

National Bank of the Republic of North Macedonia



**Quarterly Report
November 2019**



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Introduction

After the monetary policy relaxation at the end of the first quarter, the National Bank kept the policy rate at the level of 2.25% also in the third quarter of 2019. The current monetary position was assessed as appropriate to the existing economic and financial conditions, given sound economic fundamentals and without any imbalance in the economy. In the third quarter of the year, the movements on the foreign exchange market were favorable, and the National Bank continued purchasing foreign currency. In the third quarter of the year, the foreign reserves increased, and according to all adequacy ratios, they are still in the safe zone. At the same time, despite the favorable assessments of the domestic economic environment, global economic performance was lower than previous expectations, thus increasing uncertainty and creating the need for careful monitoring of the situation in this segment.

The latest macroeconomic forecast cycle for the current and the next two years does not indicate major changes in the macroeconomic environment, compared to the April forecast. Comparison of macroeconomic performance for the domestic economy with their projected dynamics within the April forecast cycle showed some deviations in certain segments of the economy, but still without major effects on the estimates of macroeconomic perspectives during the forecast horizon. Generally speaking, the October macroeconomic scenario for the current and the next three years (2019-2022) preserves the forecast for moderate acceleration of economic growth amid solid credit growth, absence of significant price pressures and balance of payments position that provides growth of foreign reserves. **However, the negative risks regarding the current macroeconomic scenario, which were in part emphasized also within the April forecast cycle, are currently assessed as more pronounced.** The external risks are related to the escalation of trade tensions between the world's largest economies and the accompanying uncertainty about the future course of policies. At the same time, the uncertainty in the financial markets is more pronounced, caused by the increase of trade and geopolitical tensions, the manner and time of implementation of Brexit, as well as the greater slowdown of economic activity in the most important economies. At the same time, unlike in April, uncertainty over the start of accession negotiations with the EU, combined with the possible emergence of political uncertainty in the short term, has created additional unfavorable domestic risks that could cause greater restraint for consumers and investors. As in April, the positive risk for the forecast is still the NATO integration process, which is not envisaged in the basic scenario. The current projection does not include shocks from the possible realization of the negative risks for global growth or domestic risks.

Certain changes occurred in the expected movements of the key indicators of the external economic environment in the period between the two projections. Thus, the forecasts for the growth of **foreign effective demand** have been revised downwards in relation to the April expectations, largely as a result of the expectations for lower economic growth of Germany. However, in terms of dynamics, in the period 2019-2021, a gradual moderate acceleration of the growth of foreign demand is expected, so that it will be 1.3%, on average. Also, **foreign effective inflation** has been revised downwards for 2019 and 2020. However, its moderate acceleration during the forecast horizon is expected and in 2021 it will reach 2%. The latest forecasts of **primary commodities prices** on the world markets for 2019 and 2020 indicate a downward revision of almost all prices relative to the April forecasts, with the exception of the nickel price, which has been revised upwards. Regarding the dynamics, after the realized growth in 2018, in most of the prices of the primary commodities, downward adjustments are expected in the period 2019-2020, while for 2021, the movements are in different directions.

The latest forecast show the economic growth the same as in the April cycle, i.e. the growth of the domestic economy is expected to gradually accelerate in the next period, given similar structure of growth factors. Thus, it is expected that by the end of 2019 the favorable movements from the beginning of the year will continue, which would **give the economy in 2019 a**



real growth of 3.5%, caused mainly by exports, while assessing further growth of activity in new export-oriented facilities, as well as to some of the traditional export sectors, as well as domestic demand, supported by higher investment activity ratings related to public infrastructure projects and higher personal consumption ratings, supported by the growth of all components of disposable income. **It is expected that the economic growth will intensify and reach 3.8% in 2020 and 4% in 2021**, with the estimations for further solid inflow of new foreign investment in the sector of tradable goods, public investment in road infrastructure, activities of the export-oriented facilities, as well as growth in disposable income and stable household expectations being the main factors for growth, as in the previous forecast cycle. From the aspect of the contributions of individual components, the October forecast envisages a growth that will arise from investments and exports. Such assessments are based on expectations for growth of investment activity, in conditions of stable domestic environment, further growth of foreign investment and continuation of the cycle of public investments in road infrastructure. The export growth estimates are in line with expectations for further growth in the activity of new facilities with foreign capital, as well as of some of the traditional export sectors, inflow of new foreign investments, as well as relatively favorable global environment (but with more pronounced downward risks). The favorable economic environment is expected to stimulate further growth of private consumption by increasing wages and employment in the private sector, and additional impact is expected from the credit support of the banks. The growth of domestic demand and export components will increase imports, but it is estimated that the increase in imports will be moderate and will not disturb external balance. **In a longer term, for 2022, it is expected that the Macedonian economy will keep on increasing, at a rate of around 4%.**

Credit activity of the banking sector would still be a major supportive factor for the economic growth. The latest credit market estimates in the forecast period indicate increased credit activity in 2019 and retention of solid growth rates in the next three years. Given the increased credit support in the first three quarters of 2019 and the expectations for its continuation by the end of the year, for 2019, the credit growth would be 5.4%¹, i.e. around 7% if the regulatory changes are exempted (7.3% at the end of 2018). As in the April forecast, the credit growth in 2020 is expected to be about 8% annually, and to continue at the same pace in the coming period (2021-2022). The estimates for the dynamics of the credit growth rely on the assumptions for stable expectations, growth of the deposit base and favorable capital and liquidity position of the banks. In line with the assessments for intensification of the economic activity, and having in mind the higher performance in the first nine months of the year, it is projected that the total deposits growth in the financial system for 2019 will be 9.6% (8.3% in the April projection). For 2020 and the next two years (2021-2022), given a assessment of a growth of the economy and further maintenance of the relatively high propensity to save in banks, annual deposit growth of 8.5% on average as expected in April forecast.

Regarding the future price trajectory in the domestic economy, the latest forecast points to environment of stable prices, without major inflationary pressures. The inflation projection for 2019 and 2020, given current lower performance and expectations for lower pressures from the import prices of primary goods and foreign effective inflation, was corrected downwards by 1% and 1.5%, respectively (compared to 1.5% and 2%, respectively in the April projection). In 2021, the inflation rate is expected to stabilize near 2% and to preserve that level until 2022. Over the forecast horizon, significant pressures from the domestic demand are not expected, given that the output gap is assessed as positive, but relatively small.

The external position of the economy is expected to remain favorable, in the absence of significant imbalances in the economy. **The current transaction deficit in the period 2019-2022 would be moderate and would average 1.5% of GDP, similar to the projected average deficit in the April forecast of 1.4% of GDP.** Such expectations for the future movements of the balance on the current account are a result of the slightly higher deficit in the balance of goods and

¹ The effect of the regulatory change that determined write off of suspicious and contested claims fully provisioned longer than one year from balance sheet records and their transfer to off-balance sheet records.



services, caused by the moderately higher trade deficit for the entire forecast period, with slightly better expectations in the balance of services. On the other hand, the projected lower primary income deficit and higher net inflows in current transfers largely mitigate the unfavorable expectations at the balance of goods. **The analysis of the annual dynamics indicates an expansion of the current account deficit in 2019 by 1.2 percentage points of GDP compared to 2018 and is projected at 1.3% of GDP.** For 2020, stabilization in the current account deficit at the level of 1.3% of GDP is expected, after which for 2021 and 2022 its slight expansion on an annual basis, to the level of 1.7% of GDP is projected. For the period 2020-2022, a steady improvement in the balance of goods is expected, in conditions of improvement of the balance in the non-energy deficit under the influence of growth of net exports in some of the new export capacities in the economy and part of the traditional export sectors. After a slight deterioration in 2020, the energy deficit would also improve during the projection period. At the same time, the service surplus is expected to continue to grow. On the other hand, the surplus of secondary income during the forecast period is expected to stabilize at a lower level, with a gradual deepening of the primary income deficit, in line with the expected growth of foreign investors' income in the domestic economy. **Analyzing the financial account, current transactions in the period 2019-2022 are expected to be funded through non-debt and debt financial flows i.e. foreign direct investment and borrowing of the public and private sector abroad.** In the three-year period under observation, the financial flows will fully cover the current account deficit, ensuring further foreign reserves growth. Foreign reserves adequacy indicators show that they have been in the safe zone throughout the forecast horizon.

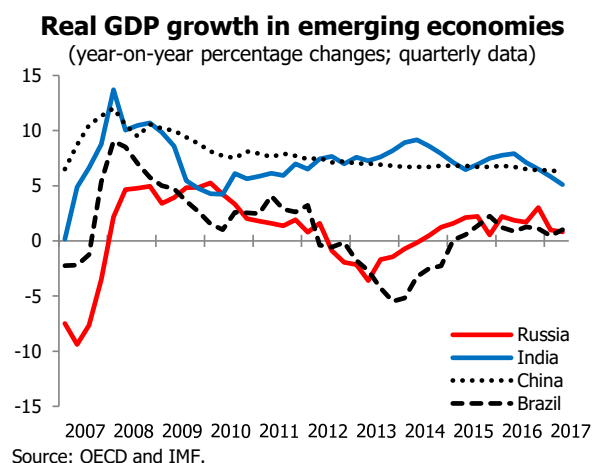
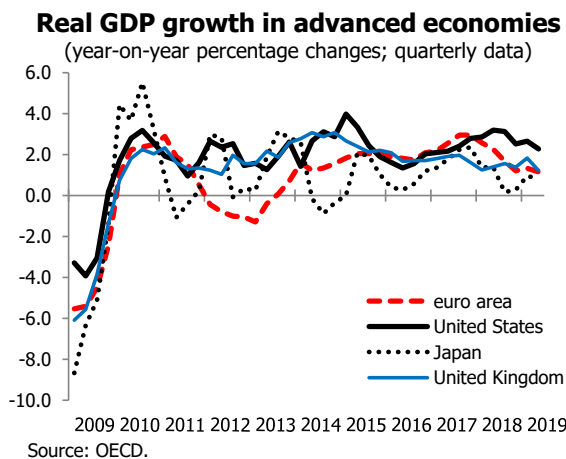
Generally speaking, the current macroeconomic forecasts point to safe and sound fundamentals of the domestic economy, with potential for solid growth supported by the banks' lending activity, amid absence of inflationary pressures and maintenance of favorable external position. This scenario assumes stable domestic environment, further inflow of foreign investments, enhanced public infrastructure cycle and higher external demand, more moderate though, compared to the April forecast. **However, the risks from the external environment, as well as from the domestic economy, are more pronounced compared to the April projections.** Any lack of materialization of the incorporated assumptions or risks may cause deviations from the forecast path of the key indicators. **In the period ahead, the National Bank will closely monitor the current trends** and changes in the domestic and external environment, in light of the monetary policy conduct.



I. Macroeconomic developments

1.1 International economic surrounding

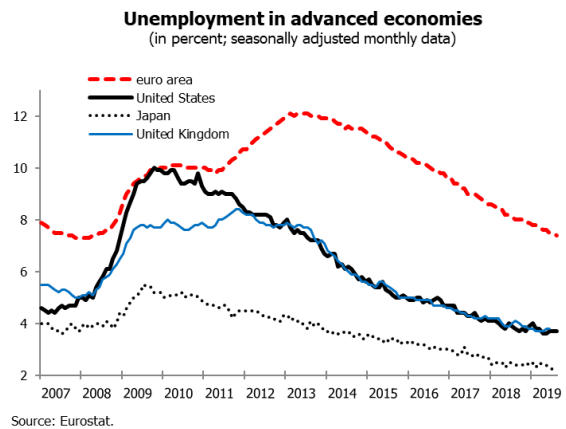
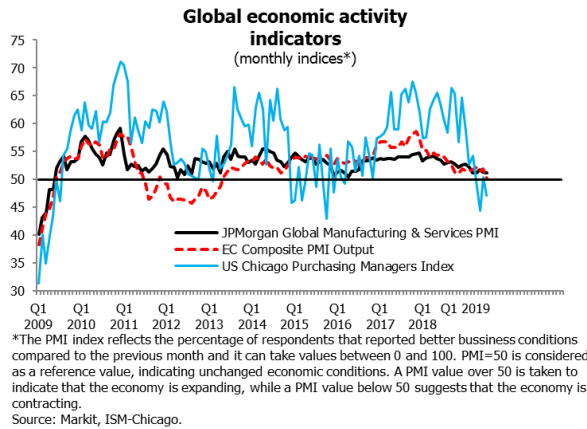
The global economic growth continued in the second quarter of 2019, but slowed down compared to the previous quarter, reflecting the movements in both developed and most of the emerging economies. In line with the weaker performance, as well as expectations, the latest IMF estimations from October 2019 have been revised downwards compared to the April forecast. Thereby, the global economic growth is expected to decelerate from 3.6% in 2018 to 3% in 2019 (the lowest rate since the global economic crisis) and then to accelerate moderately to 3.4% in 2020. Compared to the April forecast, expected growth of the global economy in 2019 and 2020 was revised downwards by 0.3 percentage points and 0.2 percentage points, respectively. In the short and medium term, there are significant downward risks to the global economic growth, with the escalation of the trade tensions and accompanying policy uncertainty, as well as deterioration of the financial market conditions that could be caused by trade and geopolitical tensions, no deal Brexit, and the continued slowdown in global economic growth being recognized as the most significant ones.



Global economy continued growing in the second quarter of 2019, but at a slower pace compared to the first quarter. The slowdown in economic activity in the second quarter is typical for the United Kingdom, the United States, Japan and the euro area. The annual economic growth rate in the United States in the second quarter was 2.3% (2.7% in the first quarter), with the slowdown largely due to weaker exports and investments, despite favorable private and public consumption. The euro area registered minimal slowdown in economic activity, with annual growth of 1.2% in the second quarter (1.3% in the first quarter), generally due to weaker performance in the German economy. The slowdown in economic activity in the UK (1.2% annual growth in the second quarter compared to 1.8% in the first quarter) is largely due to weak performance in the manufacturing sector amid uncertainty stemming from Brexit, while the slowdown in Japanese economy is the result of weaker performance in exports in conditions of reduced global demand. **Similar to developed countries, most emerging economies are registering deceleration of the economic growth.** China's annual economic growth slowed in the second quarter to 6.2% (6.4% in the first quarter), largely due to trade tensions between the country and the United States, while deceleration in the Indian economy (annual growth of 5.1% in the second quarter compared to 5.8% in the first) is due to

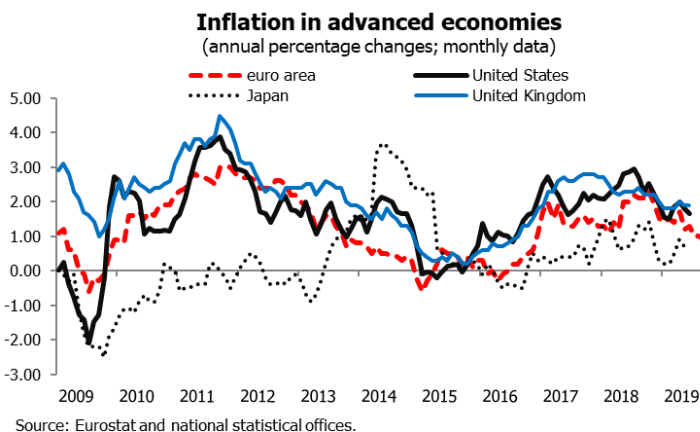


weaker domestic demand and weaker investment, in conditions of relatively unfavorable external factors. Furthermore, there was a slight slowdown also in Russia amid weaker investments and exports, while slight economic growth acceleration was registered in Brazil under the influence of investment growth and industrial output.



In terms of growth assessments in the third quarter of the year, currently available data point to similar movements as in the second quarter. Thus, the high frequency survey indicators - PMI are almost unchanged in the third quarter compared to the second, so the average PMI index in the third quarter is 51.4 (51.5 in the second quarter). However, the trend of the average index value in the last few quarters has been declining, which corresponds to the gradual global economic slowdown, which is expected to last until the end of 2019.

According to the latest IMF projections from October 2019, global economic growth is expected to decelerate to 3% in 2019 (3.6% growth in 2018), while in 2020 moderate acceleration of global economic activity, with a growth rate of 3.4%, is expected. This is a downward revision of the expected growth rates compared to the April estimates (by 0.3 percentage points for 2019 and 0.2 percentage points for 2020), which is mainly explained by the weaker economic performance in the first half of the year, as well as the unfavorable expectations for the rest of the year. The global growth of 3.4% in 2020 largely reflects the expectations for economic recovery in some emerging economies, for example, such as Latin America, the Middle East, and some emerging countries in Europe. **The risks in terms of projected global economic growth remain downward** and are mainly related to trade and geopolitical tensions between the world's largest economies, uncertainty over Brexit, and a slowdown in economic activity in the most significant economies compared to expectations. **From the aspect of global inflation**, during 2019 the inflation rates remain stable, relatively low, without expectations for significant price pressures, while in developed countries, mainly below the target level. Expectations for 2020 do not indicate significant changes in global price trends.





In the second quarter of the year, the economy in the euro area grew at an annual growth rate of 1.2% (0.2% on a quarterly basis), which compared to the first quarter of the year, is a slight slowdown². By sector, the lower growth in the euro area is linked to reduced activity in the manufacturing sector in conditions of declining international trade, global political uncertainty and trade tensions. On the other hand, both services and construction sector register solid performance, given relatively favorable financing conditions and moderately expansive fiscal policy. Labor market movements are also favorable, with the average unemployment rate in the second quarter being equal to 7.6%, the lowest since September 2008. In terms of countries, the slowdown in economic growth in the euro area is largely linked to the weaker performance of the German economy. According to the latest ECB projections, in 2019 the real GDP growth in the euro area is expected to be 1.1%, while for 2020 and 2021 a slight acceleration of growth is expected, which would reach 1.2% and 1.4%³. **The annual inflation rate in the euro area slowed in the third quarter to 1%** (1.4% in the second quarter). The low inflation rate, according to the ECB forecast will remain until the end of the year, so that the inflation rate in 2019 would equal 1.2%. For 2020, the slowdown in price growth is expected to continue (inflation rate of 1%), while for 2021 moderate acceleration of inflation to 1.5% is projected. Such expectations represent a downward correction compared to previous projections in June, mainly due to lower energy prices and weaker global economic growth⁴.

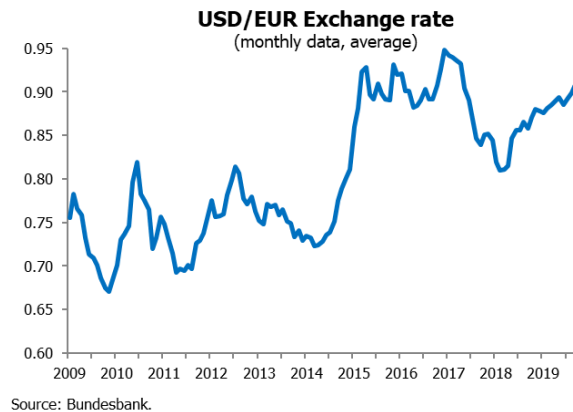
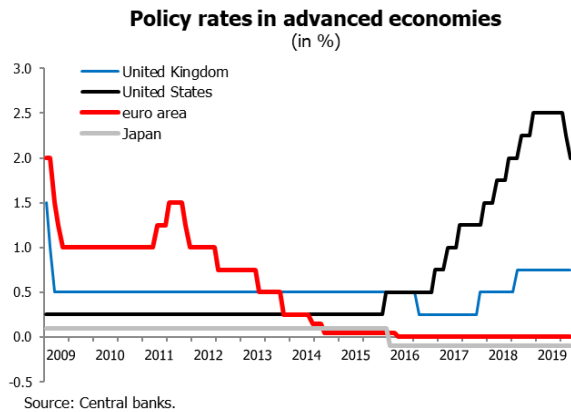
In the third quarter of 2019, monetary policy in developed countries was stimulating. Namely, after a long period of normalization of the interest rate, in July 2019 FED for the first time decided to reduce the target interest rate by 25 b.p., lowering it by the same amount at the meeting in September, thus reducing it to 1.75% to 2% interval. Amid favorable performance and expectations for the domestic economy, the easing of monetary policy is due to uncertainty about expectations in conditions of deceleration in the global economic activity and low inflation. At the same time, the financial markets expect another interest rate cut by the end of 2019. At the same time, the ECB eased monetary policy by lowering the deposit interest rate by 10 b.p. at the last meeting in September to the level of -0.5%, expecting that the interest rates will remain at current or lower level until the inflation rate approaches the level close to but below 2% for the projected period, despite the announcements in June of unchanged interest rates and their retention at least until the end of the first half of 2020. In addition, other measures were announced, including the resumption of the quantitative easing program⁵. In contrast, the Bank of England and the Bank of Japan have not made any changes to the monetary policy setup, but emphasize the risk of adverse global movements.

² In the first quarter, the annual growth equaled 1.3%, while 0.4% on a quarterly basis.

³ In September, the ECB revised the June forecasts for 2019 and 2020, estimating that the euro area real GDP growth will be 1.2% in 2019 and 1.4% in 2020 and the forecast for 2021 will remain unchanged.

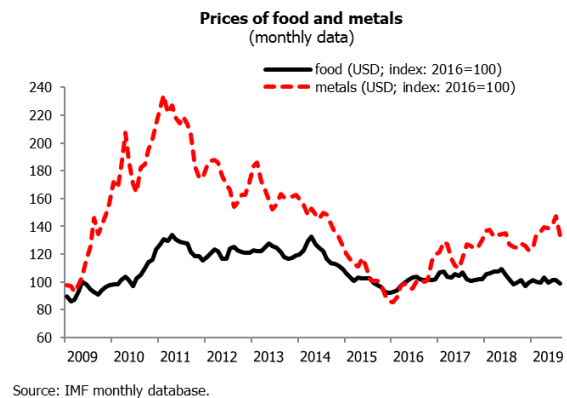
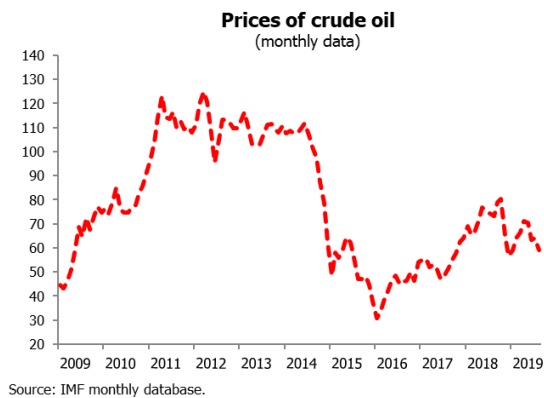
⁴ In September, the ECB revised the June forecasts, according to which the inflation in the euro area was projected to be 1.3% in 2019, 1.4% in 2020 and 1.6% in 2021.

⁵ At the meeting held on 12 September 2019, in addition to the decision on key interest rates, it was announced that: 1) from 11 November 2019, the quantitative easing program will resume, envisaging that securities in the amount of Euro 20 billion will be purchased on a monthly basis and that it will last until the ECB decides to increase interest rates; 2) full reinvestment of the due securities will continue for a longer period, as long as it is necessary to maintain the favorable liquidity conditions and the significant monetary adjustment; 3) changes in the program of long-term refinancing operations were made so that the interest rate will be at the level of the reference interest rate for refinancing operations, but not lower than the deposit rate, in contrast to the previously announcement for 10 b.p. higher than the reference interest rate and the measure will last for three years instead of two; and 4) on 30 October 2019, a two-tier system will be introduced for the reserve requirement, and part of the excess liquidity in the banking sector will be released from the negative deposit rate of the ECB.



In the third quarter of 2019, the US dollar depreciated slightly against the euro by 1.1%, on average, compared to the previous quarter. Annually, in the third quarter, the US dollar against the euro appreciated by 4.6%, and one US dollar was exchanged for 0.90 euros on average. This shift mostly reflects the uncertainty arising from the further trade tensions between the United States and China, the favorable economic performances in the USA, the weaker economic performances in the euro area, as well as the expectations in the course of the quarter for significant monetary accommodation by the ECB.

The price of oil averaged Euro 55.8 per barrel in the third quarter of 2019 and was significantly lower compared to the previous quarter (a decrease of 8.3%) and to the same quarter last year (down 14%). This change reflects mainly the growing uncertainty in trade relations between the United States and China, expectations for slowing global growth, as well as increased production in the United States and OPEC+ member states⁶.



The prices of the non-energy primary commodities⁷ (in euros) registered an increase of 1.7% in July – August period, compared to the previous quarter. Analyzed by group of products, the quarterly growth mostly stems from the higher metal prices. The basic metal index⁸ recorded quarterly growth of 1%, while the price of nickel and iron ore rose, amid solid demand and weaker supply. On the other hand, food prices, including cereals, are generally declining, with the food price index⁹ being lower by 0.5%, in conditions of favorable weather conditions in the United States,

⁶ The production of the OPEC+ countries increased in August although in the June meeting agreed to continue the measure for reduction of the production of oil by 1.2 millions of barrels of oil per day by the end of the first quarter of 2020 (additional 9 months).

⁷ This aggregate index includes the precious metals index, the food and beverage index, the agricultural raw material index and the basic metals index.

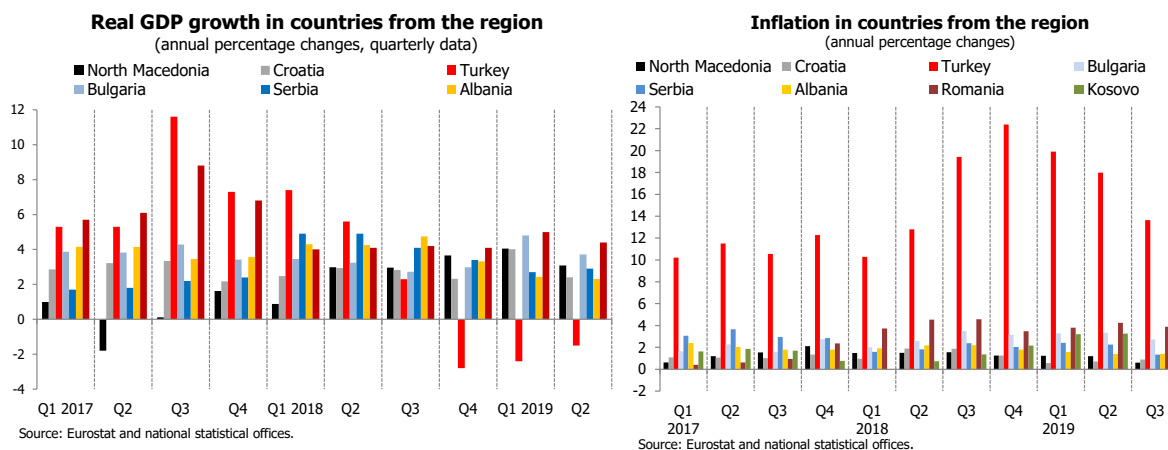
⁸ This index includes the following metals: aluminum, cobalt, copper, iron, lead, molybdenum, nickel, tin, uranium and zinc.

⁹ This index includes the following primary food products: cereals, vegetable oil, meat, seafood, sugar and other food.



increased global supply and increased export competition. Observed on an annual basis, the prices of primary non-energy commodities in euros increased by about 10% in the analyzed period.

In terms of macroeconomic performance in the economies in the region, most countries registered decelerated economic activity in the second quarter of 2019. At the same time, Romania and Bulgaria, as in the previous quarter, have the highest growth in the region of 4.4% and 3.7%, respectively. However, in both countries, economic activity slowed, mainly due to domestic demand and, to a lesser extent, exports. Croatia as well registered a growth slowdown, with lower rise in private consumption and exports, as well as Albania, given lower investment, but also higher imports. In contrast, Serbia recorded slightly stronger growth than in the first quarter as a result of accelerated growth in gross investment. Turkey has again registered a decline in the economy, but a slower amid a moderate decline in private consumption.



In the third quarter of 2019, inflation decelerated in most countries in the region. However, inflation slowdown was registered in Serbia, Bulgaria, Romania, Turkey and Kosovo, largely due to food and energy, which mainly registered smaller increase compared to the previous quarter. In Albania, the price growth is stable, while in Croatia inflation has accelerated, mainly due to the increase in food prices, contrary to their decline in the previous quarter

1.2 Domestic supply

According to the published GDP estimations, the domestic economic activity grows in the second quarter of 2019, with a real annual growth rate of 3.1% (4.1% in the previous quarter). The growth of the added value is dispersed, with the largest positive contribution being made by the activities "trade, transport and catering", supplemented by the contribution of the activities "public administration and defense"; "education and health and social care", "agriculture" and "construction". Most of the available data for the period July-August mainly indicate further growth of activity in the domestic economy. Also, the expectations of the managers of the companies in the retail trade, construction and processing industry for the upcoming period are generally favorable.

In the second quarter of 2019, the domestic economy recorded solid economic growth of 3.1% on an annual basis (slowing growth of 4.1% in the first quarter), i.e. growth of 0.3% on a quarterly basis (seasonally adjusted). The most significant positive contributions to the annual economic growth rate accounts cumulatively to the activities of "trade", "transport" and "catering". Also, solid activities have contributed to the activities of "public



administration and defense"; compulsory social insurance; education; activities of health and social care", agriculture and construction. The added value in the industry as well has a positive contribution to the total growth in the second quarter. However, in this segment there was a significant slowdown in growth compared to the last quarter, mostly due to the decline in the manufacturing industry.

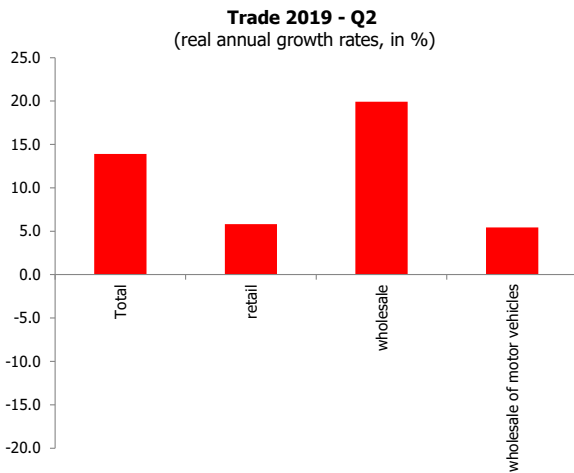
Annual growth rates (in %) and contributions to the GDP growth (in percentage points)

	annual growth rates, in %										contribution in GDP growth, in p.p.									
	2015	2016	2017	2018	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019	2015	2016	2017	2018	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019
Agriculture	1.9	-0.4	-13.5	-5.0	-4.7	-12.4	-4.8	0.3	13.6	3.9	0.2	0.0	-1.2	-0.4	-0.3	-0.9	-0.4	0.0	0.8	0.3
Industry	4.9	-3.0	1.8	3.7	0.0	5.6	3.6	5.4	3.4	0.5	0.8	-0.5	0.3	0.7	0.0	1.0	0.6	1.0	0.6	0.1
Manufacturing	5.0	-1.5	1.5	5.6	6.4	5.8	4.1	6.3	3.5	-2.1	0.5	-0.2	0.2	0.7	0.7	0.8	0.5	0.8	0.4	-0.3
Construction	8.0	-2.8	-4.4	0.2	-19.3	-2.0	-2.6	19.6	7.0	2.8	0.6	-0.2	-0.3	0.0	-1.1	-0.1	-0.2	1.3	0.4	0.2
Trade and transport	1.4	8.7	4.9	9.2	7.9	11.6	9.4	7.9	6.6	7.5	0.3	1.6	0.9	1.8	1.5	2.3	2.0	1.6	1.4	1.6
Information and communication	13.4	7.2	13.9	-6.6	-9.1	-3.0	-1.7	-12.6	-0.7	-4.6	0.4	0.2	0.4	-0.2	-0.3	-0.1	-0.1	-0.4	0.0	-0.1
Financial and insurance activities	8.7	1.5	-1.3	1.7	1.8	0.8	2.3	1.7	-1.1	0.2	0.3	0.0	0.0	0.0	0.1	0.0	0.1	0.0	0.0	0.0
Real estate activities	2.7	-3.2	-0.7	0.1	1.7	2.1	0.4	-3.8	1.3	2.3	0.3	-0.4	-0.1	0.0	0.2	0.2	0.0	-0.3	0.1	0.2
Professional, scientific and technical activities	5.9	11.5	5.7	10.7	19.2	10.8	7.7	5.2	0.7	3.6	0.2	0.4	0.2	0.4	0.7	0.4	0.3	0.2	0.0	0.1
Public administration	6.5	3.5	-2.1	-3.6	-5.0	-5.5	-1.8	-2.3	2.8	3.5	0.8	0.4	-0.3	-0.4	-0.7	-0.7	-0.2	-0.3	0.4	0.4
Other service activities	4.5	7.2	3.5	18.7	23.0	21.1	17.0	14.0	0.0	-0.2	0.1	0.2	0.1	0.5	0.7	0.6	0.5	0.4	0.0	0.0
Gross Domestic Product	3.9	2.8	0.2	2.7	0.9	3.0	3.0	3.7	4.1	3.1	3.9	2.8	0.2	2.7	0.9	3.0	3.0	3.7	4.1	3.1

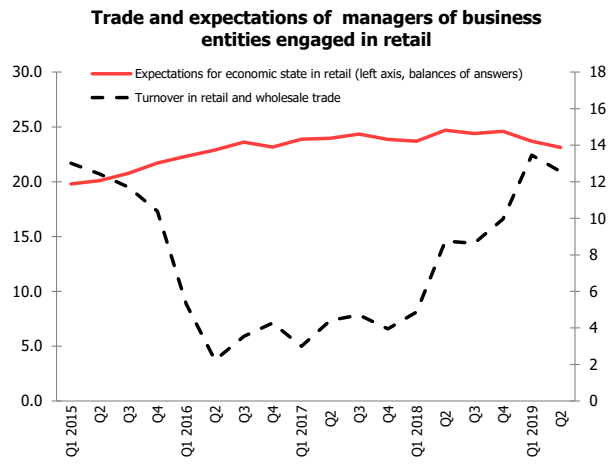
*From the release for GDP of 06.09.2019
Source: State Statistical Office and NBRNM calculations.

The trade turnover increases on an annual basis during the second quarter, as well.

The growth in this quarter is slightly slower compared to the previous quarter, with the more moderate dynamics being characteristic for all components, and the most pronounced slowdown in motor vehicle trade. In the period July-August, there was a moderate acceleration of the growth of the turnover in the total trade annually, amid favorable movements in all three categories (wholesale trade, retail trade and trade in motor vehicles). According to the positive results in the trade, the expectations of the managers of the companies in the "retail trade" sector for the third quarter in terms of orders, sales prices and the number of employees are mainly favorable¹⁰.



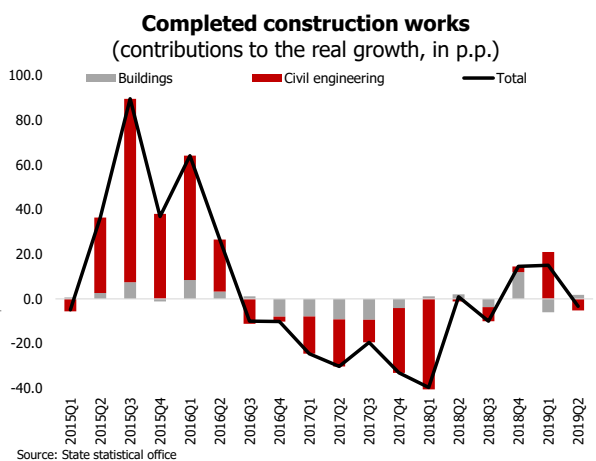
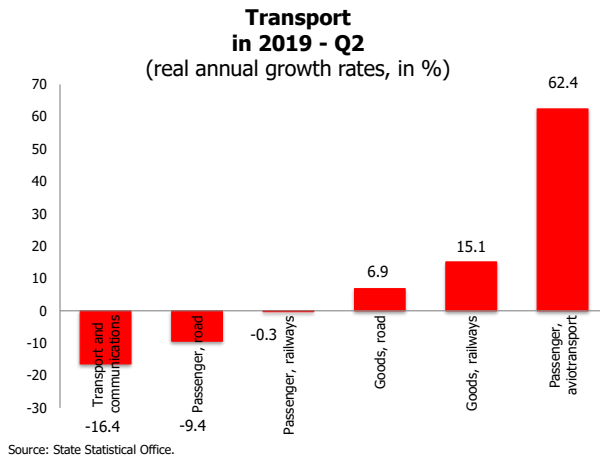
Source: State Statistical Office and NBRNM.



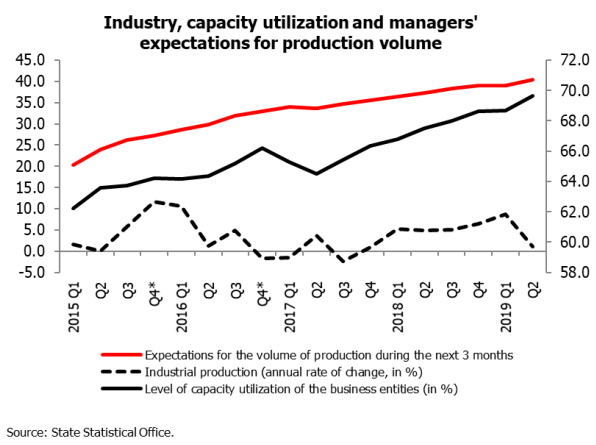
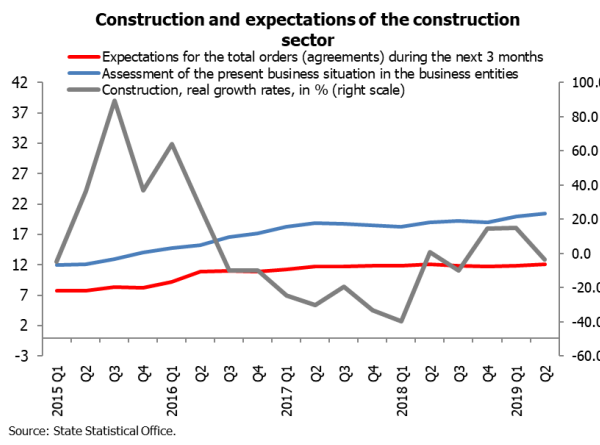
Source: State Statistical Office and NBRNM.

Regarding the transport, in the second quarter there was an increase in both the freight and passenger air traffic and the freight railway traffic. During this quarter, in the freight and passenger road traffic and in the passenger railway traffic, the decline continues.

¹⁰ The expectations of the managers of construction enterprises, in retail sale and manufacturing industry for the third quarter of 2019 are taken from the Business Tendencies Survey for the respective sector conducted in the second quarter of 2019.

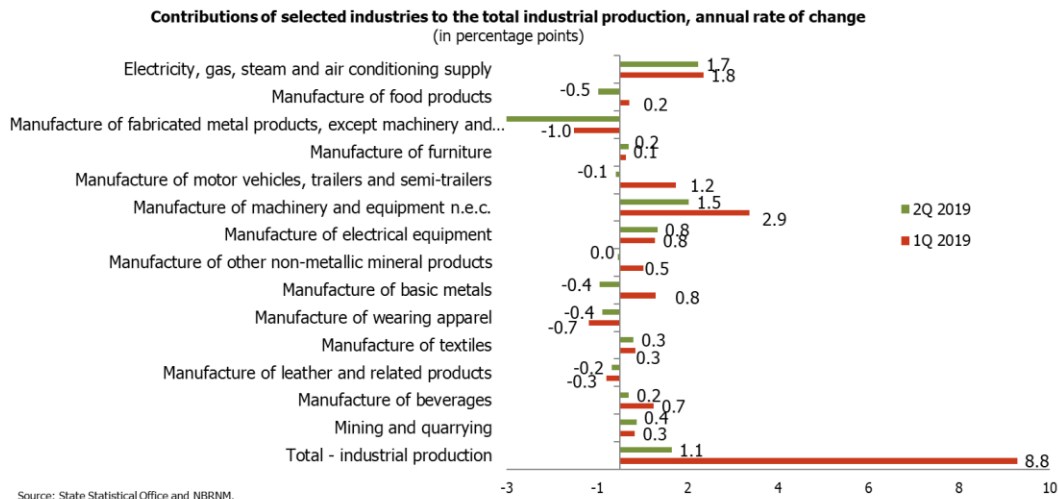


In the second quarter of the year, the added value in construction is characterized by a positive contribution to the total growth of real GDP, but twice lower compared to the contribution from the previous quarter. Such performance in the added value in construction does not fully correspond to the high-frequency indicators for this activity. Namely, after the high growth rates observed in the previous two quarters, the value of the total construction works performed in the second quarter decreased slightly, which is explained by the decline in civil engineering, while building construction recorded growth. In July, the activity in the construction sector again increased on an annual basis, visible through the favorable shifts in the total construction works performed, in the part of building construction. Also, the expectations of the managers in the construction sector for the third quarter in terms of sales prices, total orders, as well as the number of employees, are mainly favorable.



The increase in industry continued also in the second quarter of the year, but slower compared to the first quarter of the year. By structure, the growth generator are both, energy sector and mining¹¹. The manufacturing industry registered a decrease in production due to weaker activity in the sectors: "production of fabricated metal products other than machinery and equipment", production of tobacco products, clothing, food products, and metal production. The activities where larger foreign export facilities are operating (production of machinery and equipment and production of electrical equipment) continue to register solid growth and have the most significant positive contribution. In the period July-August, the annual growth in industrial output accelerates, under the influence of the energy sector and the processing industry, with mining registering more moderate contribution. Managers in the industrial sector have favorable expectations for the third quarter in terms of production, sales prices and the number of employees.

¹¹ The analysis of trends in industry uses data on the SSO's monthly data for the industrial output indices.

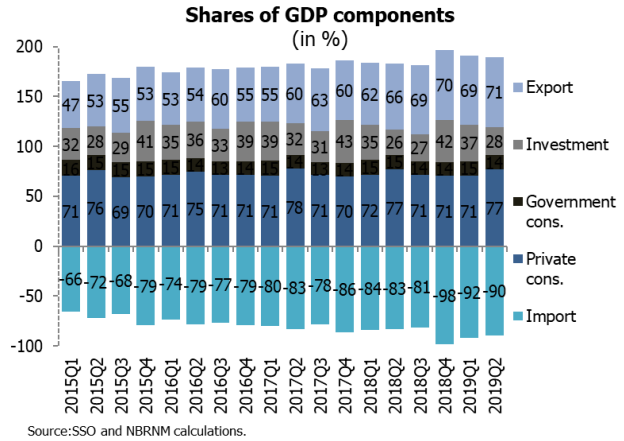
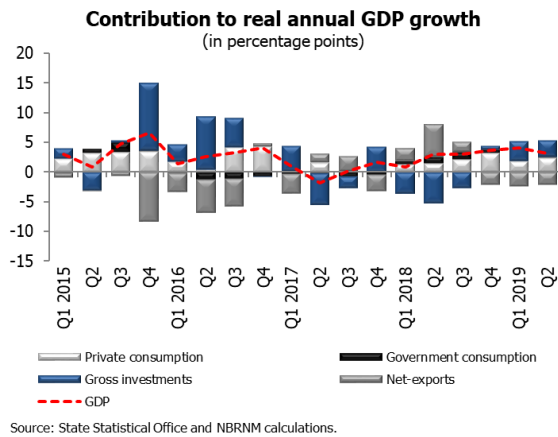


1.3 Aggregate demand

From the expenditure side of GDP, the annual growth of 3.1% in the second quarter of 2019 is driven by domestic demand, which arises primarily from the growth of gross investment and private consumption, with a small positive contribution of public consumption. The continuation of positive developments in gross investment corresponds to further growth of value added in construction, and solid growth of disposable income and lending supported the accelerated growth of private consumption. However, exports are still a category with the highest individual positive contribution to economic growth, which is mainly related to the activity of foreign export industrial facilities. The high growth of exports, together with the increased investment and private consumption, led to more pronounced growth of imports, so that net exports in this quarter had a negative contribution to economic growth.

The structural analysis of the GDP components¹² from the aspect of the demand shows that the growth in the second quarter of the year is due to domestic demand where the main drivers are gross investment and private consumption, and a small positive contribution is observed from public consumption. The shifts in investment correspond to changes in the value added of construction, which is growing (although weaker than in previous quarters), mainly due to the realization of some of the infrastructure projects. On the other hand, exports continue to grow and, as before, remain the category with the highest individual contribution to GDP growth. However, with the simultaneous growth of imports also in this quarter, the contribution of net exports is negative.

¹²The quarterly changes in GDP and its components are calculated on the basis of seasonally adjusted data.



	Real annual growth rates (%)								Contributions to real annual growth (in p.p.)											
	2015	2016	2017	2018	2018-Q1	2018-Q2	2018-Q3	2018-Q4	2019-Q1	2019-Q2	2015	2016	2017	2018	2018-Q1	2018-Q2	2018-Q3	2018-Q4	2019-Q1	2019-Q2
Private consumption	4.4	3.9	0.7	2.9	2.0	1.9	3.0	4.6	2.6	3.1	3.1	2.7	0.5	1.9	1.3	1.2	2.0	3.0	1.7	2.0
Government consumption	3.9	-4.9	-2.5	6.2	3.0	7.7	9.6	4.7	0.1	1.2	0.7	-0.8	-0.4	0.9	0.5	1.2	1.3	0.7	0.0	0.2
Exports of goods and services	8.5	9.1	8.1	15.3	12.8	14.1	12.0	21.7	15.6	10.6	4.0	4.4	4.1	8.5	6.5	7.8	7.1	12.1	8.8	6.3
Imports of goods and services	9.9	11.1	6.4	9.0	6.2	3.4	7.5	17.5	14.4	10.9	-6.5	-7.2	-4.2	-6.2	-4.2	-2.4	-5.0	-12.8	-10.1	-7.7
Gross capital formation	8.3	12.5	0.8	-7.2	-9.3	-16.4	-8.5	1.6	9.9	11.1	2.5	3.8	0.3	-2.4	-3.3	-4.8	-2.5	0.7	3.7	2.2
Domestic demand	5.4	5.1	0.4	0.3	-1.4	-2.2	0.6	3.6	4.4	4.6	6.3	5.6	0.3	0.4	-1.5	-2.4	0.8	4.3	5.4	4.4
Net exports*	14.1	16.7	2.1	-7.8	-8.8	-23.5	-11.9	8.0	11.0	12.1	-2.4	-2.8	-0.1	2.2	2.3	5.4	2.1	-0.7	-1.3	-1.3
Statistical discrepancy											0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
GDP	3.9	2.8	0.2	2.7	0.9	3.0	3.0	3.7	4.1	3.1	3.9	2.8	0.2	2.7	0.9	3.0	3.0	3.7	4.1	3.1

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

1.3.1 Private consumption

The growth of private consumption continued in the second quarter, with annual and quarterly growth of 3.1% and 1.6%, respectively. The private consumption was supported by an increase in almost all components of disposable income¹³. Namely, in the second quarter of the year, further growth in wages and pensions was registered, but smaller than in the first quarter, and the growth of household borrowings from banks had a positive contribution. In line with the growth of consumption, in the second quarter there was a further growth of retail trade and gross VAT revenues.

The signals from the available high-frequency data have indicate further growth¹⁴ of private consumption¹⁵ in the third quarter of 2019. Thus, in the period July-August, growth was registered in retail trade, real wages and pensions, with the lending to households increasing solidly. This partially corresponds with the results of the Lending Survey, which indicate a moderate easing of the total lending conditions, and a net decrease in the households demand for loans in this period. Also, during this period, the gross income from VAT increased, as well

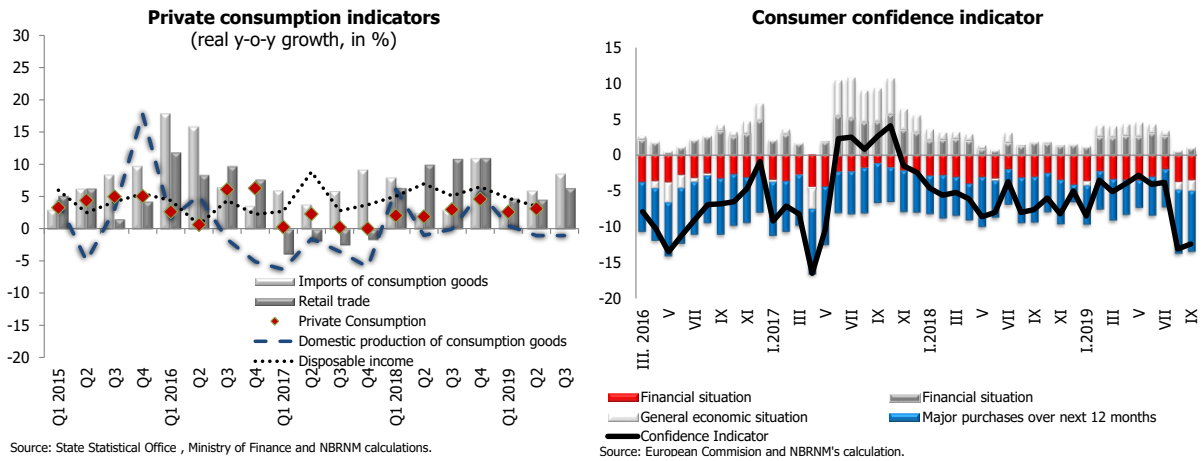
¹³ Out of the components of disposable income, only private transfers register a decrease in the second quarter of 2019.

¹⁴ According to the private consumption indicators, only the domestic production of consumer goods registered a decrease in the period July-August 2019.

¹⁵ Data on wages are as of July 2019, while data on household loans, pensions, retail trade, domestic production of consumer goods, import of consumer goods and gross revenues from VAT refer to the period July-August 2019.



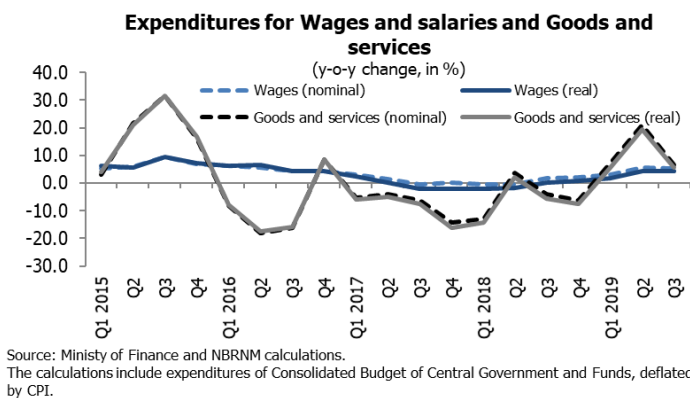
as the import of consumer goods. On the other hand, signals from consumer confidence surveys¹⁶ conducted in the third quarter indicate declining confidence given greater restraint from larger purchases and unfavorable expectations regarding the general economic situation, as well as perceptions of the less favorable financial standing of households.



1.3.2 Public consumption

In the second quarter, public consumption registered slightly more intensive growth, recording annual and quarterly growth of 1.2% and 3.2%, respectively. According to budget data, this increase in public consumption in the second quarter is supported by all its components, and most of all by higher expenditures based on goods and services.

The data for July-August 2019 indicate a nominal annual growth of **public consumption** in the third quarter, amid growth in almost all categories¹⁷ of public consumption.



¹⁶ European Commission's Consumer Survey as of September 2019. The chart shows the consumer confidence index as a net percentage of responses. This index is an integral component of the total index of economic confidence. Starting from January 2019, the European Commission revised the structure of consumer confidence indicator, and accordingly, the composite indicator of economic confidence. For more information on the new methodological changes visit: https://ec.europa.eu/info/files/revised-consumer-confidence-indicator_en

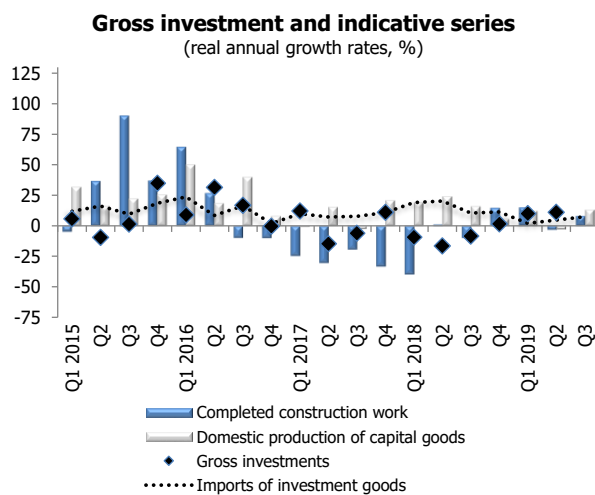
¹⁷ In the period July-August 2019, only the transfers to the PDIF registered a decline.



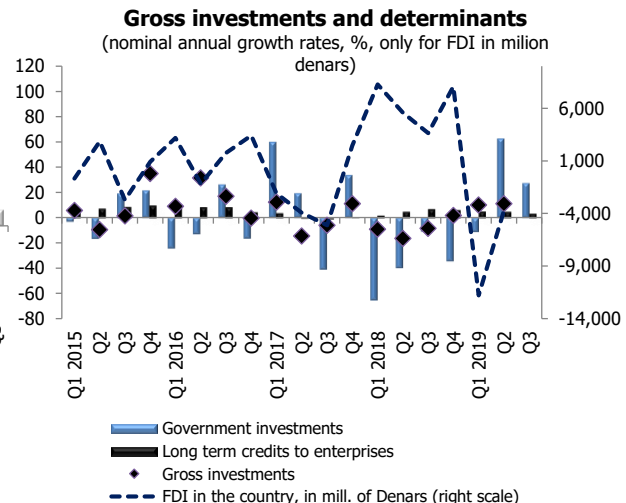
1.3.3 Investment consumption

Favorable shifts in gross investment in the last quarter of 2018 continue in the second quarter of 2019, with an annual growth of investment of 11.1% (decrease on a quarterly basis of 7.5%). Favorable changes in gross investment occur in the conditions of relatively low comparison basis from last year and are in line with the growth of value added in the construction sector and higher import of capital products in the second quarter of the year. Also, shifts in most short-term investment indicators are generally favorable. The strengthened investment activity was supported by the growth of long-term lending to enterprises, and growth was also registered in government capital investments.

Regarding the movements in investments in the third quarter of 2019, the high-frequency data on gross investments¹⁸ in the period July-August 2019 are also favorable. Thus, growth was observed in the construction sector, industry, the domestic production of capital goods, the import of investment products, as well as in government capital investments. The growth of the performed construction works corresponds to the favorable expectations of the construction managers for the total orders in the third quarter. Further favorable developments are also observed in the long-term loans of enterprises, in the case of net easing of credit conditions and minimal net decrease in the demand for loans, according to the results of the bank surveys. On the other hand, the only decline in the short-term indicators of investment dynamics was registered in corporate tax.



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



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

1.3.4 Net external demand

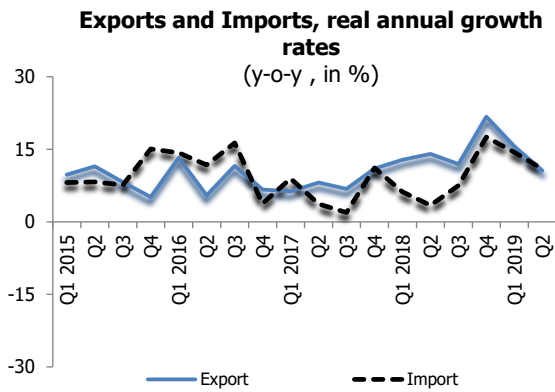
The negative contribution of net exports, present since the end of 2018, continued in the first half of 2019. Real exports in the second quarter of 2019 recorded an annual growth of 10.6%, which is a slight slowdown compared to the growth of the previous quarter, but is still a component with the highest positive contribution to GDP growth (on a quarterly basis a minimal decline of 0.2%). Analyzed according to the high frequency foreign trade statistics, the growth of the nominal export was mostly supported by the solid performances of the new export-oriented industrial facilities and some of the traditional export sectors (mainly food and tobacco). The growth of exports, along with

¹⁸ Data on completed construction works are as of July 2019, while data on long-term corporate loans, government capital investments, industrial production, imports of investment goods and domestic production of capital goods refer to the period July-August 2019.

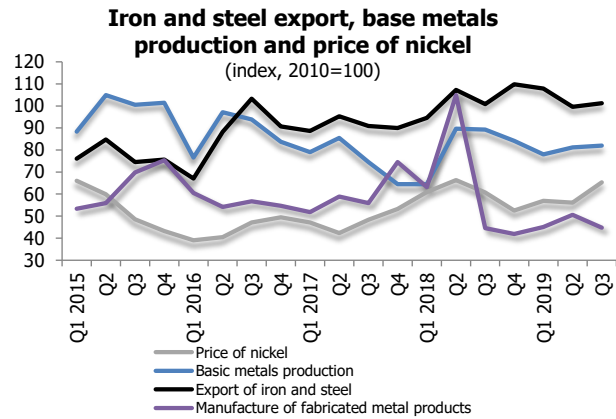


the growth of investment demand and private consumption, led to an annual growth of imports of 10.9% (quarterly decrease of 3.0%), which led to a negative contribution of net exports.

Foreign trade data in July-August 2019 indicate potential deficit expansion in the third quarter, on an annual basis, amid higher nominal growth of the import than the export of goods.



Source: State Statistical Office



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

1.4 Employment and wages

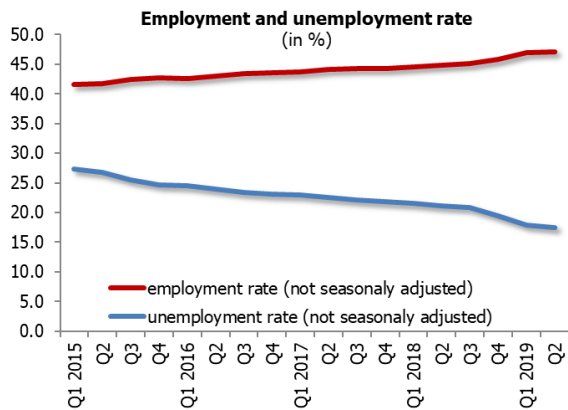
The labor market indicators in the second quarter of 2019 show further increase in the number of employees, with similar dynamics as in the previous quarter. Employment growth mainly stems from the growth in the number of employees in the manufacturing industry, from activities related to "art, entertainment and recreation" and from "administrative and auxiliary service activities". At the same time, the unemployment rate reduced to 17.5%, which again is the new historical minimum. The business tendency surveys mainly point to increased optimism about employment for the next three months. On the supply side, the annual growth of the active population, which began in the last quarter of 2016, continued. In terms of competitiveness indicators, in conditions of employment growth, the moderate decrease in labor productivity continues, and unit labor costs continue to grow.

The employment growth continued in the second quarter of 2019, with similar intensity as in the previous quarter. Thus, the number of employees increased by 5.2%, on an annual basis and by 0.6%¹⁹ on a quarterly basis. In terms of individual activities, annual employment growth is dispersed, with the largest contributions accounting to the manufacturing industry, activities related to "art, entertainment and recreation", "administrative and auxiliary service activities" and activities related to "wholesale and retail trade"; repair of motor vehicles and motorcycles ". On the other hand, a decrease in employment was observed only in the activity "agriculture, hunting and

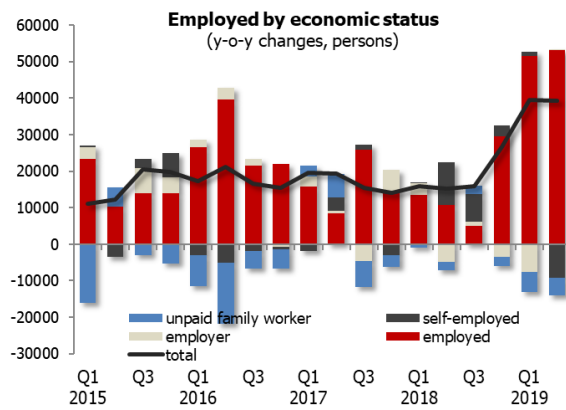
¹⁹ Analysis of quarterly dynamics of employment, unemployment and total active population is made by using seasonally adjusted data.



forestry". In terms of the economic status²⁰, the category of employed recorded the largest growth of the number of employees.



Source: State Statistical Office, Labour Force Survey.



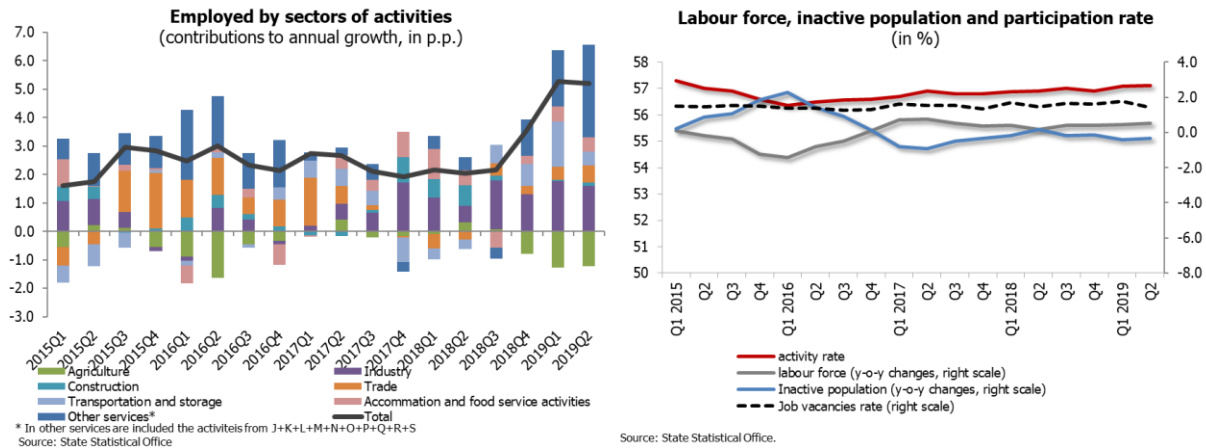
Source: State Statistical Office, Labour Force Survey.

In the second quarter of 2019, the employment rate amounted to 47.1%, which is an annual growth of 2.3 percentage points. Simultaneously, **the aggregated signals from business tendency surveys²¹ mainly suggest increased optimism** among of entities' managers regarding the employment for the next three months. In the second quarter **the job vacancy rate²² equals 1.4%** (identical to the same period of 2018). Analyzed on a longer-term basis, the job vacancy rate is relatively stable, which, amid continuous decrease in the unemployment rate, points to possible improvement of the connection process of the supply with the demand for skills in the labor market. In terms of activities, the highest rates of vacancies were recorded in the activities "accommodation facilities and food service activities" (4.1%), "administrative and auxiliary service activities" (3.0%), as well as "information and communications" (2.3%).

²⁰ 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).

²¹ Source: State Statistical Office, business tendency surveys in manufacturing industry (July and August 2019), construction (second quarter of 2019) and trade (second quarter of 2019).

²² The job vacancy rate is defined as the ratio between the number of job vacancies and the total number of jobs. Usually, the job vacancy rate is considered along with the unemployment rate (a relationship known as the Beveridge Curve). The placement of these two indicators gives information on labor market performance in terms of potential mismatches between demand profiles and those available on the job market at a given moment (skill mismatches). In particular, if both indicators are moving simultaneously, they are temporary, cyclical fluctuations, while in the case of the unemployment rate decreasing, with a stable vacancy rate, these are structural changes, that is, improving the efficiency of the labor market.



Analyzing the labor supply, the growth trend from the last quarter of 2016 continued in the second quarter of 2019. Thus in the second quarter, the total labor force increased by 0.5% annually, while the activity rate equaled 57.1%.

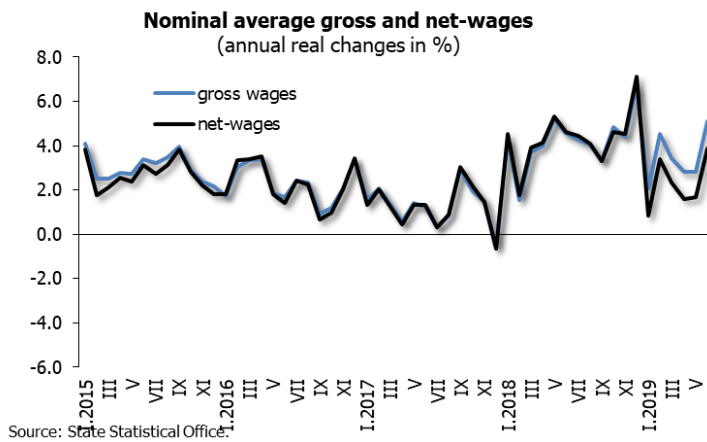
The stronger rise in the demand relative to supply of labor force in the second quarter of 2019 resulted in further fall in unemployment. The number of unemployed in the first quarter significantly decreased by 16.9% annually, while the unemployment rate reduced to 17.5% (annual and quarterly fall of 3.7 and 0.4 percentage points, respectively).

The average net and gross wages paid in the second quarter registered an annual growth of 3.6% and 4.8%²³, respectively, in part reflecting the annual adjustment of growth of the legally set minimum net wage²⁴, as well as the second-round effect of the wage increase in some public sector segments²⁵. Thereby, the highest annual growth of the net salary was registered in the activities: "transport and storage", "health and social care", "construction", "administrative and auxiliary service activities" and "agriculture, forestry and fishery". In the second quarter, given the growth of consumer prices of 1.2%, **the real annual growth of net and gross wages was 2.4% and 3.6%, respectively.**

²³ The faster increase in gross wages compared to net wages is a result of the increase in the rates at which contributions for compulsory pension and disability insurance and compulsory health insurance are paid, and due to the introduction of progressive personal income tax rates from early 2019. The rates at which contributions are paid in 2019 are 18.4% for compulsory pension and disability insurance and 7.4% for compulsory health insurance (previously these rates were 18% and 7.3%, respectively). The income tax, for the income acquired by labor, the income from self-employment, the income from copyrights and related rights and the income from the sale of own agricultural products, is paid at progressive rates, as follows: 10% personal income tax rate for income up to 90,000 denars (monthly tax base) and 18% on part of the income over 90,000 denars (previously applied proportional tax rate so-called "flat tax", which amounted to 10%).

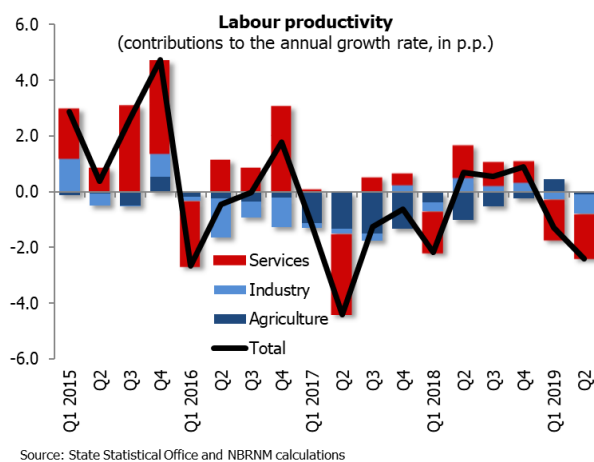
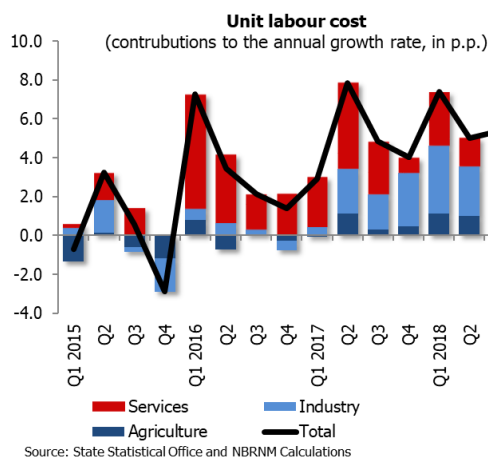
²⁴ The amount of minimum wage according to the Law on Minimum Wage (Official Gazette of the Republic of North Macedonia No. 59/19) which is paid for the period from April 2019 to March 2020 is Denar 17,943 in gross amount, i.e. Denar 12,507 net wage (before this period, the minimum wage was Denar 17,370 gross and Denar 12,165 net) in accordance with the adjustment with the increase for the previous year of the average wage paid in the RNM, the consumer price index and the real GDP growth (with one third of the growth of each indicator, respectively).

²⁵ There was an increase in the wages of 5% for the employees in health, education and in kindergartens starting with the September wage in 2018. According to the RNM Budget for 2019, the wages of specialists were increased by 10% from January and an additional increase of 5% is planned starting with the payment of the September wage in 2019, and the wages of other medical personnel in the public health institutions were also increased by 5% with the payment of the January wage in 2019. Also, the Decision of the Government of the Republic of North Macedonia adopted in May 2019, leveled the wages of around 2,900 employees in the field of culture, from both the national and the local institutions, starting from the April wage for 2019. In addition, the amendments to the Law on Protection of Children, starting with the June wage, increase the wages of educators, carers/nurses, professional workers and associates by 16%, and the Labor Agreement increases the wages of ancillary-technical staff. The wages of social workers were also increased by 22% with the payment of the June wage, and an additional increase of 5% is planned from September.



In terms of labor productivity, the annual decline, which was observed in the first quarter, continued in the second quarter of 2019. In conditions of stronger employment growth than the growth of the added value, labor productivity²⁶ decreased by 2.4% (decrease of 1.3% in the previous quarter). In terms of sectors, the decrease in the second quarter stems from the decline in productivity in all three sectors, but is largely explained by lower productivity in the services sector.

Then continuation of the wage growth, with a simultaneous decline in productivity, led to a further acceleration in unit labor costs, which in the second quarter reached 8.2% (7.9% in the previous quarter). At the same time, most of the growth is explained by the higher costs in the services sector, with a small increase in industry costs and a minimal reduction in costs in the "agriculture" sector.



1.5 Inflation

In the third quarter of 2019, the annual growth of domestic prices slowed down, bringing the annual inflation rate to 0.6%. Regarding the structure of key components, the slower annual growth of prices is a reflection of the slower annual growth of the prices of the food component of inflation and the slowdown in core inflation, as well as the larger fall in energy prices, in line with the movements of

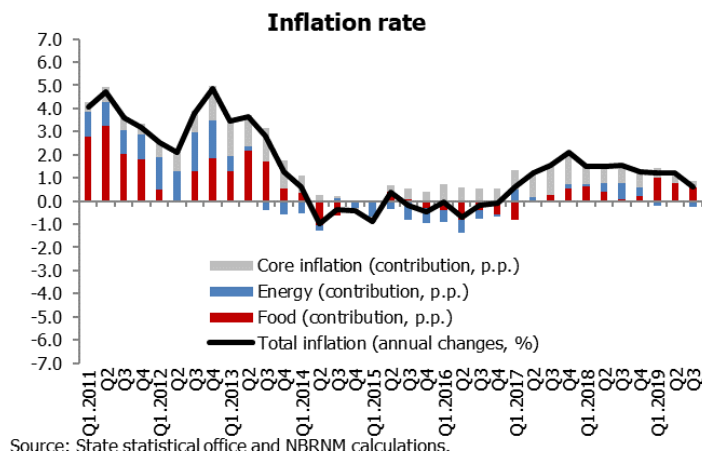
²⁶ Total labor productivity is a weighted sum of productivity of each sector. Sector productivity is the ratio of the sector's value added to the number of employees.



oil prices and oil derivatives on world markets. Regarding the future short-term dynamics of consumer prices, current movements in imported inflation and production prices of domestic producers indicate the absence of significant upward pressures on the general price level. However, unit labor costs moderately accelerated in the second quarter of the year. Regarding the expectations for the inflation rate in the coming period, according to the National Bank Survey, economic analysts expect that the inflation rate will be 1.4% in 2019, while in 2020 and 2021 they indicate an average inflation of 1.8% and 1.9%, respectively. Such expectations are similar to the National Bank's forecast, as well as the expectations of international institutions.

1.5.1 Current inflation

In the third quarter of 2019, the annual growth of domestic consumer prices registered a deceleration compared to the previous quarter (annual inflation rate of 0.6% versus 1.2% in the previous quarter)²⁷. During this period, the food prices and the basic inflation component, there is a slight slowdown in the annual growth, compared to the growth of the previous quarter, while in the energy prices the annual fall continues.



The core inflation rate slowed in the third quarter to 0.6% annually (1% in the previous quarter). The slowdown is largely a reflection of the slower annual growth in tobacco prices and clothing and footwear prices. From a structural point of view, tobacco has the highest positive contribution, followed by health and hospital services, cars, and travel arrangements. Other inflation sub-indices, which exclude the most volatile prices, have seen moderate growth acceleration on an annual basis. Thus, the total index, excluding energy²⁸, liquid fuels and lubricants (for transport) and unprocessed food registered an annual growth of 1.1% (0.9% in the previous quarter), while the total index excluding energy, liquid fuels and lubricants (for transport), unprocessed food, tobacco and alcoholic beverages registered an annual growth of 0.9% (0.5% in the previous quarter).

²⁷ On a quarterly basis, consumer prices decreased by 0.4%, while on a seasonally adjusted basis they decreased by 0.1%.

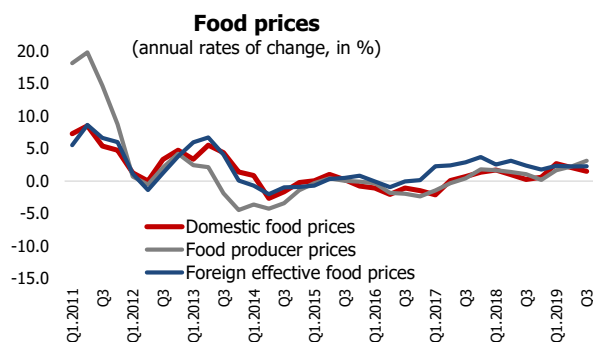
²⁸ The category "energy" refers to electricity, gas, liquid and solid fuels for heating and central heating.



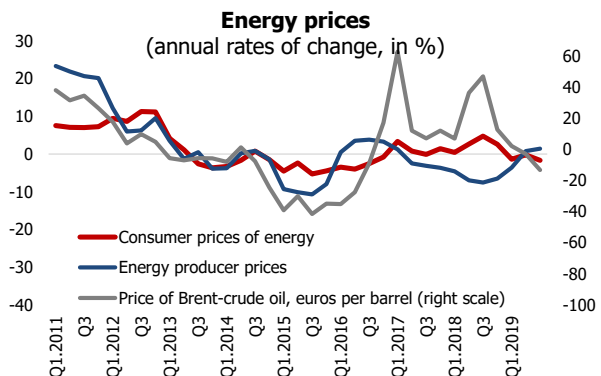
	(annual changes, in %)										(contribution to annual changes, in p.p.)								
	2017				2018			2019			2017			2018			2019		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q1	Q2	Q3	Q1	Q2	Q3	Q4	Q1	Q2	Q3		
Consumer price index - all items	1.4	1.5	1.5	1.6	1.2	1.5	1.2	1.2	0.6	1.4	1.5	1.5	1.6	1.2	1.5	1.2	1.2	0.6	
Food	0.0	1.7	1.0	0.2	0.6	0.9	2.7	2.1	1.5	0.0	0.7	0.4	0.1	0.2	0.3	1.0	0.8	0.6	
Energy	1.4	0.5	2.7	4.8	2.6	2.6	-1.4	-0.2	-1.7	0.2	0.1	0.4	0.7	0.4	0.4	-0.2	0.0	-0.2	
Electricity	-0.2	-0.2	-0.2	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	0.0	
Heat energy	-7.6	-2.5	-2.5	-2.8	-2.9	-2.7	-2.9	-2.9	-5.2	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Fuels and lubricants	6.7	2.0	11.1	19.6	10.7	10.7	-4.5	0.1	-5.1	0.2	0.1	0.4	0.6	0.4	0.4	-0.2	0.0	-0.2	
Food and energy (volatile prices)	0.4	1.4	1.5	1.5	1.1	1.4	1.6	1.5	0.6	0.2	0.7	0.8	0.8	0.6	0.7	0.8	0.8	0.3	
Core inflation calculated by the NBRM (total index - food and energy (categories 01.1, 04.5, 07.2.2))	2.3	1.6	1.5	1.7	1.3	1.5	0.9	1.0	0.6	1.1	0.8	0.7	0.8	0.6	0.7	0.4	0.5	0.3	
Overall index excluding energy, liquid fuels and lubricants and unprocessed food (SSO)	1.5	1.3	1.1	1.1	0.6	1.0	0.6	0.9	1.1										
Overall index excluding energy, liquid fuels and lubricants, unprocessed food, tobacco and alcoholic beverages (SSO)	1.2	1.0	0.7	0.9	0.3	0.7	0.3	0.5	0.9										

Source: State Statistical Office and NBRNM calculations.

In the third quarter, the growth of **food prices** was more moderate (annual growth rate of 1.5%, compared to 2.1% in the second quarter). At the same time, the main driver of the price growth of food are the prices of bread and wheat, while the prices of meat, dairy products and fish have slightly smaller contribution. On the other hand, the selling prices of domestic food producers, as well as the foreign effective food prices register minimal growth acceleration in the third quarter²⁹. In **energy prices**, annual decline was registered also in this quarter, which is significantly larger compared to the previous quarter, which is mainly explained by the movement of domestic prices of oil derivatives, and to a lesser extent the prices of central heating³⁰. This shift in domestic energy prices is in line with the downward movement in the price of crude oil and oil derivatives on the world market. On the other hand, selling prices of energy producers recorded a small annual growth³¹ for the second consecutive quarter.



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



Source: State statistical office and NBRNM calculations.

Industrial producers' prices rose slightly in the third quarter (1.2% compared to 1% in the second quarter), as well as **production prices of energy and consumer goods** (increase of 1.4% compared to 1.2% in the second quarter)³². **The foreign effective inflation**³³, as an indicator of imported inflation, in the third quarter recorded a moderate slowdown in growth dynamics compared to the previous period (annual growth of 1.4% compared to the increase of 1.6% in the second quarter).

²⁹The analysis of the selling prices of domestic food producers and foreign effective food prices refers to the first two months of the third quarter.

³⁰ According to the decision of the Energy Regulatory Commission, the price of heating in the BEG system as the largest supplier of heat in Skopje is reduced by 6% from August 2019, as a result of the previously adopted decision to reduce VAT on heat from 18 to 5 %.

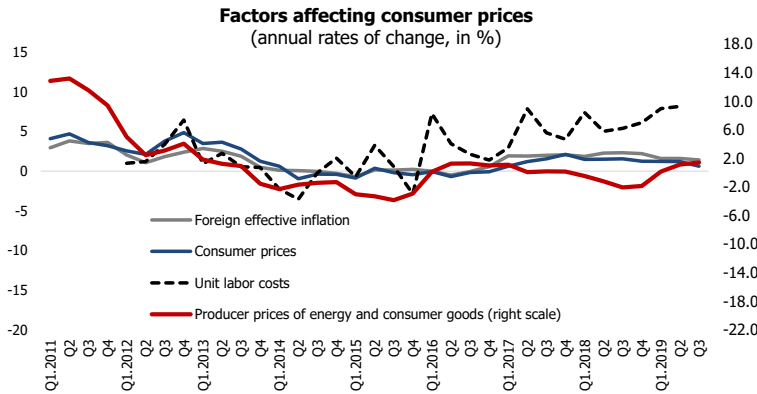
³¹The analysis of oil prices and selling prices of energy producers refers to the first two months of the third quarter.

³²The analysis of the prices of producers of industrial products and production prices of energy and consumer goods for the third quarter refers to the first two months of the third quarter..

³³ The calculation of foreign effective inflation derives from the weighted sum of consumer price indices of the countries that are major partners of the Republic of North Macedonia in the field of import of consumer goods. The weight structure is based on the normalized shares of nominal imports from each country in the total nominal imports in the period 2010-2012. The calculation of this indicator includes Bulgaria, Germany, Greece, France, Italy, Austria, Slovenia, Croatia and Serbia. The analysis refers to the first two months of the quarter.

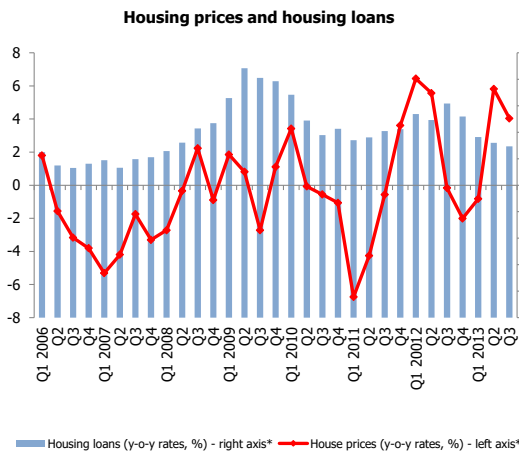


Although so far there has been no significant pressure on domestic inflation through the channel of foreign prices and producer prices, **unit labor costs** remain high (8.2% in the second quarter, compared to 7.9% in the first quarter of 2019). Given the small positive output gap³⁴ in the domestic economy, a possible continuous growth of labor costs could potentially put upward pressures on the prices of final products in the future.

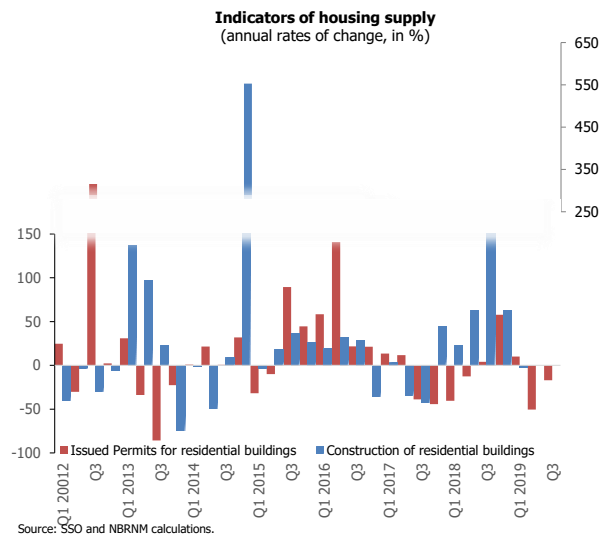


Source: State statistical office and NBRNM calculations.

In the third quarter of the year, apartment prices, as measured by the Hedonic index³⁵, increase at a rate of 4% which is more moderate compared to the annual growth of the previous quarter. From the aspect of the offer, the value of the built residential buildings increased slightly in the second quarter of the year, and an increase is also noticed in the value of the issued approvals for construction of residential buildings³⁶. Analyzing the demand, also in the third quarter of 2019, the demand for apartments was supported by the solid rise in the housing loans³⁷.



Source: NBRNM. Index of housing prices is calculated by the employees of the NBRNM based on the data from the daily newspapers.
*Annual changes for 2009 are not calculated due to changes in methodology.



Source: SSO and NBRNM calculations.

³⁴ The National Bank assessments show that domestic production is above the potential level (positive output gap) throughout the period of forecast (until 2020). However, it is estimated that the positive output gap throughout the period is small and stable.

³⁵ Hedonic index of housing prices, prepared by the National Bank on the basis of the notices of sale in the capital city, and published by the agencies dealing with trade in real estate. The apartment price is a function arising from the size of the apartment, the neighborhood in which it is located, the floor, whether the apartment has central heating and whether the apartment is new.

³⁶The analysis refers to the first month of the third quarter.

³⁷Available data for the first two months of the quarter.



1.5.2 Inflation expectations

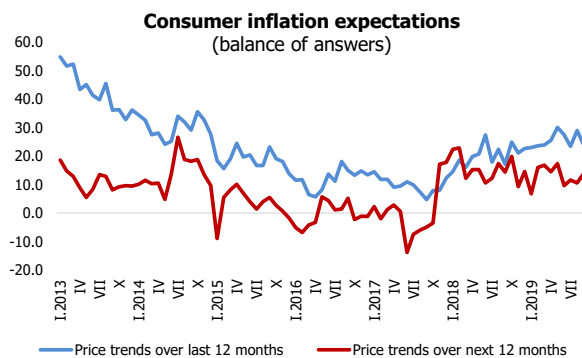
Expectations for the next period do not indicate significant changes in terms of dynamics and movement of the inflation rate. Thus, according to economic analysts, a slight acceleration of the inflation rate in the next two years is expected. According to a **Survey on Inflation Expectations and Expectations for Movement of the Real GDP**³⁸ in September, surveyed analysts expect an inflation of 1.4% in 2019, while the inflation rate will accelerate slightly in the coming period and that will equal 1.8% and 1.9% in 2020 and 2021, respectively. Similar movements and dynamics of inflation are predicted by other domestic and international institutions.

Forecasts and expectations for the inflation rate

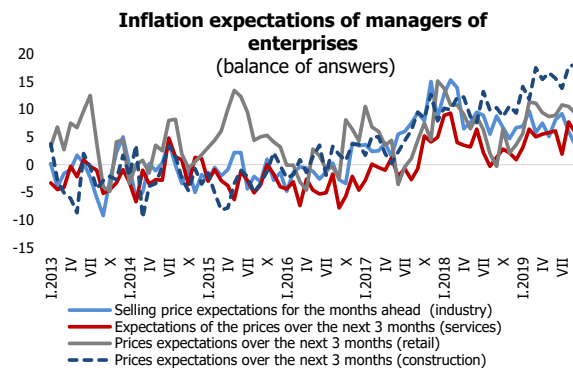
	2019	2020	2021
Economic analysts	1.4	1.8	1.9
IMF	1.3	1.7	2.0
Consensus Forecast	1.6	2.0	/
Ministry of Finance	2.0	2.0	2.2
NBRNM	1.0	1.5	2.0

Source: Inflation and real GDP growth expectations survey, June 2019; IMF World Economic Outlook, April 2019; Consensus Forecast, June 2019; Ministry of Finance, Fiscal strategy 2020-2022, May 2019; NBRNM, October 2019.

The short-term consumer and company managers' expectations for price movements, expressed in the surveys in the third quarter, are similar. Thus, according to "**consumer expectations for price changes in the next 12 months**"³⁹, many people believe that in the next 12 months there will be an increase in prices, as opposed to the number of people expecting a reduction or unchanged prices. Also, expectations for increase in their prices in the next few months prevail in the **corporate sector**⁴⁰. At the same time, the expectations in trade and construction are more optimistic compared to those from the previous quarter, while the expectations in the industry and service activities are more moderate.



Source: European Commission.



Source: European Commission.

1.6 Balance of payments

In the second quarter of 2019, the current account of the balance of payments recorded a moderate deficit, unlike the same period last year when there was a

³⁸ Starting from October 2017, the National Bank changed the current Inflation Expectations Survey. The new Survey on Inflation Expectations and Expectations for the Movement of the Real GDP is conducted on a sample of economic analysts, and the subject of the Survey has also been expanded, according to the practice of the European Central Bank (ECB).

³⁹ European Commission's Consumer Survey as of September 2019.

⁴⁰ European Commission's business tendency surveys in industry, retail trade, construction and services sector as of September 2019.



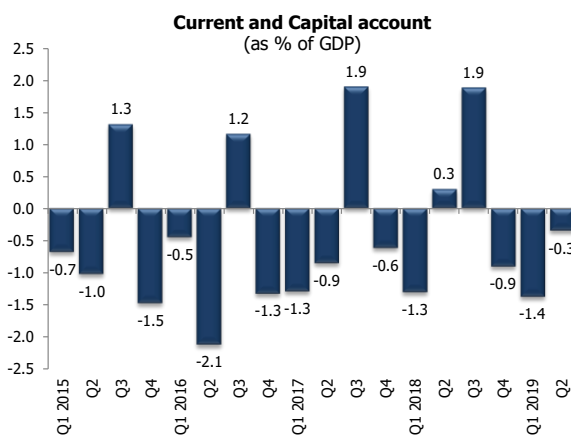
small surplus in the balance of current transactions. These changes in the current account are mainly a reflection of the higher deficit in the balance of goods and services. In the financial account, higher net inflows were realized compared to the second quarter of 2018, caused by better performance in the currencies and deposits of banks and trade loans, while inflows based on foreign direct investment are lower on an annual basis. The financial flows in the second quarter of 2019 enabled full financing of the current account deficit, as well as additional growth in foreign reserves during the quarter.

	2018						2019			2018						2019		
	Ks.1	Ks.2	Ks.3	Ks.4	I-VI	I-XII	Ks.1	Ks.2	I-VI	Ks.1	Ks.2	Ks.3	Ks.4	I-VI	I-XII	Ks.1	Ks.2	I-VI
	in EUR mil.																	
	% of GDP																	
I. Current account	-141.0	30.8	199.9	-104.7	-110.1	-14.9	-156.1	-39.4	-195.5	-1.3	0.3	1.9	-1.0	-1.0	-0.1	-1.4	-0.3	-1.7
Goods and services	-359.2	-285.6	-208.2	-519.7	-644.8	-1372.7	-370.1	-336.0	-706.1	-3.4	-2.7	-1.9	-4.9	-6.0	-12.8	-3.3	-3.0	-6.3
Credit	1407.4	1566.2	1690.9	1788.0	2973.6	6452.5	1624.0	1708.7	3332.7	13.2	14.6	15.8	16.7	27.8	60.3	14.4	15.1	29.5
Debit	1766.6	1851.8	1899.1	2307.7	3618.3	7825.2	1994.1	2044.7	4038.8	16.5	17.3	17.8	21.6	33.8	73.1	17.7	18.1	35.8
Goods	-462.8	-403.1	-395.4	-473.6	-865.9	-1734.9	-472.7	-433.9	-906.6	-4.3	-3.8	-3.7	-4.4	-8.1	-16.2	-4.2	-3.8	-8.0
Services	103.6	117.6	187.1	-46.1	221.2	362.2	102.6	97.9	200.5	1.0	1.1	1.7	-0.4	2.1	3.4	0.9	0.9	1.8
Primary income	-113.8	-111.3	-117.7	-107.9	-225.1	-450.7	-112.4	-111.3	-223.7	-1.1	-1.0	-1.1	-1.0	-2.1	-4.2	-1.0	-1.0	-2.0
Secondary income	332.0	427.7	525.8	523.0	759.7	1808.5	326.4	407.9	734.3	3.1	4.0	4.9	4.9	7.1	16.9	2.9	3.6	6.5
II. Capital account	1.2	1.4	1.2	7.7	2.7	11.6	0.6	0.1	0.7	0.0	0.0	0.0	0.1	0.0	0.1	0.0	0.0	0.0
Net lending (+) / net borrowing (-) (balance from current and capital account)	-139.7	32.3	201.1	-96.9	-107.5	-3.3	-155.5	-39.3	-194.8	-1.3	0.3	1.9	-0.9	-1.0	0.0	-1.4	-0.3	-1.7
III. Financial account	-415.0	-16.7	112.7	-226.2	-431.7	-545.2	-149.1	-73.9	-223.1	-3.9	-0.2	1.1	-2.1	-4.0	-5.1	-1.3	-0.7	-2.0
Direct investment	-233.5	-69.7	3.8	-304.4	-303.2	-603.7	-41.2	-7.6	-48.7	-2.2	-0.7	0.0	-2.8	-2.8	-5.6	-0.4	-0.1	-0.4
Portfolio investment	-368.6	1.4	35.0	11.9	-367.2	-320.3	22.3	18.3	40.6	-3.4	0.0	0.3	0.1	-3.4	-3.0	0.2	0.2	0.4
Currency and deposits	80.0	73.1	72.8	59.8	153.1	285.6	35.2	-30.0	5.3	0.7	0.7	0.7	0.6	1.4	2.7	0.3	-0.3	0.0
Loans	47.9	-56.4	-35.3	36.5	-8.5	-7.2	-16.8	-25.6	-42.4	0.4	-0.5	-0.3	0.3	-0.1	-0.1	-0.1	-0.2	-0.4
Trade credit and advances	59.3	35.5	36.6	-29.7	94.8	101.7	-148.7	-28.7	-177.4	0.6	0.3	0.3	-0.3	0.9	1.0	-1.3	-0.3	-1.6
Other accounts receivable/payable	0.0	0.0	0.2	0.1	0.0	0.2	0.0	-0.3	-0.3	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	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
IV. Net errors and omissions	-18.6	12.0	3.2	11.9	-6.7	8.4	0.9	14.7	15.6	-0.2	0.1	0.0	0.1	-0.1	0.1	0.0	0.1	0.1
V. Reserve assets	256.6	60.9	91.6	141.1	317.6	550.3	-5.6	49.4	43.8	2.4	0.6	0.9	1.3	3.0	5.1	0.0	0.4	0.4

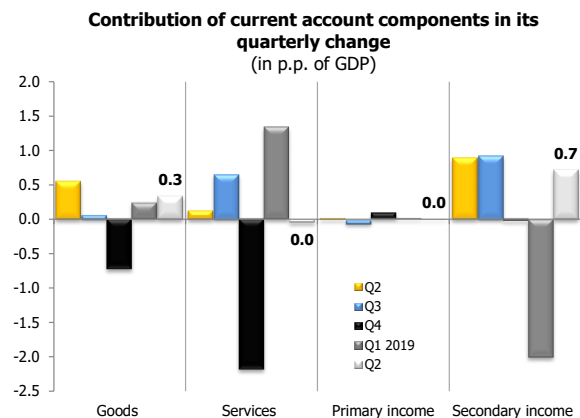
Source: NBRM.

1.6.1 Current account

The current account deficit in the second quarter of 2019 amounted to Euro 39.4 million, or 0.3% of GDP, a deterioration of 0.6 percentage points compared to the same period of the previous year, when a surplus was realized.



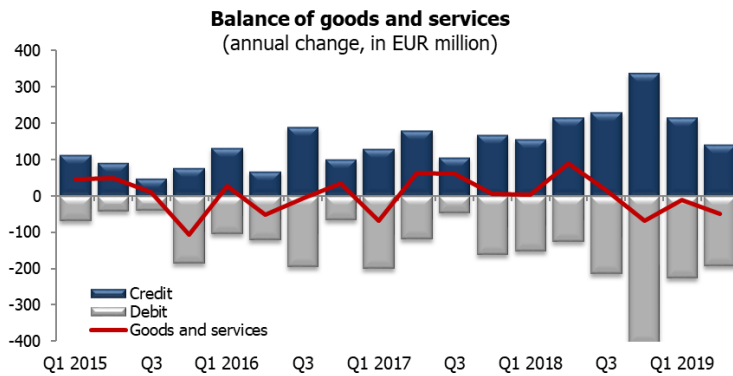
Source: NBRM.



Source: NBRM.



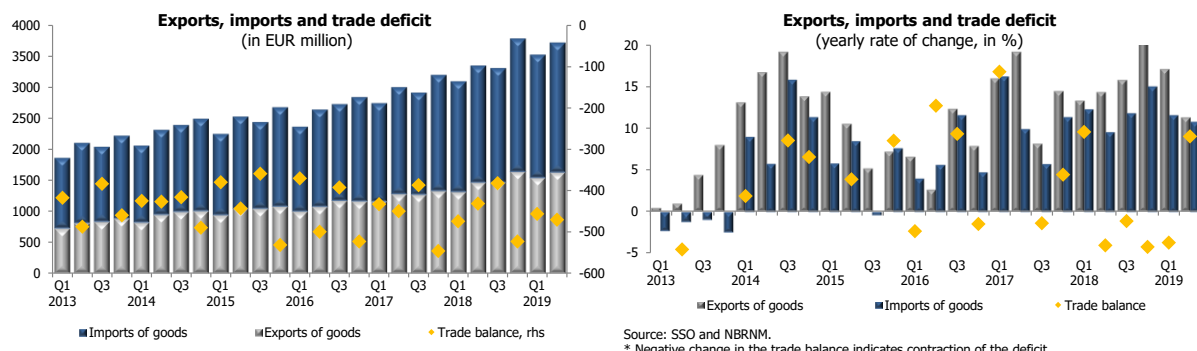
This change is largely due to the higher deficit in trade in goods and services, as well as lower net inflows in secondary income (as a result of lower performance in private transfers). The annual changes in the services arise in most of the more unfavorable performance, i.e. the lower surplus in the production services for further processing. A slight deterioration on an annual basis has also been registered in the balance of goods, caused by higher raw material imports for industry, especially in the import of raw materials for part of the new production facilities in the economy. Primary income does not change significantly on an annual basis.



* Positive change in the import of goods mean it's decrease.
Source: NBRM.

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

In the second quarter of 2019, foreign trade amounted to Euro 3,719 million, i.e. 32.9% of GDP, which is higher by 11.1% (or 1.7 percentage points of GDP) compared to the same period last year. The annual growth in total trade stems from the solid growth of its two components.



Source: SSO and NBRNM.

Source: SSO and NBRNM.

* Negative change in the trade balance indicates contraction of the deficit.

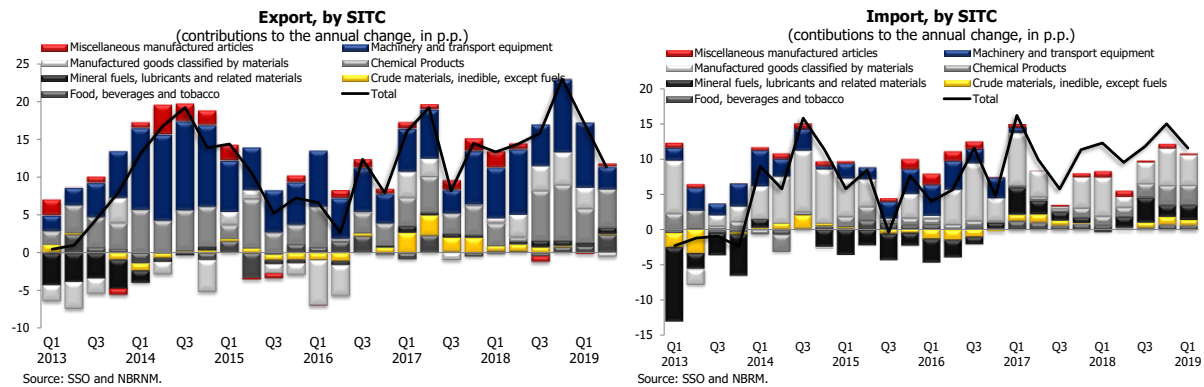
The export of goods in the second quarter of 2019 recorded an annual growth of 11.3% (17.1% in the previous quarter), which is still mostly due to the favorable performance of the new export-oriented facilities. Structurally speaking, this is largely perceived through the increased placement of chemical substances and products, and machines and transport equipment. In addition, some of the traditional export sectors have a positive contribution to export growth, i.e. increased exports are in the food and tobacco categories. On the other hand, iron and steel exports registered slight fall, after four quarters of solid positive contribution. Taking into account the growth on a quarterly basis, the annual decline in this category arises from the higher comparative base and is a result of lower exported quantities, and in conditions of slightly higher implicit export prices. **The import of goods in the second quarter of 2019 grew by 10.9%, on an annual basis, which is slightly**

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.

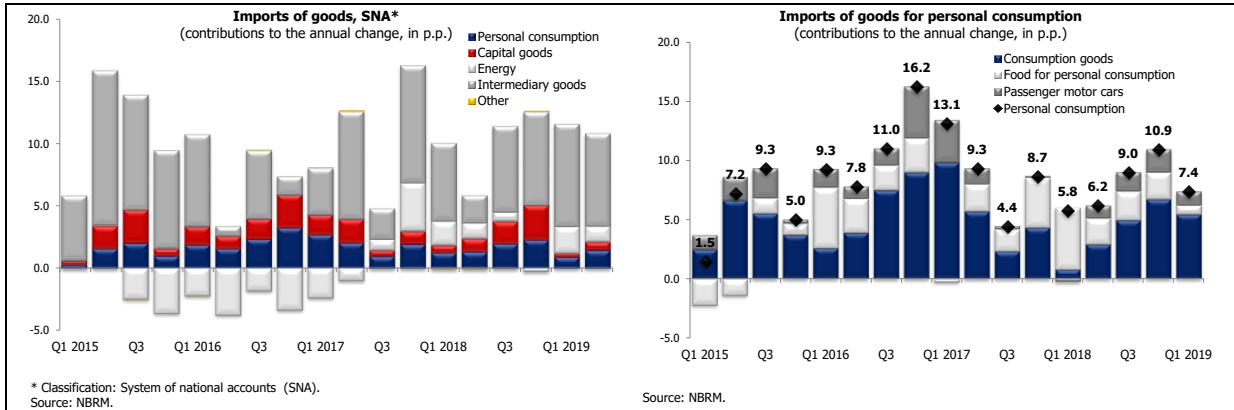


more moderate compared to the growth of 11.6% in the previous quarter. The increase in import of goods is mostly due to the increased import of raw material components for new industrial facilities, i.e. higher import of non-ferrous metals and non-metallic minerals, as well as the categories "machinery and transport devices" and "chemical products". Contribution to the total growth of imports is also made by the higher energy imports, which mainly reflects the more substantial increase in the imports of oil derivatives. At the same time, the annual growth of the import of oil derivatives for the most part results from the higher imported quantities, with a small annual decline in the import prices. **Such trends of the foreign trade components in the second quarter of 2019 slightly widened the trade deficit by 9.4% on an annual basis.** From the point of view of individual balances, such a change is primarily due to the higher deficit in the non-energy component, given simultaneous more moderate deepening of the energy deficit.

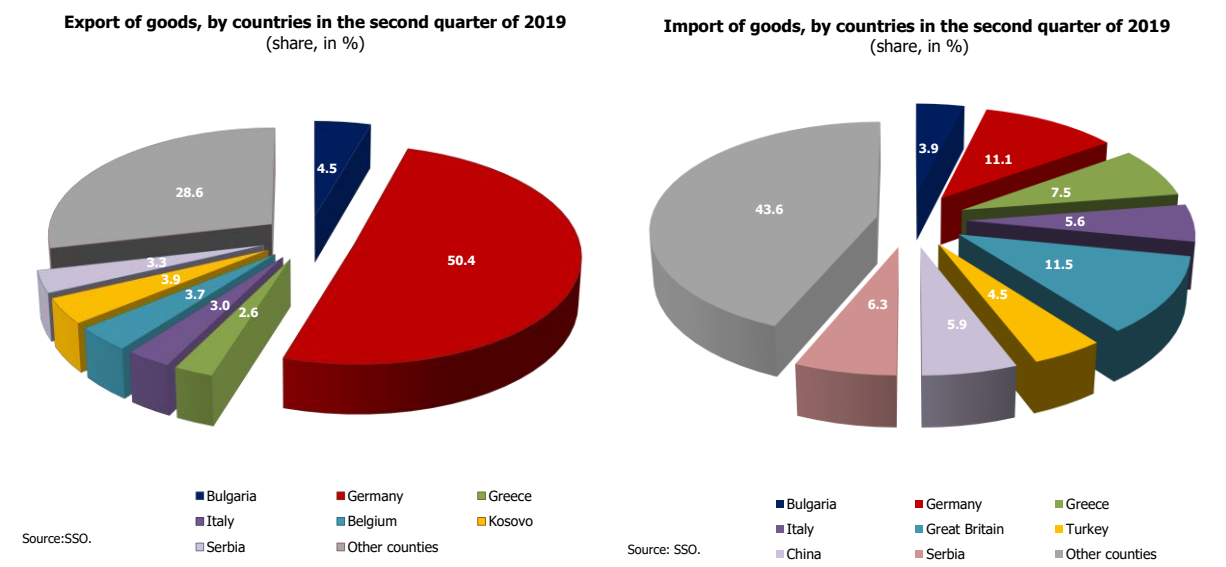
The latest available data on foreign trade during July and August 2019 indicate annual growth of both the exports and the imports of goods. The **export of goods** registered an annual growth of 14.1%, mostly due to the higher exports of the new production facilities in the economy, and a slower growth was also registered in most of the traditional export sectors and energy exports. In July and August 2019, the **import of goods** grew by 14.0% annually, reflecting the growth in most import categories, primarily the higher import of raw materials for the new industrial facilities and the higher import of food, energy and iron and steel.



According to the analysis of the import of goods in terms of division according to the System of national accounts (SNA), the increase in total imports in the second quarter is largely due to higher imports of intermediate products, while the positive contribution of other components to overall growth is more moderate. In terms of imports for private consumption, the annual growth of this component reflects the higher imports of consumer goods and food, amid moderate contribution by the import of passenger vehicles. Analyzed dynamically, the growth of imports for personal consumption in the second quarter of 2019 does not indicate significant pressures on the total imports.



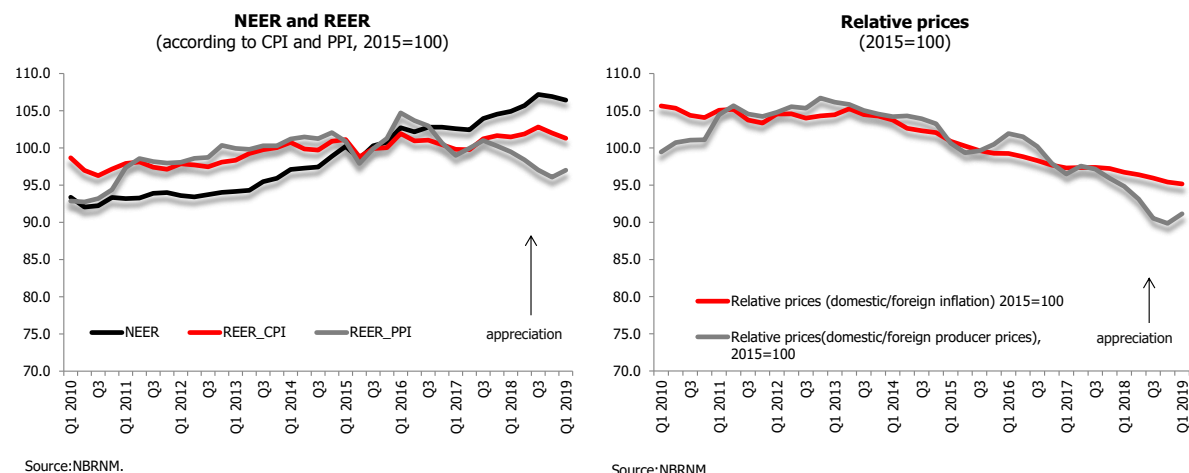
The foreign trade analysis by trading partners shows that in the second quarter of 2019 the European Union was still the major trading partner of the domestic economy, making up 72.1% of total trade. In terms of individual countries on the export side, a key driver of the annual growth is the exports of equipment and machinery to Germany, as a market to which the export activity of the new facilities in the economy is largely targeted. The increased export of iron and steel to China, supplemented by higher food, beverage and energy exports to Kosovo, also made a positive contribution to annual growth. The analysis of imports shows that the largest contribution to annual growth has the import of precious metals from Great Britain, which is followed by higher imports of equipment and machinery and iron and steel from Serbia. The imports for the new industrial facilities from Germany also had additional positive contribution. Analyzed in terms of balances, the expansion of the trade deficit in the second quarter largely reflects the performance in trade with European Union countries, with which deficit was realized in the second quarter, mainly through the deterioration of balances in trade with Great Britain, followed by Austria and Belgium, given simultaneous higher surplus with Germany. At the same time, the surplus with Kosovo increased, while the deficit with Serbia grew compared to the same period last year.



In the second quarter of 2019, price competitiveness indicators of the Macedonian economy registered favorable movements compared to the same period last year. The CPI-deflated REER depreciated annually by 0.9%, while the PPI-deflated REER depreciated by 1.4%. The relative prices decreased on an annual basis, given the decline in the relative consumer prices and the

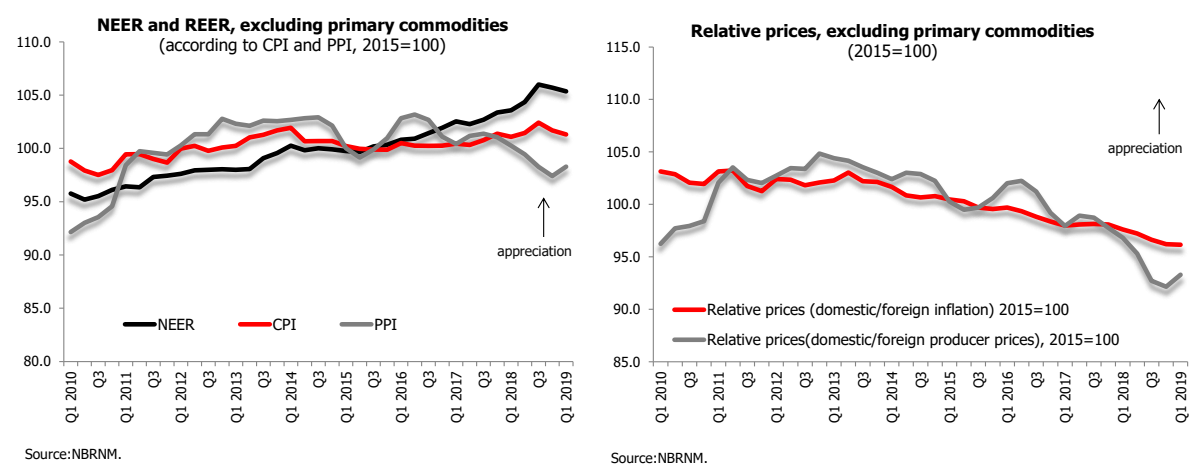


relative producer prices (of 1.6% and 2.2%, respectively). On the other hand, the NEER index registered an annual depreciation of 0.8%, largely caused by the denar's appreciation against the Turkish lira.



The analysis of REER indices, as measured using weights based on the foreign trade without primary commodities⁴², basically points to similar conclusions. Namely, the REER deflated by consumer prices remained the same, while the REER deflated by producer prices depreciated by 0.5% on an annual basis. The NEER index appreciated by 1.5% on an annual basis, unlike the decline in the relative consumer prices and the relative producer prices (of 1.5% and 2.0%, respectively).

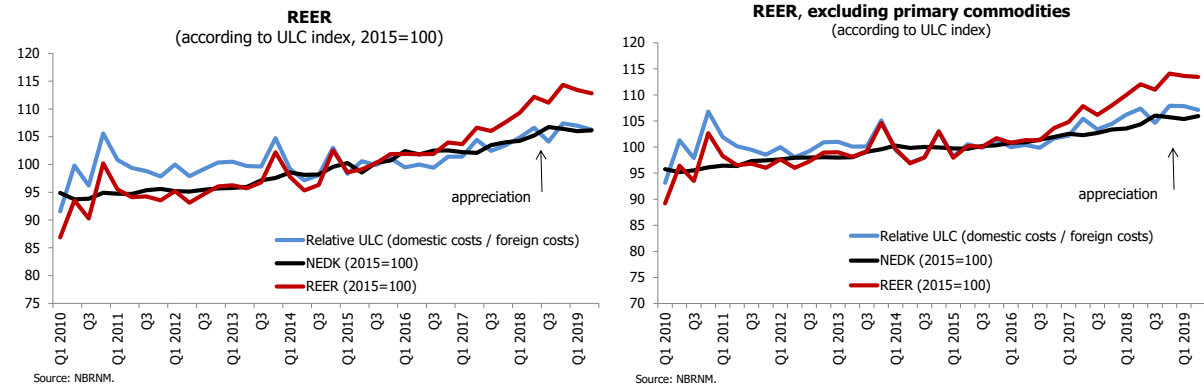
The latest data on price competitiveness for the period July-August 2019 indicate positive movements of the REER as measured using weights of the total trade of goods. The CPI-deflated REER depreciated annually by 2.0%, while the PPI-deflated REER depreciated by 0.4%. REER indices, as measured using weights based on the foreign trade without primary commodities registered divergent movements. The REER deflated by consumer prices have appreciated by 0.1% and the REER deflated by producer prices depreciated by 1.3%.



⁴² Primary products not included in the calculation are: oil and oil derivatives, iron and steel, ores and imported raw materials for the new industrial facilities. For more detailed information on the methodology for calculating the real effective exchange rate visit: http://nbrm.mk/WBStorage/Files/Statistika_REDK_Informacija_za_promenite_na_metodologijata_za_presmetuvanje_na_realno_t_efektiven_devizen_kurs_na_denarot_mak.pdf

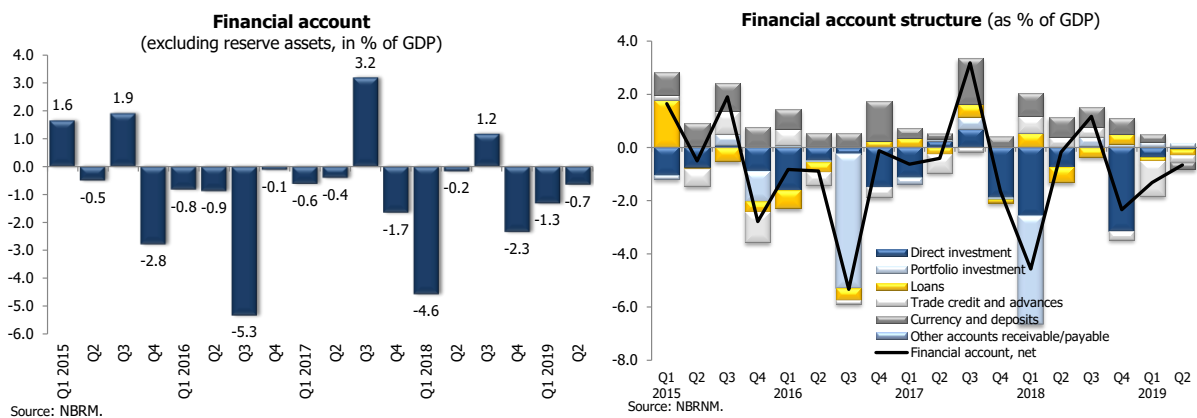


In the second quarter of 2019, the analysis of REER indices calculated using unit labor costs indicates small deterioration of price competitiveness of the domestic economy. The REER index, calculated on the basis of the weights based on the total foreign trade, registered an appreciation of 0.6%, in conditions of a small annual decline in the relative labor costs of 0.3% and an NEER appreciation of 0.9%. Annual appreciation was registered in the REER index calculated by using weights based on the foreign trade without primary products (by 1.3%), determined by the appreciation of the NEER (by 1.5%) amid annual fall of the relative labor costs (by 0.2%).



1.6.2 Financial account

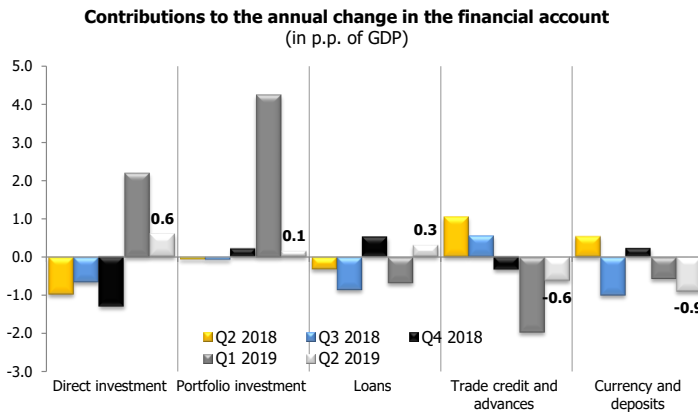
The financial account in the balance of payments recorded net inflows of Euro 73.9 million in the second quarter of 2019, or 0.7% of GDP. The sources of funding in this period are dispersed between "currencies and deposits" (0.3% of GDP), trade loans (0.3% of GDP) and financial loans (0.2% of GDP). In the category "currencies and deposits", which is an outflow category in the balance of payments for a long time, net inflows were realized in the second quarter, which are related to the reduction of funds of depository institutions abroad, with further outflows to other sectors. Net inflows in trade loans continue for the third consecutive quarter, although less intensive. Positive flows were also realized in the loans, caused by the long-term borrowing of the other sectors, during the realized repayment based on short-term loans during the second quarter. Foreign direct investment recorded small net inflows, amid inflows in the non-debt categories⁴³ and simultaneous outflows in intercompany loans.



⁴³ Equity capital and reinvested gain.

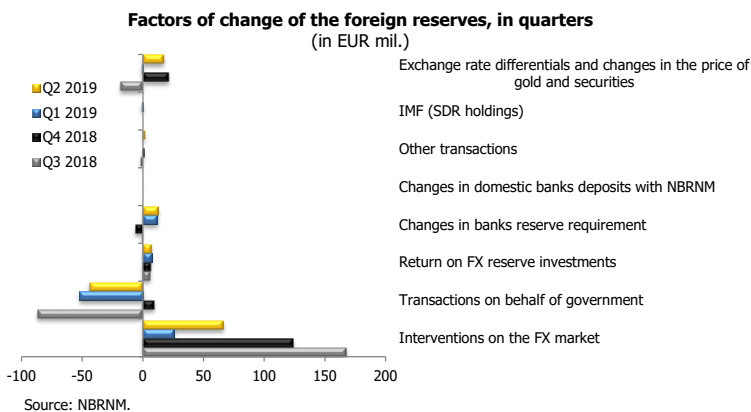


The analysis on an annual basis indicates favorable changes, with higher net inflows compared to the same period last year. Favorable changes arise from the performance of currencies and deposits, as well as trade loans, where net inflows are realized against the realized net outflows in the second quarter of 2018. Foreign direct investments acted in the opposite direction, where lower net inflows were recorded, on an annual basis. Also, lower net inflows were realized in financial loans and portfolio investments.



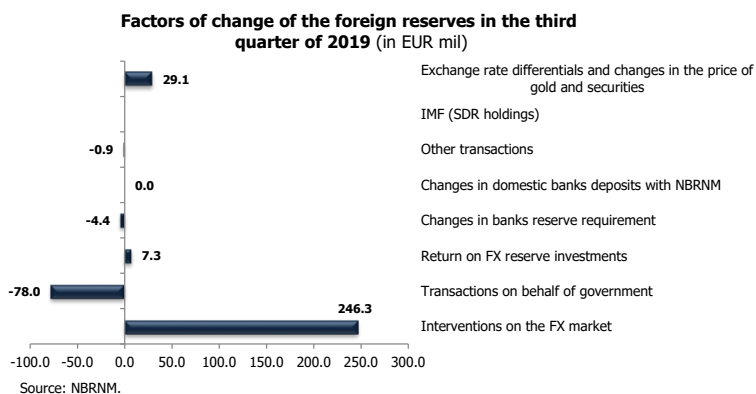
Source: NBRNM.

At the end of the second quarter of 2019, the gross foreign reserves amounted to Euro 2,928.2 million, which is a quarterly growth of Euro 61.7 million. The growth of foreign reserves largely stems from the National Bank's interventions with purchase during the second quarter. On the other hand, transactions for the account of the government had an opposite effect on foreign reserves. The remaining categories had a moderate positive impact on the growth of foreign reserves in this period.



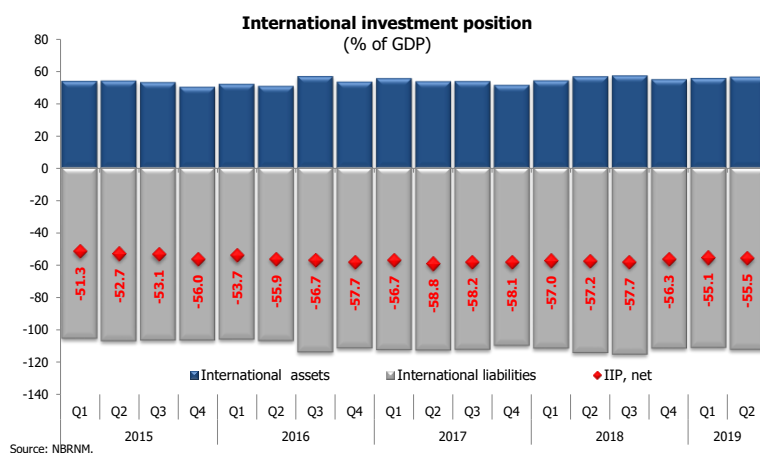
Source: NBRNM.

The gross foreign reserves at the end of the third quarter of 2019 amounted to Euro 3,127.5 million, which is a quarterly increase of Euro 199.3 million compared to the end of the second quarter. The National Bank interventions on the foreign exchange market significantly increased the foreign reserves, while the transactions on behalf of the government reduced the foreign reserves.

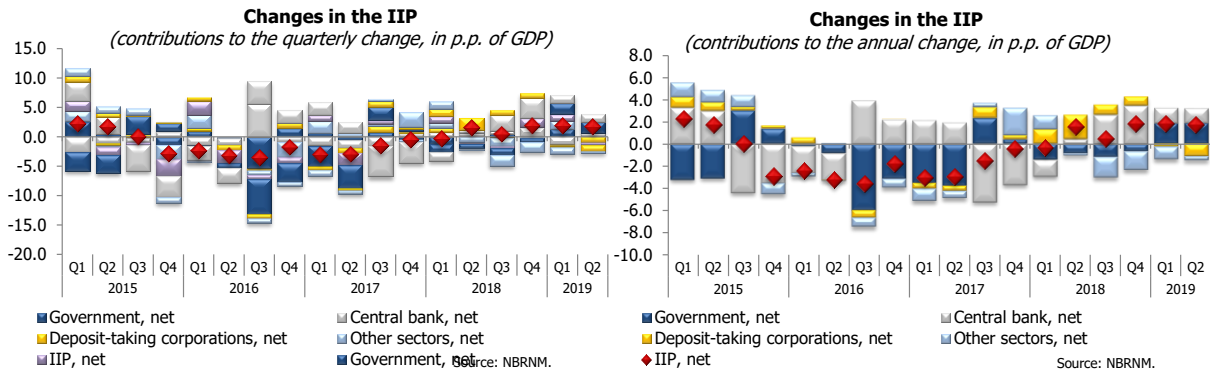


1.6.3 International investment position and gross external debt

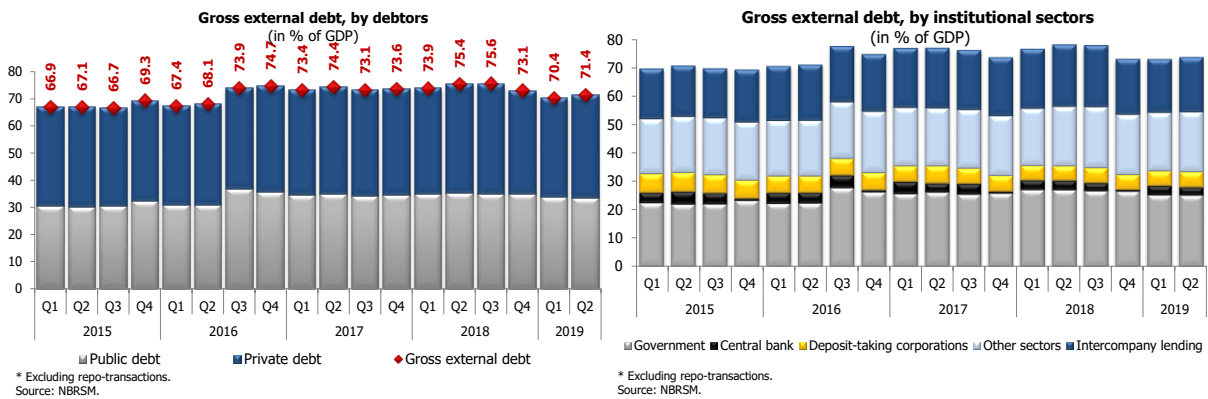
The net debt position of the Macedonian economy, compared to the rest of the world at the end of the first half of 2019 amounted to Euro 6,264.6 million, or 55.5% of GDP. The quarterly change indicates a slight deterioration in the negative international investment position by 0.3 percentage points of GDP, in conditions of higher growth of foreign liabilities in relation to the growth of foreign assets. Observed by sectors, quarterly growth is due to the increase in the net liabilities of the banking sector (mainly based on currencies and deposits and long-term loans) and the net liabilities of other sectors in the economy (higher liabilities to direct investors). On the other hand, higher net assets of the central bank and almost unchanged net liabilities of the Government were registered.



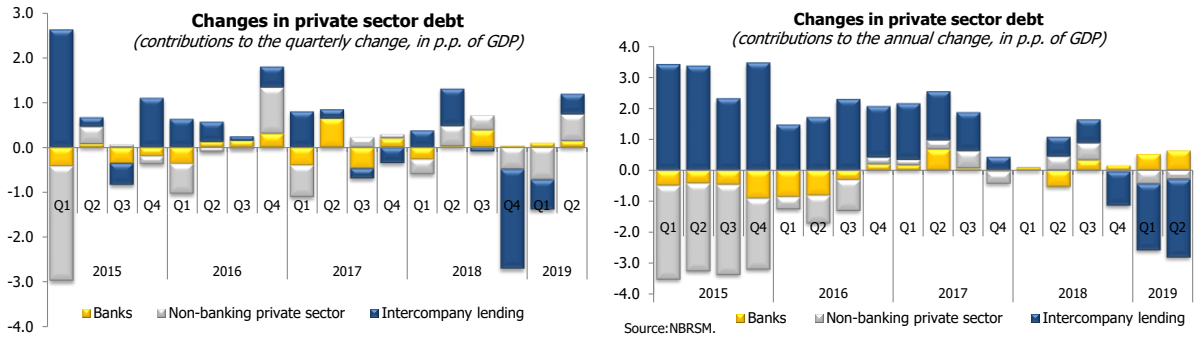
On an annual basis, the international investment position improved by 1.8 percentage points of GDP, as a result of the decline in foreign liabilities, with a slight decrease in foreign assets (by 2 percentage points and 0.2 percentage points of GDP, respectively). In terms of sectors, this change stems from favorable shifts in the net position of the Government (mainly as a reflection of lower liabilities based on debt securities and loans) and the central bank (as a result of rising foreign reserves). These movements were partially neutralized by the shifts in the net position of depository institutions (lower net assets in currencies and deposits) and the net position of other sectors (increased net liabilities based on direct investment, lower net assets in currencies and deposits and higher net liabilities based on long-term loans).



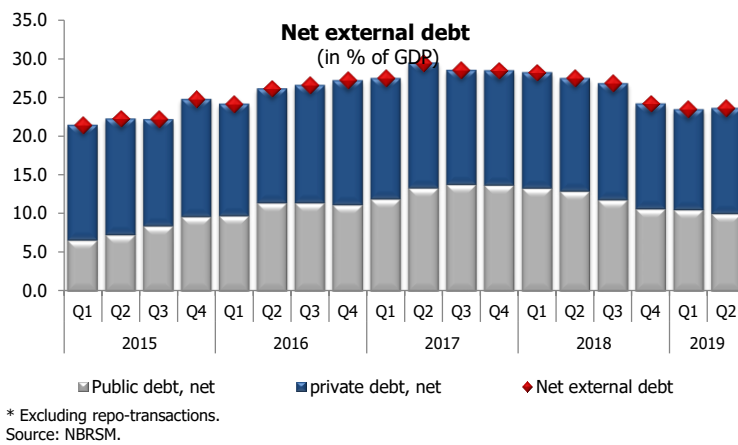
At the end of the second quarter of 2019, the gross external debt stood at Euro 8,324.1 million, or 73.7% of GDP, which is a quarterly increase of 0.7 percentage points of GDP. Excluding the effect of the National Bank's repo transactions, gross external debt is 71.4% of GDP and is higher by 1 percentage point of GDP, compared to the previous quarter, which is entirely due to higher private sector debt, amid a quarterly decrease in the public sector debt. Thus, within the private debt, the quarterly change is a reflection of the higher debt of the non-banking private sector, in the form of long-term borrowings, then the increased intercompany debt, as well as the higher liabilities of the banking sector. Regarding the public debt, the change was mostly due to the lower long-term government liabilities and public enterprises based on debt securities.



The annual analysis points to a lower gross external debt by 3.9 percentage points of GDP, in case of decline in both private and public debt (of 2.2 and 1.8 percentage points of GDP, respectively). The annual decrease in private debt is mostly due to the decrease in the intercompany borrowing. The reduction of public sector debt is largely due to lower government liabilities based on debt securities and loans, while higher liabilities on the basis of long-term loans to public enterprises acted in the opposite direction.



As of the end of the second quarter of 2019, the net external debt stood at Euro 2,671.7 million, or 23.7% of GDP, which is a small increase of 0.2 percentage points of GDP, on a quarterly basis. The higher net external debt is mainly due to the slightly higher net debt of the private sector, with a small decline in public net debt.



In general, external indebtedness indicators of the national economy remain in the safe zone. Gross external debt to GDP ratio still classifies our economy in the group of highly indebted countries, while all other ratios point to low indebtedness. In addition, the dynamic analysis indicates favorable annual shifts in most indicators of solvency and liquidity.



Indicators for external indebtedness	Solvency				Liquidity		
	Interest payments/ Export of goods and services and other inflows	Gross debt/ of goods and services and other inflows	Export Gross debt/ GDP	Debt servicing/ Export of goods and services and other inflows	Foreign reserves/ Short- term debt	Foreign reserves/ Short-term debt, with residual maturity**	Short-term debt/ Overall debt
	in %				ratio	ratio	in %
31.12.2010	3.22	140.4	59.7	13.9	1.49	0.99	27.9
31.12.2011	3.12	148.4	64.6	16.8	1.78	1.18	25.2
31.12.2012	2.92	142.1	67.6	13.1	1.64	1.03	26.7
31.12.2013	2.51	137.3	67.3	15.8	1.64	1.08	23.3
31.12.2014	3.01	149.1	74.0	17.2	1.82	1.13	22.3
31.12.2015	2.69	143.9	73.2	20.0	1.69	1.13	21.3
31.12.2016	2.37	149.39	79.33	14.89	1.65	1.16	21.93
31.03.2017	2.69	138.68	76.67	12.72	1.47	1.00	23.53
30.06.2017	2.69	140.69	77.79	12.72	1.33	0.88	24.19
30.09.2017	2.69	138.24	76.43	12.72	1.26	0.86	24.57
31.12.2017	2.69	139.17	76.95	12.72	1.32	0.89	23.94
31.03.2018	2.22	132.80	78.23	15.77	1.30	0.93	25.06
30.06.2018	2.22	135.55	79.85	15.77	1.27	0.96	25.61
30.09.2018	2.22	135.98	80.11	15.77	1.30	0.98	25.59
31.12.2018	2.22	131.37	77.39	15.77	1.42	1.04	25.75
31.03.2019	2.41	120.15	74.45	10.46	1.40	0.98	25.81
30.06.2019	2.41	121.93	75.55	10.46	1.38	0.97	26.28
<i>moderate indebtedness criterion*</i>	<i>12 - 20%</i>	<i>165 - 275%</i>	<i>30 - 50%</i>	<i>18 - 30%</i>		<i>1.00</i>	

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

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

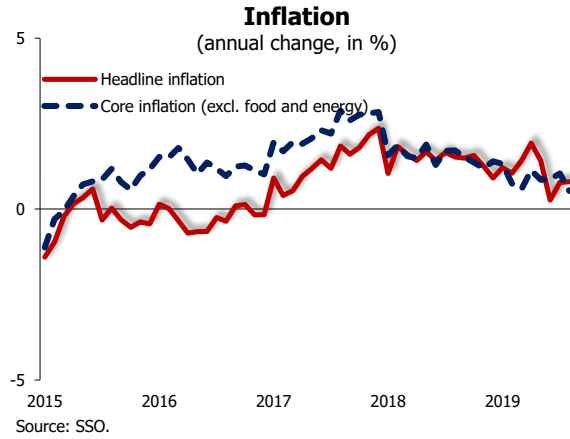
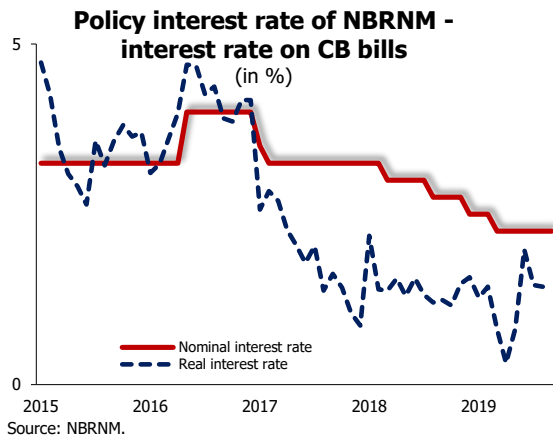
**According to the "Greenspan-Guidotti rule", a country should maintain full coverage of short-term debt at remaining maturity with gross foreign reserves. Short-term debt at remaining maturity is calculated by addition of the long-term external debt (original maturity), with final contractually scheduled payment of less than a year, to the short-term debt (original maturity).

Source: NBRNM.

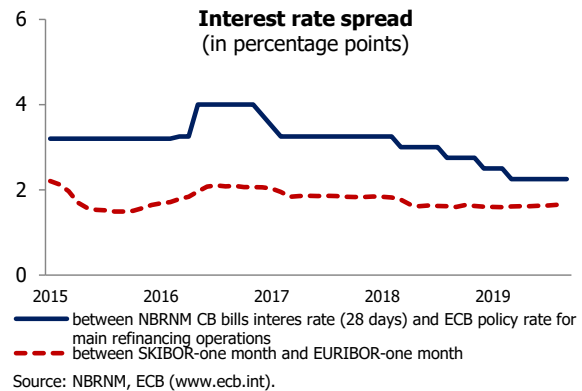
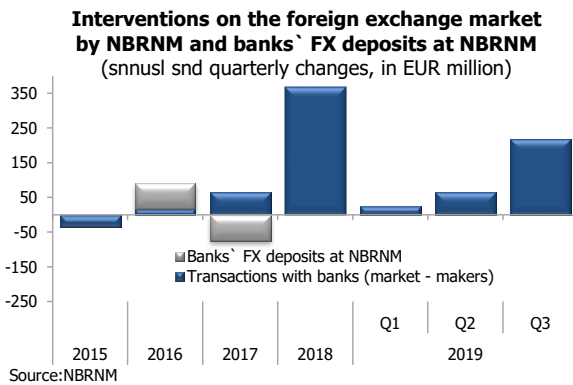
II. Monetary policy

In the third quarter of the year, the National Bank did not change the monetary policy position, and the policy rate remained at the level of 2.25%. In the conditions of further assessments of sound economic fundamentals and the absence of imbalances in the economy, movements in the foreign exchange market are still favorable, with the National Bank continuing to intervene by purchasing foreign currency from banks. In the fourth quarter of the year, the foreign reserves increased, and according to all adequacy ratios, they were maintained in the safe zone. Total deposits and total loans continue to grow on an annual basis, with no major deviations from expectations. The dynamics and currency structure of household savings show stable expectations. The latest data does not indicate major deviations from the forecasts in the key monetary policy segments. The National Bank will continue to carefully monitor the trends and potential risks of the domestic and external environment, in order to adequately adjust the monetary policy setup.

During the third quarter of 2019, the National Bank policy rate - CB bill interest rate remained the same at 2.25%. During the regular re-examination of the monetary setup, it was assessed that most of the macroeconomic indicators, which are important for the monetary policy, do not deviate significantly from the projections, and the fundamentals of the economy are still sound, without any imbalance. Favorable external position and stable expectations of economic entities continue to contribute to favorable developments in the foreign exchange market and interventions with the purchase of foreign currency by the National Bank. The dynamics and currency structure of household savings show stable expectations and favorable perceptions.



The performance in the basic macroeconomic indicators in the domestic economy was mainly within their projected dynamics with the April projection cycle. The inflation growth in the July-August period was moderate and stood at 0.8%, on average, on an annualized basis, which is lower than expected with the April projection, at lower food and energy prices. Amid current lower inflation than forecasted and downward revisions in the expectations for the movement of the foreign prices that affect the domestic prices, the risks assessments regarding the inflation forecast of 1.5% for 2019 were mostly downward. In terms of economic activity, the estimated GDP data show that in the first half of the year, GDP was 3.6% which is slightly more moderate than the forecasts for this period of the year. In terms of the economy in the third quarter, the available high-frequency indicators pointed to the continuation of favorable trends. Foreign reserves increased in the third quarter, largely as a result of National Bank interventions in the foreign exchange market by purchasing foreign currency. Foreign reserves adequacy ratios have shown that their level is appropriate and maintained in the safe zone. Regarding the deposit and credit flows, the available data as of August showed a slightly higher growth of the total deposits compared to the April projection. As for the credit activity, if the effect of the regulatory changes on the suspicious and contested claims⁴⁴ of the banks is excluded, no greater deviations from the expectations were noticed.



In terms of the external environment, the downward risks to the realization of the projected economic growth were more pronounced during the third quarter, due to which the central banks at the global level took measures. At the session held in September, the European Central Bank⁴⁵ cut the

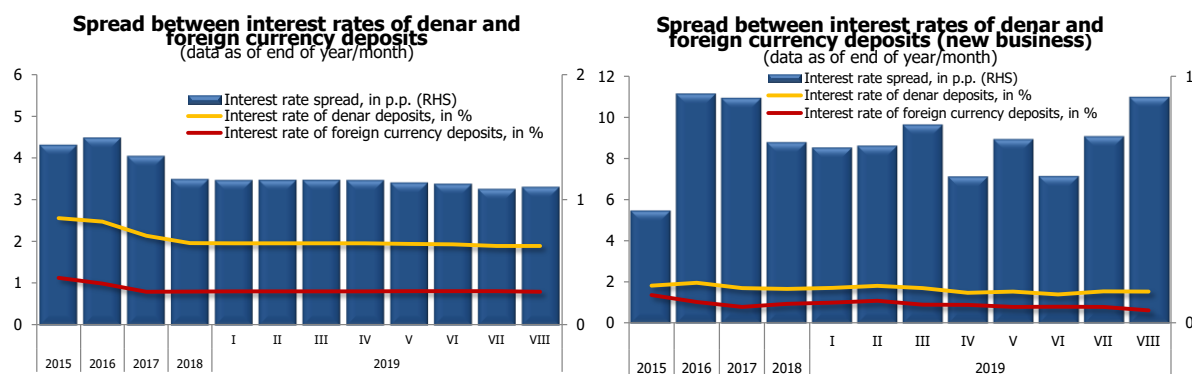
⁴⁴ On 9 August 2018, the National Bank Council adopted the Decision on the methodology for credit risk management that requires from banks to transfer, from the on-balance sheet to the off-balance sheet records (and to continue to transfer), all claims that have been fully booked for more than one year. Notwithstanding the transfer of these claims to the off-balance sheet record, the banks reserve the right for collection. The Decision started to apply on 1 July 2019.

⁴⁵ The session of the ECB Board of Directors was held on 12 September 2019. For more detailed information see <https://www.ecb.europa.eu/press/pr/date/2019/html/ecb.mp190912~08de50b4d2.en.html>



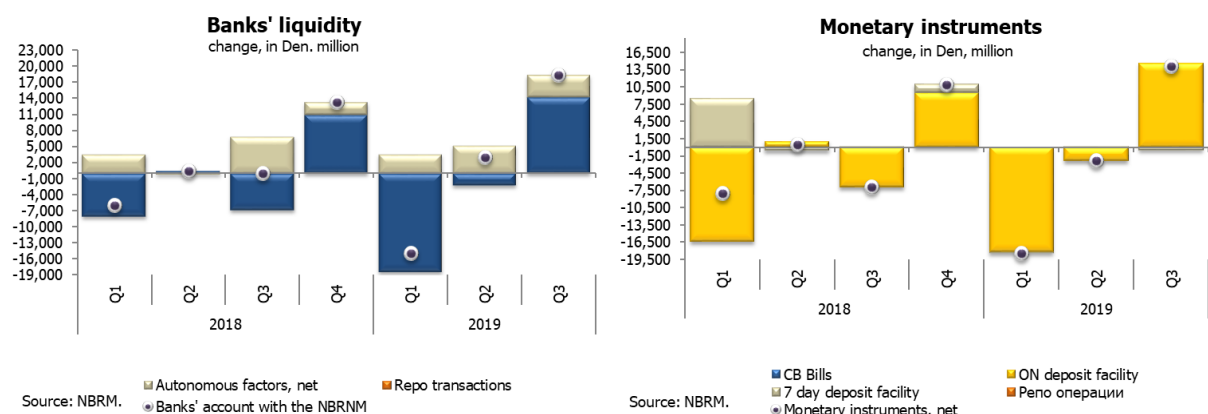
interest rate on overnight deposits from -0.4% to -0.5%, while other interest rates remained the same. Reference interest rates are expected to remain at the same or lower levels until inflation approaches the expected 2% rate in the coming period. The ECB has also announced a new package of measures to stimulate the euro area economy. With the unchanged key interest rate of the National Bank and the ECB interest rate⁴⁶ in the third quarter of 2019, the range between these interest rates remained at the same level as in the previous quarter. Regarding the indicative market interest rates, there was a decrease of the one-month EURIBOR by 0.03 percentage points given unchanged one-month SKIBOR, compared to June, during which their interest rate spread widened minimally.

In the domestic economy, the interest rates on total denar and foreign currency deposits remain stable compared to June, so the interest rate continues to be 1.1 percentage points. In the newly received deposits, there is a decrease in the interest rate on foreign currency deposits by 0.2 percentage points, which in case of unchanged interest rate on denar deposits contributed to a minimal expansion of the interest rate from 0.8 percentage points to 0.9 percentage points.



2.1 Bank liquidity

In the third quarter of 2019, the denar liquidity of banks increased, which was mainly due to the change of monetary instruments, primarily the disposable deposits of the bank with the National Bank. Autonomous factors also contributed to the higher liquidity, but to a lesser extent.

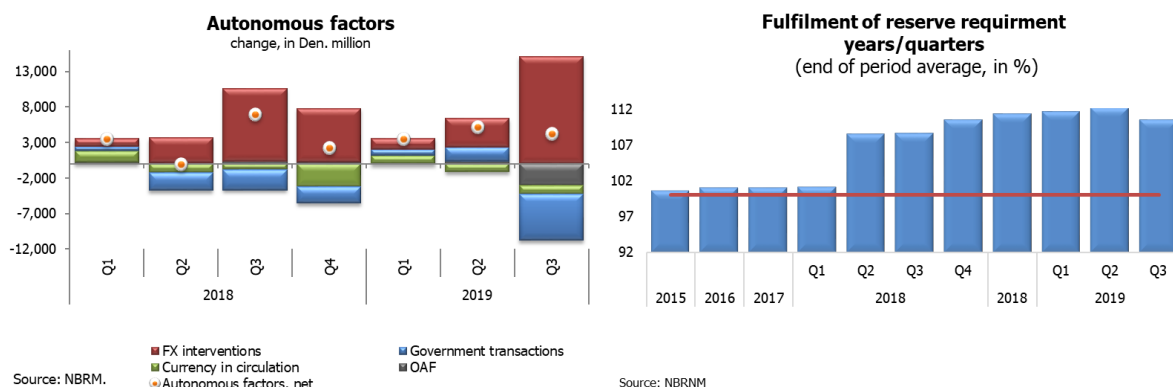


The available bank deposits with the National Bank decreased (by Denar 14,142 million), which is entirely due to the decline in the balance of overnight deposits.

⁴⁶ Main refinancing operations rate.



In the third quarter, the autonomous factors, on a net basis, contributed to liquidity creation in the amount of Denar 4,325 million. This change is a result of the National Bank interventions in the foreign exchange market by purchasing foreign currency, with the highest contribution being made by the seasonally higher supply of foreign currency from exchange offices, as well as moderately lower net demand for foreign exchange liquidity from the corporate sector. On the other hand, the government transactions caused fall in the banks' liquidity, with the cash in circulation having the same effect.



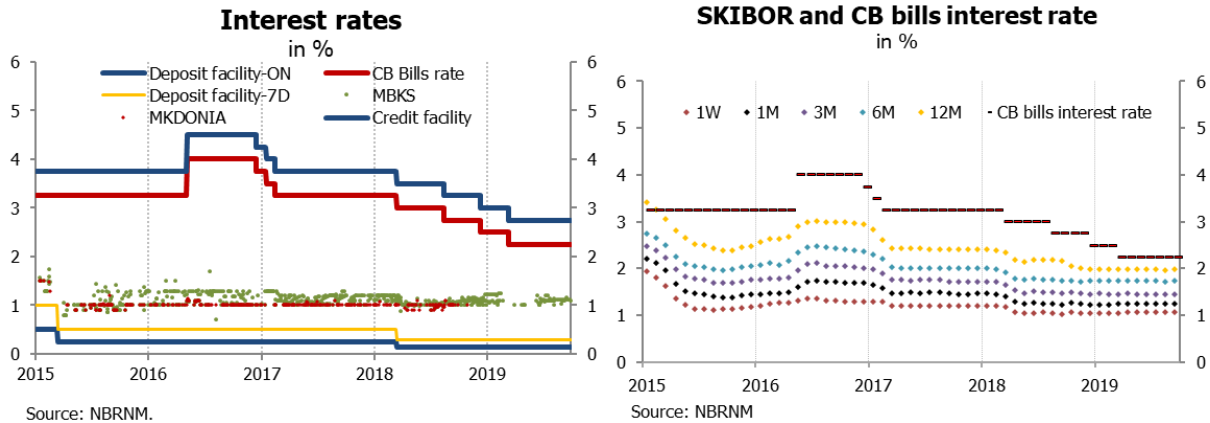
The banks maintained higher liquidity levels than the reserve requirement level. The balance of banks' denar liquid assets on the accounts with the National Bank in the third quarter was by 10% higher than the denar reserve requirement calculated as an average of the reserve maintenance periods in the third quarter of the year.

III. Financial market developments

In the third quarter of 2019, the interbank interest rate on the deposit market remained low and stable. During the change of the basic interest rate of the National Bank, no changes were noticed in the indicative interest rates for interbank deposit trading (SKIBOR). In the primary market of government securities, the new issues were mostly in the long run and in domestic currency. CB bills and government bonds were traded on the secondary market. Macedonian Eurobond yields continued to decline, narrowing the spreads relative to yields on German government bonds, which also registered a downtrend. On the Macedonian Stock Exchange, MBI-10 continued increasing, same as most stock markets in the region. On the international financial markets, the financial conditions indexes moved in different directions, pointing to a small increase in uncertainty in the bond trading segment.

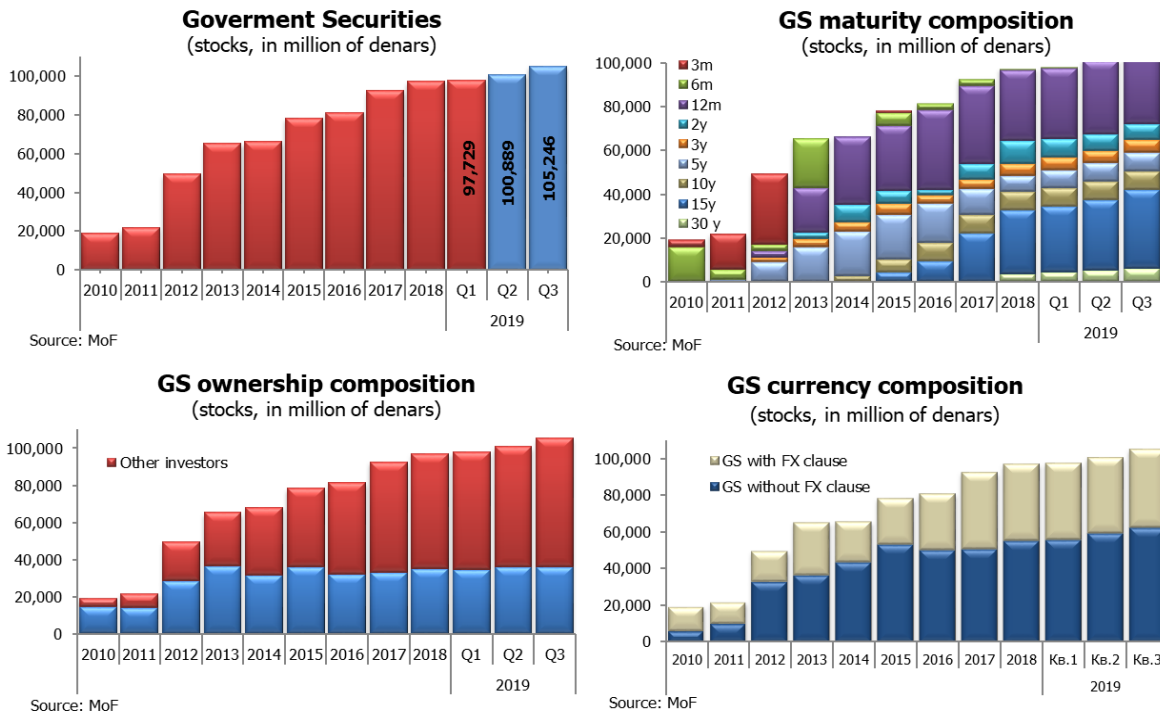
3.1 Interbank market for uncollateralized deposits

In the interbank deposit market, the interbank interest rate remained low and stable (1.1%). During the change of the key interest rate of the National Bank, no changes were noticed in the quotations of SKIBOR. The total turnover of this market segment was entirely a result of trading with uncollateralized deposits with a maturity of up to 7 days.



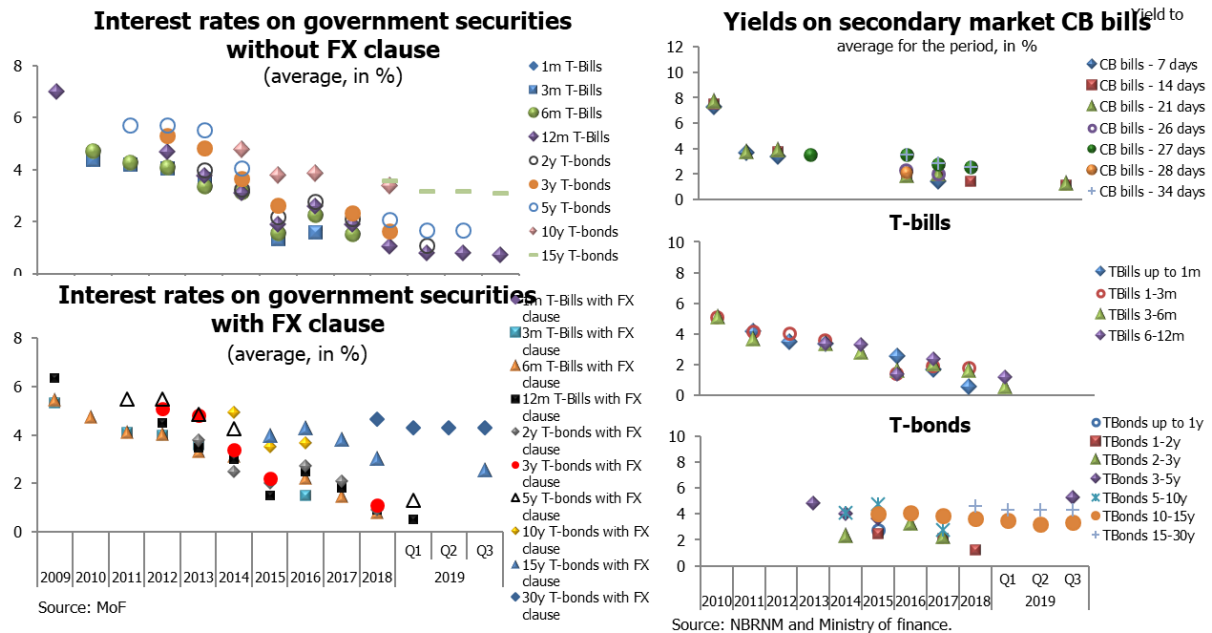
3.2 Government securities market

The amount of the government securities rose in the third quarter of the year. From the maturity point of view, the growth was a result of the increase in the long-term government securities, i.e. the government bonds with a maturity of 15 and 30 years. At the same time, a decrease was registered in the shorter terms of securities, i.e. in the 2-year government bonds and the 12-month treasury bills. The 12-month treasury bills and 15-year government bonds dominated the total amount of government securities with a share of 33% and 32%, respectively. Both components of government securities (with and without currency clause) registered an increase, but without changes in their share in the total amount. Thus, securities without foreign exchange clause still prevail in the total amount of issued government securities on the primary market, with a share of 59%. In terms of ownership, growth of the government securities portfolio was registered in all groups of investors. The majority of the total issued government securities at the end of the third quarter of the year remained in the ownership of other investors (66%), primarily pension funds, while 34% of the total government securities are in bank ownership.

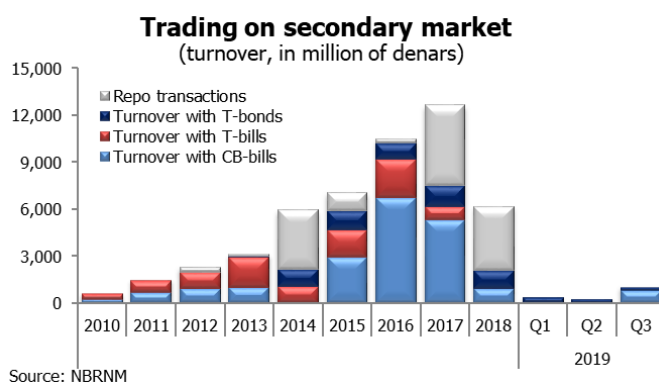




The interest rates on government securities sold on the primary market, i.e. the interest rates on 12-month treasury bills without currency clause, 15-year government bonds with and without currency clause and 30-year government bonds without currency clause, equaled 0.7% 2.6%, 3.1% and 4.3%, respectively.



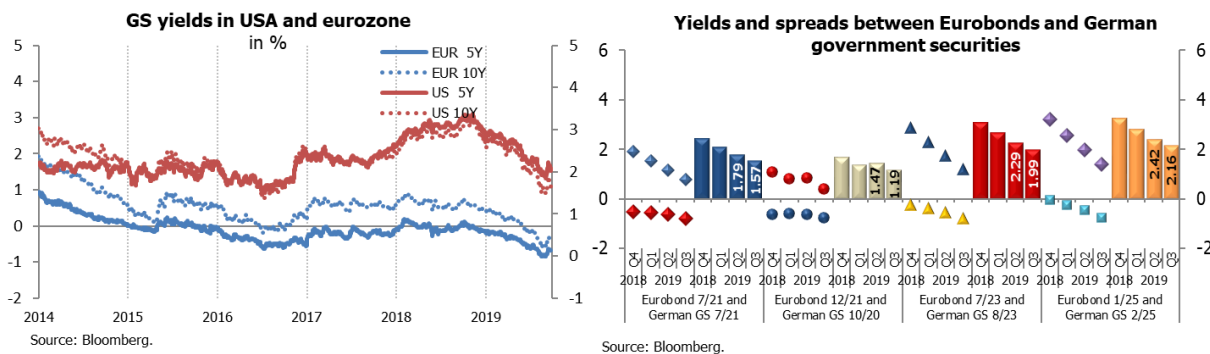
Trade in securities i.e. government bonds on the secondary market was higher in the third quarter compared to the previous quarter (trade in CB bills and government bonds). From the aspect of the mature segments on the basis of which the trading with government bonds was performed, the realized transactions were with the residual maturity of 3 to 5 years (with average yield up to maturity of 5.3%), with the residual maturity from 10 to 15 years (with average yield up to maturity of 3.3%) and with the residual maturity of 15 to 30 years (with average yield up to maturity of 4.3%).



In the US and euro area financial markets, long-term government bond yields continue to fall. Yields on US 10-year government bonds continued to decline in the third quarter, averaging 1.8% (2.3% in the second quarter). Declining yields are linked to global trade tensions as a result of deteriorating US relations with China and the imposition of new tariffs on each other. This has contributed to the growth in demand for government securities, the rise in their prices and the consequent decline in their yields. Further decrease was registered also in the yields on 10-year government securities in the euro area, which averaged -0.4% in the quarter (0.1% in the second

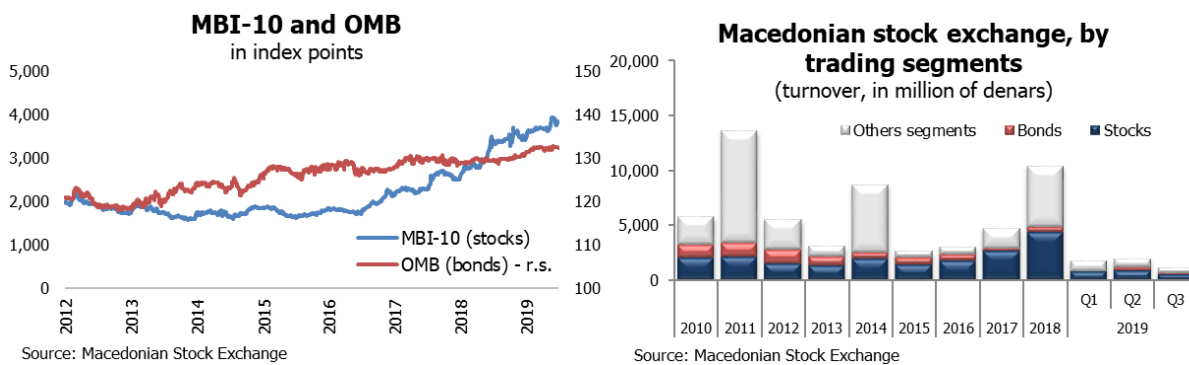


quarter). Further decrease was observed in the yields of the Macedonian Eurobonds⁴⁷, which contributed to further narrowing of the spreads in relation to the yields of the German government bonds. The spread between the yields on the issued Macedonian Eurobonds and the yields on the German government bonds averaged 1.6 percentage points, 1.2 percentage points, 2.0 percentage points, and 2.2 percentage points, respectively in the third quarter.



3.3 Stock exchange markets

On the Macedonian Stock Exchange, the value of the Stock Exchange Index (MBI-10) continues to rise and at the end of the third quarter amounted to 4,328, which is a quarterly growth of 13%. Since the beginning of the year, the growth of MBI-10 has equaled 25%. The total turnover on the Macedonian Stock Exchange in the third quarter of the year was slightly lower compared to the previous quarter, with a decline in bond trading. The value of the bond index (OMB) at the end of the third quarter was 133 and remained at a relatively stable level (small growth of 1%).



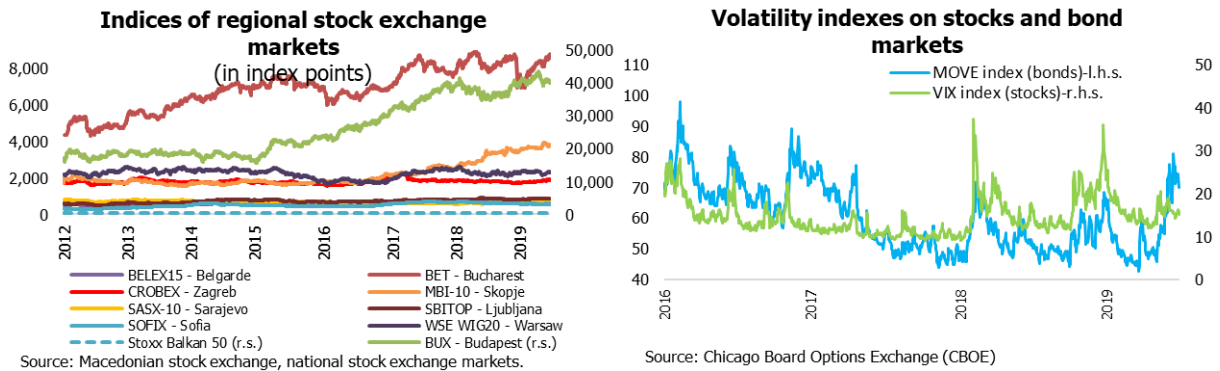
On regional stock exchanges, the value of stock indexes continues to rise. Significant upward movement was observed in the Bosnian, Macedonian and Romanian stock indices, which registered quarterly growth of 14%, 13% and 9%, respectively. Other indices of the region's stock markets also grew, except for the Polish, Slovenian and Bulgarian indices, whose value on a quarterly basis decreased by 7%, 3% and 3%, respectively. Volatility indices on bond and equity markets during the second quarter moved in different directions. The VIX index⁴⁸ registered variable movement during the quarter,

⁴⁷ It refers to Macedonian Eurobonds issued in July 2014, in December 2015, July 2016 and in January 2018. Eurobonds are issued in the nominal amount of Euro 500 million, Euro 270 million, and Euro 500 million, respectively, with a maturity of 7, 5, 7 and 7 years, respectively, and annual interest rates of 3.975%, 4.875% 5.625% and 2.75%, respectively.

⁴⁸ The MOVE index (Merrill Lynch Option Volatility Estimate) shows the volatility of the US government bond markets. The VIX index (Volatility Index) is constructed based on the implied volatility of S&P500 index options. Investors use both indices as indicators of the conditions and expectations for the financial markets volatility. Downward path in the indices indicates a decrease in volatility.



with its average value in the third quarter still being at a relatively stable level compared to the second quarter. The MOVE index moved upwards, pointing to a slight increase in uncertainty.

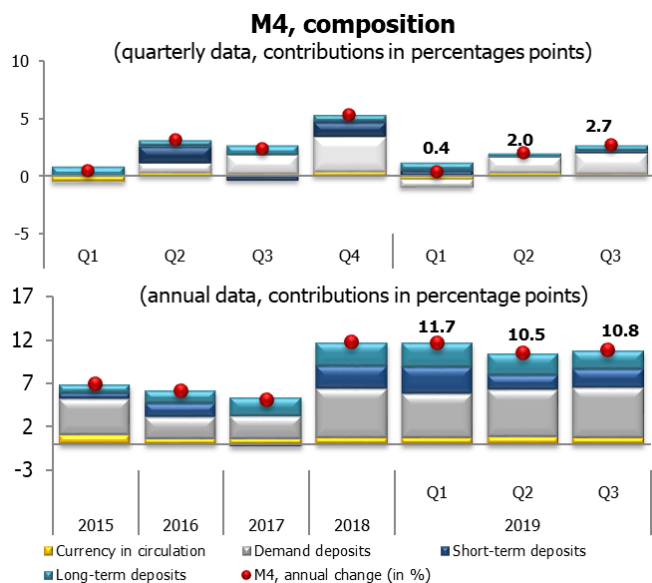


IV. Monetary and credit aggregates

In the third quarter of 2019, the favorable movements of the monetary aggregates continued. The broad money continues to grow on a quarterly basis, but stronger than in the previous period. From a structural point of view, growth is recorded in all components of the money supply, with the largest contribution being made by the most liquid component. Such movements are in line with the signals of favorable shifts in economic activity. From a sectoral point of view, the growth of total deposits in the financial system causes the growth of deposits of households and enterprises, with lower growth and deposits of other sectors. In lending activity, a decrease compared to the previous quarter was registered in the third quarter, which is a reflection of regulatory changes. By sector, the decline in lending activity is entirely due to the reduction of corporate loans, where the effect of regulatory changes was the largest. Loans to households continued to grow but at a moderately slower pace compared to the previous quarter. Controlled for this effect, the total loans register increase in the third quarter. The Bank Lending Survey for the third quarter indicates a fall in loan demand, amid further easing of total credit standards.

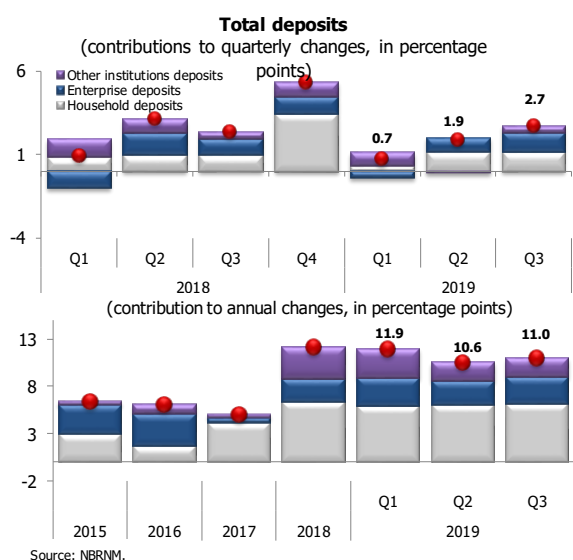
4.1 Monetary aggregates

The quarterly growth of the broad money M4 in the third quarter was 2.7% and is moderately higher compared to the previous quarter (2.0%). This change is in line with the signals of favorable movements in economic activity. The analysis of the money supply structure indicates that the acceleration of the growth, for the most part, stems from the most liquid component, i.e. the demand deposits. Moderate growth is also recorded by the other broad money components, i.e. currency in circulation, short-term and long-term deposits. Analyzed by currency, the money supply growth is mostly driven by denar deposits (including demand deposits), with positive contribution of 2.0 percentage points. Foreign currency deposits (0.5 percentage points) also have a small positive contribution, and their share in M4 at the end of the third quarter decreased to 35.5% (35.9% at the end of the previous quarter). Annually, the growth of broad money was 10.8% at the end of the third quarter (10.5% at the end of the second quarter).



Source: NBRNM.

The total deposits in the financial system⁴⁹ in the third quarter of the year continue to grow strongly, with their quarterly growth reaching 2.7%. From a sectoral point of view, the growth of deposits is almost equally a result of the growth of deposits of both households and enterprises, with a smaller positive contribution to the deposits of other sectors. Observing by currency, denar deposits (including demand deposits) account for most of the growth of total deposits, amid moderate increase in foreign currency deposits, as opposed to their fall in the previous quarter. Analyzing the maturity structure, the growth mostly reflects the long-term deposits, with positive contribution of the short-term deposits. On an annual basis, the growth of total deposits equaled 11.0% at the end of September (10.6% at the end of June).



Source: NBRNM.

	2018				2019		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
quarterly change, in %							
Total deposits	0.9	3.1	2.4	5.3	0.7	1.9	2.7
contributions to quarterly growth, p.p.							
Deposit money	-0.1	1.0	1.7	3.3	-0.7	1.4	2.0
Denar deposits	0.5	0.7	0.6	0.8	0.4	0.5	0.1
FX deposits	0.5	1.4	0.1	1.2	0.9	-0.1	0.6
Short-term deposits	0.1	1.5	-0.4	1.5	0.6	0.1	0.2
Long-term deposits	0.9	0.6	1.0	0.6	0.8	0.3	0.5
Households	0.8	1.0	0.9	3.4	0.3	1.1	1.1
Enterprises	-1.0	1.3	1.0	1.1	-0.4	0.9	1.2
Other institutions deposits	1.1	0.8	0.4	0.8	0.8	-0.1	0.4

Source: NBRNM.

In the third quarter of the year the household deposits maintained the growth dynamics as in the second quarter. The quarterly growth of household deposits (by 1.7%), from a currency point of

⁴⁹ Data refer to non-government deposits in banks and savings houses, funds of other financial institutions on the accounts with the National Bank and funds of local government authorities on the accounts with the National Bank. The data are consistent with the methodological changes of the National Bank from June 2018. For more information on the methodological changes visit: http://www.nbrm.mk/monetarna_statistika_i_statistika_na_kamatni_stapki.nspk.



view, is largely due to higher foreign currency deposits, given the simultaneous increase in the denar deposits (including demand deposits), as well. According to the maturity structure, positive shifts are still registered in both short-term and long-term deposits (contribution of 0.8 percentage points and 0.4 percentage points, respectively). On an annual basis, the growth of total household deposits at the end of September equaled 9.3%, accelerating slightly compared to the growth of 9.0% at the end of June.

Corporate deposits increased by 4.7% in the third quarter (3.4% in the second quarter), which according to the currency structure, is mostly derived from denar deposits, i.e. demand deposits, with a small growth in foreign currency deposits. By maturity, short-term deposits continue to have a negative contribution, with small increase in long-term deposits. On an annual basis, corporate deposits increased by 11.1% at the end of September, which is a faster increase than that at the end of the previous quarter (of 10.1%).

Household deposits							Enterprise deposits						
2018							2019						
Q1 Q2 Q3 Q4 Q1 Q2 Q3							Q1 Q2 Q3 Q4 Q1 Q2 Q3						
quarterly change, in %							quarterly change, in %						
Total household deposits							Total household deposits						
1.2 1.4 1.4 5.2 0.5 1.7 1.7							-3.9 5.3 3.9 4.2 -1.6 3.4 4.7						
contribution to quarterly change of total deposits. in p.p.							contribution to quarterly change of total deposits. in p.p.						
Deposit money							Deposit money						
-0.1 0.3 0.4 3.4 -0.8 1.2 0.5							-2.7 1.7 5.6 0.6 -2.1 3.6 4.9						
Denar deposits							Denar deposits						
0.5 0.1 0.2 0.7 0.6 0.2 0.2							-1.2 1.2 0.0 1.4 -0.8 0.9 -0.3						
FX deposits							FX deposits						
0.8 1.1 0.8 1.1 0.7 0.3 1.0							0.0 2.3 -1.7 2.2 1.3 -1.1 0.2						
Short-term deposits							Short-term deposits						
0.5 0.7 0.2 0.8 0.5 0.1 0.8							-1.4 3.7 -2.0 3.8 -0.1 -0.5 -0.2						
Long-term deposits							Long-term deposits						
0.8 0.5 0.8 0.9 0.8 0.3 0.4							0.2 -0.1 0.2 -0.2 0.6 0.3 0.1						

Source: NBRNM.

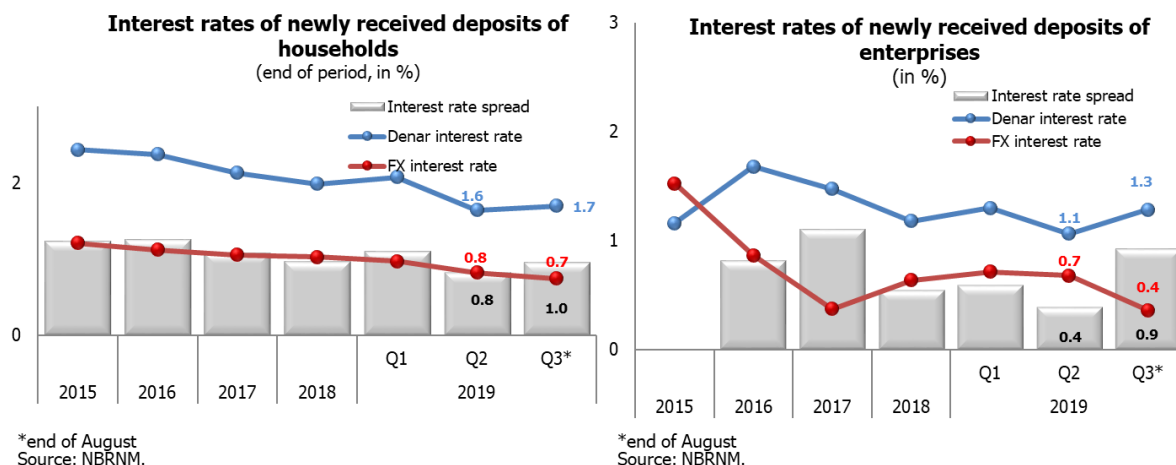
Source: NBRNM.

According to the analysis of the yields on the new savings⁵⁰, in August the interest rate on the newly received denar household deposits⁵¹ was 1.7% and registered a minimum growth of 0.1 percentage points compared to June, while the interest rate on foreign currency deposits equaled 0.7% and was lower by 0.1 percentage points. compared to June. In such conditions, the interest rate spread between the new denar and foreign currency savings of households in August widened relative to June (by 0.2 percentage points) to 1.0 percentage points. In the corporate sector, the interest rate on newly received denar deposits in August was 1.3% and increased by 0.2 percentage points, while the interest rate on foreign currency deposits was 0.4% and was lower by 0.3 percentage points compared to June. With such shifts, the interest rate spread between denar and foreign currency corporate deposits in August equaled 0.9 percentage points and expanded compared to June (0.4 percentage points). Regarding the total received deposits, the interest rate on household deposits (denar and foreign currency) in August amounted to 1.3% and registered a minimal decline of 0.1 percentage points compared to June, while the interest rate on corporate deposits (denar and foreign currency) remained at the level of 1.6%.

⁵⁰ Data on interest rates are in accordance with the methodological changes of the National Bank from June 2018. For more information on the methodological changes visit:

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

⁵¹One should have in mind that the interest rates on the newly accepted deposits are volatile. Volatility of interest rate on newly accepted deposits results from the fact that they derive from the volume of newly received deposits (which can vary from month to month) and their interest rate.



4.2 Lending activity

Private sector loans fell slightly in the third quarter as a result of regulatory changes.⁵² Thus, after the growth in the second quarter (of 1.8%), in the third quarter the loans are lower on a quarterly basis by 0.5%. The effects of mandatory write-offs were most pronounced in July 2019, which contributed to a monthly decrease in corporate loans. However, if this effect is isolated⁵³, total loans grew by 0.8% in the third quarter. The Bank Lending Survey⁵⁴ for the third quarter indicates a small net decrease in loan demand, amid further easing of total credit standards. For the fourth quarter of 2019, banks expect an increase in total credit demand by both sectors, with further easing of total lending conditions.

⁵² Pursuant to the Decision on the methodology for credit risk management (Official Gazette of the Republic of Macedonia No. 149/18), starting from 1 July 2019, the banks are obliged to transfer from off-balance sheet to off-balance sheet all overdue unpaid claims that are fully reserved for more than one year (instead of two years in accordance with the previous regulations). Notwithstanding the transfer of these claims to the off-balance sheet record, the banks reserve the right for collection. The implementation of the Decision started from July 2019.

⁵³ In the third quarter, the bank made mandatory transfer of the accounts for off-balance sheet records of credit exposures where twelve months have passed from the date when the bank was obliged to make impairment, or allocate special reserve of 100% (pursuant to the Decision on the methodology for credit risk management). On this basis, in the third quarter of 2019, the total amount of mandatory write-offs amounted to Denar 4,492 million.

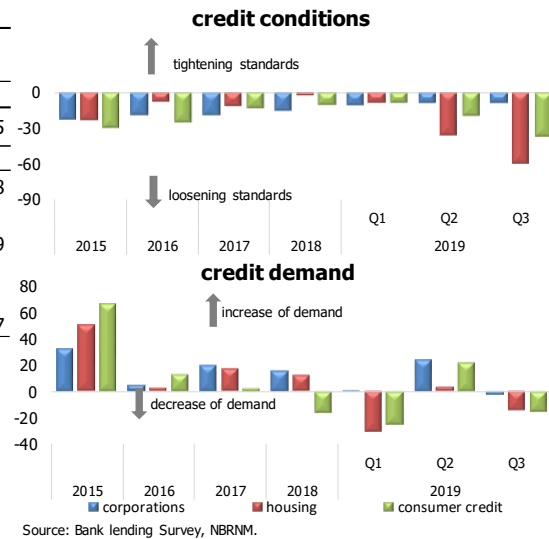
⁵⁴ For more information, also see Bank Lending Survey at <http://nbrm.mk/?ItemID=F7AC78DEE498764FBAF39049F726CE3C>.



Total credits of private sector

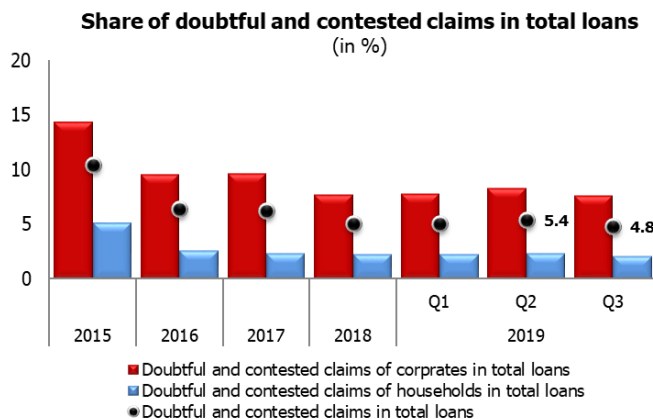
	2018				2019		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
quarterly change, in %							
Total credits of private sector	-0.7	2.7	1.8	3.4	0.8	1.8	-0.5
Contribution in quarterly change of total credits (in p.p.)							
Denar credits	-0.6	1.6	1.1	3.4	0.4	0.8	-0.8
Foreign currency credits	-0.2	1.1	0.7	0.0	0.5	1.0	0.3
Short-term credits	-0.8	0.6	0.0	1.5	-0.1	-0.3	-0.9
Long-term credits	1.3	2.0	1.7	1.6	0.8	1.8	1.2
Households	1.1	1.6	1.2	0.9	0.9	1.7	1.1
Corporations	-1.8	1.1	0.6	2.4	0.0	0.2	-1.7

Source: NBRNM.



Source: Bank lending Survey, NBRNM.

The analysis of the sectoral structure indicates that the quarterly decline in private sector loans is entirely due to the reduction of corporate loans, where the effect of regulatory changes prevails, with a positive contribution of household loans. From a currency point of view, the decline is entirely due to denar loans, given an increase in foreign currency loans⁵⁵. Analyzing the maturity structure, the quarterly fall of total loans was solely due to short-term loans, amid growth of long-term loans. Also, the share of doubtful and contested claims in total loans at the end of September decreased by 0.6 percentage points compared to the previous quarter and reduced to 4.8%.



Source: NBRNM.

On an annual basis, total loans grew by 5.6% at the end of the third quarter, which is more moderate compared to the previous quarter (8.1%). If exclude the effect of mandatory write-offs in this period, the total loans in September increased by 7% annually. Thereby, the share of total loans in total deposits decreased and at the end of September amounted to 81.2%, i.e. 82.2% if the effect of regulatory changes is excluded (83.8% at the end of June).

In the third quarter of 2019, the growth of household lending slowed down compared with the previous quarter. The realized quarterly growth of 2.2% (3.4% in the second quarter) mostly results from the increase of consumer loans, with further positive contribution of housing loans and other loans, while credit cards and overdrafts on current accounts decreased slightly. The Bank Lending Survey for the third quarter of the year indicates a fall in housing and consumer loan demand, amid eased credit

⁵⁵ Foreign currency loan data also include denar loans with currency clause.

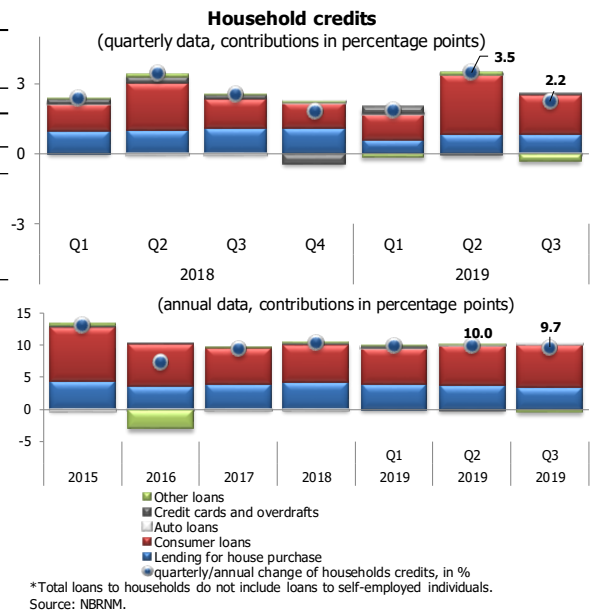


standards. From currency aspect, the growth of household loans derives primarily from foreign currency loans (including the loans with currency clause), as well as denar loans. By maturity structure, the quarterly growth stems from long-term loans, given stable level of short-term loans. Annually, at the end of September, total loans to households increased by 9.5% (9.9% at the end of June).

Total credits of households

	2018				2019		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
quarterly change, in %							
Total credits of households	2.3	3.3	2.5	1.8	1.8	3.4	2.2
Contribution in quarterly change of household credits (in p.p.)							
Denar credits	1.4	2.4	1.7	1.1	1.6	1.7	0.8
Foreign currency credits	0.9	0.9	0.8	0.7	0.2	1.7	1.4
Short-term credits	0.3	0.3	0.2	-0.3	0.4	0.0	0.0
Long-term credits	2.0	2.9	2.3	2.1	1.4	3.2	2.5

Source: NBRNM.



In the third quarter of 2019, total loans granted to the corporate sector declined as a result of regulatory changes. After modest growth in the second quarter (0.3%), corporate sector loans fell by 3.4% in the third quarter. The Bank Lending Survey for the third quarter indicates lower corporate loan demand, amid eased credit standards. By currency, the decline in total corporate loans is primarily due to the decrease in denar loans, given the simultaneous fall in foreign currency loans. The analysis of maturity structure shows that the quarterly decline is due to the lower short-term loans, with a minor fall in long-term loans. Annually, at the end of December, total corporate loans increased by 1.7% (6.4% at the end of June).

Total credits of corporations

	2018				2019		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
quarterly change, in %							
Total credits of corporations	-3.5	2.1	1.1	4.8	0.0	0.3	-3.4
Contribution in quarterly change of corporation credits (in p.p.)							
Denar credits	-2.4	0.9	0.5	5.5	-0.8	0.1	-2.5
Foreign currency credits	-1.1	1.2	0.6	-0.7	0.7	0.2	-0.9
Short-term credits	-1.8	0.8	-0.1	3.3	-0.5	-0.7	-2.0
Long-term credits	0.7	1.1	1.2	1.0	0.4	0.4	-0.1

Source: NBRNM.

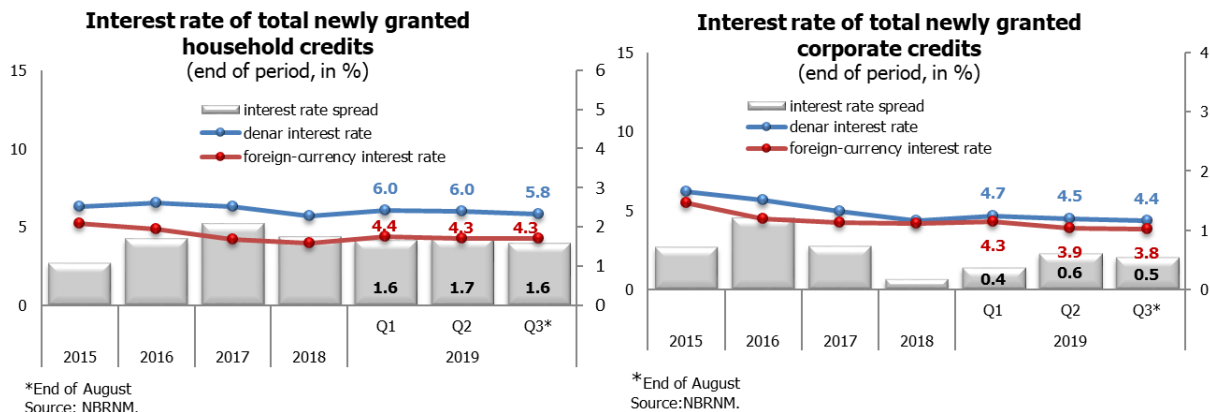
According to the data on the interest rates⁵⁶ on the newly approved loans⁵⁷ in August, the interest rates on denar household loans decreased from 6.0% in June to 5.8% in August, while the interest rates on foreign currency loans remained the same (4.3%), which conditions the narrowing of the interest rate spread to 1.6 percentage points. With the companies, the interest rates on the newly

⁵⁶ Data on interest rates are in accordance with the methodological changes of the National Bank from June 2018. For more information on the methodological changes visit: http://www.nbrm.mk/monetarna_statistika_i_statistika_na_kamatni_stapki.nspix.

⁵⁷ One should have in mind that the interest rates on newly approved loans are volatile. Volatility of interest rate on newly approved loans results from the fact that they are determined by the volume of newly approved loans (which can vary from month to month) and their interest rate.



approved denar and foreign currency loans in August decreased to the level of 4.4% and 3.8%, respectively (previously 4.5% and 3.9%, respectively), with the interest rate minimally decreased to a level of 0.5 percentage points (0.6 percentage points at the end of June). In relation to the total approved loans, at the end of August the interest rates on household and corporate loans decreased by 5.8% and 4.4%, respectively (5.9% and 4.5%, respectively in June).



V. Public finances

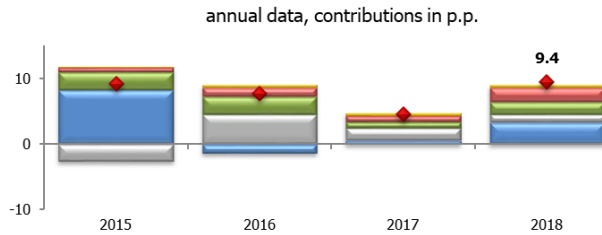
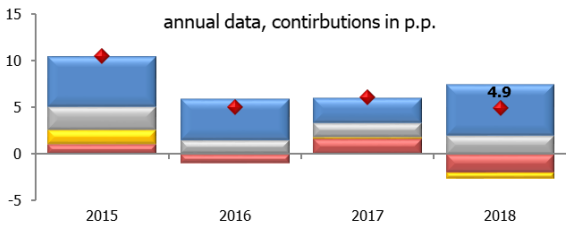
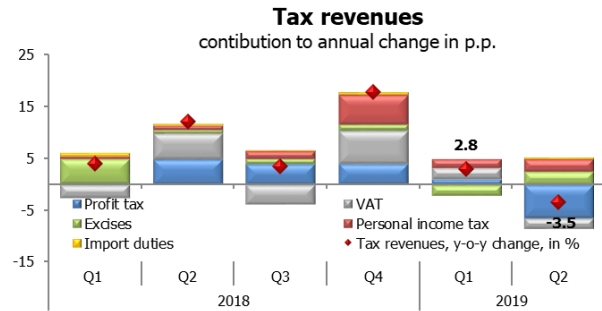
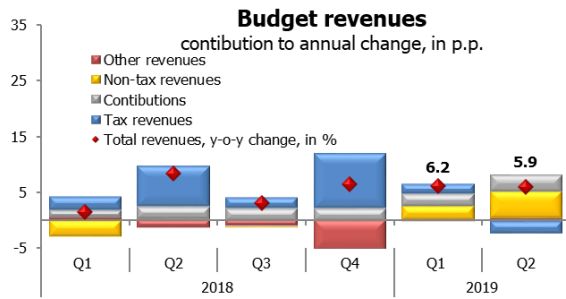
In the second quarter of 2019, budget revenues and expenditures increased on an annual basis. The largest contribution to the growth of budget revenues was made by non-tax revenues and contributions, while the growth of budget expenditures, besides from current costs, also derives from capital costs. The budget deficit is 0.6% of GDP and is slightly higher compared to the same quarter last year (0.2% of GDP). For the first eight months of the year, the budget deficit equals 1.3% of GDP, which is 51.0% of the 2019 budget plan. The budget deficit in January-August was financed through the withdrawal of government deposits from the government deposit account with the National Bank and less through net issuance of government securities on the domestic financial markets. At the end of the second quarter of 2019, total public debt equaled 46.9% of GDP, which is more by 0.5 percentage points of GDP compared to the previous quarter.

In the second quarter of 2019, the total revenues in the Budget of the Republic of North Macedonia⁵⁸ were by 5.9% higher on an annual basis. The growth of budget revenues mostly results from the higher non-tax revenues⁵⁹, contributions and other revenues⁶⁰ (with contribution of 4.8 percentage points, 3.0 percentage points and 0.4 percentage points, respectively), while the contribution of taxes was negative (2.2 percentage points).

⁵⁸ Central budget and budgets of funds.

⁵⁹ Higher non-tax revenues were mostly due to inflows to the Pension and Disability Insurance Fund's account in the RNM Budget. These inflows are a result of the transfer of funds of the private pension funds in accordance with the Law Amending the Law on Mandatory Fully Funded Pension Insurance and the Law Amending the Law on Pension and Disability Insurance (Official Gazette of RM No. 245 of 28 December 2018). With these amendments, the membership of some insuree categories in the second pillar of the pension system ceased on 1 January 2019.

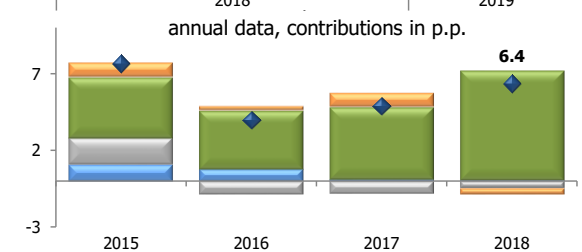
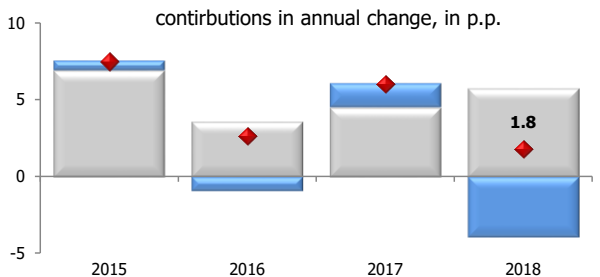
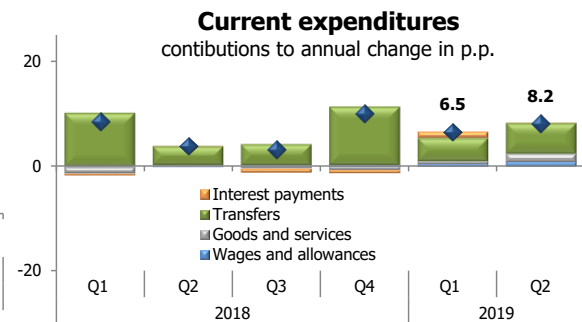
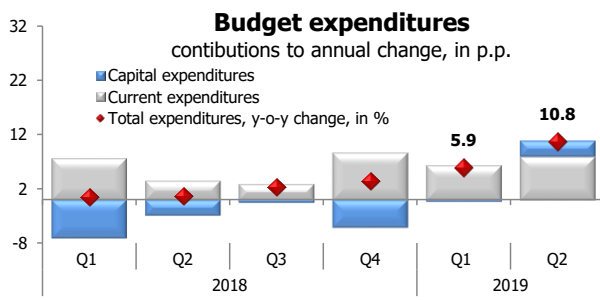
⁶⁰ Other revenues include capital revenues, donations from abroad and revenues from recovered loans.



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

Source: Ministry of finance and NBRNM's calculations

In the same period, the total tax revenues⁶¹ decreased by 3.5% on an annual basis. In terms of structure, the reduction in tax revenues as a whole is a result of lower income tax revenues and lower net VAT revenues⁶² (with a contribution of 6.5 percentage points and 2.1 percentage points, respectively), while personal income tax, excise duties and import duties have positive contributions (2.6 percentage points, 2.5 percentage points and 0.2 percentage points, respectively).



Source: Ministry of finance.

Source: Ministry of finance and NBRNM's calculations.

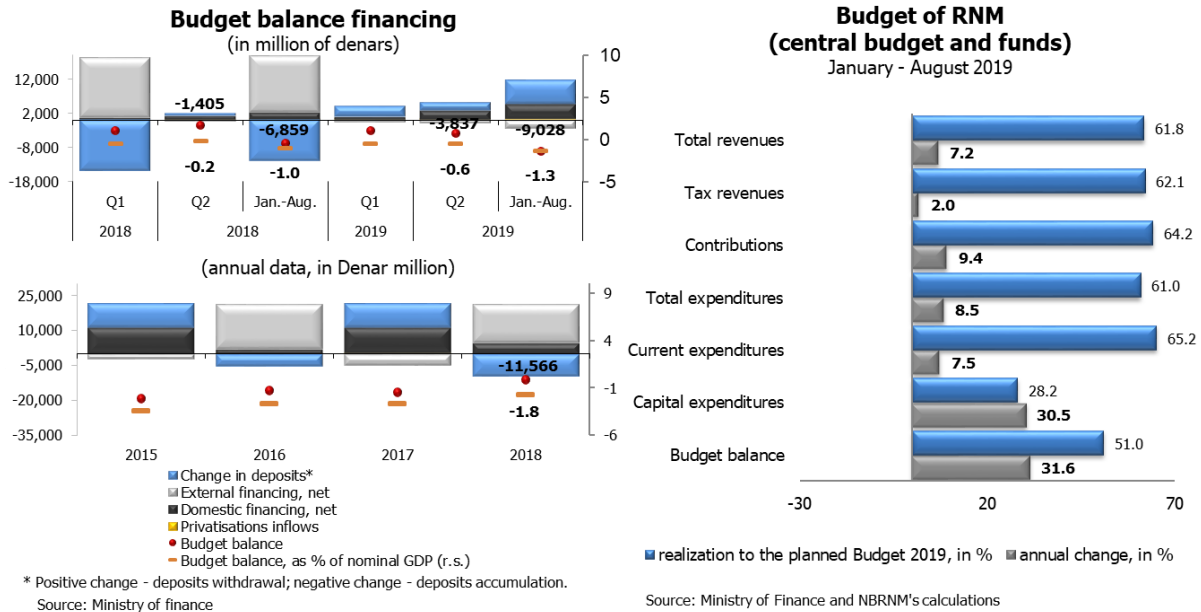
Total expenditures in the Budget in the second quarter of 2019 were by 10.8% higher on an annual basis. The growth of **budget expenditures** stems from the higher current and capital costs with a contribution of 7.8 and 3.0 percentage points, respectively. Total current costs increased by 8.2%

⁶¹ It also includes own revenue accounts (SSP).

⁶² Lower net VAT revenues in the second quarter of 2019 are mostly explained by the higher payment of VAT refunds, by 19.8% on an annual basis, amid annual increase in gross VAT revenues of 2.6%.



annually. In terms of structure, growth is recorded in all categories of current expenditures, with the largest contribution being made by "transfers" category (5.8 percentage points).



In the second quarter of 2019, the Budget deficit was Denar 3,837 million or 0.6% of GDP⁶³, which is slightly higher performance compared to the same period last year (0.2% of GDP). The deficit was mostly funded through government borrowing on the domestic financial market and withdrawing funds from the government deposit account with the National Bank.

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

	2019									
	Budget for 2019	Q1	Q2	Jan.-August	Q1		Q2		Jan.-August	
					Annual changes, period in Q1 2019, in %	Contributions in annual changes, period in Q1 2019, in p.p.	Annual changes, period in Q2 2019, in %	Contributions in annual changes, period in Q2 2019, in p.p.	Annual changes, period in January to August 2019, in %	Contributions in annual changes, period in January to August 2019, in p.p.
TOTAL REVENUES	210,848	46,045	50,077	130,323	6.2	6.2	5.9	5.9	7.2	7.2
Tax revenues and contributions	184,201	40,646	43,912	115,695	4.4	4.0	0.9	0.8	4.3	3.9
Taxes	120,166	26,272	28,191	74,658	2.9	1.7	-3.3	-2.0	2.0	1.2
Contributions	62,316	14,061	15,357	40,003	7.7	2.3	10.2	3.0	9.4	2.8
Non-tax revenues	18,521	4,293	4,993	11,533	34.3	2.5	82.3	4.8	48.0	3.1
Capital revenues	2,025	218	177	668	-52.2	-0.5	-50.1	-0.4	-37.7	-0.3
Foreign donations	6,000	888	995	2,427	12.7	0.2	57.4	0.8	35.6	0.5
Revenues from repayments of loans	100	0	0	0	0.0	0.0	0.0	0.0	0.0	0.0
TOTAL EXPENDITURES	228,548	49,241	53,914	139,351	5.9	5.9	10.8	10.8	8.5	8.5
Current expenditures	202,577	47,627	50,249	132,038	6.5	6.3	8.2	7.8	7.5	7.1
Capital expenditures	25,971	1,614	3,665	7,313	-10.0	-0.4	64.6	3.0	30.5	1.3
BUDGET DEFICIT/SURPLUS	-17,700	-3,196	-3,837	-9,028						
Financing	17,700	3,196	3,837	9,028						
Inflow	34,195	7,704	8,243	18,688						
Privatisation receipts	100	168	51	335						
Foreign loans	25,416	64	853	935						
Deposits	-10,325	3,225	2,214	7,115						
Treasury bills	19,001	4,217	5,125	10,273						
Sale of shares	3	30	0	30						
Outflow	16,495	4,508	4,406	9,660						
Repayment of principal	16,495	4,508	4,406	9,660						
External debt	6,175	855	1,943	3,516						
Domestic debt	10,320	3,653	2,463	6,144						

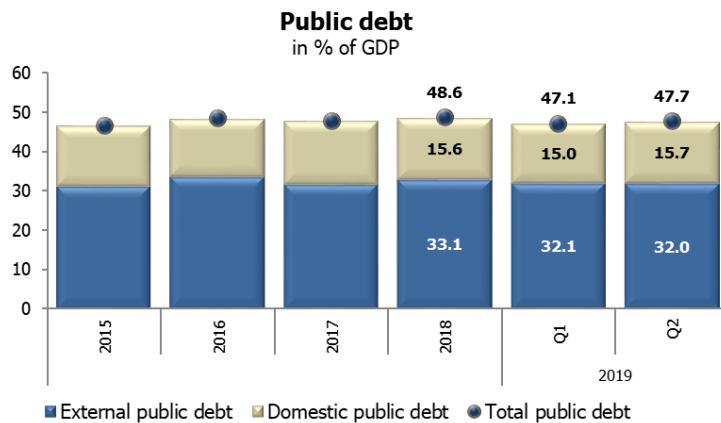
Source: Ministry of Finance and NBRNM calculations.

In the period January-August 2019, the total budget revenues increased by 7.2% compared to the same period last year. The growth is largely the result of better performance, mainly in non-tax revenues and contributions (contributions of 3.1 percentage points and 2.8 percentage points, respectively). In the same period, the budget expenditures increased by 8.5% on an annual basis, mostly due to the growth of current expenditures, with a contribution of 7.1 percentage points, given positive contribution to capital expenditures of 1.3 percentage points. In the first eight months of the

⁶³ The analysis uses the NBRNM April forecast for the nominal GDP for 2019.



year, the budget deficit totaled Denar 9,028 million, or 1.3% of GDP. The budget deficit constitutes 51% of the 2019 Budget. Most of the deficit was financed through the withdrawal of government deposits from the government deposit account with the National Bank and less through net issuance of government securities on the domestic financial markets.



Source: MoF and NBRNM calculations.

At the end of the second quarter of 2019, total public debt⁶⁴ was 46.9% of GDP⁶⁵, which is a quarterly increase of 0.5 percentage points. Analyzing the structure, such increase is due to the growth of the internal debt from 14.8% to 15.4% of GDP, amid small decrease in the external debt from 31.6% to 31.5% of GDP. From the aspect of the debt structure, the total state debt is 38.7% of GDP and has increased by 0.3 percentage points compared to the previous quarter, while the guaranteed and non-guaranteed debt of public companies increased by 0.2 percentage points, reaching 8.2% of GDP. Compared to the same period and the end of 2018, the total public debt is lower by 0.9 percentage points of GDP and about 1.5 percentage points of GDP.

VI. Macroeconomic forecasts and risks

As part of the October forecast cycle, assessments for further moderate acceleration of the growth of the domestic economy have been retained. The expected growth rates are unchanged compared to the April projections and **equal 3.5% in 2019, 3.8% in 2020 and 4% in 2021, expecting this growth rate to continue in 2022.** Compared to April, the global economic context is less favorable and is characterized by more pronounced uncertainty and more pronounced downward risks, and there are some short-term risks from the domestic environment. This mainly points to more pronounced downside risks to economic growth projections compared to April. However, given the current favorable signals from high-frequency economic indicators, as well as specific domestic factors related to the public infrastructure cycle and further use of export sector capacity, such a global environment is not expected to have significant effects on economic growth. **Structurally, a positive impulse is still expected from domestic demand, while net exports would have a negative effect.** Inflation projection is corrected downwards, with **the expected inflation rate in 2019 and 2020 of about 1% and 1.5%** (as opposed to 1.5% and 2% in the April forecast). The changes in the expectations are a reflection of the more moderate realized inflation than expected, as well as the

⁶⁴ The public debt is defined under the Law on Public Debt (Official Gazette of the Republic of Macedonia No. 62/2005, 88/2008, 35/11, 139/14 and 98/19) as the sum of the government debt and the debt of public companies 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.

⁶⁵ At the end of the second quarter of 2019, the total public debt equals Euro 5,300 million.

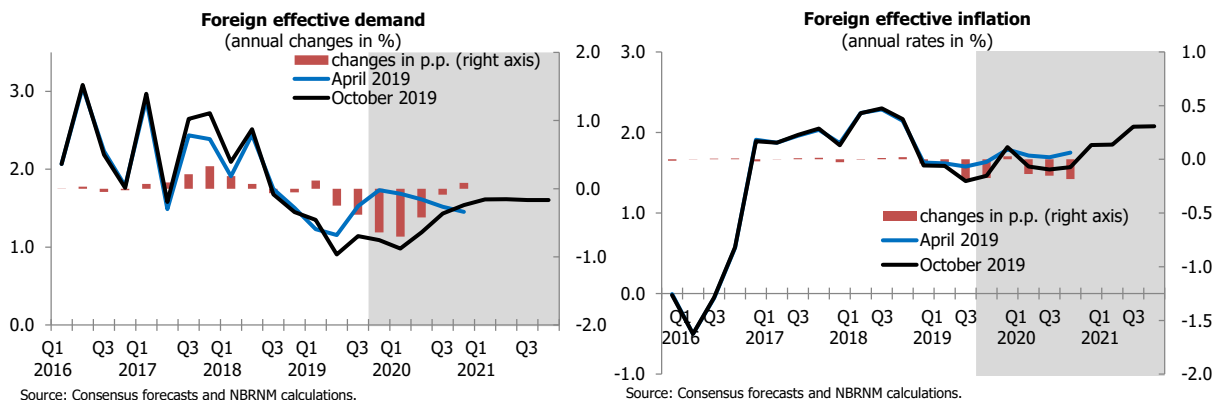


assessments for lower pressures of the import prices on the domestic inflation. For the period 2021-2022, the price growth forecast remained 2%, assuming the absence of major shocks on the supply and demand side. **The estimates for the movement of the of the balance of payments' components in the 2019 - 2022 forecasts period continue to indicate a moderate deficit in the current account (of about 1.5% of GDP on average for the period).** In this period, the current account deficit is expected to be fully financed by the flows in the financial account, through foreign direct investments and external borrowing, which will enable further growth of the foreign reserves and their maintenance at the appropriate level.

6.1 Assumptions in the external environment forecast⁶⁶

The latest assumptions about the foreign effective demand⁶⁷ in 2019 and 2020 were revised downwards compared to the April forecasts. Thus, the foreign effective demand growth will be 1.1% and 1.3% in 2019 and 2020, respectively (1.8% and 1.4% in April). The downward revision is largely due to the lower expected economic growth of Germany. In 2021, the growth dynamics is expected to continue, so it is estimated that the growth of foreign demand will accelerate and reach 1.6%.

In the case of foreign effective inflation⁶⁸, small downward corrections were made for 2019 and 2020 compared to the April forecast, with the growth of 1.5% and 1.6% being expected, respectively (compared to 1.6% and 1.8% in 2019 and 2020, respectively, in April). The downward revision for 2019 mainly reflects the lower expected growth of prices in Croatia, Greece and Italy, while for 2020 the revision results from the downward revision of inflation in almost all countries. In 2021, it is expected that the price growth with our trading partners will accelerate, estimating that foreign inflation will be 2%.



According to the latest projections for the movement of the Euro / US Dollar exchange rate in 2019 and 2020, an upward revision was made compared to April. According to the October forecast, a stronger appreciation of the US dollar against the euro of 5.4% in 2019 is expected, compared to 2.9% in April and a smaller depreciation (0.8% in 2020, compared to 2.5% in April). Such changes are largely a reflection of more favorable economic performance in the United

⁶⁶ Historical data on foreign demand, foreign inflation, exchange rate of the US dollar/euro and EURIBOR are sourced from Eurostat, while the World Bank statistics is a source of the data on prices of oil, food and metals. The forecasts of the foreign demand, foreign inflation, foreign exchange rate of the US dollar and EURIBOR are based on the Consensus Forecast, while the forecasts of the prices of oil, food and metals are based on the forecasts of market analysts. The analysis uses various reports of the IMF, the World Bank, ECB, FAO, OPEC and specialized economic portals.

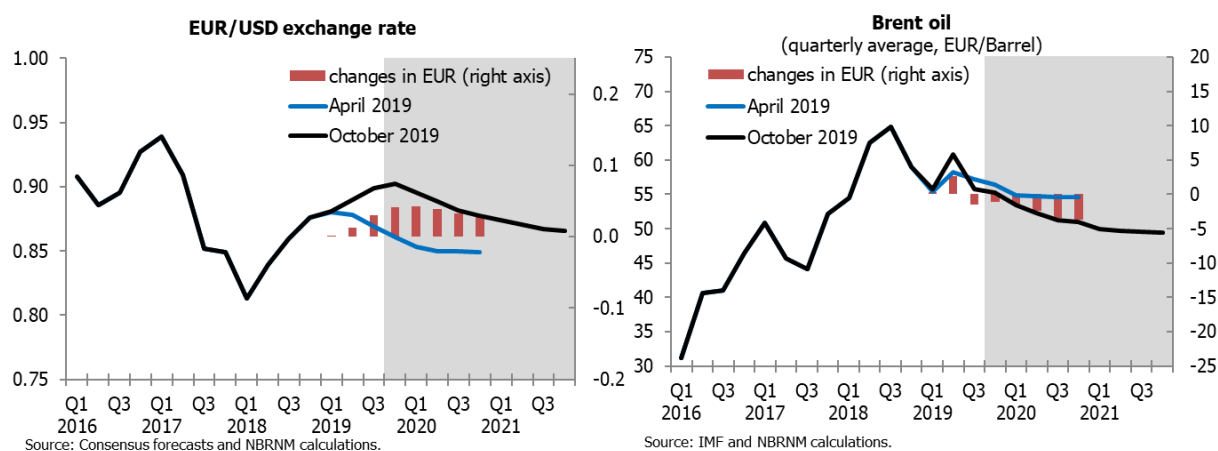
⁶⁷ Foreign effective demand is calculated as the weighted sum of GDP indices of the major trading partners of the Republic of North Macedonia. The calculation of this index includes Germany, Greece, Italy, the Netherlands, Belgium, Spain, Serbia, Croatia, Slovenia and Bulgaria.

⁶⁸ The foreign effective inflation is calculated as the weighted sum of consumer price indices of the countries that are major partners of the Republic of Macedonia in the field of import of consumer goods. The calculation of this indicator includes Bulgaria, Germany, Greece, France, Italy, Austria, Slovenia, Croatia and Serbia. Inflation in Croatia and Serbia has been adjusted for the changes in the exchange rate.



States, lower expectations for the eurozone economy, and perceptions of the FED's lower-than-expected monetary expansion. For 2021, the value of the US dollar against the euro is expected to continue to fall, and the decline will be 1.9%. Such changes are largely a reflection of more favorable economic performance in the United States, lower expectations for the euro area economy, and perceptions of the FED's lower-than-expected monetary expansion. For 2021, further fall in the value of the US dollar against the euro is expected, and the decrease will be 1.9%.

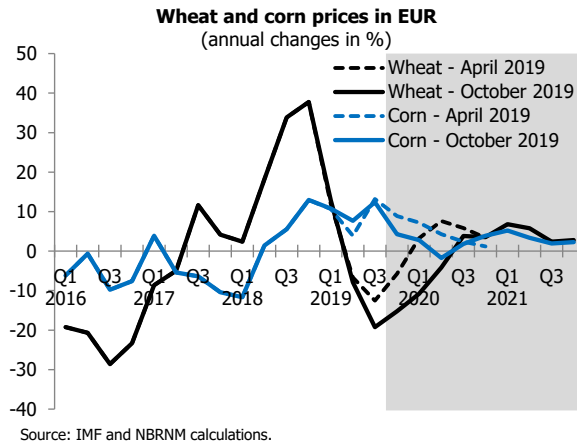
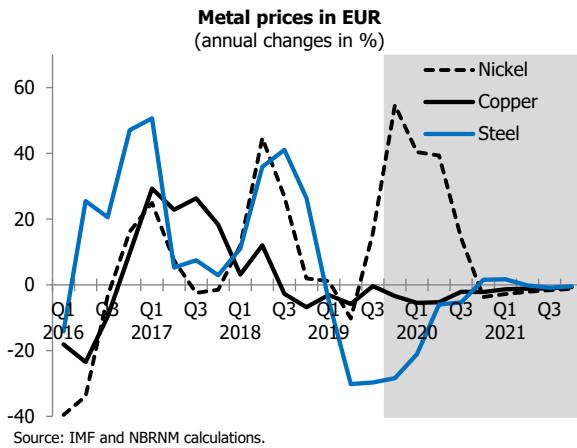
The new assessments for 2019 regarding the oil price, denominated in US dollars, indicate a downward revision compared to April, but the euro prices remain unchanged, as an effect of the movement of the exchange rate euro / US Dollar. For 2020, current expectations point to a deeper decrease in the oil price in euros of 8.7% compared to the April projections (a decrease of 3.7%), in conditions primarily of the expectations for global growth deceleration, which will cause decelerated demand for oil. For 2021, further fall in the price of crude oil in euros is expected, which will equal 4.4%.



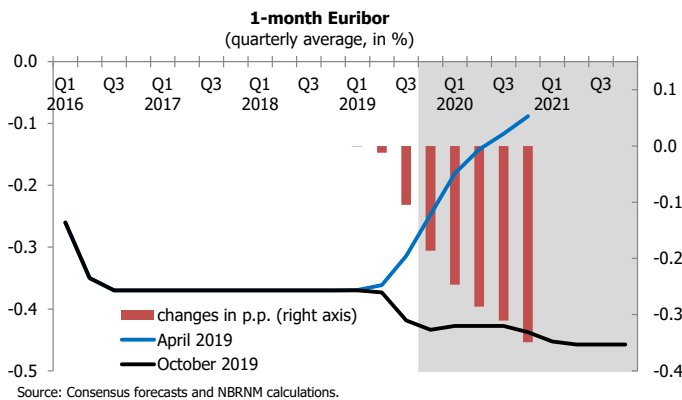
In the October forecasts, metal prices were revised in different directions. Namely, in the prices of copper and steel, denominated in euros, a downward correction was made for 2019 and 2020, with a stronger decrease in prices compared to previous estimates, mainly due to further trade tensions between the United States and China and expectations for slowdown of global economic activity, and especially of China. On the other hand, the price of nickel in euros made a significant upward revision for 2019 and 2020 (stronger growth compared to April), in conditions of solid demand and expectations for reduced supply⁶⁹, as well as reduced inventories. In 2021, metal prices are expected to stabilize.

Compared to the April projections, current estimates for food prices in 2019 and 2020 have been revised downwards. Thus, the **wheat price in euro** is now expected to register stronger decline in 2019 and fall, instead of growth in 2020, due to the high global supply, as well as to the strong export competition. Current projections for the corn price, for both years, show lower growth compared to the April forecast, largely due to increased global supply and expectations for higher inventories in the United States. In 2021, the price of wheat is expected to rise, and the price of corn is expected to accelerate slightly.

⁶⁹ From the beginning of 2020, Indonesia will introduce a complete ban on the export of nickel ore. Also, since mid-September 2019, the work of several nickel mines in the southern part of the Philippines has been stopped indefinitely by the regional government, which currently revises the mining policy in order to adopt a law on responsibility in mining.



Regarding **the interest rate of the one-month EURIBOR**, for 2019 and 2020, a downward revision was made in relation to the April projections, especially for 2020. The average level for 2019 is expected to be -0.40% (-0.32% in April), while in 2020 it will be positioned at an average level of -0.43%, contrary to the April expectations for gradual normalization of the interest rate (-0.13%). The downward revision results from the ECB decision from September 2019 to reduce the deposit interest rate by 10 basis points, to -0.5%, expecting the interest rates to be maintained at the current or lower level until the inflation rate approaches the level close to, but below 2% for the forecasted period. In addition to this measure, other measures have been adopted for accommodative monetary policy for a longer period, including the resumption of the quantitative easing program from November 1, 2019, during which securities worth 20 billion euros per month will be purchased⁷⁰. Therefore, for 2021 it is expected that the interest rate EURIBOR will continue with the downward trend and will amount to -0.46%, on average.



6.2 Forecast and effects on monetary policy

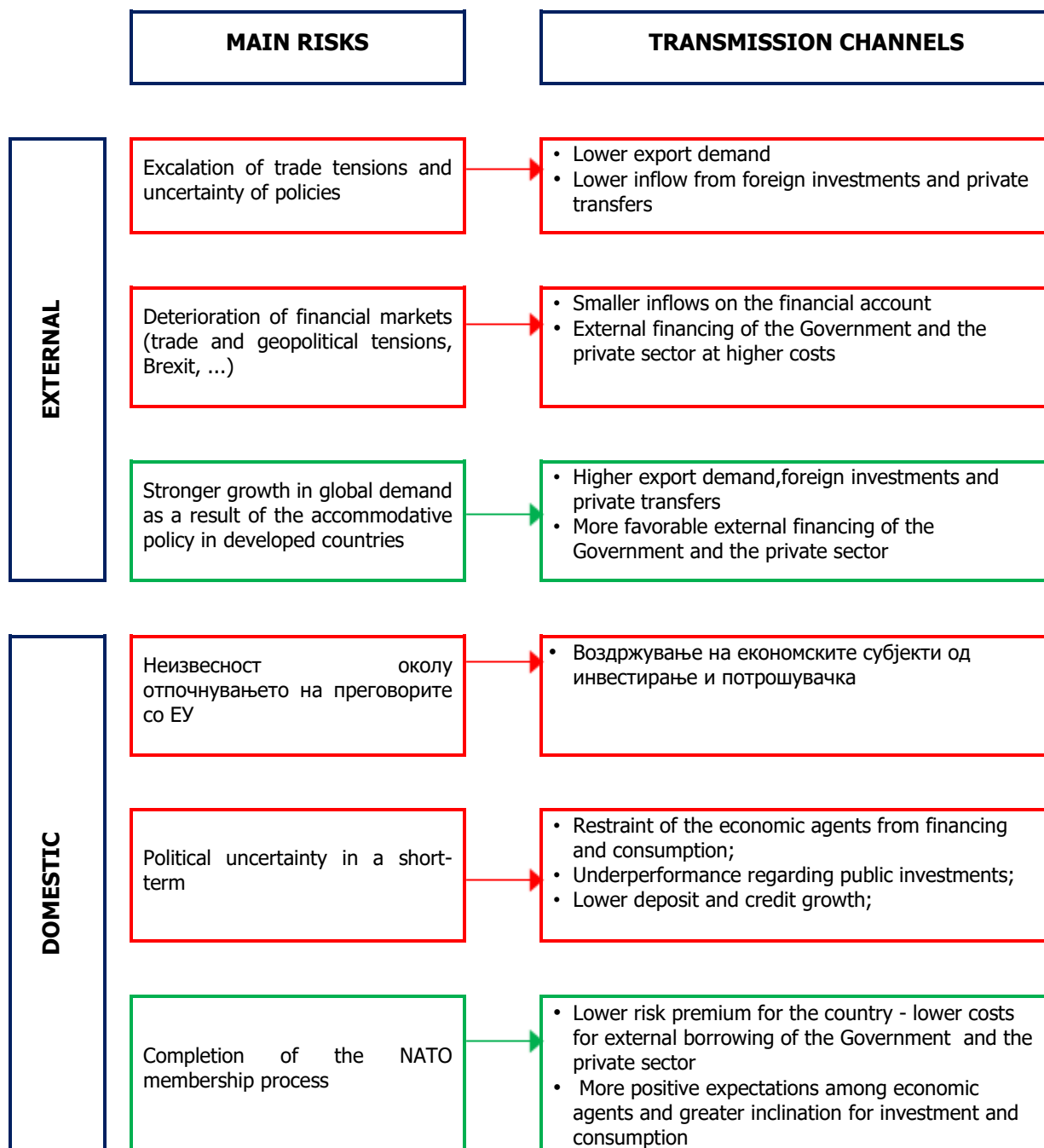
The October macroeconomic scenario for the Macedonian economy is similar to the April forecast, with a similar expected growth structure, but with more pronounced downside risks, especially related to the external environment. Notwithstanding the above, the forecasts still indicate favorable external position of the economy and foreign reserves,

⁷⁰ Other measures include: resumption of reinvestment of due securities for a longer period; prolongation of the program of long-term refinancing operations from two to three years and the interest rate will be at the level of the key interest rate for refinancing operations, but not lower than the deposit rate, unlike the previously announced increase in the key interest rate of 10 bp.; and the introduction of a two-tier system for the reserve requirement starting from October 30, 2019.



which in the next period will be maintained at an appropriate level. At the same time, despite the expectations for maintaining the trend of gradual strengthening of the economy in the following period and possible pressures on the import side due to the high dependence on imports, they would still not be such to jeopardize the maintenance of external balance. Hence, it is predicted that the current account deficit will remain moderate, with the main sources of financing being inflows from foreign direct investment and borrowings of the public and private sectors. **From the aspect of the foreign interest rate, as an important external factor for the implementation of domestic monetary policy, this forecast has made significant downward revisions for 2019 and 2020 compared to April.** Namely, in anticipation of a downward deviation of inflation from the target and relatively weak economic growth, in September the ECB made an additional easing of monetary policy, with the expected retention of the extremely adjustable setting for a longer period of time. Therefore, contrary to previous expectations that the interest rate will start to enter the positive zone after 2020, the latest estimates show that the interest rate on the one-month EURIBOR will remain in the negative zone until the end of 2021, i.e. no significant shifts from the current historically low level are expected. **The risks for achieving the basic macroeconomic scenario in the area of the external environment are assessed as less favorable, compared to the April forecast, and these projections are accompanied by certain risks from the domestic environment.** Given downward revisions of global growth, which is expected to decelerate from 3.6% in 2018 to 3% in 2019 (the lowest rate since the global economic crisis) and then moderately accelerate to 3.4% in 2020, **external risks** related to global economic environment are assessed as more negative⁷¹. At the same time, the escalation of trade tensions between the world's largest economies and the possible effects on the trust of economic entities, investment decisions and total global trade are highlighted as significant risks. At the same time, an important risk factor is the deterioration of financial market conditions, which could be caused by the deterioration of trade and geopolitical tensions, the manner and time of implementation of Brexit, as well as the slowdown in economic activity in the most important economies. Furthermore, the main medium-term negative risks are related to the slowdown in productivity growth as a result of higher trade barriers and higher trade and geopolitical tensions, the accumulation of financial vulnerabilities, and the effects of climate change, especially in vulnerable countries. As for **domestic risks**, they are moderately downward and reflect the continued uncertainty over the start of accession negotiations with the EU, which, combined with possible short-term political uncertainty, could lead to restraint in spending and investment, and with and lower economic growth than projected. On the other hand, the successful completion of the NATO membership process could have significantly more beneficial effects on economic growth and the risk premium of the domestic economy. In addition, the current projection does not include shocks from the possible realization of the negative risks for global growth or domestic risks.

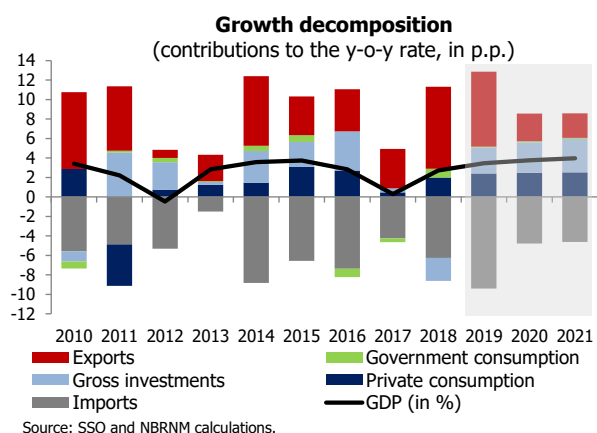
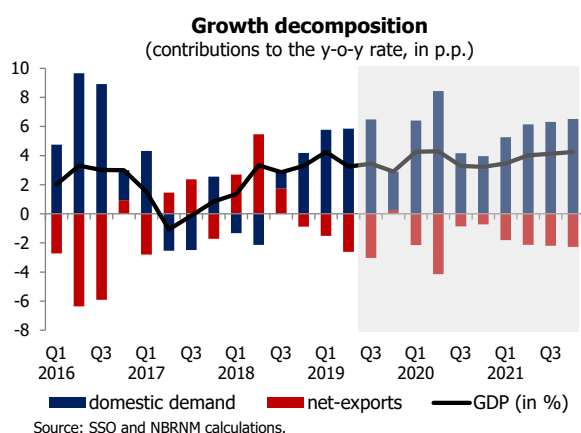
⁷¹World Economic Outlook, IMF, October 2019.



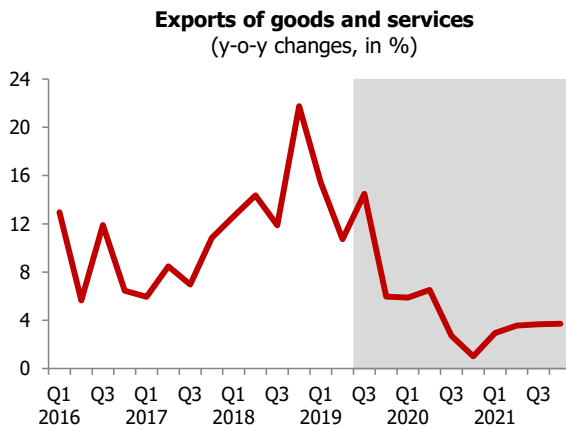
In the first half of 2019, the growth of economic activity accelerated. Thereby, the realized growth in this period completely results from the high positive contribution of the domestic demand, during the negative contribution of the net export. In terms of components, exports were again a component with the largest individual contribution to GDP growth. Within the net export demand, the real export continues to record high growth rates, in conditions of high export activity of the facilities with foreign capital, but also of some of the traditional manufacturing facilities. However, in conditions of relatively high growth and real imports, the contribution of net exports was negative. On the other hand, unlike the previous two years of anemic growth of gross investment, in the first half of 2019 there was a higher growth of investment activity, in conditions of gradual



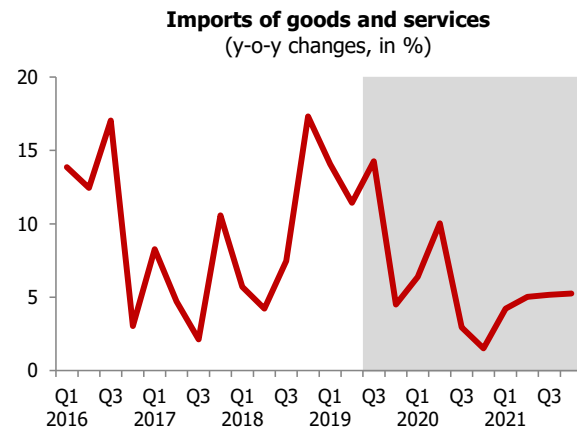
strengthening of public infrastructure projects. In these conditions, the contribution of gross investment to growth was the highest among the factors of domestic demand. Furthermore, personal consumption continues to record solid growth rates, in terms of positive developments in all factors of disposable income, as well as constant credit support from banks. At the same time, small growth was observed in public consumption. The available high-frequency data and estimates for the second half of 2019 indicate similar performance as in the first half of the year, i.e. moderate acceleration of private consumption, consistently solid growth of investments, as well as more moderate negative contribution of net exports at relatively high growth rates of both exports and imports. **Consequently, GDP growth in 2019 is expected to average 3.5% (at a rate of 2.7% in 2018) and will further accelerate to 3.8% in 2020 and 4% in 2021.** In terms of growth structure, domestic demand is expected to maintain its high positive contribution throughout the forecast period, as a result of the strengthening of investment activity and the constantly high stimulus from private consumption, while the contribution of net exports will be negative. In the long run, the Macedonian economy is expected to grow further, with the growth rate in 2022 at around 4%.



Analyzed by GDP components, it is expected that real export of goods and services will remain the main growth generator. In terms of dynamics, given the positive performance in the first three quarters of the year and the assessment of similar movements in the last quarter, it is expected that export activity will show a relatively high growth rate in 2019. Furthermore, the main contribution to the growth of total exports stems from the increased utilization of the export potential of foreign facilities, as well as the dynamic activity of other domestic exporters from the traditional sectors. Furthermore, given the high comparative basis, the growth rate of real exports of goods and services in 2020 and 2021 is expected to slow down, gradually stabilizing the utilization of production capacities of new export-oriented companies, as well as more moderate growth of activity in the traditional export sector amid slow growth in foreign effective demand. The uncertainty about export activity is related to the escalation of trade tensions between the world's largest economies and the possible effect on the growth, which could have a negative effect on the export of domestic companies.



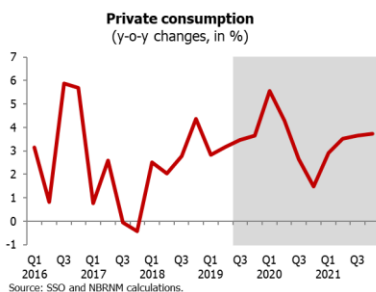
Source: SSO and NBRNM calculations.



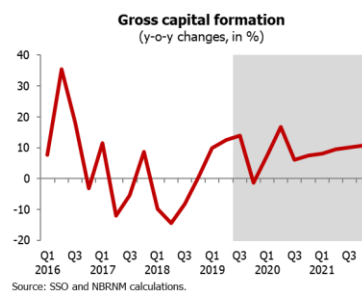
Source: SSO and NBRNM calculations.

Unlike the moderate growth in the previous two years, **domestic demand is expected to have a stronger positive contribution to GDP growth in 2019**. Regarding the individual components, it is estimated that the highest contribution will be **gross investments**, stirred by both public investment and private investment. Furthermore, **private consumption** will further have a relatively high positive contribution, which will be moderately higher compared to the previous year. **Public consumption** will also have a minimal positive contribution.

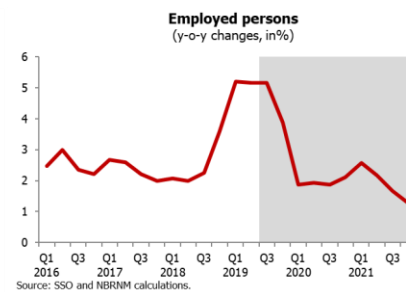
It is expected that the positive developments in private and investment consumption will be more pronounced in 2020 and 2021. **Gross investments** are expected to make a positive contribution to growth, amid expected continued performance in larger public infrastructure investments. At the same time, the stable domestic environment, further confidence and investment inclination of private entities, supported by bank lending and anticipated solid inflows of foreign direct investment, are expected to have an additional stimulating effect on the overall investment cycle. An additional positive impetus for economic growth in the next two years is expected from the moderate acceleration of **private consumption**, with expected positive movements of all components of disposable income. Solid growth is expected in real wages, supported by intensified economic activity, increased public administration wages in the last quarter of 2019, as well as announced measures to increase the minimum wage and support wage growth by subsidizing contributions. Expectations for the labor market are also favorable, but more moderate compared to the high employment growth in 2019. At the same time, the growth of inflows based on private transfers, as well as the amount of pensions, will further contribute to a greater propensity to consume during projections. At the same time, the solid credit support of the household consumption by the domestic banks is expected to be maintained. Regarding **public consumption**⁷², it is estimated that its cumulative effect on the economic activity within the forecast period will be minimally positive.



Source: SSO and NBRNM calculations.



Source: SSO and NBRNM calculations.



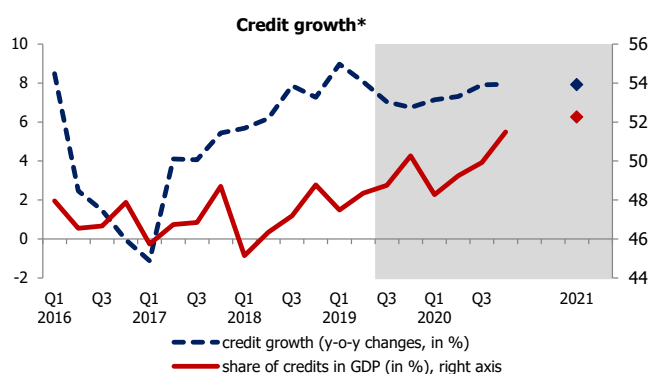
Source: SSO and NBRNM calculations.

⁷² Public spending forecasts are based on information from the 2019 Budget, as well as the fiscal strategy 2020-2022 of May 2019.



The latest assessments of the credit market in the forecast period indicate increased credit activity in 2019 and maintenance of solid growth rates in the next three years.

Solid credit growth was recorded in the first three quarters of the year, anticipating that it will continue until the end of the year and for the whole 2019 it would be 5.4%⁷³ (7.3% at the end of 2018). In the next period, a slight acceleration of the credit activity is expected, i.e. credit growth of about 8% in the period 2020-2022. Thus, amid sound solvency and liquid position of banks, with stable environment, enhanced competitiveness and sufficient level of available funding, it is expected that banks will provide sufficient credit support for both the households and the corporate sector. In line with the assessments for a stable environment and gradual acceleration of economic activity, and taking into account the deposit base dynamics in the first three quarters of the year, for 2019 growth of total deposits of 9.6% is expected (12.1% in 2018). Expectations for solid economic performance will enable further growth of the deposit base with a solid projected rate of 8.5% in the period 2020-2022.



Source: NBRNM.

* Corrected for write-offs due to regulatory changes.

The performance in the first three quarters of the year and the assessment of similar movements in the last quarter indicate **a relatively high growth rate of import demand in 2019, reflecting the positive movements in exports and domestic demand**. However, in conditions of similar real growth rates of exports and imports, the contribution of net exports on growth in 2019 will be negative (despite the positive effect in the previous year). Furthermore, import demand is expected to continue to rise in 2020 and 2021, but growth will be more moderate, adequate to the expected exports trend. However, the imports growth will exceed the expected exports growth, primarily as a result of the expected recovery of investment activity, growth of foreign direct investment and further strengthening of private consumption, which will result in increased need for import of investment and consumer goods. Hence, it is predicted that net exports will make a moderately higher negative contribution to total growth in 2020 and 2021.

According to the latest estimates for the balance of payments, in 2019, an annual deepening of the current account deficit of 1.2 percentage points of GDP is expected, which would equal 1.3% of GDP. The higher deficit in current transactions, expressed as a relative share of GDP, is mainly due to higher trade deficits and lower surpluses in secondary income. Namely, it is expected that the negative gap in the balance of goods will moderately deepen as a result of the increased deficit in both the energy and non-energy components. On the other hand, an increase in the surplus with the balance of trade of services and a slightly lower deficit in primary income is expected. Financing of the current account deficit in 2019 is expected to rely on net inflows from direct investment, long-term loans and trade loans, with expected net outflows in the categories of currencies and deposits and portfolio investments. **In the next medium term (2020-2022) a slight deterioration of the current account deficit is expected, which would equal 1.3%, 1.5% and 1.7% of GDP in 2020, 2021 and 2022, respectively.** At the same time, the balance of goods and services is expected

⁷³ Controlled for the effect of the regulatory change that determined write off of suspicious and contested claims fully provisioned longer than one years from balance sheet records and their transfer to off-balance sheet records. If the written offs are corrected according to the regulatory changes, the expected annual credit growth in 2019 would be around 7%.



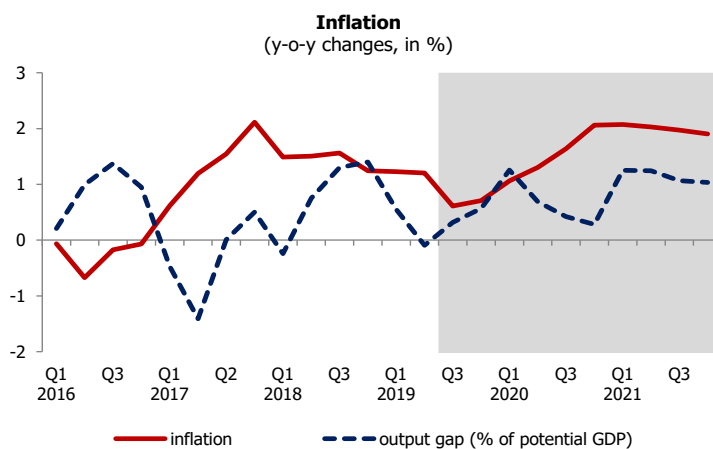
to improve, as a result of the trade balance, amid narrowing of the energy balance, in conditions of lower and stable non-energy balance (combined effect of increased net export of new production facilities and expectations for better export performance part of the traditional export sectors, with favorable movements in the nickel prices on world stock exchanges). At the same time, it is expected that the primary income deficit will increase moderately in the coming period, as a result of the increase in the income of foreign investors in the economy. In the absence of shocks, it is expected that the surplus of secondary income in the projection period will stabilize at a lower level. **Public sector debt, as well as inflows from foreign direct investment**, are estimated as the main sources of financing the current account deficit, while their volume will enable additional growth of the foreign reserves and their maintenance at an adequate level.

Balance of Payment forecast (% of GDP)

	2015	2016	2017	2018	2019	2020	2021
Current account	-2.0	-2.9	-1.1	-0.1	-1.3	-1.3	-1.5
Balance of goods & services	-16.2	-15.2	-14.1	-12.8	-13.4	-13.0	-12.5
Goods, net	-20.1	-18.8	-17.8	-16.2	-17.0	-16.6	-16.4
Services, net	3.8	3.5	3.7	3.4	3.6	3.6	3.9
Primary income, net	-3.2	-4.0	-4.0	-4.2	-4.0	-4.3	-4.5
Secondary income, net	17.4	16.4	17.0	16.8	16.1	16.0	15.5
Private sector, net	16.9	15.4	15.9	15.8	15.5	15.4	15.0
Capital account	0.1	0.1	0.2	0.1	0.0	0.0	0.0
Financial account	0.1	-6.3	0.5	-5.1	-3.6	-4.0	-2.5
FDI, net	-2.2	-3.3	-1.8	-5.6	-2.6	-3.5	-3.5
Portfolio Investment, net	-0.7	-4.4	0.2	-3.0	0.9	-2.4	4.4
Other Investment, net	3.1	1.4	2.1	3.5	-1.9	1.9	-3.4

Source: NBRNM.

In conditions of downward correction of the expected path of import prices and absence of significant pressures through the domestic demand channel, **a relatively low inflation rate is expected in the entire forecast period. The inflation in 2019 is assessed to be around 1%,** with moderate positive contribution of the core inflation and the food component, despite the negative changes in the energy component. **In 2020, inflation is expected to moderately accelerate i.e. increase to 1.5%,** given the positive contribution of core inflation as a result of the further acceleration of the growth of domestic demand, as well as the growth of food inflation, amid small negative effect of the energy component. Amid expected further acceleration of the domestic economic growth and moderate rise in world prices, **in 2021, the inflation is forecasted to gravitate around 2%, similar to 2022.** The main risk to the inflation forecast remains associated with the uncertainty regarding the future dynamics of the stock market prices of primary commodities, especially oil.



Source: SSO and NBRNM calculations.



6.3 Comparison with the previous forecast

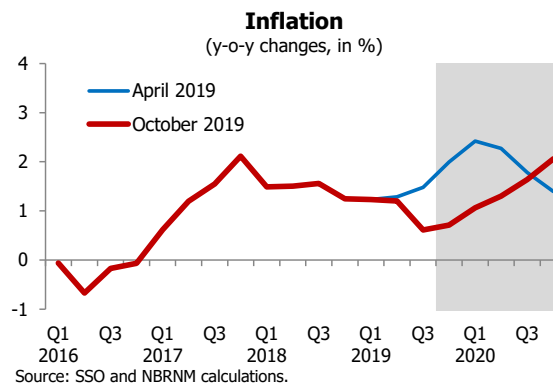
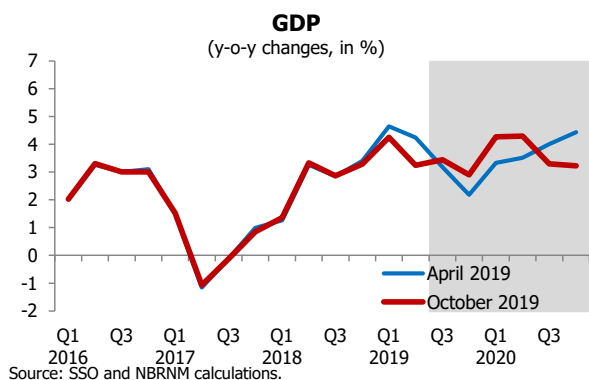
The latest October macroeconomic forecast point to relatively small changes in the April cycle. The economic growth forecast in the period 2019-2021, together with the assumptions about the main factors are the same as in April. Regarding the price movements, for 2019 and 2020 a moderate downward revision of the inflation rate was made, with the correction being mainly related to lower performance and expected lower food and energy prices. Small changes have been made in the projection of the balance of payments, which now predicts a minimum higher average current account deficit in the period 2019-2021, mainly due to the higher deficit in the balance of goods and services. The new forecasts expect slightly higher net inflows in the financial account from financial transactions, cumulatively for the three years.

Forecast of selected macroeconomic variables

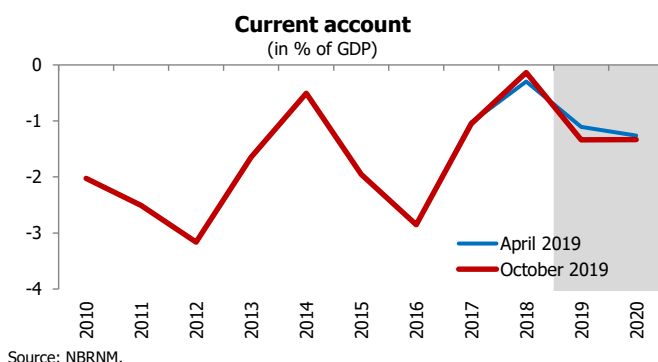
	2019 forecast		2020 forecast		2021 forecast
	Apr.	Oct.	Apr.	Oct.	Oct.
GDP, %	3.5	3.5	3.8	3.8	4.0
Private consumption	2.0	3.3	3.2	3.5	3.5
Gross capital formation	8.3	8.3	9.4	9.3	9.6
Public consumption	0.0	0.6	-0.3	1.0	0.9
Exports of goods and services	5.4	11.5	4.8	4.0	3.5
Imports of goods and services	5.6	10.8	5.4	5.1	4.9
Inflation	1.5	1.0	2.0	1.5	2.0
Current account deficit, % of GDP	-1.1	-1.3	-1.3	-1.3	-1.5

Source: NBRNM.

The projections for the growth of the Macedonian economy in the period 2019-2021 are unchanged compared to the April estimates (3.5% for 2019, 3.8% for 2020 and 4% for 2021). Also, no changes have been made in the structure of growth, i.e. it is still expected that the growth in the projection period will arise from the export of goods and services and gross investment, while retaining assumptions about the fundamental factors that will affect these two components. However, with regard to individual expenditure components of GDP, some adjustments have been made to the size of the annual growth rates. Thus, compared to the previous projection, significantly higher export growth is expected in 2019 and its lower growth in 2020, with appropriate impacts on its contribution to GDP growth. This change for 2019 is mainly due to higher performance so far, while for 2020 the downward revision is mostly a reflection of the higher comparative basis and the downward revision of foreign demand, while maintaining the assumption for gradual attainment of maximum utilization of new production capacity of the export-oriented companies. Consequently, appropriate adjustments have been made to the growth of imports during the projections. Also, the growth of private consumption, and thus its contribution to growth, in this and next year is higher than previously expected, which is in line with more favorable performance and expectations in terms of its basic determinants, and above all with higher growth in the real wages (in case of higher achievements and announced discretionary changes in the part of the minimum wage, as well as in the part of subsidizing the contributions based on the increased wage). On the other hand, gross investment and public consumption in 2019 and 2020 are expected to make a similar contribution to the April forecast. On an aggregate basis, corrections made to individual components will lead to a more positive contribution to domestic demand and a more negative contribution of net exports to growth in 2019 and 2020.



The inflation rate forecast is revised downwards in the projection period. Thus, the expected inflation rate has been reduced from 1.5% to 1% in 2019, and from 2% to 1.5% in 2020. Such a downward correction mostly arises from weaker performance in the second and third quarters of 2019 in terms of expectations, as well as from the downward correction of food prices and foreign effective inflation in the forecast period. On the other hand, the contribution of the energy component and the core inflation to the headline inflation is expected to be similar to the April forecast.



According to the last October forecasts, a slightly higher average current account deficit is anticipated for the three-year forecast period unlike the April expectations (1.4% of GDP in the current forecast compared to 1.3% of GDP in the April forecast). This change is largely due to the deteriorating balance of goods and services compared to the April projections, reflecting weaker expectations in the trade deficit, despite expectations of a higher surplus in the trade of foreign services. These shifts, compared to previous projections, are mostly due to the increased energy deficit due to higher performance, while at the same time expectations for a slightly less favorable non-energy balance. **Analyzing financial flows, slightly higher net inflows are expected for 2019-2021 cumulatively, compared to the April forecast.** Such expectations arise from higher net inflows in government borrowing than previously expected, but also from higher inflows in trade loans and lower outflows in currencies and deposits. On the other hand, as a result of the weaker performance in 2019 with a larger outflow of intercompany debt, slightly lower inflows based on FDI are planned.

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

Organisation	Month of publication	Real GDP growth, %				Inflation (average rate, %)			
		2019	2020	2021	2022	2019	2020	2021	2022
IMF	October 2019	3.2	3.4	3.2	3.3	1.3	3.2	2.0	2.2
World Bank	October 2019	3.1	3.2	3.3	-	1.6	3.3	2.0	-
European Commission	November 2019	3.2	3.2	3.3	-	1.4	0.0	2.0	-
EBRD	November 2019	3.2	3.2	-	-	-	0.0	-	-
Consensus Forecast	October 2019	3.2	3.1	-	-	1.6	0.0	-	-
Ministry of Finance	May 2019	3.5	4.2	5.0	5.0	2.0	5.0	2.2	2.2
National Bank of the Republic of North Macedonia	October 2019	3.5	3.8	4.0	4.0	1.0	4.0	2.0	2.0

Source: IMF, World Economic Outlook, October 2019; World Bank, Western Balkans Regular Economic Report, Fall 2019; European Commission European Economic Forecast, Autumn 2019; EBRD Regional Economic Prospects, November 2019; Consensus Forecast, October 2019; Ministry of Finance, Fiscal strategy 2020-2022, May 2019; and the National Bank of the Republic of North Macedonia.



VII. Analytical appendices

Annex 1. Growth of the technological intensity of the Macedonian economy: changes to the structure of the manufacturing industry

In the mid-1950s, the Nobel laureate Robert Solow pointed to the importance of technological development in increasing a country's wealth. In the age of globalization, the differences in economic growth and income inequality between countries are largely explained on the basis of technological differences (Martinez-Garcia⁷⁴, 2013). The use of new technologies increases international competitiveness and contributes to improving the quality of life.

The purpose of this appendix is to give an overview of the changes in the structure of the manufacturing industry of the Macedonian economy, seen through the aspect of the degree of technological intensity of the industries. The manufacturing industry has a relatively large and stable share in the value added of the Macedonian economy, which, on average, for the period 2005-2018 is 9.5% of total GDP, although since 2014 its share has been constantly maintained above this average. About 19% of the total number of employees work in the manufacturing industry, and in recent years there has been an accelerated growth in the number of employees in the sector.

Chart 1

Share of the added value in the manufacturing industry in the total GDP and indicators for employment in the manufacturing industry

Source: SSO and NBRNM calculations

In addition, we make a comparative analysis of the weight⁷⁵ structure of the physical volume of industrial output in the period from 2005-2018. On an annual basis, the State Statistical Office makes regular changes to the weight structure of the industrial output, in order to provide a more objective and updated image of the changes in the industry structure. In order to determine whether the structural shifts within the manufacturing industry are favorable in terms of the degree of technological development, for the purposes of this analysis individual manufacturing activities are classified into four groups of industries according to Eurostat technology classification (low-technology, medium-low-technology, medium-high-technology and high-technology) and are presented in Chart 2.

⁷⁴Martínez-García, Enrique (2013). "Technological Progress Is Key to Improving World Living Standards", Economic Letter index Vol. 8, No. 4, June 2013.

⁷⁵ The weights that reflect the structure of industrial output in the comparative year are obtained on the basis of the share of value added of companies in the total value added of the industry. More specifically, the weights reflect the structure of production, but according to value indicators. The weights (structure) are not determined on the basis of the quantities produced in the comparative year, as the structure of production includes different products with quantities expressed in different measure units. Hence, the structure of the physical volume of industrial production partially covers the price, and not only the quantity effect.



Source: Eurostat, SSO and NBRNM calculations

The changes in the structural participations of the four groups of activities in terms of the degree of technological intensity are shown in Chart 3. The presentation shows that during the analyzed period, there is a downward trend in the share of traditional industries, i.e. industries that are characterized by a lower degree of technological intensity, at the expense of increase in the share of industries with a higher degree of technological intensity. Thus, in 2018, compared to 2005, the structural share of the category of high-tech industries is higher by 21.3 percentage points, in industries with a high degree of technological intensity it is higher by 1.3 percentage points, while in the industries with medium and low level of technological intensity, a decrease of participation in the structure of the total processing industry was noticed (for 14.7 percentage points and 7.9 percentage points, respectively).



Source: SSO and NBRNM calculations

Figure 4 shows the disaggregated structure of the four main groups. Thereby, within the group with a low degree of technological intensity, in most of the activities there is a decrease in the share, with the exception of the manufacture of textiles and the manufacture of furniture.⁷⁷ A decline in structural participation is also observed in most of the activities that are part of the group with **medium-low degree of technological intensity**, with the decrease being most pronounced in the manufacture of metals, manufacture of other non-metallic mineral products, as well as manufacture of coke and refined petroleum⁷⁸. In the other two groups, as previously pointed out, trends are reverse. This favorable shift is mainly related to the entry and operation of several new export-oriented foreign facilities, some of them in segments where they had traditionally negligible participation in industry. Thereby, the most significant increase in the share in the group with **medium-high degree of technological intensity** is in the manufacture of machines, devices and manufacture of motor vehicles, trailers and semi-trailers. We also notice a small but significant shift in the group with a **high degree of technological intensity**, mainly as a result of the emergence of active companies in 2015 in the activity "manufacture of computer, electronic and optical products"⁷⁹.

⁷⁶ Starting from 2010, the weight structure of industrial output changes every year in order to better cover changes in the structure of industry. Before 2010, the weights changed every 5 years, which is why the industrial output was the same in the period 2005-2009.

⁷⁷ Favorable shifts in these two activities are mainly related to the entry of new export-oriented companies with foreign capital.

⁷⁸ The manufacture of refined petroleum products is no longer present in the structure of industrial output after 2015

⁷⁹ The emergence of this activity is also associated with the entry of new companies with foreign capital.



Source: SSO and NBRNM calculations

From the analysis of the industrial sector in terms of the degree of technological intensity it can be concluded that from 2005 onwards, the structure of the manufacturing industry in our economy has changed, i.e. the share of manufacture with a higher degree of technological development is growing, at the expense of traditional industrial activities with a lower degree of technological intensity. This change in the movement relates to inflows of foreign investment and the opening of new companies that operate and produce in sectors with a higher degree of technological progress. By strengthening the direct cooperation of the new companies with the domestic production companies, such favorable trends would spill over to the rest of the domestic sector, which would certainly have a beneficial effect on the degree and speed of the overall technological development of our economy.