and auxiliary services and arts, entertainment and recreation stand out as activities with the highest wage growth. Compared to the previous quarter, the nominal net and gross wages increased by about 2%. **In the fourth quarter, amid a slight decline in consumer prices, the real annual wage growth is slightly higher than in nominal terms (2.2% in both net and gross wages).**

²³ 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. The data is being published since 2012.

²⁴ Source: Statistics Explained (<http://epp.eurostat.ec.europa.eu/statisticsexplained/>) - 15 December 2016.

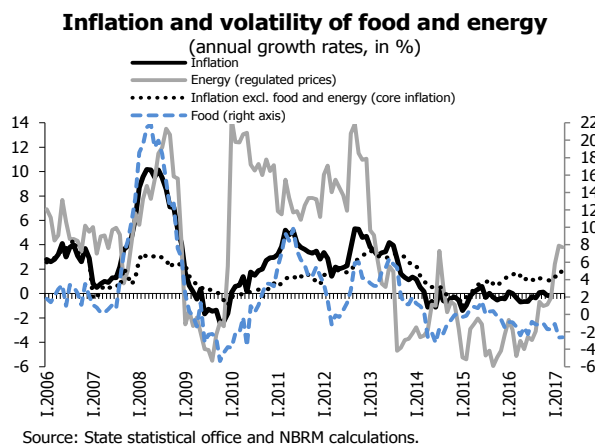
²⁵ The decreasing trend started in 2016, which is a short period for analyzing the connection between this data and potential improvements in the labor market efficiency.



Labor productivity²⁶ in the fourth quarter increased by 1.8%, which compared to the previous quarter of the year is an acceleration of the growth pace. Such shift is mostly due to the significant increase of the labor productivity in construction given the significantly higher growth of the value added compared with the employment in this sector. **At the same time, the annual growth of unit labor costs slightly decelerated in the fourth quarter compared to the previous quarter in which it amounted to 1.4%.** Unit labor costs increased the most in the services sector, while labor costs in agriculture and industry registered a decrease.

1.5. Inflation

The trend of the reduction of domestic prices was interrupted in the first quarter of 2017, when prices, for the first time after six quarters of consecutive decrease, increased by 0.5% on an annual basis. The growth of domestic prices reflects the increased prices of the eclectic component of inflation, a change which was expected given the latest shifts in the global environment of world energy prices. Additionally, core inflation (price component without food and energy) remained at the positive zone, whereby a slight acceleration of its growth was recorded. In contrary of such shifts in the energy component and core inflation, food prices continued to decrease. In the first two months of the quarter, producer prices registered a small decrease in the domestic market, although slower than in the previous quarter. In terms of future expectation in consumer prices, results from the Inflation Expectations Survey conducted in March indicate unchanged inflation expectations relative to the previous quarter.



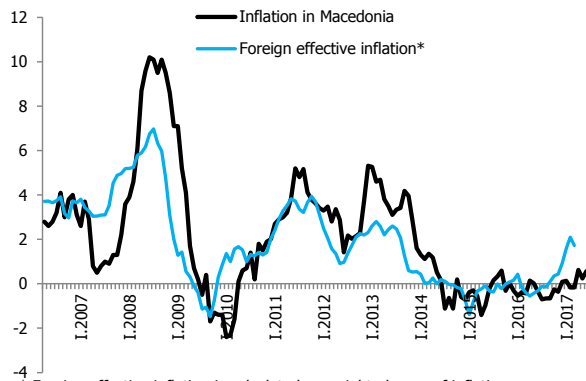
In the first quarter of 2017, for the first time after six quarters of consecutive decrease, the domestic consumer prices increased by 0.5% on an annual basis. Analyzed by components, core inflation made the highest contribution to the growth of prices, amid the increase of prices in most categories included in the index, with the highest prices of tobacco²⁷, shoes and telephone services having the greatest contribution. Growth is registered in subindices of inflation which exclude the most volatile prices. Total index, excluding energy, liquid fuels and lubricants and unprocessed food has an annual growth of 0.8%, whereas total index, excluding energy, liquid fuels and lubricants, unprocessed

²⁶ Total productivity is calculated as weighed sum of the calculated productivity on an individual sector level. Within each sector, productivity is calculated as a ratio between the value added in that sector and number of employees.

²⁷ The annual growth of tobacco prices in the first quarter is a combination of the previous flat increase in cigarette prices by five denars per box in March 2016, and the increase in the price of a certain type of cigarettes in June 2016. In July 2016, the cigarette excise additionally increased (from 1 July 2017 to 1 July 2023 the excise duty will increase by 0.20 denars each year), but the monthly and quarterly changes in tobacco prices did not show any price adjustment.



Domestic inflation and foreign effective inflation
(annual growth rates, in %)



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

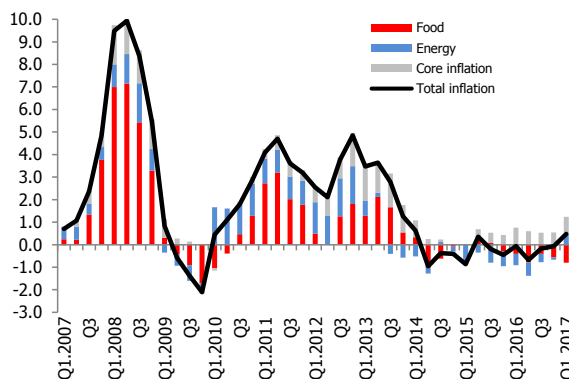
food, tobacco, alcoholic beverages point to an annual growth of 0.5%. For the first time after a several-year period of continuous decrease, the energy component made an additional positive contribution to the growth of consumer prices in the first quarter. Such change is due to the increase of domestic prices of liquid fuels and lubricants following the change in the global environment of world prices of oil and oil derivatives. On the other hand, food prices continued to decline in the first quarter of 2017, mainly under the influence of the lower prices of vegetables.

Foreign effective inflation²⁸ remained in the positive zone in the first quarter of the year when it amounted 1.8% compared to the growth of 0.6% in the previous quarter.

	(annual changes, in %)							(contribution to annual changes, in p.p.)						
	2015	2016				2016	2017	2015	2016				2016	2017
		Q1	Q2	Q3	Q4		Q1	Q1	Q2	Q3	Q4		Q1	
Consumer price index - all items	-0.3	-0.1	-0.7	-0.2	-0.1	-0.2	0.5	-0.3	-0.1	-0.7	-0.2	-0.1	-0.2	0.5
Food	0.1	-1.1	-2.0	-1.1	-1.5	-1.4	-2.1	0.1	-0.4	-0.8	-0.4	-0.6	-0.5	-0.8
Energy	-4.1	-3.4	-4.0	-2.5	-0.8	-2.7	3.4	-0.6	-0.5	-0.6	-0.4	-0.1	-0.4	0.5
Electricity	1.5	-0.4	-0.4	-0.2	-0.2	-0.3	-0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Heat energy	-6.8	-18.3	-18.3	-13.6	-10.8	-15.5	-10.8	-0.1	-0.2	-0.2	-0.1	-0.1	-0.1	-0.1
Fuels and lubricants	-16.5	-10.2	-11.8	-8.1	-0.3	-7.7	16.4	-0.8	-0.4	-0.5	-0.3	0.0	-0.3	0.6
Food and energy (volatile prices)	-1.1	-1.7	-2.6	-1.5	-1.3	-1.8	-0.7	-0.6	-0.9	-1.4	-0.8	-0.7	-0.9	-0.3
Core inflation (inflation excl. food and energy)	0.5	1.6	1.3	1.1	1.1	1.3	1.6	0.2	0.8	0.6	0.5	0.5	0.6	0.8
Overall index excluding energy, liquid fuels and lubricants and unprocessed food (SSO)	0.5	1.5	1.0	0.7	0.4	0.9	0.8							
Overall index excluding energy, liquid fuels and lubricants, unprocessed food, tobacco and alcoholic beverages (SSO)	0.1	1.3	0.8	0.4	0.1	0.7	0.5							

Source: State Statistical Office and NBRM calculations.

Volatile (food and energy) and core inflation
(contribution to inflation, in percentage points)

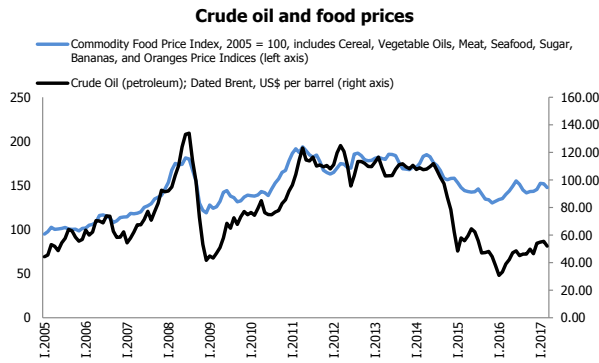


Source: State statistical office and NBRM calculations.

Regarding the dynamics, the growth in the first quarter is mostly due to the shifts in the energy component, where an increase of the prices was recorded compared to the decline in the previous quarter. Moreover, core inflation remained in the positive zone with a higher growth rate compared to the previous quarter. Core inflation in the first quarter was 1.6% (compared to 1.1% in the previous quarter), and the acceleration is mainly due to the growth of the prices of telephone services as well as prices of catering services. Contrary to such shifts in the energy component and core inflation, the decline in food prices deepened, a shift which, given the trends in world food prices, is probably due to specific domestic factors.

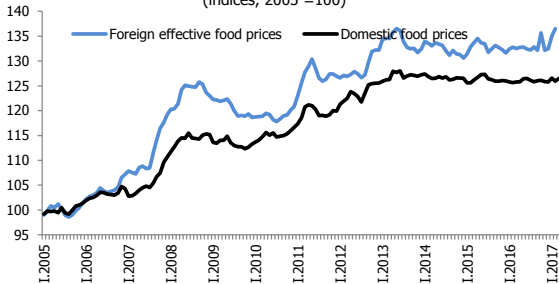
On a quarterly basis, in the first quarter of 2017, consumer prices were higher by

²⁸ The calculation of foreign effective inflation derives from the weighted sum of consumer price indices of 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.



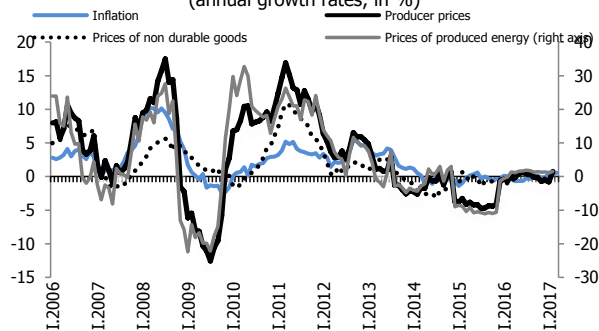
Source: IMF Primary Commodity Prices.

Foreign effective food prices* and domestic food prices (indices, 2005 =100)



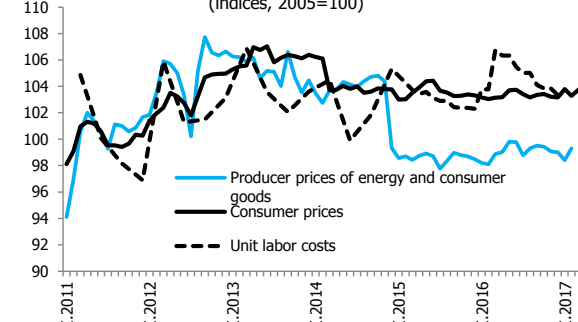
* Foreign effective food prices are calculated as weighted sum of food prices in countries that are major trade partners with Macedonia.
 Source: State statistical office, Eurostat and NBRM calculations.

Inflation and industrial producer prices (annual growth rates, in %)



Source: State statistical office and NBRM calculations.

Factors affecting consumer prices (indices, 2005=100)



Source: State statistical office and NBRM calculations.

0.3% (seasonally adjusted rate)²⁹, fully explained by the higher energy prices and commodity prices within the core inflation, amid small decrease in food prices.

The annual decrease of the prices of industrial products in the domestic market also continued during the first quarter of 2017³⁰ (0.1% compared to 0.5 in the fourth quarter), a movement which as during 2016 is explained by the lower prices in the manufacturing industry. Thus, lower producer prices of food products, tobacco products as well as producer prices of other non-metal mineral products have the highest negative contribution within the manufacturing sector. On the other hand, producer prices of beverages and non-metals have a more significant positive contribution. On a quarterly basis, producer prices registered a decrease of 0.1%. **On the other hand, producer prices which influence the domestic component of inflation³¹ continue to be in the positive zone** (annual growth of 0.7% in the first two months and quarterly growth of 0.9%³²). Although this is a moderate increase of these prices, still the continuation of such trends might lead to certain upward pressures on the overall consumer prices in the following period.

In the fourth quarter of 2016, unit labor costs registered a slightly lower growth of 1.4% on an annual basis compared to the previous quarter when an annual growth of 1.6% was registered. Given the estimates for positive output gap³³, the continuing growth of labor costs points to potential upward pressures on prices of final products through this channel in the future period.

²⁹ Seasonally adjusted quarterly growth rate is positive (0.6%).

³⁰ The analysis refers to the first two months of the quarter.

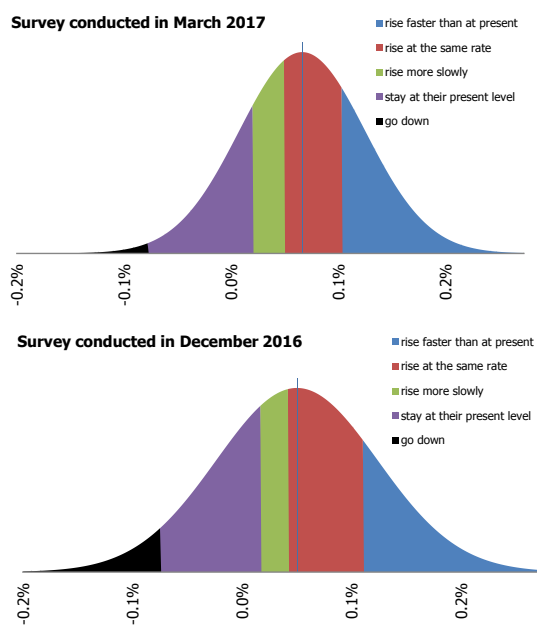
³¹ Consumer goods (durable and non-durable) and energy.

³² The quarterly growth has been calculated using seasonally adjusted data.

³³ The NBRM assessments show that domestic production is above the potential level (positive output gap) in the second half of 2015.

Box 1: Inflation Expectations Survey

Inflation Expectations Survey includes three groups of respondents: economic analysts, companies, and financial institutions. The questionnaire contains two questions to measure inflation expectations, one qualitative and one quantitative in nature. For the first question on inflation expectations, the respondents indicate the direction and extent of price changes compared with the change in the previous 12 months³⁴. Carlson and Parkin (1975) probability approach has been used for quantification of qualitative answers, which assumes that amid a sufficiently large number of respondents, the expected change in prices is normally distributed among the population. The second question requires from the respondent to quantify precisely the expected average rate of change of prices in the next two years³⁵. The overall expected rate is calculated as a simple average of the responses of all participants. The resulting indicator is useful for obtaining indications for the direction of the respondents' expectations.



The Inflation Expectations Survey was conducted in March 2017³⁶. Same as in the previous survey cycle, **the average inflation rate for the previous 12-month period³⁷ remained in the negative zone³⁸. The results of the survey indicate unchanged inflation expectations relative to the previous survey, i.e. as in December, respondents expect inflation to be around 0% in the next 12 months. Expectations for the inflation rate of around 0% are common for all three groups of respondents (economic analysts, companies, and financial institutions).**

In terms of the quantitative question on the expected rate of inflation for 2017 and 2018, the respondents' inflation expectations for 2017 are by 0.1 percentage points lower, and for 2018, they remained unchanged compared to the previous survey.

³⁴ The qualitative question of expectations reads as follows: Compared with the past 12 months, how do you expect consumer prices to change in the next 12 months? a) will have a faster growth; b) will grow at the current pace; c) will grow at a slower pace; d) will remain almost unchanged; e) will decrease; f) it is difficult to determine

³⁵ The quantitative question reads as follows: What are your expectations/forecasts for the average inflation rate for 2017 and 2018?

³⁶ The percentage of responsiveness to the Survey conducted in March was 28.4%, which compared to the previous quarter, represents a decrease of responsiveness. Analyzed by group of respondents, the financial institutions' responsiveness is 55.6%, followed by economic analysts with 27.1% and companies with 24.5%.

³⁷ Refers to the period March 2016 to February 2017.

³⁸ In circumstances of a negative price growth, the interpretation of the results of the survey can be blurred, and therefore, it is necessary to change the method of calculation of the indicator for inflation expectations. Thus, in the procedure for quantification, the negative rate is replaced with the last positive growth rate. This is the way to avoid the contradictory responses from the survey that assume a positive price growth. Taking into account that changes in the method are of a purely technical nature, the quantification of qualitative answers for the expected rate of inflation in periods of negative inflation should be taken with caution, while the indicator for inflation expectations as approximate.



1.6. Balance of Payments³⁹

In accordance with the usual seasonal pace, a current account deficit in the balance of payments was registered in the last quarter compared to the surplus in the previous quarter. The quarterly shift is due to the deterioration of the trade balance of goods and services and weaker inflows in the secondary income. On an annual basis, in the last quarter of the year, the current account deficit improved. The improved performances are due to the narrowing of the deficit in trade of goods and services, as well as higher net inflows based on the secondary income. Driving factors that narrowed the trade balance include the improved export performances of the new facilities in the economy. Cumulatively, for the entire 2016, the current account recorded a deficit of 3.1% of GDP, or expansion of 1 percentage point of GDP compared to the previous year as a result to the more unfavorable movements in the primary and partially in the secondary income. In the last quarter of 2016, net inflows were registered in the financial account, mainly in the form of direct investments and through trade credits to a lesser extent. Cumulatively, in 2016, the financial account was characterized by high net inflows, for which the government borrowing on the international financial markets contributed greatly by issuing the fifth Eurobond, as well as foreign direct investments, which during 2016 were an important source of the financial inflows in the economy. The balance of payments position in the fourth quarter led to a decrease of the foreign reserves, whereas for the entire 2016 their level increased.

	2015					2016					2015					2016				
	Q1	Q2	Q3	Q4	I-XII	Q1	Q2	Q3	Q4	I-XII	Q1	Q2	Q3	Q4	I-XII	Q1	Q2	Q3	Q4	I-XII
	euro mil										% of GDP									
I. Current account	-61.7	-97.2	114.4	-142.4	-187	-258.7	-219.4	100.3	-125.6	-303.3	-0.7	-1.1	1.3	-1.6	-2.1	-0.6	-2.2	1.0	-1.3	-3.1
Goods and services	-318.7	-387.6	-279.7	-498.6	-1485	-295.3	-438.0	-279.8	-442.4	-1455	-3.5	-4.3	-3.1	-5.5	-16.4	-3.0	-4.4	-2.8	-4.5	-14.8
Credit	987.6	1094.8	1159.6	1168.9	4411	1099.9	1141.8	1326.3	1268.5	4836	10.9	12.1	12.8	12.9	48.7	11.2	11.6	13.4	12.9	49.0
Debit	1306.3	1482.4	1439.4	1667.5	5896	1395.1	1579.7	1606.1	1710.9	6292	14.4	16.4	15.9	18.4	65.1	14.1	16.0	16.3	17.3	63.8
Goods	-427.3	-440.3	-418.7	-540.2	-1827	-409.2	-513.0	-429.1	-503.0	-1854	-4.7	-4.9	-4.6	-6.0	-20.2	-4.1	-5.2	-4.4	-5.1	-18.8
Services	108.6	52.7	139.0	41.6	342	114.0	75.0	149.3	60.6	399	1.2	0.6	1.5	0.5	3.8	1.2	0.8	1.5	0.6	4.0
Primary income	-70.0	-73.5	-69.9	-72.7	-286	-105.5	-102.7	-104.3	-106.7	-419	-0.8	-0.8	-0.8	-0.8	-3.2	-1.1	-1.0	-1.1	-1.1	-4.3
Secondary income	327.0	363.9	464.0	428.9	1584	342.0	321.3	484.5	423.5	1571	3.6	4.0	5.1	4.7	17.5	3.5	3.3	4.9	4.3	15.9
II. Capital account	1.8	1.0	2.1	2.4	7	2.3	2.9	5.0	-0.2	10	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.1	0.0	0.1
Net lending (+) / net borrowing (-) (balance from current and capital account)	-59.9	-96.2	116.5	-140.0	-180	-56.5	-216.5	105.3	-125.8	-293	-0.7	-1.1	1.3	-1.5	-2.0	-0.6	-2.2	1.1	-1.3	-3.0
III. Financial account	126.2	-44.3	151.8	-233.5	0	-80.7	-87.6	-463.7	-13.6	-646	1.4	-0.5	1.7	-2.6	0.0	-0.8	-0.9	-4.7	-0.1	-6.5
Direct investment	-78.5	-60.8	7.7	-71.1	-203	-132.7	-52.2	-28.2	-141.0	-354	-0.9	-0.7	0.1	-0.8	-2.2	-1.3	-0.5	-0.3	-1.4	-3.6
Portfolio investment	-11.3	4.8	33.8	-93.0	-66	6.7	-6.0	-432.4	2.5	-429	-0.1	0.1	0.4	-1.0	-0.7	0.1	-0.1	-4.4	0.0	-4.4
Currency and deposits	64.7	71.1	87.4	64.0	287	59.7	46.4	46.9	126.6	280	0.7	0.8	1.0	0.7	3.2	0.6	0.5	0.5	1.3	2.8
Loans	135.0	-5.2	-43.1	-32.6	54	-55.8	-33.4	-36.9	20.1	-106	1.5	-0.1	-0.5	-0.4	0.6	-0.6	-0.3	-0.4	0.2	-1.1
Trade credit and advances	16.3	-54.3	66.2	-100.7	-73	41.5	-42.4	-12.3	-21.8	-35	0.2	-0.6	0.7	-1.1	-0.8	0.4	-0.4	-0.1	-0.2	-0.4
Other accounts receivable/payable	0.1	0.1	-0.1	0.0	0.1	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	0.0	0.0
Special drawing rights (Net incurrence of liabilities)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
IV. Net errors and omissions	19.6	-10.4	3.3	-16.1	-3.5	-10.7	-4.1	-10.2	10.8	-14.1	0.2	-0.1	0.0	-0.2	0.0	-0.1	0.0	-0.1	0.1	-0.1
V. Reserve assets	-166.6	-62.2	-32.0	77.4	-183.4	13.5	-132.9	558.9	-101.3	338.2	-1.8	-0.7	-0.4	0.9	-2.0	0.1	-1.3	5.7	-1.0	3.4

Source: NBRM.

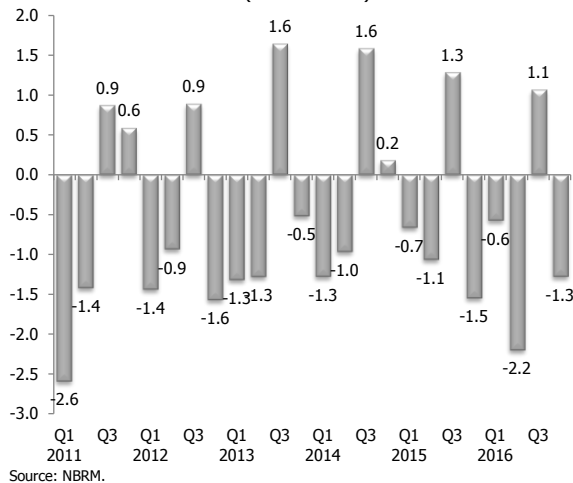
1.6.1. Current account

In the last quarter of 2016, the balance of payments current account registered a

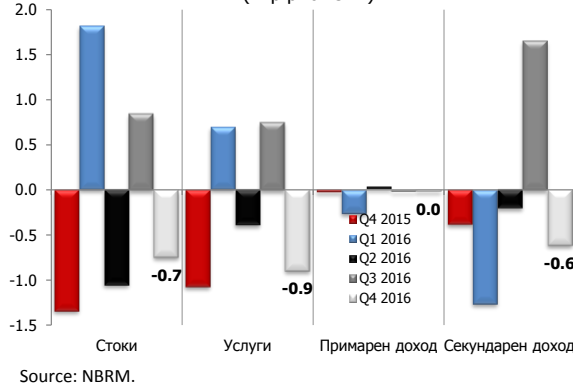
³⁹ Starting from the Quarterly Report October 2014, the analysis of the movements in the balance of payments is based on data compiled under the *Manual on the Balance of Payments and International Investment Position, sixth edition (IMF, 2009) (IMF, 1993)*. For more information on the methodological changes, visit the NBRM website (http://nbrm.mk/WBStorage/Files/Statistika_Informacija_za_promenite_vo_platniot_bilans_megunarodnata_investiciska_pozicija_i_nadvoresniot_dolg_koisto_proizleguvaat_od_primenata_na_novite_megunarodni_statisticki_standardi.pdf).



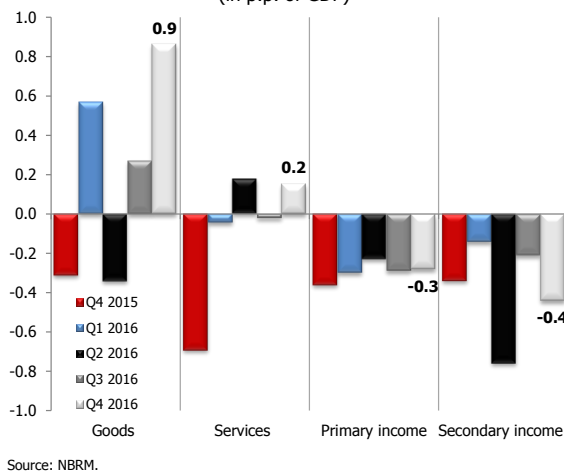
Current and Capital account
(as % of GDP)



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



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

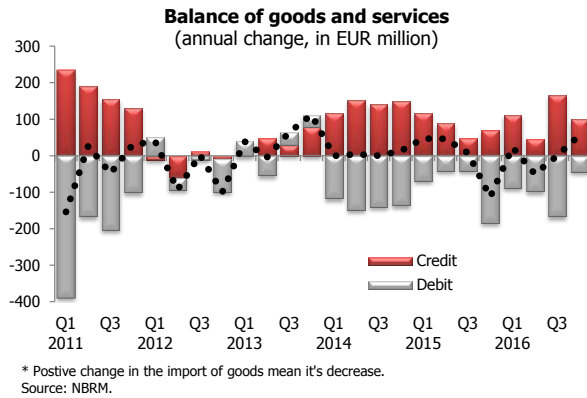


deficit of Euro 125.6 million, or 1.3% of GDP. Compared to the previous quarter, the current account deficit expanded by 2.3 percentage points of GDP which is an usual seasonal shift. Excluding primary income which registered no quarterly changes, other current account components had a deteriorating influence on a quarterly basis. Foreign trade deficit widened by 0.7 percentage points of GDP on a quarterly basis due to the more intensified growth of the importing activity in comparison to the exporting activity. The surplus in services registered a quarterly decline of 0.9 percentage points mostly due to the weaker performances in traveling, production services for customization and construction. Also, the surplus of secondary income decreased by 0.6 percentage points of GDP, amid lower net inflows of private transfers i.e. lower amount of purchased net cash in the currency exchange market⁴⁰.

Observing the annual changes, the current account balance indicates an improvement by 0.3 percentage points of GDP, reflecting favorable movements in the balance of trade in goods and services. In the last quarter of 2016, the trade deficit significantly decreased by 0.9 percentage points of GDP on an annual basis. Trade balance improvement is mainly due to the positive net effect from the activities of new facilities in the economy despite the deepening of the energy deficit in accordance with the gradual recovery of crude oil prices in global markets. The positive balance in services registered an annual growth of 0.2 percentage points of GDP, influenced by the lower net outflows in other professional services and higher net inflows in production services for customization. On the other hand, the balance of primary and secondary register less favorable annual changes. The decreased surplus in secondary income (by 0.4 percentage points of GDP) is due to the weaker net inflows of private transfers. The deepening of the primary income deficit (by 0.3 percentage points of GDP) is due to the deteriorated balance of income from investments as a reflection of higher estimated profit of foreign capital companies.

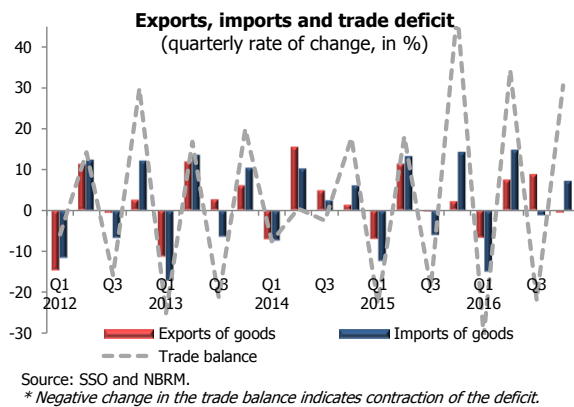
According to the latest data on the balance of payments, in January 2017 the current account balance was balanced (deficit of Euro 0.9 million), compared to the slight surplus of the same month last year. Thus, there was a widening of the negative trade balance on an annual basis amid

⁴⁰ Foreign cash purchased on the currency exchange market is used to estimate private transfers in cash.



more intensified growth of the import compared to export. The positive impact on the changes in the current account caused an increase of the surplus in services (better performances in construction) and secondary income to a lesser extent.

Box 2: Foreign trade of goods and movement of the Nominal and the Real Effective Exchange Rate (NEER and REER)⁴¹

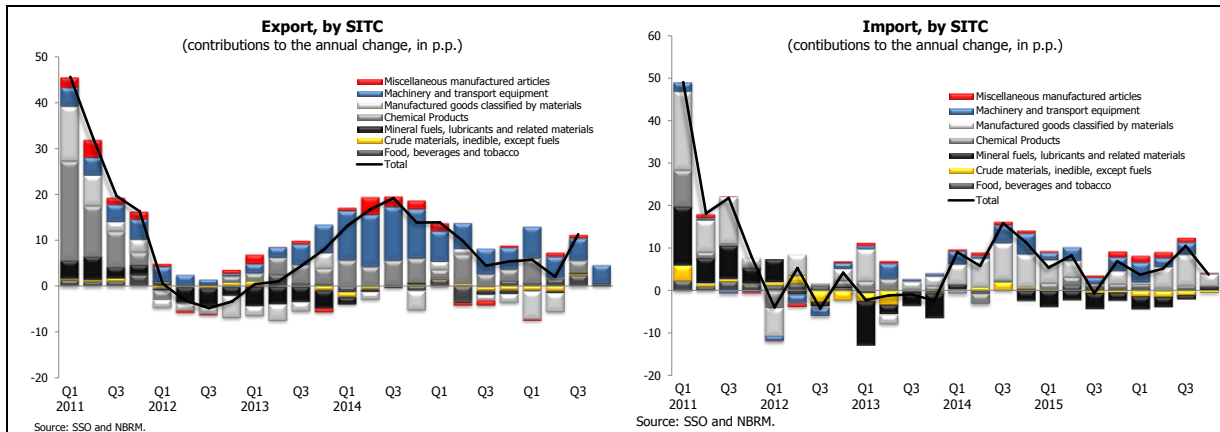


In the first quarter of 2016, the foreign trade amounted to Euro 2,793.5 million, or 28.3% of GDP, and compared to the same quarter of the previous year, it increased by 5.5%, amid higher growth in the export rather than the import component. Export of goods in the fourth quarter registered a solid annual growth of 6.4%, but still slightly lower compared to the previous quarter when the growth was 10.5%. The activity of the new foreign facilities continues to be the main driver of the positive export results amid almost neutral contribution of the traditional export sectors. The export of metal processing

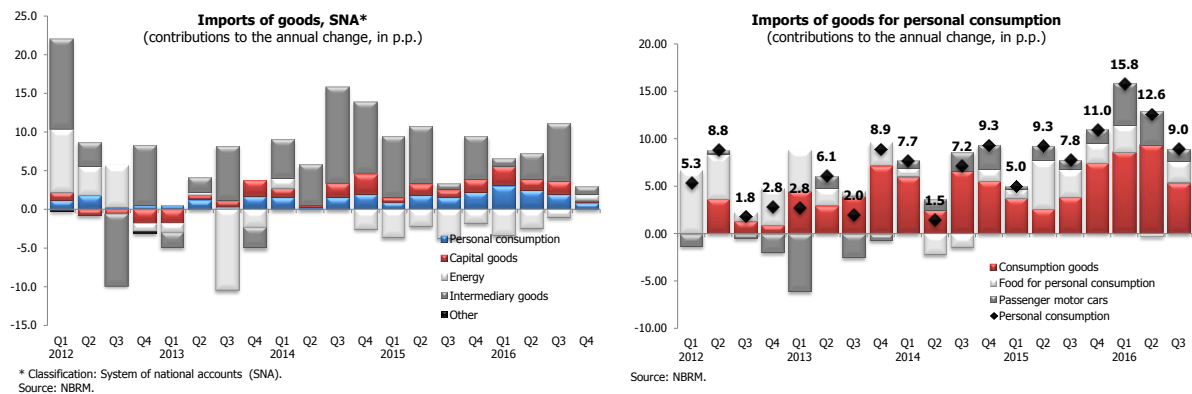
industry registered a slight annual growth, interrupting the trend of negative contribution and downward export pressures in the third quarter of 2015. On an annual basis, the exported quantity of metals registered a high increase which was mitigated by the negative price effect⁴². At the same time, food export had a negative contribution to the export growth. **Unlike the solid export growth, in the fourth quarter of 2016, the import growth was lower and amounted to 3.0% (compared to the growth of 10.2% in the third quarter of 2016).** The import increase is mostly due to the higher import of the raw materials component for the new industrial facilities and also due to the import of energy, more specifically oil and oil derivatives, as a result of both the oil price growth in the global markets in the last quarter of 2016 and the imported quantities also. Other import categories had a neutral effect on the import growth. **The changes in both components of the foreign trade regarding the fourth quarter of the previous year led to narrowing of the trade deficit by 3.8%.** This is as a result to the non-energy deficit whereas the negative energy balance in the fourth quarter of 2016 widened.

⁴¹ According to the Foreign Trade Methodology, data on the export of goods are published on an f.o.b. basis, and on the import of goods, on a c.i.f. basis.

⁴² The annual decline of iron and steel export prices in the last quarter of 2016 is 16%.



The analysis of the import of goods under the System of National Accounts (SNA) indicates that in the fourth quarter of the year, all the components acted towards growth, whereby the import of intermediate products made the dominant contribution to the annual growth of total imports. In terms of imports for private consumption, the annual growth of this component reflects the higher import of consumer goods and food, with relatively smaller positive contribution by the import of passenger vehicles. Overall, despite the acceleration of private consumption in 2016, the annual growth of import for private consumption continues to be moderate and decelerates, reaching the lowest growth rate since the second quarter of 2014 pointing to a presence of relatively low pressures on the import for private consumption.

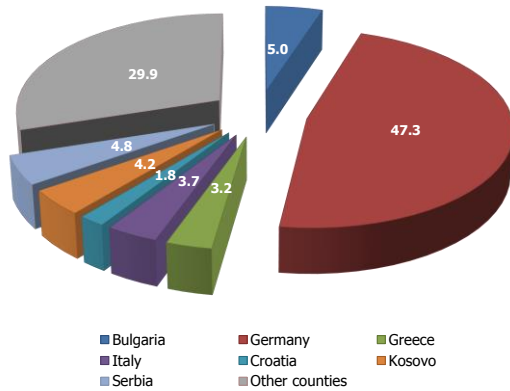


The latest available data on foreign trade for January and February 2017 point to a solid growth of export and import on an annual basis. Export of goods registered an annual growth of 10.8% driven by the export activity of part of the new industrial facilities and better export of metal processing industry. Import of goods in the period January-February 2017 registered an annual growth of 14.6% annually, whereby the increase of the import is mainly due to the increased import of raw materials for the needs of the new export facilities as well as import of energy.

The foreign trade analysis by country shows that in the fourth quarter of 2016, the European Union was our major trading partner (making up 66.6% of total trade). Observing the export side, by country, the exports to Germany, as a market to which the export activity of the new facilities in the domestic economy is largely targeted, remain the main driver of the annual growth. The increase of exports to Germany is mostly due to the increase of the export of machinery and equipment. In the fourth quarter of 2016, the increased export to Hungary and Slovenia (automobile industry parts) also had a positive contribution to the export growth, and out of countries which are not members of the European Union, growth was registered in the export to Russia (tobacco, equipment and machinery and pharmaceutical products), as well as to USA (tobacco). In terms of import, the higher import to Great Britain, Hungary and USA had the largest contribution to the growth, which reflects the import of raw materials for the needs of new industrial facilities. The growth of the import of raw materials (ceramic products) to USA and Hungary was partially offset with the decline of the export of raw materials to Germany. Import of Energy from Russia and Greece also registered a more significant annual growth as a result to the increase of the

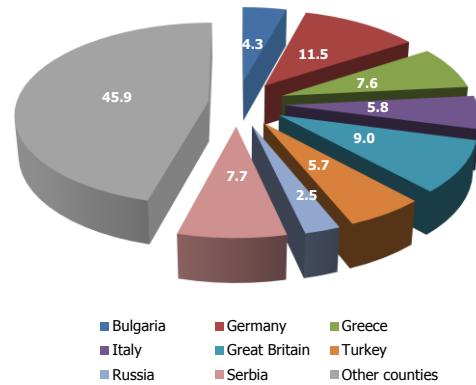
energy import. Analyzed by balances, the trade deficit narrowing mostly arises from the increase of the trade surplus with Germany, as well as decrease of the deficit with Bulgaria and Romania. At the same time, the deepening of the negative trade balance with the Great Britain and China, as well as Hungary, Greece, USA and Russia acted in the opposite direction.

Export of goods, by countries in the fourth quarter of 2016 (share, in %)



Source: SSO.

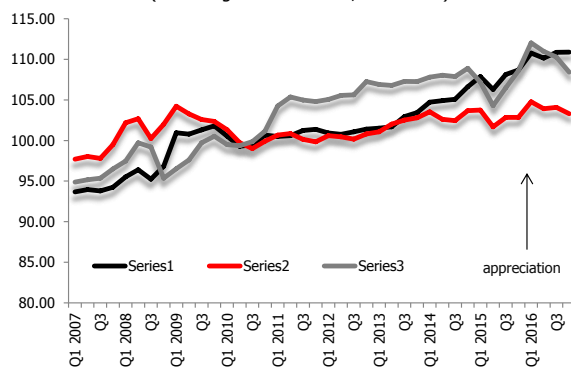
Import of goods, by countries in the fourth quarter of 2016 (share, in %)



Source: SSO.

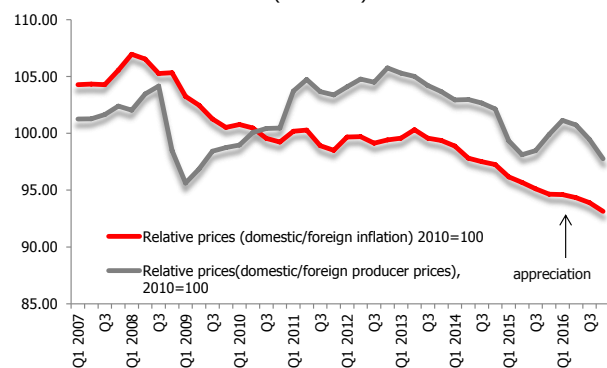
In the fourth quarter of 2016, price competitiveness indicators of the domestic economy registered divergent movements. REER deflated by consumer prices appreciated by 0.4%, while REER deflated by producer prices appreciated by 0.1%. Thus, the upward pressures arise from NEER which registered an annual growth of 2.0% due to the appreciation of the Denar against the British pound, as well as the Ukrainian grivna and Turkish lira. In terms of relative prices, relative consumer prices registered a decrease of 1.6% while the decline in relative producer prices was higher and amounted to 2.1% on an annual basis.

NEER and REER
(according to CPI and PPI, 2010=100)



Source: NBRM.

Relative prices
(2006=100)



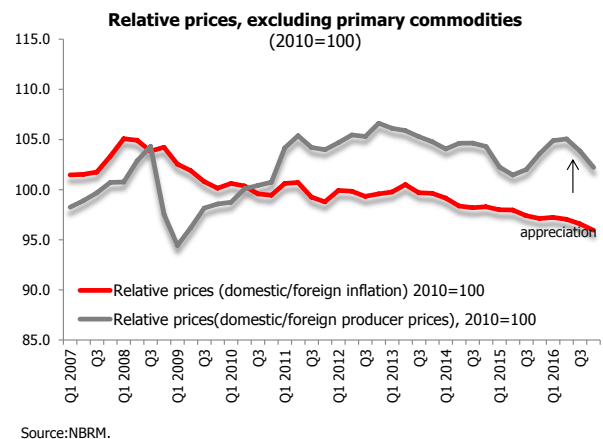
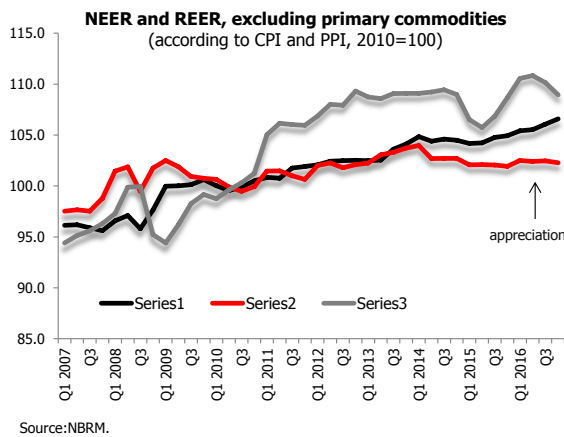
Source: NBRM.

The analysis of REER indices as measured using weights based on the foreign trade without primary commodity⁴³, indicate that the trend of moderate appreciation of the price competitiveness indicators which started in the first quarter of 2016, will also continue during the fourth quarter of 2016. Namely, REER deflated by consumer prices appreciated by 0.4%, while REER based on producer prices appreciated by 0.2% on an annual basis. The upward pressures arise from NEER, which increased by 1.6% amid annual decline in

⁴³ 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_realno_t_efektiven_devizen_kurs_na_denarot_mak.pdf

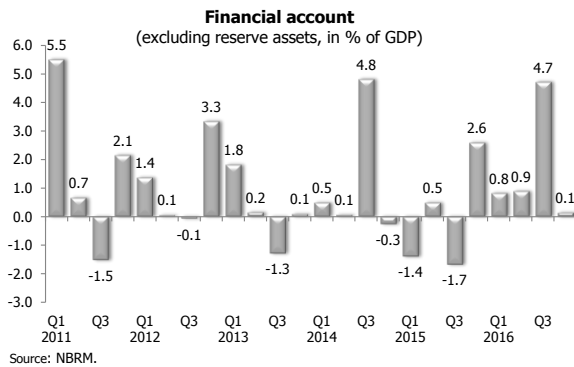


relative consumer prices and relative producer prices.



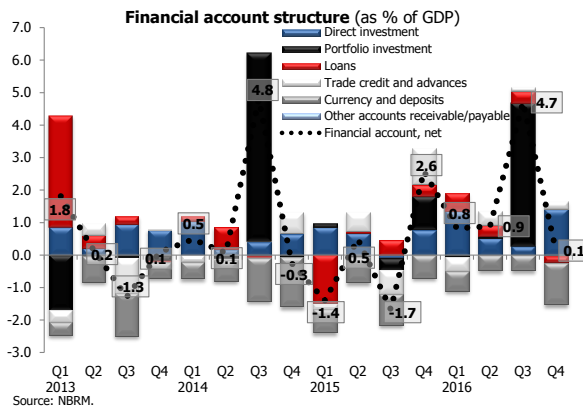
The latest data on price competitiveness for the period January-February 2017 indicate favorable movements i.e. moderate annual appreciation of the REER, as measured using weights of the total trade of goods, as well as weights based on foreign trade without primary commodities. Appreciation in both indices is mostly due to the decline of the relative prices, whereby divergent movements are registered in NEER. Namely, in REER, as measured using weights of the total trade of goods, the influence of the NEER change is almost neutral (0.3% in January and 0.8% in February), whereas in NEER, as measured using weights based on foreign trade without primary commodities, the influence of the in NEER change is negative (1.8% in January and 1.5% in February - contrary to the impact of relative prices).

1.6.2. Financial account



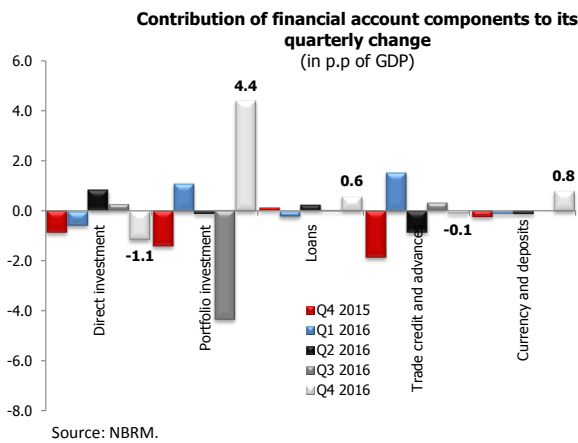
In the last quarter of 2016, the financial account of the balance of payments registered net inflows of Euro 13.6 million or 0.1% of GDP. Funding was mostly made through direct investments, and net inflows were registered based on trade credits. In the fourth quarter, currency and deposits remain the most important outflow category, coupled with small net outflows in financial loans. The positive developments in direct investments arise from both net inflows in equity capital and reinvested earnings and debt component. The accumulation of trade credits also has a small favorable effect on the position of the financial account. On the other hand, negative developments were registered in the category of currency and deposits, affected by the net outflows in depository institutions⁴⁴ and other sectors. Financial loans also caused small net outflows, mainly due to the reduction in short-term liabilities to abroad by the banking sector, on a net basis. On the other hand, the long-term net

⁴⁴ Such movements have been attributable to the Decision on foreign currency deposit with the National Bank of the Republic of Macedonia, valid in the period from 6 May – 25 October 2016. Namely, net outflows in depository institutions arise from the increased net-acquisition of assets in deposit accounts abroad, after the decision foreign currency deposits not to be offered as an alternative of placing foreign assets.

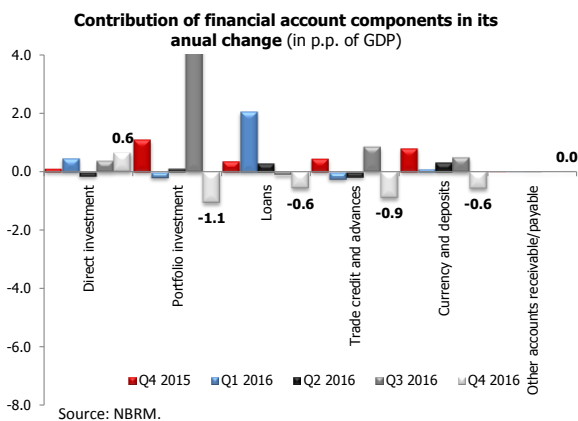


borrowing in other sectors was almost completely offset by the government deleveraging abroad⁴⁵. *The quarterly analysis points to significantly lower net inflows compared to the previous quarter.* These changes largely derive from the net outflows in portfolio investment (as opposed to the net inflows in the previous quarter⁴⁶), and to a lesser extent, the increased outflows in currency and deposits and the net outflows in financial loans, contrary to the net inflows in the previous quarter.

The annual analysis shows a less favorable position of the financial account compared to the fourth quarter of 2015. Deterioration was registered in all categories, except for direct investments, which registered increased net inflows on an annual basis.



In January 2017, *the latest data on the balance of payments* suggest net outflows in the financial account of Euro 51.5 million. Such performances were largely caused by the net outflows registered in the debt component of direct investments, contrary to the inflows registered in the same month of the previous year. Additional negative developments resulted from the category of currency and deposits and short-term financial loans. On the other hand, the inflows based on trade credits and portfolio investment had a favorable effect on the balance of the financial account.



The gross foreign reserves at the end of December 2016 amounted to Euro 2,613.4 million, registering a quarterly decrease of Euro 85.6 million. The foreign reserves reduced due to the transactions on behalf of the government for the regular repayment of liabilities to foreign creditors, and the reduction in foreign currency deposits of domestic banks in the NBRM⁴⁷. The net purchase of foreign currency on the foreign exchange market by the NBRM and the positive currency changes and the changes in the price of gold acted in the opposite direction. Compared to the end of 2015, the gross foreign reserves increased by Euro 351.7 million. The favorable developments are due to all individual factors, with largest contribution of net

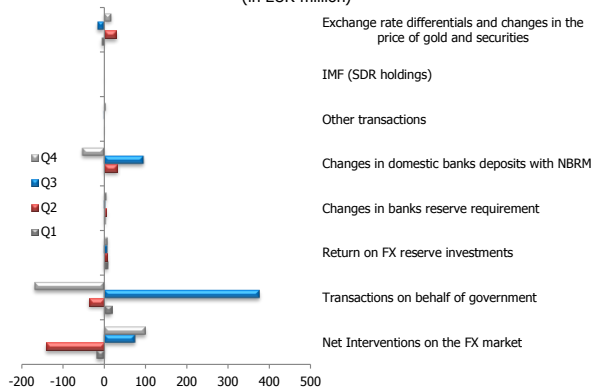
⁴⁵ During November 2016, the government made a regular repayment of liabilities in the amount of Euro 132.7 million on the basis of a financial loan from Citibank.

⁴⁶ In July 2016, the government borrowed on the international markets by issuing the fifth Eurobond in the amount of Euro 450 million, at a coupon rate of 5.625% and 7-year maturity.

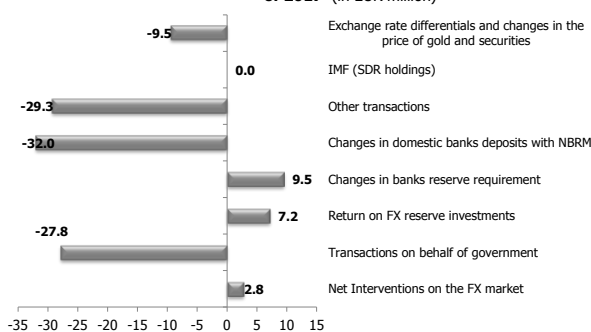
⁴⁷ On 25 October 2016, the NBRM's Operational Monetary Policy Committee decided not to offer additional foreign currency deposits, which banks would place in the NBRM, which affected the decrease in the amount of the banks' foreign currency deposits with the NBRM.



Factors of change of the foreign reserves in 2016, in quarters
(in EUR million)



Factors of change of the foreign reserves in the first quarter of 2017
(in EUR million)

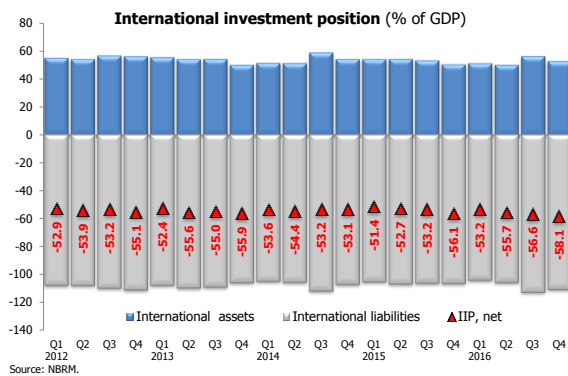


Source: NBRM.

transaction on behalf of the government, as well as the increase in foreign currency deposits of commercial banks with the NBRM. During 2016, the foreign reserves remained at an appropriate level.

According to the latest available data, at the end of the first quarter of 2017, the foreign reserves amounted to Euro 2,534.4 million, which is by Euro 79 million less compared to the end of 2016. Analyzing change factors, the reduction of foreign reserves is mostly due to the maturity of the foreign currency deposits of the domestic banks with the NBRM, as well as from transactions with a temporary effect, related to swap transaction in gold. At the same time, the transactions on behalf of the government also reduce the foreign reserves.

1.6.3. International investment position⁴⁸ and gross external debt

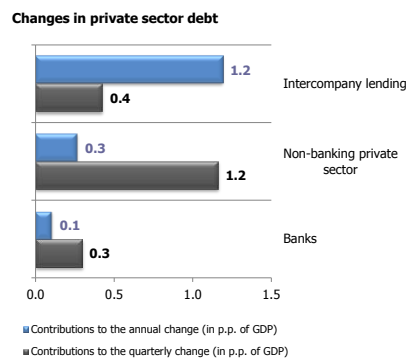
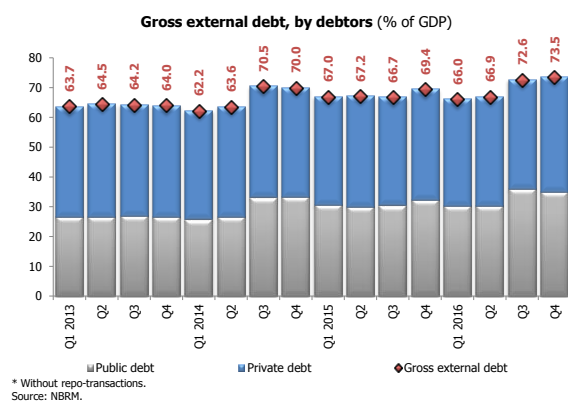
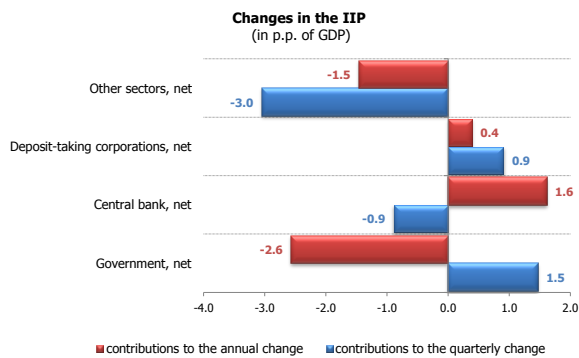


Source: NBRM.

At the end of 2016, the **negative IIP⁴⁹ of the Republic of Macedonia equaled Euro 5,731.6 million, or 58.1% of GDP.** The quarterly analysis points to deterioration of 1.6 percentage points of GDP, amid greater decline in international assets compared to the fall in international liabilities. Observing the division by sectors, the quarterly shift is mostly due to the increase in the negative position of other sectors (higher liabilities on long-term loans and direct investment), as well as the reduced net assets of the central bank. On the other hand, there was a quarterly decrease in the net liabilities of the

⁴⁸ 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_investiciska_pozicija_i_nadvoresniot_dolg_koisto_proizleguvaat_od_primenata_na_novite_megunarodni_statisticki_standardi.pdf).

⁴⁹ 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.



Government (as a result of the reduced liabilities based on long-term loans⁵⁰) and depository institutions (accumulation of funds on the foreign exchange accounts abroad).

On annual basis, the debt net position of the country increased by 2 percentage points of GDP, amid faster growth of international liabilities (of 4.3 percentage points of GDP) compared to international assets (of 2.3 percentage points). The annual sector-by-sector analysis indicates an increase in the net government liabilities (based on portfolio investments), and then an annual increase in net liabilities of other sectors (due to increased net liabilities based on financial loans as well as to direct investors). Changes in the position of the central bank are aimed towards increasing the net assets, as a result of the accumulation of foreign reserves. At the same time, net liabilities of depository institutions registered a decline on an annual basis.

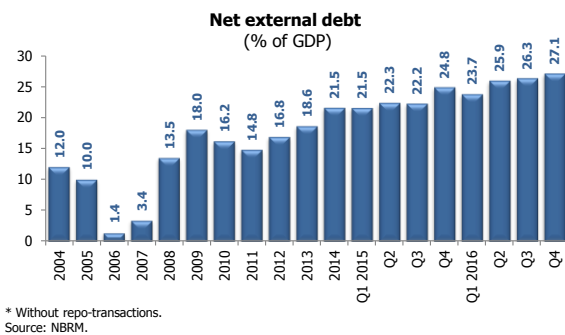
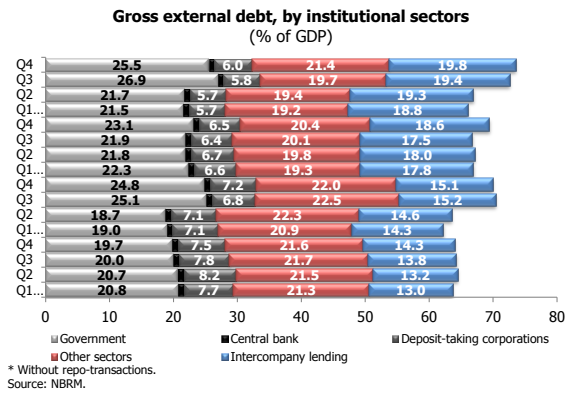
At the end of 2016, the gross external debt stood at Euro 7,253.2 million, or 73.5% of GDP, which is a quarterly decrease of 2.6 percentage points of GDP. If we exclude the effect of repo transactions, there is an increase of 0.9 percentage points of GDP⁵¹ on a quarterly basis. The higher gross external debt arises from the quarterly increase in private debt, given simultaneous downward correction of public debt. Higher private debt is mainly due to the borrowing of the non-banking private sector, and to a lesser extent, the increased liabilities to foreign direct investors and the debt of the banking sector. The decrease in the public debt is mostly due to the reduction of the central government debt based on long-term loans, while a moderate increase was registered in the debt of public enterprises.

Compared to the end of 2015, gross external debt increased by 4.1 percentage point of GDP. The annual increase in gross debt is due to both the increase in public debt and private debt. Higher public debt was mostly due to the borrowing of the central government in the form of debt securities, as a result of the issued Eurobond⁵². An additional contribution to the annual growth of the public debt was made by the long-term borrowing of public companies to support road

⁵⁰ Regular repayment of liabilities based on a financial loan.

⁵¹ The overall analysis below relates to gross external debt without the central bank liabilities based on repo transactions.

⁵² During the third quarter of 2016, the government borrowed on the international markets by issuing the fifth Eurobond, in the amount of Euro 450 million, resulting in an increase in government liabilities on the basis of portfolio investments.



infrastructure. At the same time, the debt of public banks registered a decrease on an annual basis. Regarding the debt position of the private sector, an increase was registered in all three subsectors, and especially in intercompany debt.

External indebtedness indicators of the national economy still show that the gross external debt is in the safe zone. The only indicator that classifies the economy in the group of highly indebted countries is the gross external debt to GDP ratio. The dynamic analysis of the external debt⁵³ indicates favorable annual developments in two solvency indicators (shares of interest repayment and repayment of gross debt in the export of goods and services and other inflows). On the other hand, the share of gross debt in the export and the ratio between the gross debt and GDP deteriorated. Liquidity ratios are in the safe zone, but indicate slight deterioration of the external position on an annual basis. An exception is the coverage of liabilities based on short-term debt with the residual maturity of foreign reserves, which remains above one and registers annual growth.

At the end of 2016, net external debt, as an additional indicator of the external position of the economy, amounted to Euro 2,669.8 million, or 27.1% of GDP, which is a quarterly decrease of 0.8 percentage points of GDP. Lower net external debt is the result of the reduction of the debt of the Government and depository institutions.

⁵³ The analysis of external indebtedness indicators uses 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 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	2.36	135.9	71.1	14.9	1.52	1.05	23.0
30.06.2016	2.36	137.7	72.0	14.9	1.41	0.98	23.1
30.09.2016	2.36	149.4	78.2	14.9	1.74	1.16	21.6
31.12.2016	2.36	151.3	79.2	14.9	1.64	1.15	22.0
<i>Moderate indebtedness criterion</i>	<i>12 - 20%</i>	<i>165 - 275%</i>	<i>30 - 50%</i>	<i>18 - 30%</i>		<i>1.00</i>	

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

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

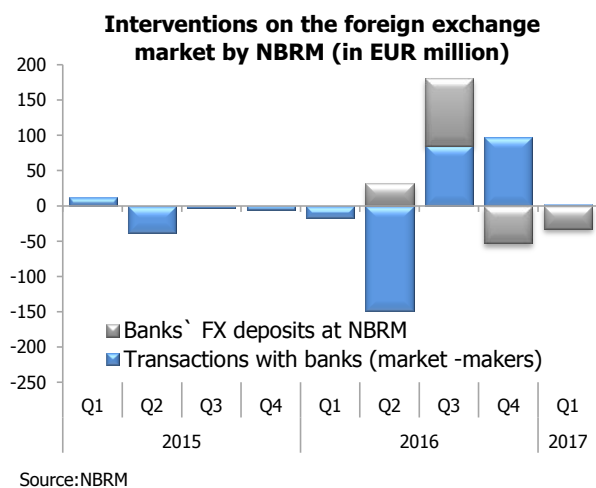
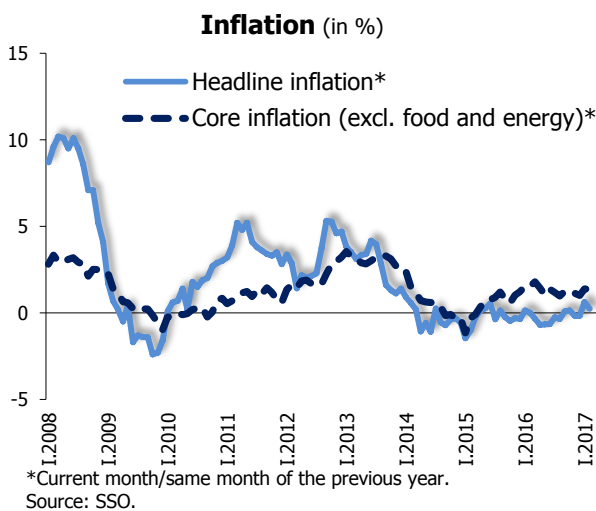
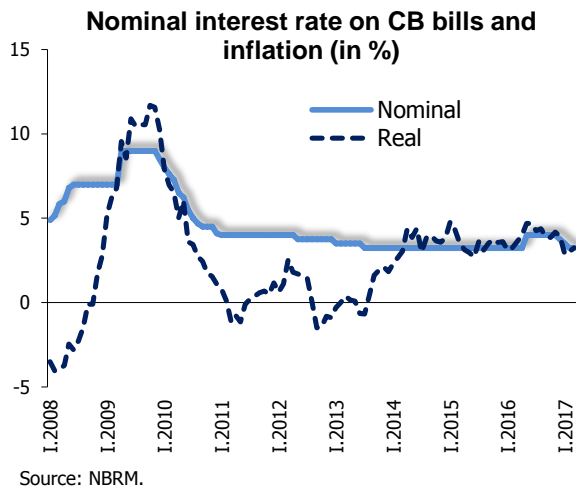
*According to the "Greenspan-Guidotti rule", a country should maintain full coverage of short-term debt at remaining maturity with gross foreign reserves.

Source: NBRM.

II. Monetary policy

As a continuation of the normalization of the monetary policy started in December 2016, during the first quarter of 2017, the NBRM cut its policy rate by 0.50 percentage points on two occasions, i.e. from 3.75% to 3.25%. The reaction to the monetary policy was the result of the further evident and continually present stabilization of the expectations of economic agents, after the measures taken by the NBRM, and in conditions of retention of the assessments of the soundness of the economic fundamentals. Signs of stabilization remain evident to two points where the political crisis hit the most in the previous year – propensity for managing foreign currency and household savings. In the first quarter of the year, the foreign exchange market registered net purchase of foreign currency from market makers, and household savings continued to increase. However, despite the complete depletion of the direct effects of political instability on the economy, uncertainty arising from the domestic political situation and risks arising from the external environment are still present and pronounced. In such a setting, the NBRM will continue to monitor closely the situation in the period ahead for timely and appropriate adjustment of the monetary policy.

During the first quarter of the year, the NBRM cut its policy rate by 0.50 percentage points on two occasions i.e. from 3.75% to 3.25%. Decisions to cut the policy rate were made at the monthly meetings of the Operational Monetary Policy Committee, in January and February, amid perceptions of further stabilization of the expectations of economic agents and depletion of the direct effects of political instability on the economy. Signs of stabilization were evident to two points where the political crisis hit



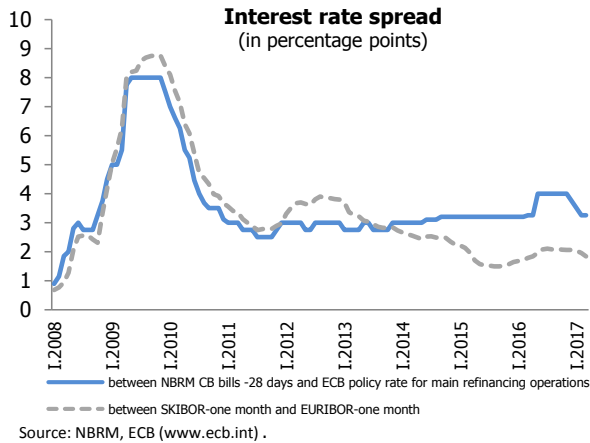
the most - propensity for managing foreign currency and household savings.

The comparison of the performances in the main macroeconomic indicators with their forecast dynamics with the October forecasts indicates smaller deviations in the individual segments of the economy.

In the period January-February, the inflation rate passed in the positive zone and averaged 0.4%, on an annual basis, amid an increase in energy prices and a decrease in food prices, while core inflation remained stable and averaged 1.4%. Compared with the October forecasts, the realization with the inflation is somewhat lower than estimated, reflecting the factors on the supply side. In terms of economic activity, in accordance with the expectations, in the fourth quarter of the year, the economy continued to grow with slightly stronger intensity compared to the previous quarter (annual GDP growth of 2.4% versus 2%, respectively). During January-February, available data on economic activity point to divergent movements, which hampers the assessment of the situation in the economy for the first quarter. Foreign reserves registered a decline in the first quarter of the year, which was dominantly influenced by certain temporary factors⁵⁴, while the banks' foreign currency deposits with the National Bank⁵⁵ and the foreign exchange transactions on behalf of the government also reduced the reserves. On the other hand, the NBRM foreign exchange interventions with market makers (net purchase of foreign currency) acted towards moderate growth of foreign reserves. Foreign reserves adequacy analyses suggest that the level of foreign reserves is appropriate and sufficient to deal with any future shocks. In the period January-February, the banks' deposit base continued to grow, but with a moderate slowdown in the dynamics (from 6.0% in December to 5.1% in February). However, the performance is higher than estimated with the October forecasts for the first quarter (annual growth of 3.8%). Household savings grows continuously for nine consecutive months. In terms of developments on the credit market, lending registered a moderate slowdown in the pace of growth (from 0.9% in December to -0.3% in February), which is weaker performance than estimated with the October forecasts for the first quarter (annual growth of 1.9%). Risks

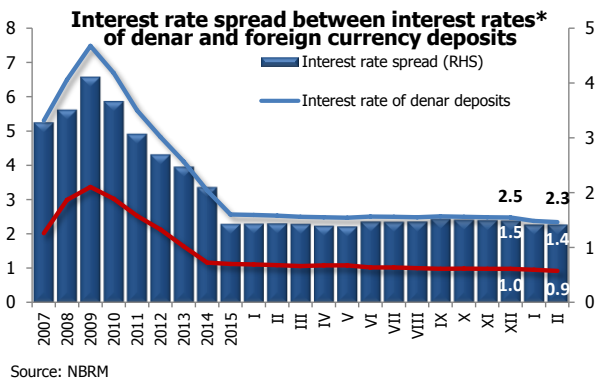
⁵⁴ The swap transaction in gold in the amount of Euro 29.4 million, executed during January 2017, had an effect on the change in foreign reserves.

⁵⁵ Pursuant to the decision made at the regular meeting of the Operational Monetary Policy Committee, held on 25 October 2016, to leave the possibility the banks to place foreign currency deposits with the NBRM.

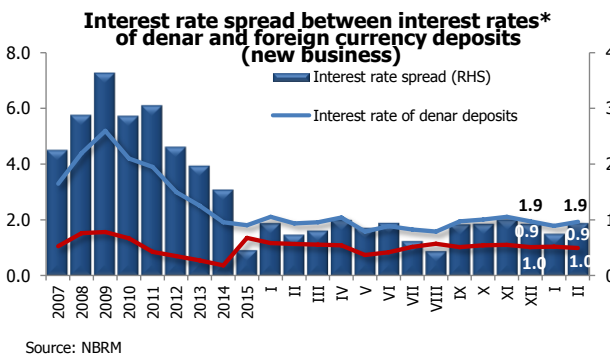


arising from domestic political developments are still present and pronounced, and the risks arising from the global surrounding also remain present. In such a setting, the NBRM will continue to monitor closely the situation in the period ahead for timely and appropriate adjustment of the monetary policy.

Interest rate spread between the policy rates (of the ECB and the NBRM) and the indicative market interest rates (in RM and in the euro area) narrowed. Thus, in the first quarter of the year, amid a decrease in the NBRM policy rate (of 0.5 percentage points), 1M SKIBOR also decreased, but at a more moderate pace (by 0.2 percentage points). On the other hand, the ECB maintained its policy rate at an unchanged level (of 0.00%), and 1M EURIBOR registered no changes and averaged -0.4% for the first quarter. As a result of these developments, the interest rate spread between the policy rates (of the ECB and the NBRM) and the indicative market interest rates (in RM and in the euro area) narrowed.



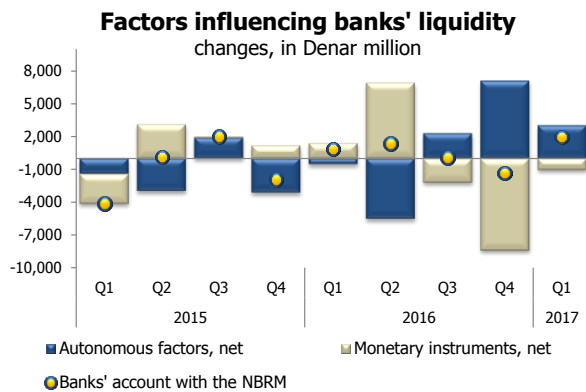
Interest rates in the banking sector in the domestic economy remained relatively stable. Interest rates on total denar and total foreign currency deposits in the banking sector moderately declined. In February, interest rate on denar deposits decreased compared to December (from 2.5% to 2.3%), which led to a narrowing of the interest rate spread from 1.5 percentage points to 1.4 percentage points, amid simultaneous moderate decline in interest rate on foreign currency deposits (from 1.0% to 0.9%). Interest rates on newly accepted denar and newly accepted foreign currency deposits registered no changes compared to December⁵⁶.



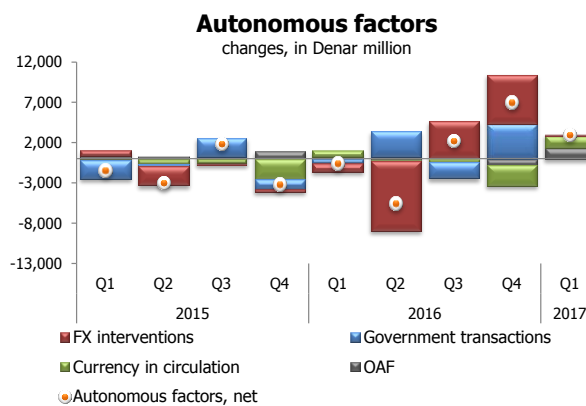
⁵⁶ The interest rates on newly received deposits are volatile, which can result in frequent and temporary adjustments of the interest spread.



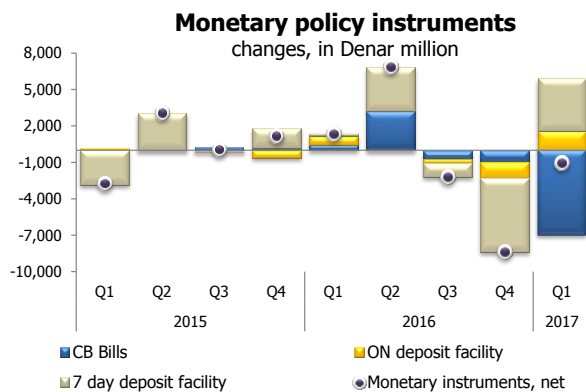
2.1. Banks' liquidity



Source: NBRM



Source: NBRM



Source: NBRM

In the first quarter of 2017, bank liquidity⁵⁷ on the accounts with the NBRM increased by Denar 1,955 million.

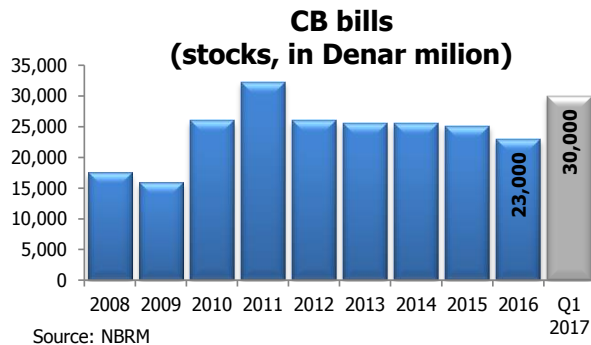
Autonomous factors acted towards creating net liquidity in the banking system. In the first quarter of the year, the total effect of autonomous factors amounted to Denar 2,999 million and was mostly due to the decrease in currency in circulation (of Denar 1,526 million) affected by seasonal factors. Additionally, the NBRM foreign exchange interventions also increased the bank liquidity, but to a lesser extent.

Amid growth of bank liquidity affected by autonomous factors, liquid assets were withdrawn from the banking system through the NBRM monetary instruments. In the first quarter of the year, Denar 1,044 million were withdrawn through monetary instruments. Namely, amid growth of the structural liquidity in the system and accumulation of the excess liquidity in deposits with the NBRM, in the first quarter of the year, Denar 7,000 million (Denar 2,000 million in January and Denar 5,000 million in March)⁵⁸ were withdrawn through CB bills⁵⁹. Given the banks' interest to place the excess liquidity in CB bills, the stock of short-term deposits with the National Bank (overnight and 7-day deposits) decreased by Denar 5,956 million. At the end of March, the stock of CB bills amounted to Denar 30,000 million, and was by Denar 7,000 million higher compared to the end of 2016. In the first quarter, the banks' excess funds on the accounts with the NBRM, above the reserve requirement averaged 6.6%, and was lower compared to the fourth quarter of the year (8.4%).

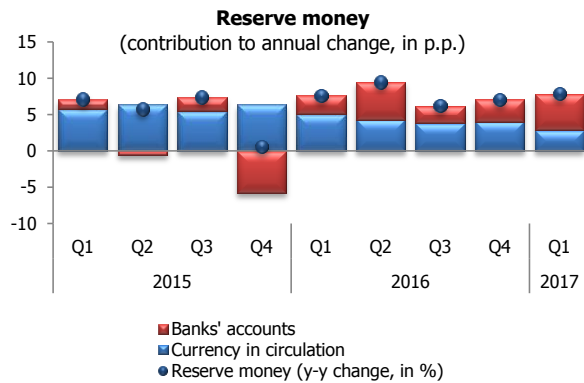
⁵⁷ Refers to the change in banks' account balances with the NBRM.

⁵⁸ Decisions on the amount of CB bills to be offered at auctions are adopted in the monthly meetings of the Operational Monetary Policy Committee.

⁵⁹ The auctions of CB bills were conducted by applying volume tender (with limited amount) and fixed interest rate. The CB bill interest rate at the auction in January and February was reduced by 0.25 percentage points respectively i.e. from 3.75% to 3.25%.



In the first quarter of the year, the reserve money registered an increase. The growth of the reserve money⁶⁰ was 7.9%⁶¹ on an annual basis, which is higher compared to the end of the fourth quarter of 2016 (7.1%).



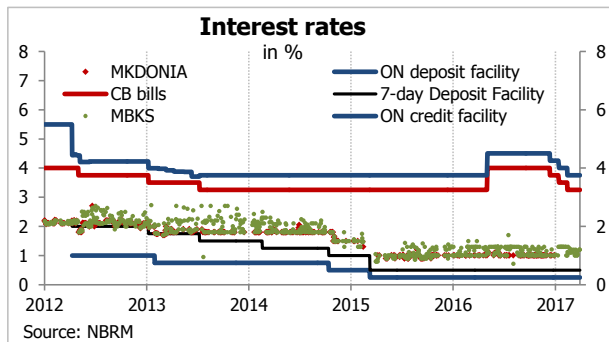
III. Financial market developments

In the first quarter of 2017, the indicative interest rates for interbank trading in deposits (SKIBOR) continued to decline, which is in line with the reduction of the NBRM policy rate. On the other hand, short-term deposit market interest rates (MKDONIA and MBKS) registered no major changes. On the primary government securities market, the Ministry of Finance reduced the interest rates and continued to redirect the due amounts of short-term securities in securities in longer maturities. The new issues of government securities were mostly with FX clause and were purchased from pension funds, while the government securities portfolio of banks reduced. The secondary securities market registered growth in turnover, partly due to the executed repo transactions, while yields on the executed transactions registered no significant changes. Macedonian Eurobond yields on international markets continued to decline, causing a further narrowing of spreads relative to yields on German government bonds, which remained relatively stable.

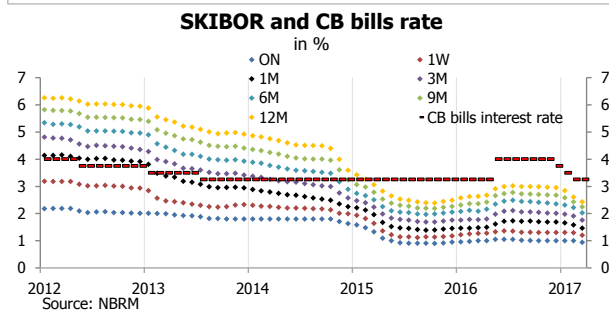
⁶⁰ Includes reserve requirement in foreign currency.

⁶¹ Preliminary data for March.

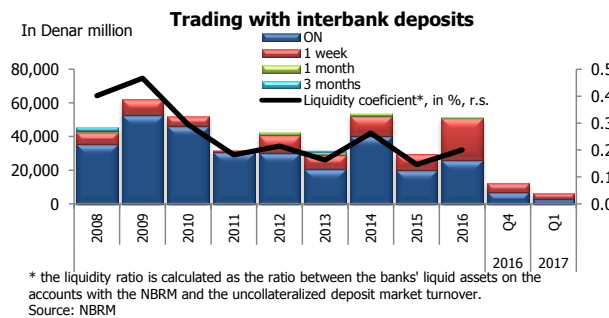
3.1. Interbank market for uncollateralized deposits



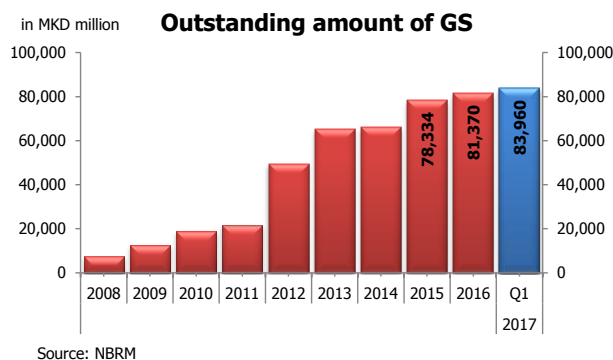
Amid further reduction of the NBRM policy rate, SKIBOR quotations⁶² continued to move downwards, while short-term interest rates (MKDONIA and MBKS⁶³) registered no significant changes. The reduction of the policy rate of 0.50 percentage points in the first quarter of the year was followed by a further downward movement in all SKIBOR quotations, whereby the most pronounced reduction (of 0.53 percentage points) was registered in 12 months SKIBOR. However, the interbank interest rate on the executed overnight transactions (MKDONIA) remained stable at 1.0%, and MBKS registered no changes, which, as in the previous quarter, ranged from 1.00% - 1.30%, depending on the terms of the concluded transactions.



In the first quarter of the year, the interbank market for uncollateralized deposits registered decreased trade activity. Total realized turnover of this market segment in the first quarter of the year amounted to Denar 6,551 million, which was by 50.5% lower on a quarterly basis. Turnover was dominated by transactions with overnight maturity and up to 7 days.



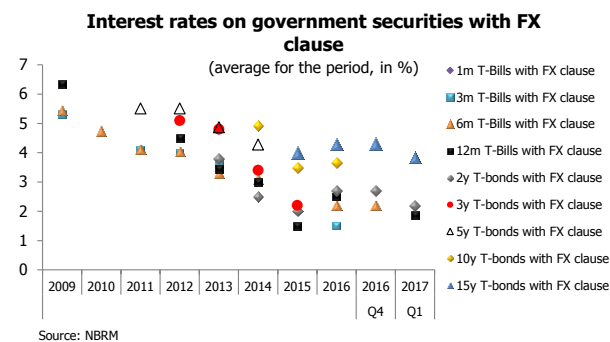
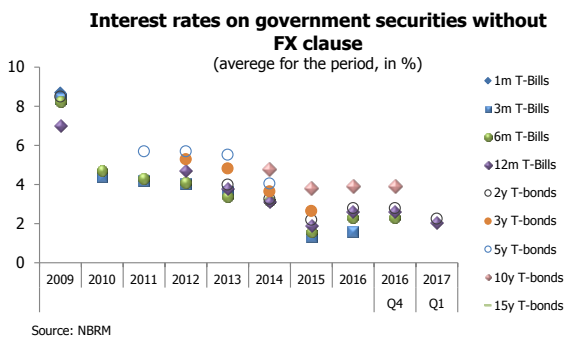
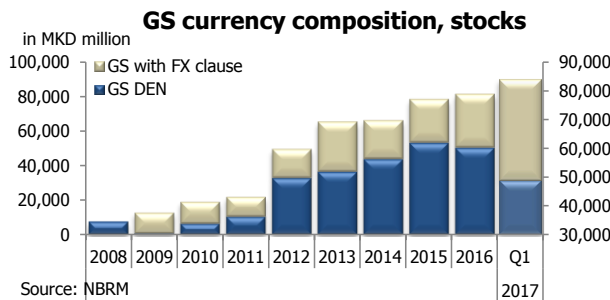
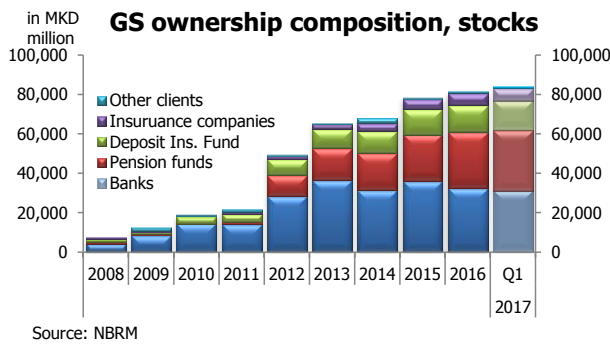
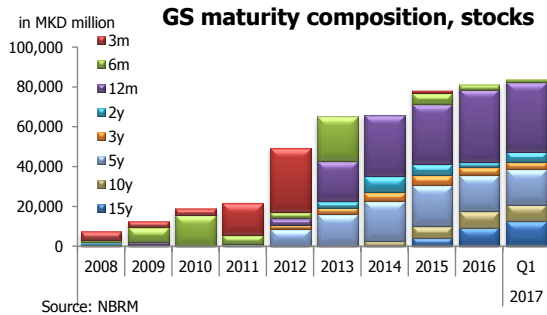
3.2. Government securities market



In the first quarter of the year, the stock of government securities was higher by Denar 2,590 million, compared to the end of the previous year. The stock of government bonds increased by Denar 5,379 million (mostly in government bonds with maturity of 2 and 15 years), while the stock of treasury bills decreased by Denar 2,789 million (in treasury bills with maturity of 6 and 12 months). At the end of the first quarter of the year, the structure of issued government securities was still dominated by the 12-month treasury bills, with a share of 42% in the total amount of government securities, followed by government bonds with maturity of 5,

⁶² Indicative interest rates for selling Denar deposits on the interbank market, with overnight maturities, 1 week, 1, 3, 6, 9 and 12 months, calculated from the quotations of reference banks.

⁶³ Interbank interest rate realized from transactions on the interbank deposit market with maturity up to 3 months.



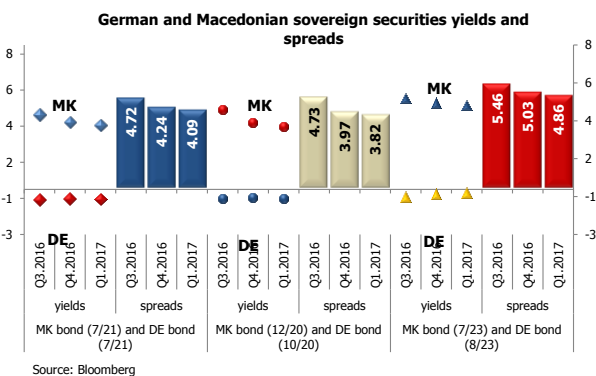
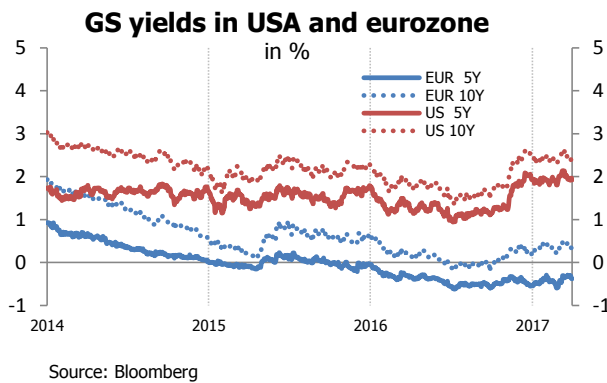
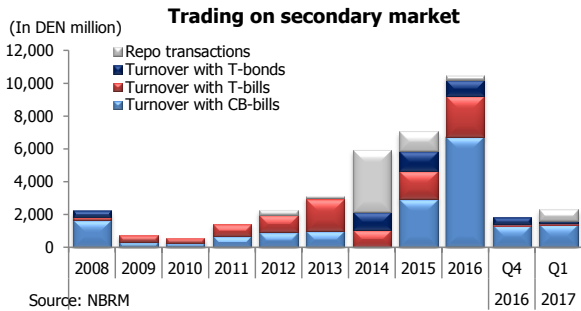
15 and 10 years, with a share of 21%, 15%, and 10%, respectively.

The increase in government securities in the first quarter of the year was almost entirely driven by the interest of pension funds. In the first quarter of the year, pension funds increased the government securities portfolio by Denar 2,079 million, and an increased interest was also shown by insurance companies, but to a small extent. On the other hand, the government securities portfolio with banks decreased. These changes contributed to shifts in the ownership structure of government securities. At the end of the first quarter of the year, the share of banks and pension funds in the overall issued government securities was even and amounted to 37%, respectively, as opposed to the end of the previous quarter, when banks dominated in the overall issued government securities, with a share of 40% (the share of pension funds was 35%).

The new issues of long-term government securities in the first quarter of the year were mostly with FX clause. In the first quarter of the year, mostly denar issues of government securities fell due, while the newly issued long-term government securities were mostly with FX clause. Therefore, in the first quarter of the year, the share of denar in the overall issued government securities decreased from 62% to 58% for account of the share of government securities with FX clause, which increased from 38% to 42%.

In the first quarter, the Ministry of Finance reduced the interest rates on government securities. During the first quarter of the year, the Ministry of Finance issued new government securities with maturity of 12 months, 2 and 15 years. The interest rates on the new issues of government securities were lower, so the interest rates on government securities in the first quarter of the year on average were lower compared to the previous quarter.

Trading on the secondary securities market increased. In the first quarter of the year, the secondary securities market registered turnover, in the amount of Denar 2,302 million, which was by 25% higher compared to the previous quarter. The structure of turnover, similar to the previous quarter, was dominated by outright CB bill transactions (with a share of 60%), and repo transactions were executed. The interest rates on the executed transactions in securities registered no major changes.



The conditions on the international financial markets were relatively stable. After the second increase in the interest rate by the Fed (in December 2016), followed by growth in yields on government bonds in the United States⁶⁴, during the first quarter of the year, the yields of US government bonds remained relatively stable. Similar changes were registered in the yields on government securities in the euro area⁶⁵.

The spreads between Macedonian Eurobonds and German government bonds continued to narrow. In the first quarter of the year, the yields of the issued Macedonian Eurobonds⁶⁶ continued to decline. On the other hand, the yields of German government bonds remained relatively stable. These shifts in yields acted towards further narrowing of the spreads between Macedonian Eurobonds and German government bonds.

IV. Monetary and credit aggregates

After the strong growth in the previous quarter, in the first quarter of 2017, the broad money declined on a quarterly basis. The adjustment is particularly pronounced in the most liquid component, which after the strong growth in the previous quarter, decreased in the first quarter of the year. In this period, there was also a decrease in short-term deposits, while savings in the long run continued to grow, but at a slower pace. The reduction in broad money in the first quarter, is partly seasonal, considering the usual slowdown in economic activity, and can be partly related to the fall in lending to the private sector in this period. Analyzed by sector, the decrease in total deposits entirely derives from the decline in corporate sector savings, while household deposits remained relatively stable. In the first quarter, the lending activity of the banking sector registered a decline. Such shift in the credit market is characteristic of the beginning of

⁶⁴Those are generic yields derived from the yield curve of government bonds of the United States.

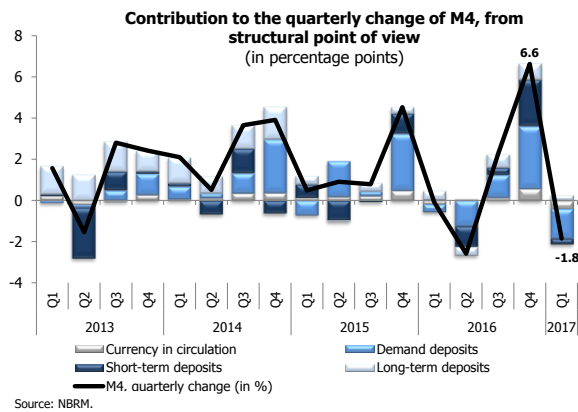
⁶⁵Those are generic government bonds derived from the yield curves of government bonds of Germany and France.

⁶⁶It 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.



the year, but it is more pronounced in comparison with previous years. Sector-by-sector analysis shows that the decrease in the lending activity stems from the decreased credit support to the corporate sector, while loans to households registered solid growth, whereby besides consumer loans, positive contribution to the growth was also made by housing loans.

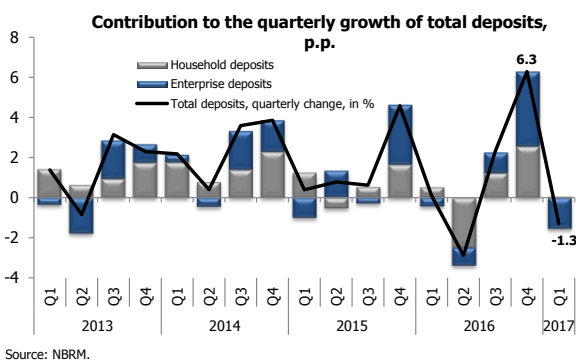
4.1. Monetary aggregates



Total deposits	2015				2016				2017
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
	q-o-q growth, %								
Total deposits	0.4	0.8	0.6	4.6	0.1	-2.9	2.3	6.3	-1.3
	contributions to quarterly growth, p.p.								
Deposit money	-0.8	1.9	0.3	3.2	-0.4	-1.3	1.2	3.0	-1.3
Denar deposits	0.0	-1.1	0.3	0.3	0.01	-1.6	0.0	1.7	0.1
Foreign currency deposits	1.2	0.0	0.1	1.1	0.5	0.1	1.1	1.6	-0.1
Short-term deposits	0.7	-1.0	-0.1	1.1	0.03	-1.0	0.4	2.5	-0.3
Long-term deposits	0.5	-0.1	0.4	0.3	0.5	-0.5	0.7	0.8	0.3
Households	1.3	-0.5	0.5	1.6	0.5	-2.5	1.2	2.5	0.0
Enterprises	-1.0	1.3	-0.3	3.0	-0.4	-0.9	1.0	3.7	-1.5

Source: NBRM.

In the first quarter of 2017, the total money supply in the economy declined by 1.8%, compared to the growth of 6.6% in the last quarter of 2016. Such dynamics can be partly explained by seasonal factors, given the slowdown in economic activity in this period of the year, as well as the fall in lending to the private sector. Analyzed structurally, changes in the dynamics of money supply were caused by its most liquid component. Thus, the most liquid monetary aggregate M1 decreased quarterly, and fall was also registered in savings in the short run, despite the high positive contribution of these categories to the monetary growth in the previous quarter. On the other hand, savings in the longer run made a positive contribution to the quarterly change, indicating continuation of the preference for savings in the long run. Analyzing the currency structure, in the first quarter of 2017, the decline in denar deposits was relatively faster than the decline in foreign currency deposits, entirely driven by the declining demand deposits. On the other hand, deposits in foreign currency continue to grow on a quarterly basis, with changes in the degree of euroisation (at the end of March, the share of foreign currency deposits in the total money supply increased to 38.3% compared to 37.7% in December). On an annual basis, the growth of broad money slowed down to 4.2% in March, from 6.1% at the end of 2016.



Total deposit potential of the banks in the first quarter of 2017 decreased on a quarterly basis (by 1.3%), compared to the growth of 6.3% in the previous quarter. The fall in total deposits in this period entirely derives from the lower corporate deposits, while household deposits stagnate. **Thus, total household deposits registered quarterly growth of 0.1%, as opposed to the increase of 3.7% in the previous quarter.** The quarterly slowdown in household deposits can be partly explained by the restrained government spending (the absence of subsidies for farmers, which are usually paid in the first quarter of the year), and partly by the high performances during the fourth quarter, amid payment of bonuses typical for the year-end. Additionally, the uncertainty arising from political

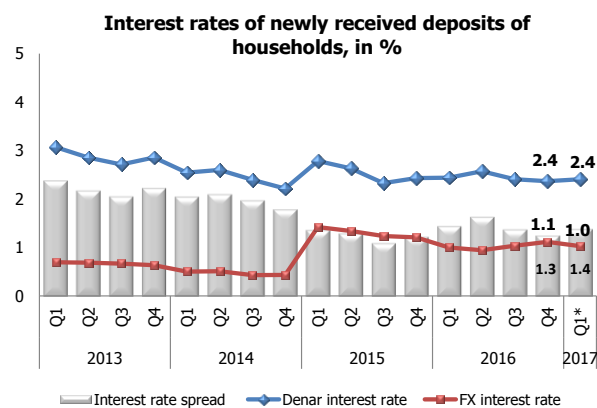


Household deposits	2015				2016				2017
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
quarterly change, in %									
Total household deposits	1.8	-0.7	0.7	2.3	0.8	-3.5	1.8	3.7	0.1
contribution to quarterly change of total deposits, in p.p.									
Deposit money	0.1	-0.2	0.3	1.8	0.1	-0.9	0.6	2.1	-0.5
Denar deposits	0.7	-0.4	-0.1	0.1	0.3	-2.6	0.0	0.6	0.1
FX deposits	1.0	-0.1	0.6	0.4	0.4	0.0	1.1	0.9	0.5
Short-term deposits	1.1	-0.7	0.1	0.2	0.1	-1.8	0.6	0.6	0.2
Long-term deposits	0.6	0.1	0.4	0.3	0.6	-0.8	0.5	0.9	0.4

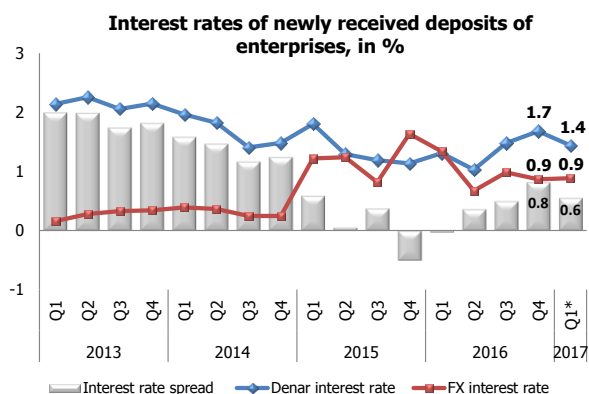
Source: NBRM.

Enterprise deposits	2015				2016				2017
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
квартални промени, во %									
Total household deposits	-4.2	5.9	-1.2	12.7	-1.7	-3.6	4.2	14.9	-5.7
contribution to quarterly change of total deposits, in p.p.									
Deposit money	-4.3	8.1	0.6	8.3	-2.3	-3.4	2.9	6.5	-3.6
Denar deposits	-1.7	-2.6	-0.4	0.7	-0.1	0.0	-0.7	4.5	-0.5
FX deposits	1.8	0.5	-1.4	3.7	0.6	-0.3	1.9	3.8	-1.6
Short-term deposits	-1.1	-1.6	-1.2	4.3	-0.2	0.7	0.5	7.9	-2.2
Long-term deposits	1.2	-0.6	-0.6	0.1	0.8	-0.9	0.8	0.4	0.1

Source: NBRM.



*refers to February 2017.
Source: NBRM.



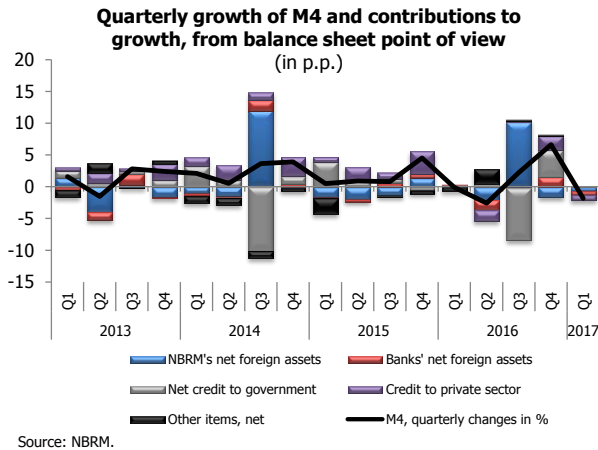
*refers to February 2017.
Source: NBRM.

developments in the country and the fall in lending to the private sector in this period are also factors that may have an effect on the change in household deposits. Analyzing the maturity structure, there was a positive contribution of long-term and short-term deposits to the growth of household deposits, but at a slower pace compared to the previous quarter. Analyzing currency, in the first quarter, foreign currency household deposits registered further, but relatively modest growth. **On an annual basis**, the growth of household deposits slowed down to 1.8% in March, from 2.5% at the end of December.

In the first quarter of the year, total corporate deposits registered a quarterly decrease of 5.7%, against the 14.9% increase in the previous quarter. This pace in corporate deposits is common for this period and is attributable to the business cycle and the method of financing their operations. Analyzing the maturity structure, the quarterly decline in corporate deposits is due to short-term deposits, amid moderate growth of long-term deposits. Observing by currency, foreign currency deposits made a negative contribution to the quarterly movement of deposits for this period, despite the high positive contribution in the previous quarter. **On an annual basis**, the growth of corporate deposits slowed down to 8.8% in March, from 13.4% at the end of December.

According to the analysis of return on new savings, interest rates⁶⁷ on newly accepted Denar and foreign currency household deposits at the end of February of 2017 registered minimal changes. Thus, the interest rate on newly accepted Denar deposits remained at the same level as in December 2016, while the interest rate on newly accepted foreign currency deposits decreased by 0.1 percentage point. The interest rates on denar and foreign currency household deposits equaled 2.4% and 1.0%, respectively. With companies, the interest rate on newly received Denar deposits decreased by 0.3 percentage points, while the interest rate on foreign currency deposits remained at the level of the previous quarter. As a result of these movements, the interest rate spread between the new Denar and foreign currency household savings moderately widened from 1.3 percentage points to 1.4 percentage points, while in companies the interest rate spread narrowed from 0.8 percentage points to 0.6 percentage

⁶⁷ 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.



points. In terms of total deposits, interest rates on Denar and foreign currency household deposits in February amounted to 2.4% and 0.9%, respectively, while on Denar and foreign currency corporate deposits they equaled 2.3% and 1.3%, respectively.

The analysis of the structure of money supply (from balance sheet aspect), for the first quarter of 2017, indicates negative contribution in almost all money supply components, with the exception of the small positive contribution of net government loans and the category of other items, net.

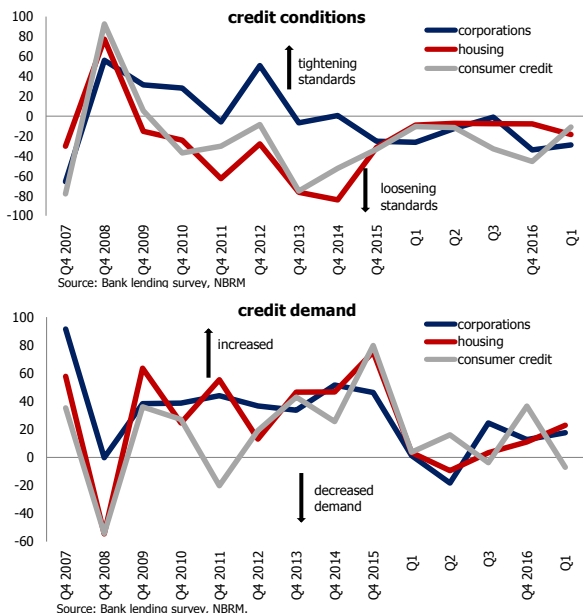
4.2. Lending activity

	2015				2016				2017
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Total credits of private sector	quarterly change, in %								
Total credits of private sector	1.1	2.7	1.2	4.2	0.1	-2.0	0.2	2.7	-0.8
Total credits of private sector (without write-offs)	1.1	2.7	1.2	4.2	0.1	2.8	0.5	3.0	-0.1
Contribution in quarterly change of total credits (in p.p)									
Denar credits	0.7	3.2	1.6	3.7	0.6	-1.1	0.5	3.2	-0.6
Foreign currency credits	0.4	-0.5	-0.3	0.5	-0.6	-0.9	-0.3	-0.5	-0.2
Short-term credits	-0.5	0.0	-0.4	1.8	-1.1	-0.3	-0.5	1.6	-1.4
Long-term credits	1.2	2.5	0.3	2.9	1.0	2.2	0.9	1.7	0.8
Households	1.0	1.8	1.4	1.1	1.1	0.1	0.8	1.0	1.0
Corporations	0.1	0.9	-0.2	3.2	-1.0	-2.1	-0.6	1.6	-1.8

Source: NBRM.

In the first quarter of 2017, the banking sector reduced the credit support to the private sector. The lending of the banking sector decreased by 0.8%, as opposed to the increase of 2.7% in the fourth quarter.

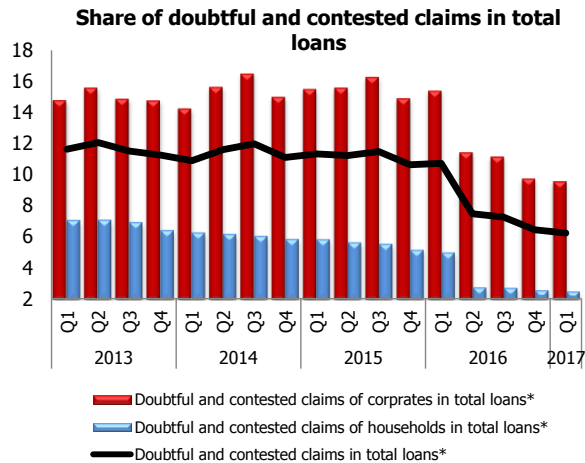
Decrease in lending activity was registered in the first two months of the year, while in March, the lending activity stabilized and increased. This credit restraint is usual for this period, but it is more intensive compared to previous years. If we exclude the effect of regulatory changes⁶⁸, in the first quarter of 2017, total loans registered a quarterly decline of 0.1%, as opposed to the increase of 3% in the previous quarter. According to the results of the latest Bank Lending Survey⁶⁹, the slowdown in lending activity in the first quarter corresponds to the net decrease in the demand for total loans to households, as well as the weaker net demand for loans to small and medium-size companies. The lending terms in both sectors registered further easing, but at a slower pace compared to the previous period.



From a structural point of view, the reduction in lending to the private sector in the first quarter was affected by the drop in corporate loans, amid further growth of loans to households. In terms of currency structure, the reduction in lending activity in this period is mostly due to the decline in Denar loans, despite their significant growth in the previous quarter. Foreign currency deposits

⁶⁸ On 17 December 2015, the National Bank Council adopted the Decision on amending the Decision on credit risk management that requires from banks by 30 June 2016 to write off (and to continue to write off) all claims that have been fully booked for more than two years, and where the bank has identified and fully covered the credit risk of default at least two years before. Despite the write-off of these claims, i.e. their transfer to the off-balance sheet record, banks reserve the right for their collection.

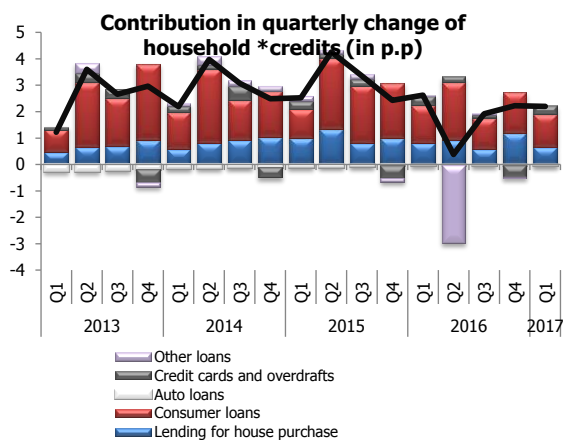
⁶⁹ For more information, also see Lending Survey at <http://nbrm.mk/?ItemID=F7AC78DEE498764FBAF39049F726CE3C>.



It refers to the share of the doubtful and contested claims in the total loans of the respective sector. Source: NBRM.

Total credits of households	2015				2016				2017
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
	quarterly change, in %								
Total credits of households	2.4	4.2	3.3	2.5	2.5	0.2	1.9	2.2	2.1
Total credits of households (without write-offs)	2.4	4.2	3.3	2.5	2.5	3.7	2.0	2.3	3.2
	Contribution in quarterly change of household credits (in p.p)								
Denar credits	2.3	3.9	3.2	2.4	2.5	0.1	1.7	2.1	2.0
Foreign currency credits	0.1	0.2	0.1	0.1	0.1	0.2	0.1	0.1	0.1
Short-term credits	0.2	0.2	0.2	-0.3	0.2	0.2	0.1	-0.4	0.2
Long-term credits	2.0	3.9	3.0	3.0	2.4	3.1	1.8	2.7	1.9

Source: NBRM.



*Total loans to households do not include loans to self-employed individuals. Source: NBRM.

Total credits of corporations	2015				2016				2017
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
	quarterly change, in %								
Total credits of corporations	0.1	1.6	-0.4	5.7	-1.8	-3.8	-1.1	3.0	-3.3
Total credits of corporations (without write-offs)	0.1	1.6	-0.4	5.7	-1.8	2.1	-0.6	3.5	-2.9
	Contribution in quarterly change of corporation credits (in p.p)								
Denar credits	-0.5	2.7	0.3	4.7	-0.7	-2.0	-0.4	4.0	-2.8
Foreign currency credits	0.6	-1.1	-0.7	0.9	-1.1	-1.8	-0.7	-1.0	-0.5
Short-term credits	-1.1	-0.1	-0.9	3.4	-2.0	-0.8	-0.9	3.3	-2.8
Long-term credits	0.6	1.4	-0.1	2.8	0.0	1.4	0.2	0.8	-0.1

Source: NBRM.

continued to decrease, but at a moderately slower pace. The analysis of the maturity structure on a quarterly basis indicates that the growth of total loans is entirely due to long-term loans, which continued to grow, but at a slower pace compared to the previous quarter. Short-term loans declined in the first quarter of 2017, as opposed to the growth in the previous period. In terms of doubtful and contested claims, at the end of March, there was a quarterly decrease in households and companies. The share of doubtful and contested loans in total loans was 6.2% and decreased by 0.2 percentage points compared to December.

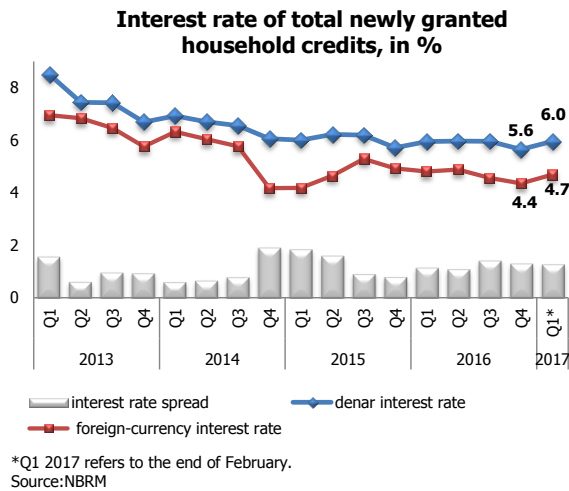
On an annual basis, total loans in March registered minimal growth (Denar 134 million), which is lower compared to the annual increase in December (0.9%). Excluding the effect of regulatory changes, the total loans in March registered annual increase of about 6.3% compared to the growth of 6.5% in the previous quarter. Loan/deposit ratio⁷⁰ equaled 88.2% at the end of March (93.7% excluding the effects of regulatory changes), which shows larger use of the deposit potential for lending to the private sector compared to the previous quarter, when this ratio was 92.6%.

In the first quarter of 2017, lending to household sector continued (growth of 2.1%), at almost the same pace as in the previous quarter (2.2). Excluding the effects of regulatory changes, total loans to households register acceleration in the quarterly growth from 2.3% to 3.2%. **Consumer loans made the largest contribution to the quarterly growth of loans to households,** and housing loans also made positive contribution. Both credit components registered a slowdown in the growth. Performances are partially in line with the results of the Bank Lending Survey, which indicate a reduced net demand for consumer loans, but with more intensive net demand for housing loans. The currency analysis shows that for the third consecutive quarter generators of the increase in the loans to households are the Denar loans, given small rise in the loans in foreign currency. **Annually,** at the end of March, total loans to households increased by 6.6% (7% at the end of December). However, if we isolate the effect of the decision to write off part of the claims, the total loans register annual increase of 11.6% at

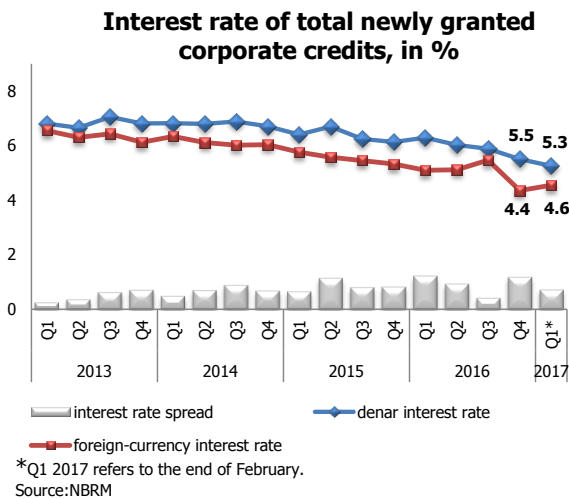
⁷⁰ According to monetary statistics data.



the end of the period.



In the first three months of 2017, lending to the corporate sector registered quarterly decrease of 3.3%, as opposed to the increase of 3% in the previous quarter. Without the effect of regulatory changes, the lending to the corporate sector in the first quarter decreases by 2.9%, compared to the growth of 3.5% in the previous period. According to the Bank Lending Survey, in the first quarter, a weaker demand for loans by small and medium-size companies was registered, amid further increase in credit demand by large companies. Observing by currency, changes in total loans are mostly due to the decrease in Denar loans, as opposed to the growth in the previous quarter. Foreign currency loans still register a quarterly decrease, with twice weaker intensity compared to the previous period. **On annual basis**, at the end of March, the credit growth of enterprises was lower by 5.2%, but excluding the effect of the decision, the total corporate loans grew by 2%.



According to the data on the interest rates on the newly approved loans as of February⁷¹, there was an increase in the interest rates on loans to households and enterprises. The interest rate on Denar corporate loans is exception, since they registered moderate quarterly decrease. In terms of total interest rates, in February, the interest rates on foreign currency loans to households and Denar loans to enterprises were moderately lower by 0.1 percentage point, respectively, compared to the end of 2016. Other interest rates remained at the level of the end of the previous quarter.

V. Public finance

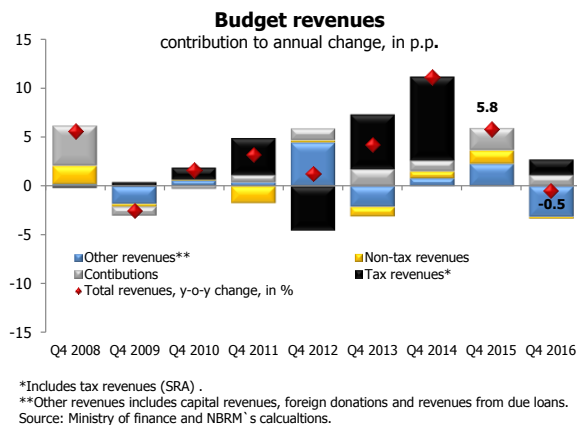
During the fourth quarter of 2016, the total revenues in the Budget of the Republic of Macedonia (central budget and budgets of funds) were lower by 0.5% annually, whereas total expenses increased by 2.4%. Decreased budget revenues largely reflect lower performance in other revenues⁷², while total revenues from taxes and contributions are higher on an annual basis. The annual growth of budget expenditures is entirely due to the higher current expenditures, while capital expenditures have a negative contribution to the growth. The budget deficit in the last quarter of 2016 was 1.1% of GDP (moderately higher compared to the same period last year) and was financed from domestic sources, mainly by

⁷¹ 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.

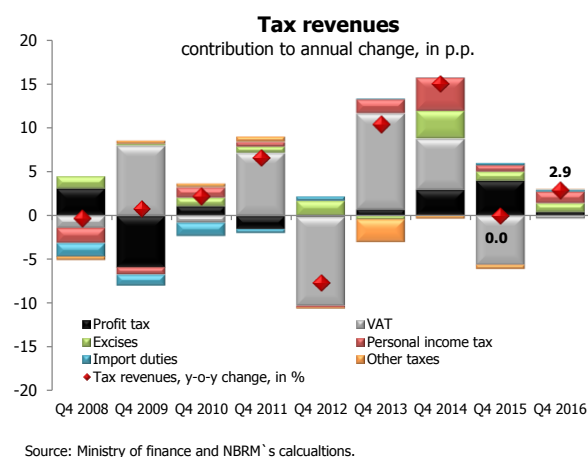
⁷² Other revenues include capital revenues, donations from abroad and revenues from recovered loans.



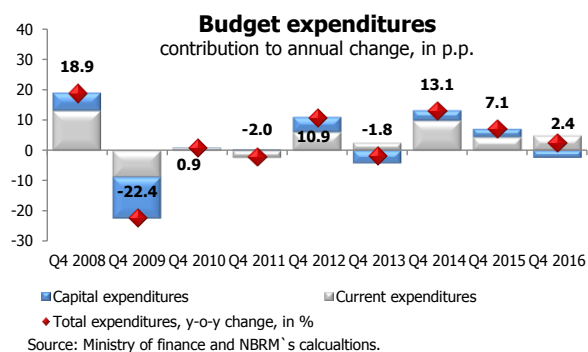
withdrawing funds from the government deposit account with the National Bank, and less through net issue of government securities. After the performance in the last quarter, total revenues in 2016 were higher by 5% on annual basis, while total expenditures were higher by 2.6%. The budget deficit for 2016 was 2.6% of GDP, constituting 69.5% of the forecast budget deficit for 2016. The budget deficit was predominantly financed through government borrowing on the foreign capital market, where some of the inflows were accumulated in the form of deposits on the government account with the NBRM. Total public debt equaled 47.8% of GDP at the end of 2016, which is an increase of 1.1 percentage points of GDP compared with the previous year.



Total revenues in the Budget of the Republic of Macedonia⁷³ generated in the last quarter of 2016 were by 0.5% lower on an annual basis. The weaker performance stems primarily from the lower realization in other revenues (primarily lower foreign donations), and less from lower non-tax revenues. On the other hand, total revenues from taxes and contributions are higher on an annual basis, contributing 1.6 percentage points and 1.1 percentage points, respectively, to the annual growth of total revenues. In 2016, total revenues increased by 5% annually.



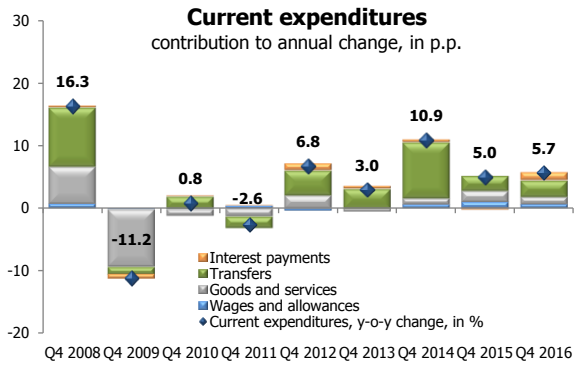
In the fourth quarter of 2016, the total tax revenues⁷⁴ increased by 2.9% on annual basis, which is largely due to the higher direct taxes (by 6.7% annually), compared to the annual growth of the indirect taxes (of 1.2%). Income tax revenues are the generators of increase in direct taxes (contribution of 1.3 percentage points), while the contribution of profit tax revenues is lower (0.4 percentage points). The growth of indirect taxes reflects solely the positive contribution of excises and import duties (1 percentage point and 0.2 percentage points, respectively), while VAT revenues are lower on an annual basis. In 2016, total tax revenues increased by 7.7% on an annual basis.



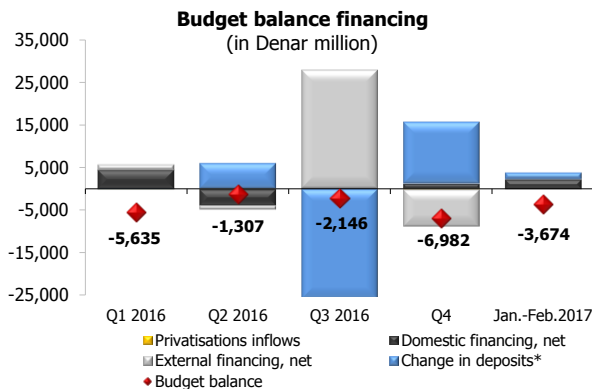
Total expenses in the Budget of the Republic of Macedonia registered an annual growth of 2.4% in the last quarter of 2016. The increase in budget expenditures in the fourth quarter of the year is solely due to higher current expenditures, while the contribution of capital expenditures is negative. All current expenditure categories that are higher by 5.7% on an annual basis, made positive contribution, particularly transfers (of 2.6 percentage points), mostly due to the higher social transfers. Moderate positive

⁷³ Central budget and budgets of funds.

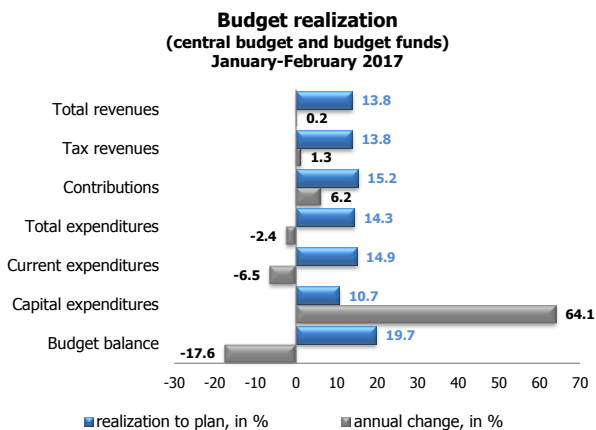
⁷⁴ Includes tax revenues (SSP)



Source: Ministry of finance and NBRM's calculations.



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



Source: MoF and NBRM calculations.

contribution to the annual increase in current costs (of 1.3 percentage points and 1.2 percentage points, respectively) was made by interest expenses and costs for goods and services. In 2016, total expenses increased by 2.6% on annual basis.

In the fourth quarter of 2016, the Budget of the Republic of Macedonia registered a deficit of Denar 6,982 million, or 1.1% of GDP which is moderately higher compared to the same period last year (1% of GDP).

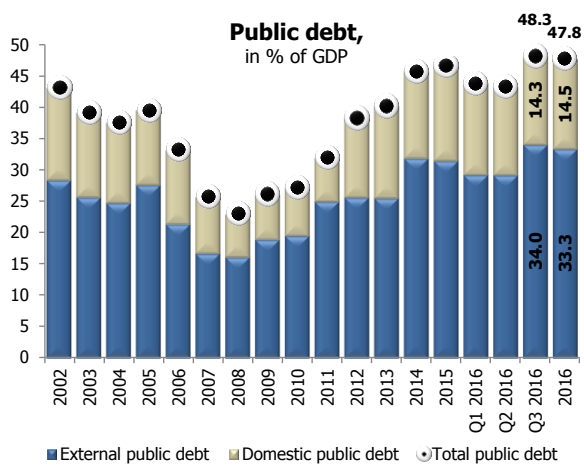
The deficit was financed from domestic sources, by withdrawing deposits from the government deposit account with the National Bank, and less from the net issue of government securities. On the other hand, the negative growth in external financing in the last quarter of the year arises from the settlement of government debt on due liabilities to external lenders⁷⁵. In 2016, the budget deficit was 2.6% of GDP, which constitutes 69.5% of the budget deficit forecast for 2016.

In the period January-February 2017, total budget revenues were insignificantly higher compared to the same period last year (by 0.2%). Tax revenues were higher by 1.3%, with growth largely arising from the inflows based on VAT and income tax, while the growth of contributions is relatively higher, amounting to 6.2% annually.

On the other hand, **budget expenditures were lower by 2.4% on an annual basis.** Lower total expenditures in the first two months of 2017 was solely due to the lower current expenditures (by 2.4% on an annual basis), while capital expenditures registered an intensified annual growth (of 64.1%). In the period January-February 2017, the budget deficit was Denar 3,674 million, which is 0.6% of GDP⁷⁶, or 19.7% of the deficit forecast for 2017. In this period, 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.

⁷⁵ In November 2016, the government repaid a loan of Euro 130 million to City Bank and Deutsche Bank.

⁷⁶ The analysis of nominal GDP for 2017 uses the NBRM October forecasts.



Source: MoF and NBRM calculations.

At the end of 2016, total public debt⁷⁷ was 47.8% of GDP, which is a quarterly decrease of 0.5 percentage points. Structurally observed, the change stems solely from the reduction of external debt of 0.7 percentage points (from 34% to 33.3% of GDP), while the domestic debt moderately increased (from 14.3% to 14.5% of GDP). The share of total government debt⁷⁸ decreased by 1 percentage point compared to the previous quarter and at the end of the year equaled 39.1% of GDP, while the debt of public companies⁷⁹ increased by 0.5 percentage points and reached 8.7% of GDP. On an annual basis, the total public debt was higher by 1.1 percentage point of GDP relative to the end of 2015.

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

	Revised Budget (II)	2016				2016	Budget 2017	Jan-Feb.	Annual changes, period in 2016 over the same period in the previous year, in %					Contributions in annual changes, period in 2016 over the same period in the previous year, in %					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 %
		Q1 2016	Q2 2016	Q3 2016	Q4 2016				Q1 2016	Q2 2016	Q3 2016	Q4 2016	2016	Q1 2016	Q2 2016	Q3 2016	Q4 2016	2016		
	Plan, in mil. Denars	Realization, in mil. denars							Q1 2016	Q2 2016	Q3 2016	Q4 2016	2016	Q1 2016	Q2 2016	Q3 2016	Q4 2016	2016	Jan-Feb.	Jan-Feb.
TOTAL REVENUES	174,291	40,583	41,422	43,807	43,524	169,336	187,612	25,894	7.4	2.7	11.4	-0.5	5.0	7.4	2.7	11.4	-0.5	5.0	0.2	0.2
Tax revenues and contributions	149,597	35,647	37,544	38,695	38,476	150,362	160,746	22,879	7.0	6.1	11.1	3.2	6.8	6.1	5.4	9.8	2.7	5.9	2.5	2.2
Taxes	97,364	23,714	24,685	25,436	24,622	98,457	107,197	14,813	8.1	6.8	13.9	2.7	7.8	4.7	3.9	7.9	1.5	4.4	1.3	0.7
Contributions	50,145	11,582	12,455	12,833	13,430	50,300	51,879	7,897	5.9	4.7	5.8	3.8	5.0	1.7	1.4	1.8	1.1	1.5	6.2	1.8
Non-tax revenues	16,576	3,422	2,557	3,556	3,432	12,967	17,516	2,516	5.6	-4.3	3.4	-2.2	0.8	0.5	-0.3	0.3	-0.2	0.1	1.7	0.2
Capital revenues	2,329	614	275	806	282	1,977	2,613	89	75.4	-78.6	142.8	-5.1	-12.7	0.7	-2.5	1.2	0.0	-0.2	-83.2	-1.7
Foreign donations	5,369	815	925	701	1,207	3,648	6,287	407	4.0	9.3	15.3	-51.6	-22.9	0.1	0.2	0.2	-2.9	-0.7	-15.4	-0.3
Revenues from repayments of loans	420	85	121	49	127	382	450	3	7.6	-28.9	-50.0	-28.2	-27.1	0.0	-0.1	-0.1	-0.1	-0.1	-91.7	-0.1
TOTAL EXPENDITURES	197,410	46,218	42,729	45,953	50,506	185,406	206,219	29,568	4.9	-1.9	5.2	2.4	2.6	4.9	-1.9	5.2	2.4	2.6	-2.4	-2.4
Current expenditures	175,079	43,076	39,730	41,223	44,403	168,432	179,265	26,696	7.9	-0.9	3.3	5.7	4.0	7.1	-0.9	3.0	4.9	3.6	-6.5	-6.1
Capital expenditures	22,331	3,142	2,999	4,730	6,103	16,974	26,954	2,872	-24.2	-13.5	26.2	-16.5	-9.1	-2.3	-1.1	2.2	-2.4	-0.9	64.1	3.7
BUDGET DEFICIT/SURPLUS	-23,119	-5,635	-1,307	-2,146	-6,982	-16,070	-18,607	-3,674	-11	-59	-51	26	-17							
Financing	23,119	5,635	1,307	2,146	6,982	16,070	18,607	3,674												
Inflow	44,573	7,545	4,321	3,584	21,405	36,855	37,132	4,534												
Privatisation receipts	54	46	13	1	71	131	0	0												
Foreign loans	31,657	2,122	137	28,098	542	30,899	17,634	499												
Deposits	4,423	-113	5,996	-25,656	14,461	-5,312	1,664	1,567												
Treasury bills	8,405	5,490	-1,836	1,141	6,321	11,116	17,824	2,468												
Sale of shares	34	0	11	0	10	21	10	0												
Outflow	21,454	1,910	3,014	1,438	14,423	20,785	18,526	860												
Repayment of principal	21,454	1,910	3,014	1,438	14,423	20,785	18,526	860												
External debt	12,273	811	1,020	560	9,218	11,609	9,232	600												
Domestic debt	9,181	1,099	1,994	878	5,205	9,176	9,294	260												

Source: Ministry of Finance and NBRM calculations.

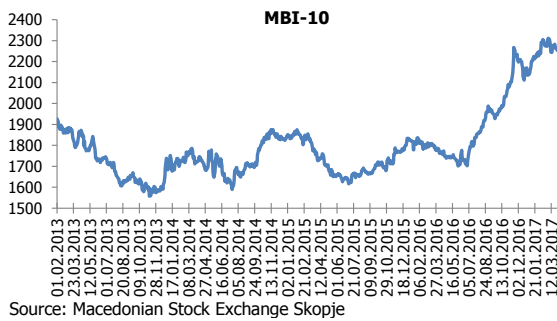
VI. Stock exchange indices and real estate prices

In the first quarter of 2017, amid positive signals for growth of the US economy and higher inflation expectations, there was a decrease in the uncertainty of the international financial markets, and positive developments in most regional stock exchanges. In the Macedonian capital market, in the first quarter, the Macedonian stock exchange index MBI-10 continued its upward trend that started in the second half of 2016. Moreover, the growth of the index in this period is mostly attributed to the increased demand for securities of individual companies. In the first quarter, real estate prices on the domestic market decreased for the fourth consecutive quarter, amid signals for stabilization of the growth in the supply of real estate.

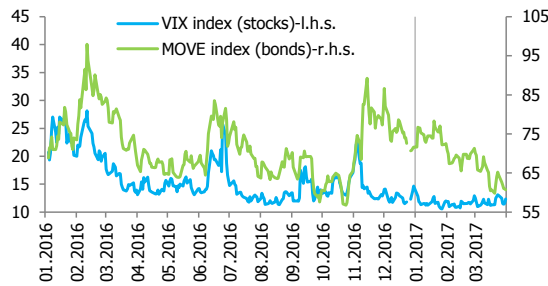
⁷⁷ The public debt is defined under the Law on Public Debt (Official Gazette of the Republic of Macedonia No. 165/14), according to which it is the sum of the government debt and the debt of public enterprises established by the state or municipalities, municipalities within the City of Skopje and the 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, backed by a state guarantee.

⁷⁸ Government debt is defined as a sum of debts of the central and the local government.

⁷⁹ 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).

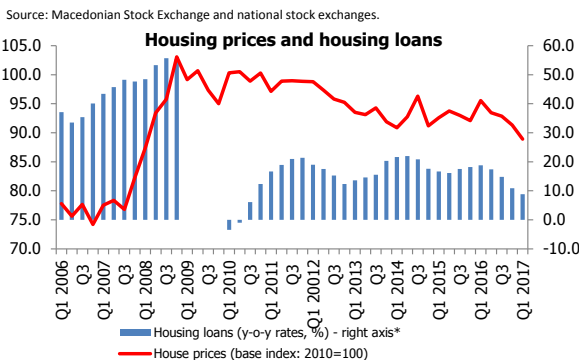
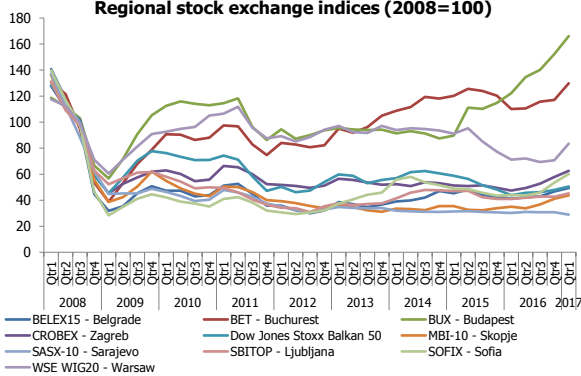


Volatility indexes on stocks and bond markets



Source: Chicago Board Options Exchange (CBOE)

Regional stock exchange indices (2008=100)

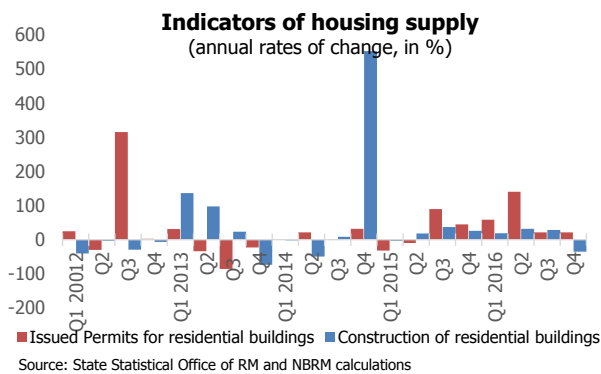
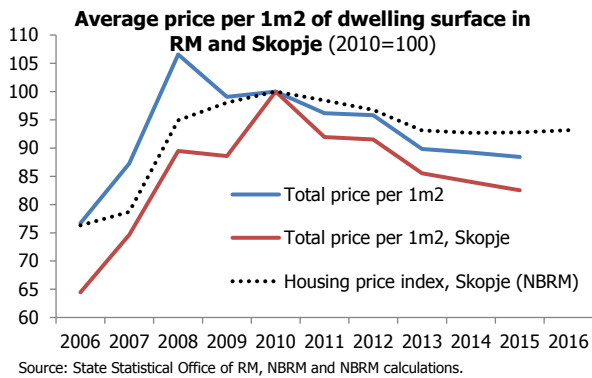


During the first quarter of 2017, the value of the Macedonian MBI-10 continued increasing (quarterly growth of 5.4%) and reached 2251.09 at the end of the quarter (2134.91 at the beginning of the quarter). The upward path of the index is associated with the increased demand for the shares of a financial sector company that constitute MBI10. The bond index (OMB) also registered a moderate growth of 1.8% at the end of March 2017 (compared to December last year). However, despite the increase in the index value that started in the second half of 2016⁸⁰, the still uncertain political situation in the country and increased risk aversion of investors could be limiting factors for the future stock market activities. Despite the increase in the index value, the total stock exchange trade in the first quarter decreased by 7.5% compared to the previous quarter as a result of the reduced trade in securities which is probably due to the greater restraint for trading in this type of securities in anticipation of the decisions for payment of dividends.

In the first quarter of the year, the uncertainty in international financial markets reduced due to the positive signals for the growth in the US economy. Namely, after the market uncertainty in the last quarter of 2016 (prior to the US presidential election), the expectations for growth in the US economy, the lower unemployment rate, the higher inflation expectations, as well as the expectations for higher interest rate of the Fed, the volatility indexes on the stock and bonds markets have declined in the first quarter this year. By the end of the first quarter, VIX and MOVE stabilized at the level before the November presidential election in the United States⁸¹. **Regional stock markets registered favorable movements and moved upwards, and despite the reduced global uncertainty, some local factors also had a significant influence.** In addition, during the first quarter, most of the regional stock indices continued to grow, with the exception of the stock markets in Sarajevo and Ljubljana. Dynamically speaking, over an

⁸⁰ The growth in the value of MBI10 as of the second half of 2016 is largely due to the increased demand for the shares of selected companies within the index (in the third quarter of 2016 - Makpetrol AD Skopje and Komercijalna Banka AD Skopje, in the fourth quarter of 2016 - Komercijalna Banka AD Skopje and Stopanska Banka AD Skopje, and in the first quarter of 2017 - NLB Bank AD Skopje).

⁸¹ MOVE (Merrill Lynch Option Volatility Estimate) index shows the volatility of the US government bond markets. VIX (Volatility Index) index is constructed based on the implied volatility of S&P500 index options. Both indices are used by investors as indicators of the conditions and expectations for the financial markets volatility. Downward path in the indices indicates a decrease in volatility.



extended period, after the fall in stock markets during the global financial crisis, the value of most regional stock indices, including the MBI-10, has still been below pre-crisis level. The exceptions are the stock indices in Budapest and Bucharest that are at a level higher than in 2008.

In the first quarter of the year, apartment prices continued to decline, at an accelerated pace⁸². Thus, the price index is lower by 7% on an annual basis (down by 0.8% in the previous quarter). This shift is consistent with the downward adjustment of apartment prices (total and newly built), both in the capital and in the country in recent years⁸³. Analyzing the supply of real estate, the indicators point to a potential stabilization of the growth. Namely, in the last quarter of the year, the construction of residential buildings decreased, same as the number of issued licenses for construction of apartments. However, no significant changes were registered in the demand for apartments, i.e. the solid growth of housing loans continued in the first⁸⁴ quarter of 2017.

VII. Macroeconomic forecasts and risks

The latest macroeconomic forecasts for 2017 and 2018 point to maintaining sound fundamentals of the domestic economy, as well as more restrained investment decisions, given the still present risks of the prolonged domestic political crisis. Hence, the latest assessment of the economic growth in 2017 is 2.5%, while for 2018, the growth is expected to accelerate to 3.2%, which is a downward revision of the growth compared with the October forecasts (where the growth was forecast at 3.5% and 3.7%, respectively). These forecasts presuppose gradual resolution of the domestic political crisis. Regarding the structure, export activity is again expected to be the main driver of growth, given the significant increase in exports of the existing foreign export-oriented capacities, and an additional stimulus is expected from the recovery of the foreign effective demand. Significant positive contribution is also expected by the household consumption, which showed a strong resistance to the political developments. It is expected to continue to grow in the next two years, albeit at a slower pace, partly as a reflection of the estimates of slower growth in some components of disposable income. The prolonged political crisis is expected to continue to affect the restraint in making decisions on larger investment ventures, which, despite the continual incentive of public and foreign investment, would have a small negative contribution to growth in 2017. Estimates for 2018 show growth of gross capital formation, amid stable environment. The latest forecasts show further positive movements in the savings and the credit market activity in 2017 with a slower pace than previously anticipated. Prolonged uncertainty is estimated to affect the propensity for borrowing and the willingness of banks to support the economy. However, with the stabilization of the conditions and the intensified economic growth, the growth of deposits and loans

⁸² Hedonic index of housing prices, prepared by the NBRM on the basis of the notices of sale in the capital city, and published by the agencies dealing with trade in real estate. The apartment price is a function arising from the size of the apartment, the neighborhood in which it is located, the floor, whether the apartment has central heating and whether the apartment is new.

⁸³ Data on prices of newly built apartments in Skopje and in the Republic of Macedonia were compiled at the SSO, while data on prices of apartments in Skopje (cumulatively, old and new buildings) was compiled at the NBRM.

⁸⁴ Available data for the first two months of the quarter.

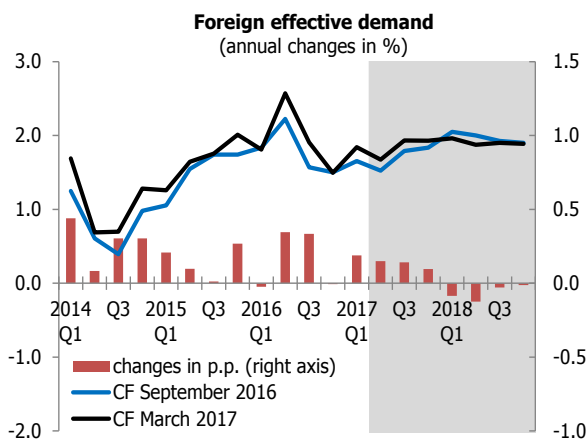


in 2018 is expected to accelerate. **As for domestic prices, in conditions of lower performance on the one hand, and mainly upward revision of external assumptions on the other hand, the price forecast remained unchanged, i.e. inflation is still expected to be 1.3% in 2017 and around 2% in 2018.** The latest estimates for the movement of the balance of payments components confirm the current estimates for moderate current account deficit (average deficit of 2.3% of GDP for 2017-2018), which is expected to be fully financed through foreign direct investments and foreign borrowing, whereby the foreign reserves will remain at an adequate level.

7.1. Assumptions in the external environment forecast⁸⁵

Global economic activity continues to recover. According to the latest estimates⁸⁶, the growth of global economy is expected to accelerate from 3.1% in 2016 to 3.5% in 2017 and 3.6% in 2018. Expectations for accelerated growth reflect the expectations for increased global demand, mitigated deflationary pressures, and increased optimism in the financial markets.

The latest estimates for foreign effective demand⁸⁷ for 2017 have been slightly revised upward compared to the October forecasts, while for 2018 it was corrected slightly downward⁸⁸. Thus, it is now forecast that the growth of foreign effective demand in 2017 and 2018 will be 1.8% and 1.9%, respectively, despite the October forecast of 1.7% and 2%. This is expected to continue the trend of gradual recovery of foreign demand. Thus the upward revision in 2017 reflects changes in the growth estimates of most countries, with the largest contribution of the Germany's growth estimates, while the correction for 2018 stemmed from lower estimates for growth in Greece and Italy.



Compared with the October forecasts, the foreign effective inflation assessment⁸⁹

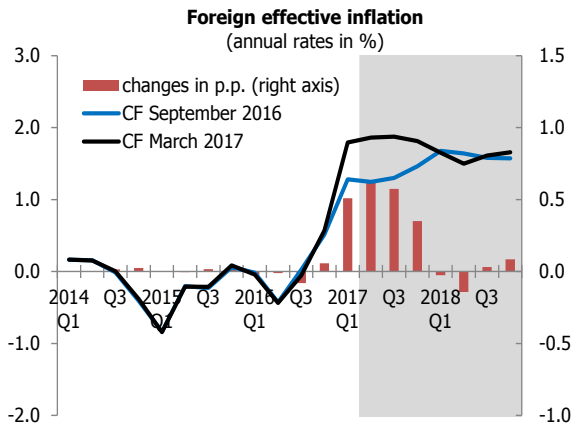
⁸⁵ The historical data on the foreign demand, foreign inflation, exchange rate of the US Dollar/Euro and EURIBOR are sourced from Eurostat, while the IMF statistics is a source of the data on prices of oil, food and metals. The forecasts of the foreign demand, foreign inflation, foreign exchange rate of the US Dollar and EURIBOR are based on the Consensus Forecast, while the forecasts of the prices of oil, food and metals are based on the forecasts of market analysts. The analysis uses various reports of the IMF, the World Bank, ECB, FAO, OPEC and specialized economic portals.

⁸⁶ World Economic Outlook, IMF, April 2017.

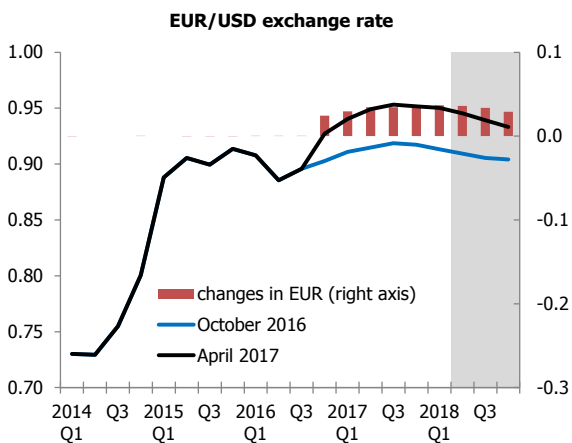
⁸⁷ Foreign effective demand is calculated as the weighted sum of GDP indices of the major trading partners of the Republic of Macedonia. The calculation of this index includes Germany, Greece, Italy, the Netherlands, Belgium, Spain, Serbia, Croatia, Slovenia and Bulgaria.

⁸⁸ Starting from this forecast cycle, changes have been made in the weights of the countries included in the calculation of the foreign demand according to their share in the Macedonian exports in the period 2013-2016. However, the comparison in the text has been made using the October forecasts with old weights. If the October forecast uses new weights, the expected foreign demand growth would be 1.6% and 1.8% respectively for 2017 and 2018, that is, the April forecasts would include upward revisions for the two years.

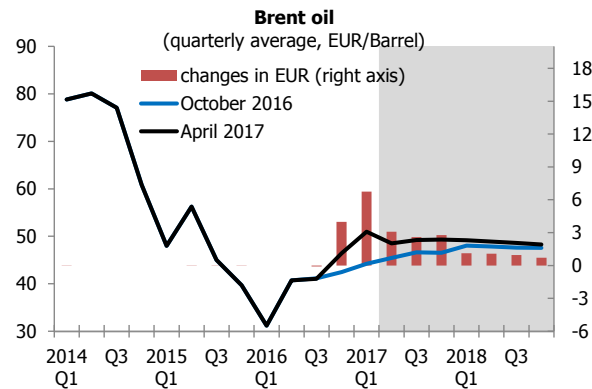
⁸⁹ The foreign effective inflation is calculated as the weighted sum of consumer price indices of the countries that are major partners of the Republic of Macedonia in the field of import of consumer goods. The calculation of this indicator includes



has been revised upward for 2017⁹⁰. Thus, it is now expected that the inflation rate will be 1.9%, compared to the growth of 1.3% as expected in October. The upward revision is largely due to the expectations for a higher price level in Croatia, Serbia, Italy and Germany. On the other hand, the forecast of foreign inflation for 2018 remained the same compared to October, i.e. the growth is still expected to be 1.6%.



Regarding the **US dollar/euro exchange rate** forecast, in 2017, the US dollar is expected to appreciate more on an annual basis compared to October (4.9% versus 1.9%), taking into account the expectations that Fed will conduct more stringent monetary policy, and the ECB will continue conducting policy of low/negative interest rate and quantitative easing. On the other hand, for 2018, there is almost no change in the US dollar exchange rate against the euro compared to October estimates (depreciation of 0.7% versus 0.8%), with built-in expectations for completion of the ECB's quantitative easing programme at the end of 2017.

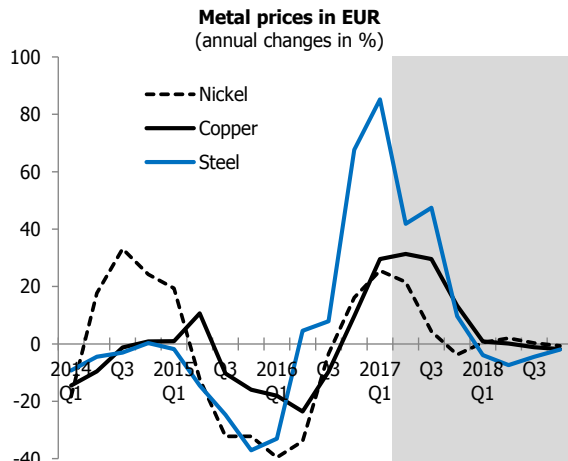


The first quarter of 2017 registered sharp increase in the price of the oil Brent, which is expected to continue by the end of the year, but at a moderate pace. Consequently, higher upward correction of the oil price was made on the year-to-year level relative to the October forecast. The upward revision mostly results from the agreement between the OPEC countries and some non-OPEC countries for reduction of the global oil production aimed to increase prices⁹¹. On the other hand, given the higher price level in 2017, slight decline in oil price on the world markets is forecast for 2018, despite the growth expected in October. Thus the oil price is forecast to average Euro 49.5 per barrel in 2017 and Euro 48.7 per barrel in 2018.

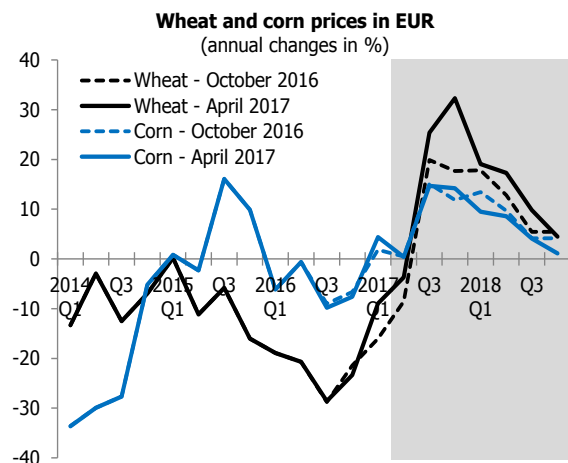
Bulgaria, Germany, Greece, France, Italy, Austria, Slovenia, Croatia and Serbia. Inflation in Croatia and Serbia has been adjusted for the changes in the exchange rate.

⁹⁰ As in the foreign demand, starting from this forecast cycle, changes has been made in the weights of the countries included in the calculation of foreign inflation in accordance with their share in the Macedonian import of goods for private consumption in the period 2013-2016. Yet, the comparison in the text was made during the October forecasts with old weights. The conclusions would remain unchanged even if the new weights apply in the October forecast, i.e. the foreign effective inflation in October would again amount to 1.3% and 1.6% respectively for 2017 and 2018.

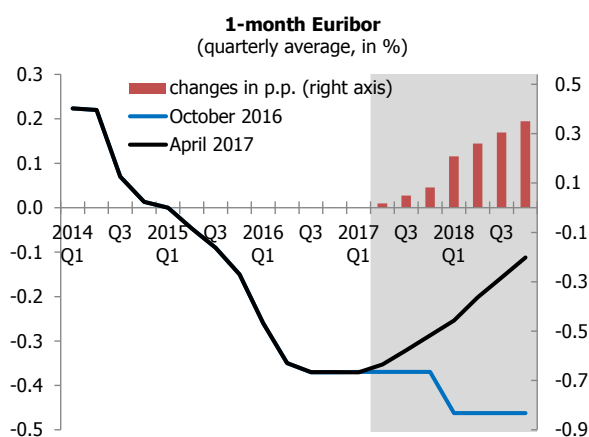
⁹¹ Agreement was reached on 30 November 2016 in Vienna, requiring the production to be cut by 1.2 million barrels a day, starting from 1 January 2017. An additional meeting between the OPEC and non-OPEC countries was held on 10 December, where, for the first time since 2001, it was agreed the non-OPEC countries to cut their oil production as well, by 558 thousand barrels, in addition to cuts that were promised by the OPEC member countries. This agreement will be implemented during the first six months of the year with a possibility of extension for another six months.



Metal prices registered a significant increase at the beginning of 2017, which is expected to continue by the end of the year. Thus, for 2017, prices of copper and steel have been significantly revised upward, while the nickel price has been revised downward compared to the October forecast. The upward movement in the copper price is a result of the fall in global copper stocks, possible supply cuts and expectations for higher demand in the US and China, while steel price increases are due to the expectations for increased world demand and the announcements for decrease in steel production in China. On the other hand, the downward revision of the nickel price is a result of the expectations for a greater supply on the market. The forecasts for metal prices for 2018, are similar as in October, except for the steel price which was significantly revised, whereby the price decline is now expected to be lower than the October estimate.



In the latest macroeconomic forecasts cycle for 2017, upward revisions were made to the wheat and corn prices in euros, i.e. higher growth is expected than forecast in October. Such a change largely results from the lower output level. On the other hand, corn prices in US dollars have been revised downwards for 2017, while prices in euros have been revised upwards relative to the October forecasts. Such movements mainly reflect expectations for greater appreciation of the US dollar against the euro. Prices of corn and wheat are expected to rise in 2018, with higher growth of wheat and lower growth of corn prices compared to the October forecast.



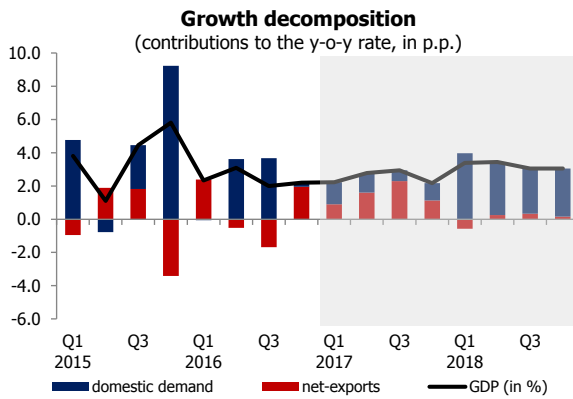
In 2017, there were no major changes in the expectations for the **foreign currency interest rate movement of the one-month EURIBOR**, with forecast for similar average level of -0.33% (slight upward revision versus -0.37% in October), amid continuation of the ECB's quantitative easing program by the end of the year, but with reduced volume. On the other hand, given the expectations for reduced monetary stimulus of the ECB, upward revision was made of the average one-month EURIBOR for 2018 to -0.18% (-0.46% in October).



7.2. Forecast and effects on monetary policy

The latest macroeconomic forecasts do not indicate significant changes in the conditions for conducting monetary policy, amid assessments for favorable and, compared to the previous forecast, unchanged foundations of the domestic economy and the external environment. Thereby, a stable external position and maintenance of foreign reserves at the appropriate level is expected in the forthcoming period. Although domestic and export demand will create certain import pressures, they are not expected to distort the external balance. For the next years, current account deficit is expected to be financed from direct investments and external borrowing, thus maintaining foreign reserves at an appropriate level. **In light of the foreign interest, as a relevant factor for the domestic monetary policy, it is expected to be adjusted slightly upward.** Thus, the market participants' expectations for gradual normalization of the ECB monetary policy contributed to the upward revision of the EURIBOR for 2017, and for 2018, in particular. Yet, it is still expected to remain in the negative zone throughout the forecast horizon. **Risks to the baseline macroeconomic scenario are similar, yet more pronounced than those of the October forecasts.** Observing domestic risks, the failure to resolve the political crisis after the parliamentary elections in December 2016 and the uncertainty arising from such a situation remains the most significant risk that limits the growth of the domestic economy. On the other hand, the potentially stronger export activity of the existing foreign capacities is a positive risk, compared with the assumptions incorporated in the forecasts. **External risks** associated with global growth are different, and still assessed as predominantly negative. On the positive side, there are the expectations for recovery of the prices of primary commodities, greater improvement of the sentiment in the financial markets, as well as the expectations for fiscal stimulus by the new US administration. Contrarily, negative risks are associated mainly with the uncertain implications of the Brexit, increased global protectionism, faster increase in interest rates than initially anticipated by the Fed and the potential negative effects on developing countries, as well as the continuing geopolitical tensions.

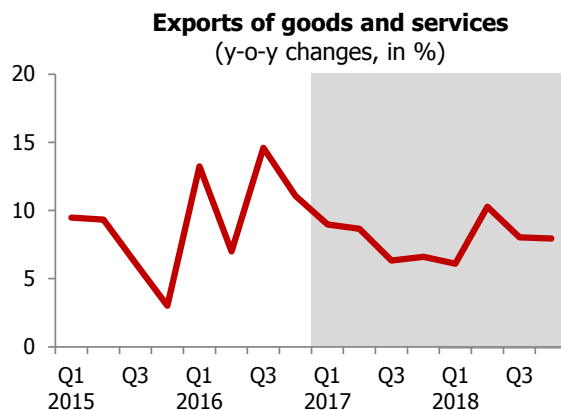
In 2016, the domestic economy grew by 2.4%, as expected with the October forecasts. Main factors of growth include export of goods and services and household consumption, with small positive



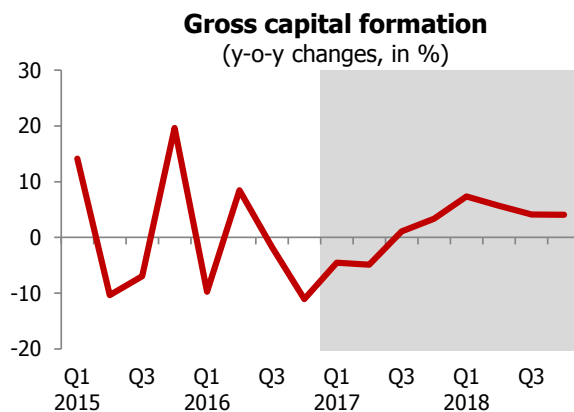
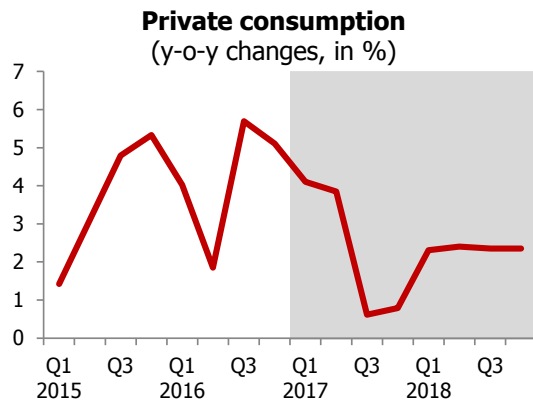
contribution of public consumption. The growth in these components determined the growth of imports, which together with gross capital formation, make negative contribution to the GDP growth. These investment performance shows that despite the strong growth in infrastructure investment and the inflow of foreign investment, the uncertain domestic environment has probably had a negative impact on this demand component.

Available high frequency data for the first quarter of 2017 point to continuation of the positive GDP growth pace. **For the entire 2017, the growth of the economy is expected to be 2.5%, with a similar structure as in the previous year, by component, but now with the dominant effect of net exports versus domestic demand. A positive contribution of investments is expected for 2018, with the total economic growth accelerating to 3.2%.**

Export of goods and services is again expected to be the most significant single growth factor for the economy over the next two years. The estimates show that growth will continue to be supported by new export-oriented companies, with a significant increase in production and exports. At the same time, the foreign demand recovery will have an additional stimulus to the rest of the export, and the increase in the prices of metals will positively affect the metal industry.



Domestic demand in 2017 is expected to make positive contribution to the economic growth, but lower than in the previous year. Analyzed by component, private consumption will make the greatest contribution to the growth of the domestic demand, in conditions of further growth of the disposable income of the households and the credit support by the banks. Although household consumption has shown resilience to the current political developments, yet, prolonged uncertainty could lead to some restraint from consumption and its slower growth. Labor market developments are also expected to slow down consumption growth, which are estimated to remain favorable, yet with moderate effects. Thus, employment rate will continue to grow, but at a slower pace. Nominal wages will register somewhat faster growth compared to 2016, but with expectations for a positive increase in consumer prices, and the pace of growth in real wages is expected to slow down compared to the previous year. In addition, real growth is expected in pensions, which in conditions of unchanged nominal growth, and accelerating inflation, will slow down compared to the previous year. Private transfers are also expected to make a



positive contribution, besides the fall in the previous year. The lending activity survey for the first quarter of 2017 shows that the continued uncertainty starts to affect the demand for loans by the households, which is also expected to moderately slowdown the credit growth. In 2017, **public consumption** is expected to increase, in line with the budget expenditures planned for 2017. On the other hand, despite the fact that the government infrastructure projects and the inflow of foreign investments will continue, and the export activity will increase, in 2017, **gross capital formation** is expected to see a moderate decrease. Namely, the uncertainty arising from the domestic political scene is assessed to reduce the risk appetite of private domestic corporate sector, and thus shy away from greater investment activity. However, it is estimated that these adverse effects would gradually be exhausted during 2017, and the fall in gross capital formation would be milder than in the previous year.

Domestic demand will grow in 2018 and will be the main generator of economic growth, with the growth registered in all three components. In addition, private consumption will again make the greatest contribution, but significant contribution is also expected from investments, after two years of decline. Namely, the government infrastructure activities will continue in 2018, with expectations for increased foreign direct investments. Additionally, greater risk appetite and investment activity of the private domestic sector is expected, in conditions of stable environment, stronger growth of foreign demand and further exports growth. The solid performances in investments and exports will contribute to the continuation of favorable trends in the labor market, which will bring about steady growth dynamics of the private consumption. Public spending will also grow in 2018, in line with the assumptions in the fiscal strategy 2017-2019.

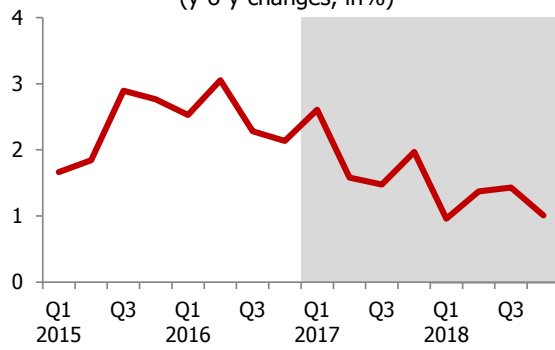
Credit support to the private sector is expected to continue⁹², but the extended political crisis has slowed down the growth in the credit market activity. Thus, the growth of private sector loans is expected to slow down to 5.6% in 2017 (from 6.5% in 2016), while in 2018, it will accelerate to 6.7%⁹³. Such switches in 2017 reflect the factors on both the demand and the

⁹² Controlled for the effect of the regulatory change that required removal of fully provisioned suspicious and contested claims on credits longer than two years from balance sheet records to off-balance sheet records.

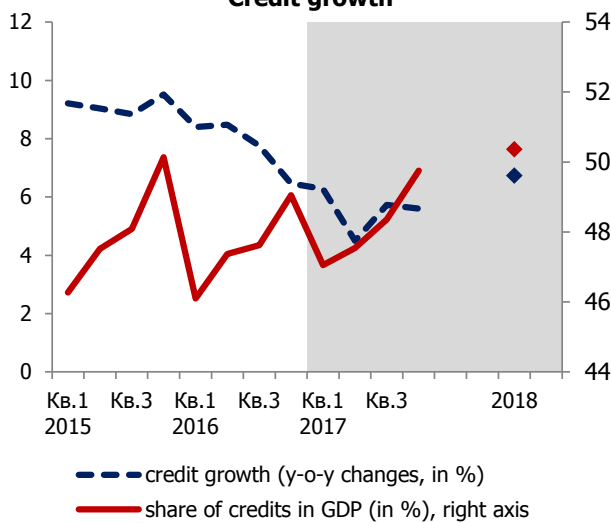
⁹³ With the effect of write-offs included, credit growth rate would be 0.9% in 2016, and would accelerate to 5.2% in 2017 and 7.1% in 2018.



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

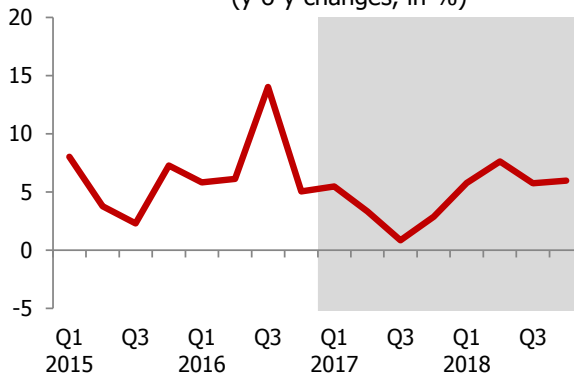


Credit growth



--- credit growth (y-o-y changes, in %)
— share of credits in GDP (in %), right axis

Imports of goods and services
(y-o-y changes, in %)



supply side. Namely, the political uncertainty is expected to adversely affect the demand for loans and the propensity for borrowing in 2017. On the other hand, amid estimates for more stable environment and acceleration of economic growth, in 2018, the demand for loans is expected to intensify next year. Certain restraint in 2017 is expected on the supply side, but in 2018, a greater incentive is expected through this channel. Namely, in 2018, the accelerated growth of the deposit base and the competitive pressures are expected to ease the lending standards, amid healthy liquidity and solvency position and assessments for absence of major risks. **Observing the deposit potential**, the growth of deposits is expected to slow down in 2017 to 4.2% (from 6% in 2016) given the prolonged political crisis. However, the intensified economic activity and expectations for stabilization of the situation in 2018 will strengthen the deposit base in the banking system, and in 2018, total deposits are expected to grow at an annual rate of 6.5%.

In 2017, the growth in real import of goods and services is expected to slow down, amid a slight fall in investments and slower growth in private consumption and exports. In addition, with the growth of real exports exceeding the imports, the net export will make dominant positive contribution to the total growth. In 2018, the recovery of investment activity, as well as the steady growth of private consumption and exports, will result in higher import pressures and accelerated import growth. Hence, the contribution of net exports to GDP growth would be neutral.

The latest estimates of future movements in the balance of payments indicate narrowing of the current account deficit in 2017, from 3.1% of GDP in 2016 to 2.4%. The improvement in the balance of current transactions is mainly due to the improvement of the balance of goods and services, in conditions of better non-energy balance, as a result of the further positive contribution of the new export capacities in the economy and the revival of some of the traditional sectors. On the other hand, the expectations for the energy deficit, driven by the increase in the price of crude oil on the global stock markets, are less favorable. In 2017, a small increase in net inflows from secondary income to 16.1% of GDP is expected in the absence of major shocks (15.9% of GDP in 2016). Despite these favorable shifts, the primary income deficit is forecast to further expand. **In 2018, a slight improvement of 0.2 percentage points of GDP is expected in the**


Balance of Payment Forecast (% of GDP)

	2013	2014	2015	2016	2017	2018
Current account	-1.6	-0.5	-2.1	-3.1	-2.4	-2.2
Balance of goods & services	-18.3	-17.2	-16.4	-14.8	-13.8	-13.1
Goods, net	-22.9	-21.7	-20.2	-18.8	-18.4	-17.9
Services, net	4.6	4.5	3.8	4.0	4.6	4.8
Primary income, net	-2.4	-1.9	-3.2	-4.3	-4.7	-5.0
Secondary income, net	19.0	18.6	17.5	15.9	16.1	16.0
Private sector, net	18.1	17.3	16.9	15.1	15.4	15.3
Capital account	0.2	0.0	0.1	0.1	0.0	0.0
Financial account	-0.8	-5.1	0.0	-6.5	-1.5	-3.1
FDI, net	-2.8	-2.3	-2.2	-3.6	-3.2	-3.4
Portfolio Investment, net	2.0	-5.6	-0.7	-4.4	0.1	0.1
Other Investment, net	0.1	2.8	3.0	1.4	1.6	0.3

current account, whereby the deficit would amount to 2.2% of GDP. Factors that drive such a change in current transactions are generally the same as in 2017. Namely, further improvement is expected in the balance of goods and services, which would reduce to 13.1% of GDP, as a result of the narrowing of both the energy and the non-energy balance. Further growth of the net added value of the new production capacities in the economy and expectations for stabilizing of the world energy prices are the driving factors for the favorable change in the trade deficit in 2018. **The financing of current account in this two-year period is expected mostly to be provided through foreign direct investment and long-term public external borrowing.**

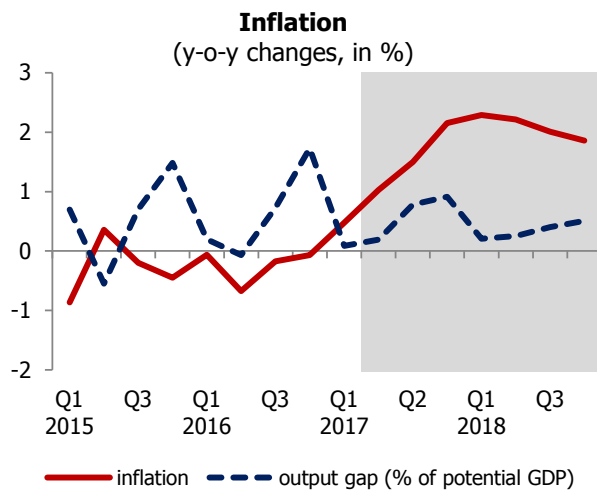
In the period 2017-2018, current account deficit is expected to be fully covered by financial flows, which will ensure additional increase in the foreign reserves. During the entire forecast horizon, foreign reserves adequacy indicators have ranged within the safe zone.

After the mild fall in price level in 2016, the domestic economy inflation is expected to intensify and reach 1.3% annually in 2017.

Inflation acceleration mostly reflects the growth of energy component of inflation, in line with the higher prices of crude oil and derivatives on the world markets of primary commodities. Also, core inflation is expected to be maintained in the positive zone. Thus its growth would moderately increase as a combination of the direct effects of higher foreign import prices (higher foreign effective inflation this year) and moderately positive output gap, as well as the second-round effects of higher energy prices. On the other hand, despite the increase in world prices of food primary commodities, the contribution of the food component of inflation will remain negative in 2017, given the significant decrease in the prices of fresh food at the beginning of the year, which in part is likely due to the second-round effect of the fall in world prices in the recent period, as well as some domestic factors. Amid faster growth of the domestic economy, inflation in 2018 is expected to accelerate moderately, averaging around 2% annually, with a positive contribution of all components. The uncertain and volatile trajectory of world prices of primary commodities remains the main source of risks surrounding the inflation forecast.



7.3. Comparison with the previous forecast

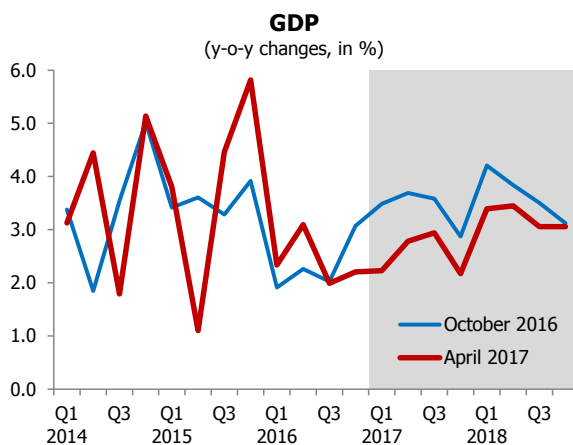


Forecasts for growth of the domestic economy in 2017 and 2018 are downwardly revised compared to October, reflecting the effects of the domestic political risks, with changes also made in the expected growth structure (weaker effect of private and, in particular, investment consumption). On the other hand, there are no changes in the inflation expectations for 2017 and 2018 compared to the October estimates. The current forecast vintage expects a slightly lower average current account deficit for the period 2017-2018. At the same time, a significantly lower deficit is expected in the balance of goods and services, which is an effect of the structural changes in the economy through the higher net added value of the new export companies, and at the same time, a higher primary income deficit, as well as somewhat weaker expectations for current transfers. In the financial flows, cumulative inflows are expected in the period 2017-2018, close to the expectations in the October forecasts, amid assessments for higher foreign direct investments and more intensive outflows in the short-term flows. As a result of the continued uncertainty about the domestic political crisis and the lower domestic growth, a small downward revision of the growth in deposits and loans for 2017 and 2018 was made compared to the October forecasts.

Given the prolonged political crisis, it is estimated that the domestic economy will grow at a slower pace than forecast in October. **Consequently, there was a downward revision of the GDP growth forecast for 2017 and 2018, which is now forecast to be 2.5% and 3.2%, respectively, as opposed to the October estimates of 3.5% and 3.7% respectively.** From the aspect of the GDP expenditure structure, the estimates for export-driven growth will remain, with expectations for significantly favorable effects of the utilization of export-oriented industrial capacities that operate within the technological-industrial development zones in the period ahead, coupled with the expectations for strengthened foreign export demand and substantial improvement of the prices of the metal industry on the world stock exchanges. As a result of these factors, exports are expected to increase their significance for the domestic growth, with its positive contribution being significantly higher compared to the October estimate. Such trends in exports also entail upward revisions of the forecasts for the growth rate of real imports, which will increase the negative contribution to the economic growth. Greater changes in the growth-

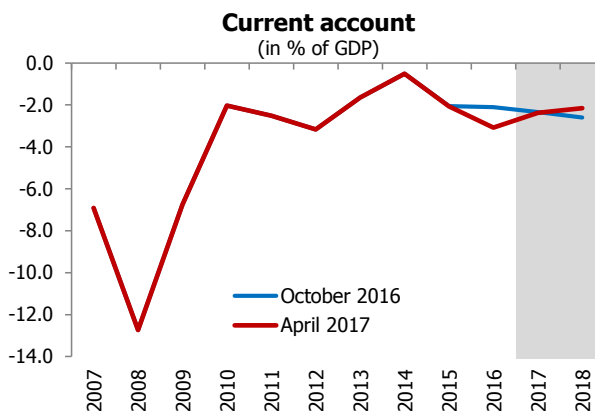
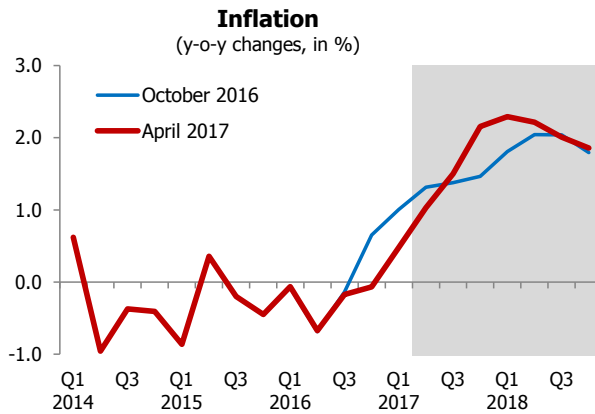
Forecast of selected macroeconomic variables

	2017 forecast		2018 forecast	
	Oct.	Apr.	Oct.	Apr.
GDP, %	3.5	2.5	3.7	3.2
Private consumption	0.8	2.3	3.0	2.4
Gross capital formation	3.9	-1.3	7.0	5.3
Public consumption	2.0	2.4	-0.2	1.2
Exports of goods and services	3.9	7.6	4.0	8.1
Imports of goods and services	2.5	3.1	3.4	6.3
Inflation	1.3	1.3	2.0	2.0
Current account deficit, % of GDP	-2.3	-2.4	-2.6	-2.2



stimulating factors have been made within the domestic demand. Thus, unlike October, it is now estimated that private consumption will be the most important domestic growth component in 2017, which is expected to continue to record solid growth rates, higher than in October, amid unfavorable political developments. Namely, the previous performance shows that this component remained relatively resistant to the political crisis. The above is also confirmed by the positive deviations in the forecasts for the most disposable income components, as the main driving factor of the private consumption for 2017. Unlike investment-driven growth expectations, private consumption is expected to be the domestic component that will contribute the most to the economic growth in 2018, though at a slower pace compared to the October's expectations. In contrast, a significant downward revision has been made in the gross capital formation forecasts. Thus, it is estimated that the investments will register moderate fall in 2017 (still be milder than in 2016), instead of growth as forecast in October, due to the negative effects of the high uncertainty on the propensity for investment, primarily of the domestic corporate sector. Thus, their contribution to the overall growth in 2017 is expected to be moderately negative. Furthermore, in 2018, gross capital formation are expected to recover, but their growth rate will be lower than the October estimate, which is one of the reasons for the reduced forecast for the growth of the domestic economic activity. On the other hand, public consumption is expected to continue to boost growth in 2017 and 2018, and on average, it will make a similar positive contribution as in October, according to the fiscal forecasts. As a result of these shifts, overall, the contribution of domestic demand in the forecast horizon is lower compared to the October estimates. On the other hand, on a cumulative basis, net exports are expected to have a significant positive contribution to the economic growth, unlike the October forecast of neutral contribution, mainly due to the higher positive contribution of the export of goods and services, amid slight changes in the contribution of imports.

The forecast for the movement of domestic prices in 2017 did not change compared to the October estimates, **and the inflation rate is still forecast at 1.3% this year.** However, significant changes have been made within each component. Thus, in line with the oil price movements on the global stock markets, energy inflation was revised upward, same as the core inflation. On the other hand, such changes are expected to be offset by food inflation movements, which is now predicted to decline, rather than to



increase. Having upward revisions of the stock market prices of primary food commodities, this is due to the lower performances of this component at the end of the previous and the beginning of this year, probably in part reflecting domestic factors. **Furthermore, inflation is again expected to accelerate to around 2% in 2018, just as forecast in October.**

The latest estimates show a slightly lower current account deficit for 2017 and 2018, compared to the October forecasts, by 2.3% of GDP on average for the both years (2.5% in October). Comparing current account components, there are differences between the two forecasts. Namely, the deficit of goods and services is expected to improve, mainly reflecting the improved expectations for the new export facilities, as well as the more favorable expectations for some of the traditional export sectors in the economy. On the other hand, the estimates for the primary income deficit are less favorable, reflecting the higher assessment of the income from direct investment. In addition, the April forecast also expects somewhat lower net inflows in the secondary income relative to the expectations in the October forecast. **Observing financial flows, no significant changes are expected in net inflows for 2017 and 2018 cumulatively, compared to the October forecast.** Moreover, the April forecast expects higher flows through foreign direct investment in the economy that showed relative resilience to domestic risks in the past year, unlike the higher net outflows in volatile short-term financial flows. Within these forecasts, no changes were made in the fiscal assumptions, neither in terms of the size of the budget deficit nor the sources of its financing. Thus, within the balance of payments forecast, the assumption remains for the government external borrowing in line with the fiscal strategy.

Comparison of GDP and inflation forecasts for Macedonia from various organisations

Organisation	Month of publication	Real GDP growth, %		Inflation (average rate, %)	
		2017	2018	2017	2018
IMF	April 2017	3.2	3.4	0.7	1.7
World Bank	April 2017	2.8	3.3	0.6	1.4
European Commission	May 2017	2.9	3.2	0.8	2.3
EBRD	May 2017	2.4	3.0	-	-
Consensus Forecast	May 2017	3.1	3.4	1.3	2.0
Ministry of Finance of the Rep. of Macedonia	July/October 2016	3.0	3.5	1.0	1.5
National Bank of the Republic of Macedonia	April 2017	2.5	3.2	1.3	2.0

Source: IMF World Economic Outlook, April 2017; World Bank SEE Regular Economic Report No.11, April 2017; European Commission European Economic Forecast, May 2017; EBRD Regional Economic Prospects, May 2017; Consensus Forecast, May 2017; Ministry of Finance of the Republic of Macedonia, 2017 Budget and Fiscal strategy 2017-2019, July/October, 2016; and the National Bank of the Republic of Macedonia.