



Recent Macroeconomic Developments and Implications for Monetary Policy

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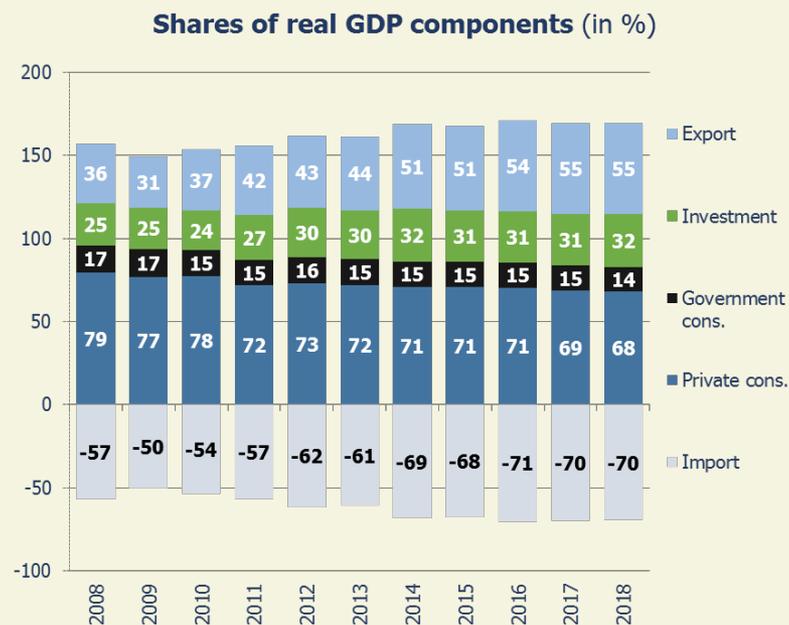
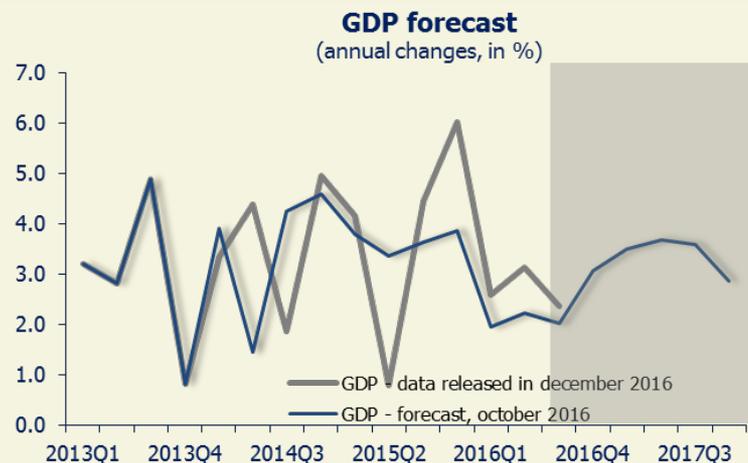
Key macroeconomic developments in 2016

- **Escalation of political crisis** in April led to withdrawal of deposits and rising preferences for foreign currency (pressures on foreign exchange market);
- In light of the CB interventions, since June, the developments have stabilized and **deposits** continued to grow, thus also supporting the credit growth.
- Despite the high political uncertainty, the **growth** of economy in 2016 continued, but at a decelerated pace;
- Absence of strong demand pressures in combination with low commodity prices (energy) resulted in slight decline of domestic **prices** for the third year in a row;
- Low commodity prices and structural reforms that led to FDIs in the tradeable sector continued to yield positive results in the **external sector** - CAD remained in a prudent zone (range 2-3% of GDP);
- Positive current account developments and solid capital inflows lead to further accumulation of **foreign reserves**;



Economic activity

- Economic growth in the first three quarters of 2016 equaled 2.7%, compared to 2.1%, as expected in the October forecasting round...
- ...with exports and households consumption making the highest individual contribution to growth...whereas investments stagnated
- according to the short-term indicators for the last quarter, the 2016 growth rate is close to the forecast (2,3%)
- In the medium term, we forecast somewhat accelerated growth (2017-3.5%, 2018-3.7%)
- Positive shifts in the structure of GDP

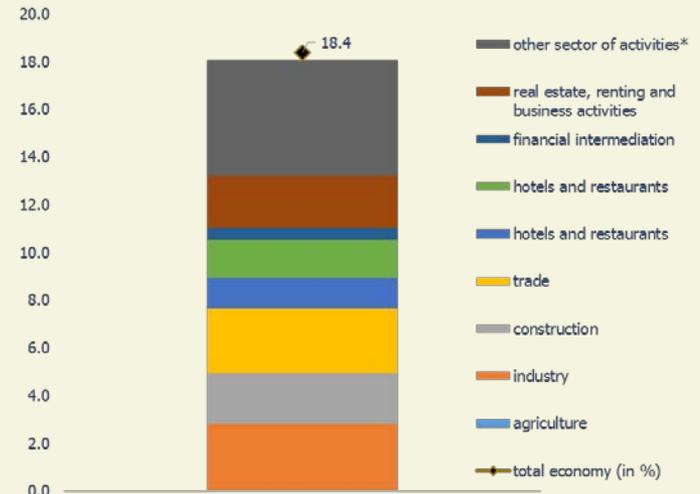




Labor market

- Number of employees** continued to grow (2.6% on average in the first three quarters of 2016) and since 2008, they have increased by 18.4% on a cumulative basis
- The increase is relatively dispersed across different sectors, with the highest contribution made by industry and trade
- Productivity** continued to grow, although it is still at the pre-crisis level
- Nominal and real wages** continued to grow (average growth in the period January-November 2016 of 1.9% and 2.1%, respectively)

Contributions of individual sectors of activities to the total number of employees change in the period 2016 (q1-q3) / 2008 (in p.p)



*Other sectors of activities include: public administration and defence, compulsory social security, education, health and social work activities, activities of households as employers, as well as activities of extraterritorial organisations and bodies.

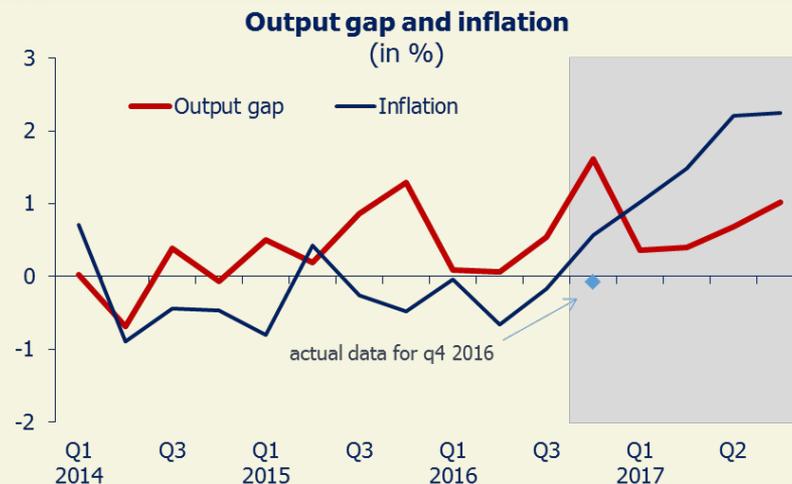
Labour productivity and unit labour costs (annual changes, in %)



Source: SSO and NBRM calculations

Inflationary developments

- Inflation averaged -0.2% in 2016, driven mostly by food and energy prices, while core inflation remained in positive territory
- In January it was 0.6%, mainly driven by energy prices
- In the forthcoming period, we expect inflation to gradually pick up (2017 to 1.3%, 2018 to 2%) in light of the anticipated rise of primary commodity prices and further recovery of domestic demand

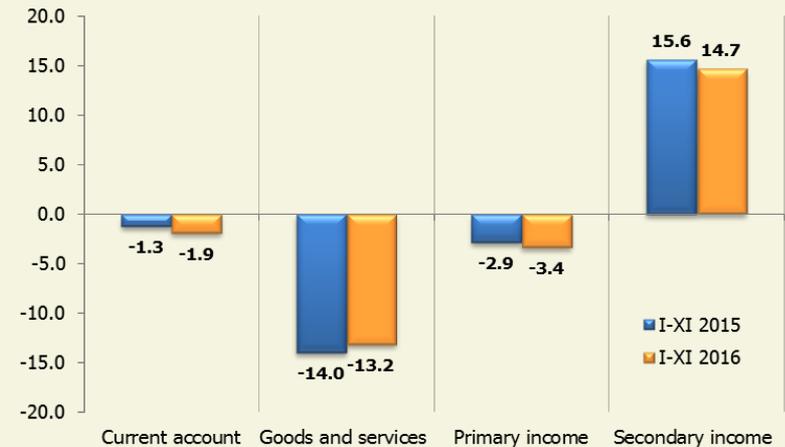




External sector developments

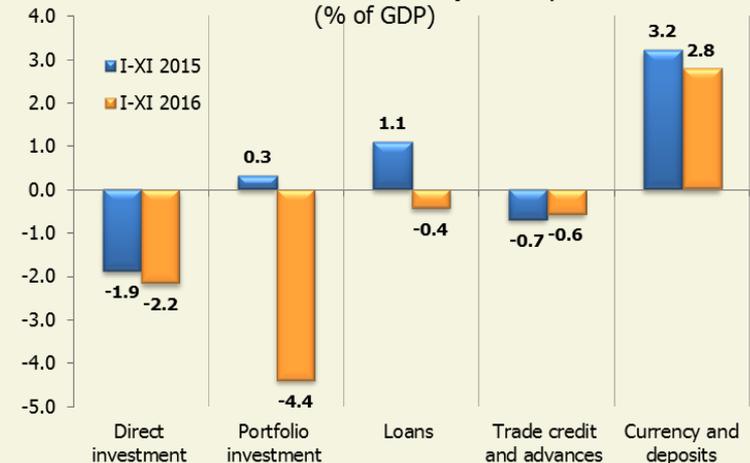
- **CAD** remained low at 1.9% of GDP, but widened on a y-on-y basis
 - trade balance continued to improve mainly due to new export oriented companies, as well as low energy prices
 - primary and secondary income balance worsened (currency conversion).
- **Financial inflows** accounted for 4.8% of GDP
 - driven mainly by portfolio and FDI inflows
- Current and financial flows has led to further accumulation of **official reserves** (4.8 months of imports)
- **In the medium term**, we expect an average CAD of 2,4% of GDP (with further narrowing of the TD), financed by FDI and borrowing

Current account (% of GDP)



Source: NBRM

Financial account components, (% of GDP)



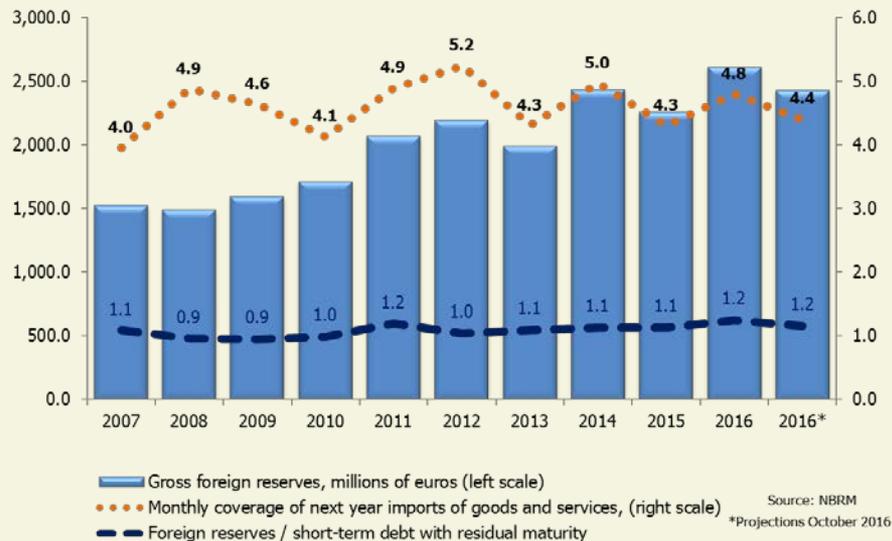
Source: NBRM



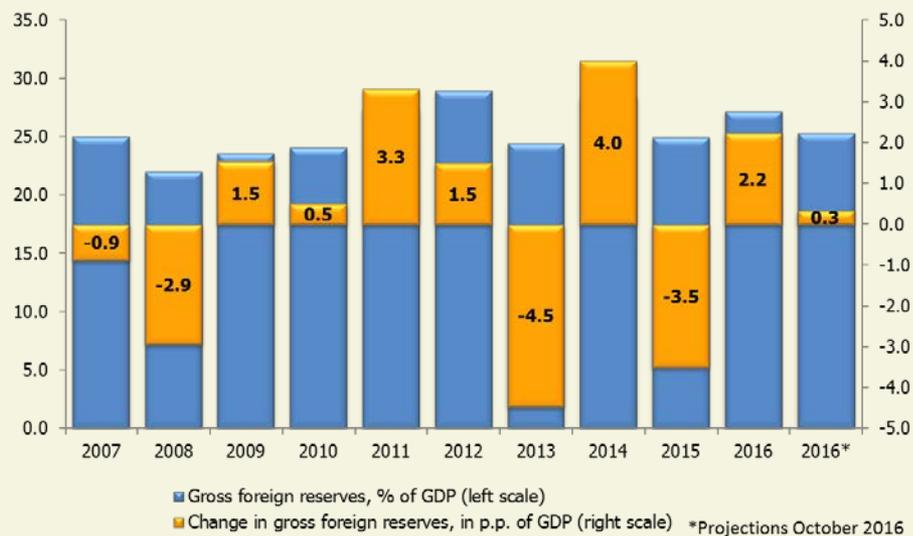
External sector developments

Higher reserve accumulation in 2016 (compared to the forecasts) has further improved reserve adequacy ratios. All indicators point to adequate level of reserves.

Reserves adequacy indicators



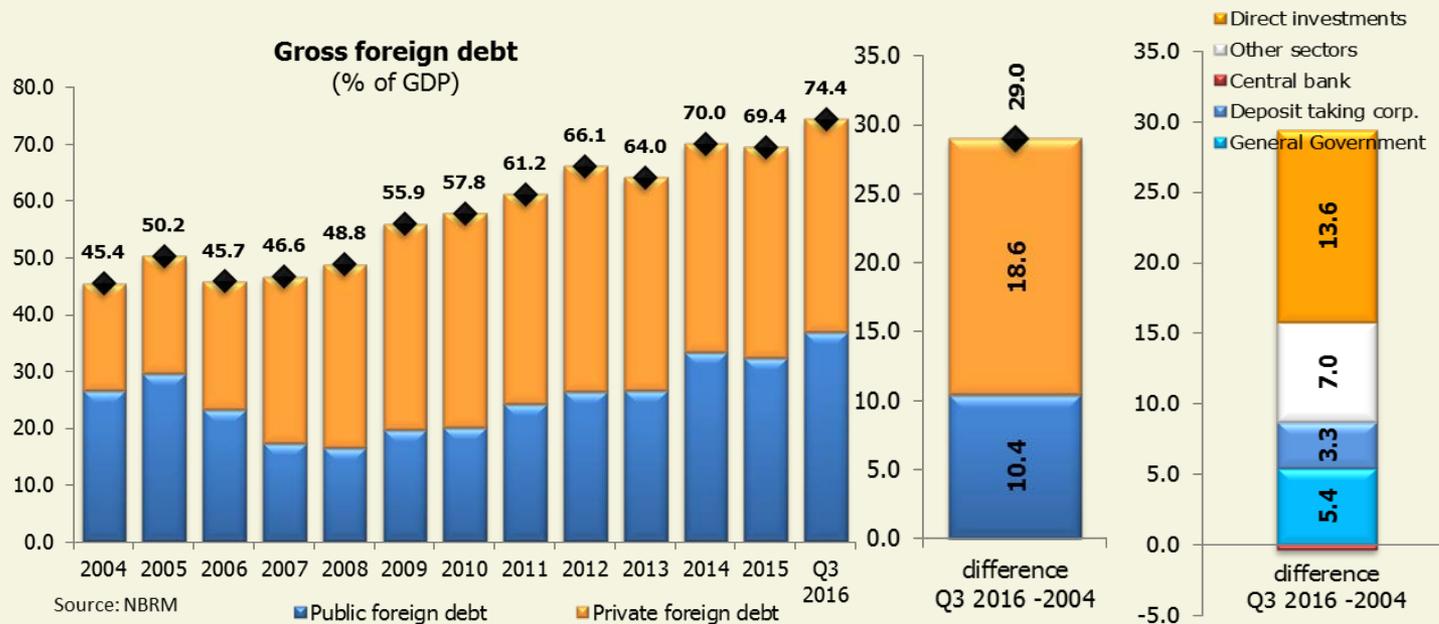
Gross foreign reserves (% of GDP)





External debt

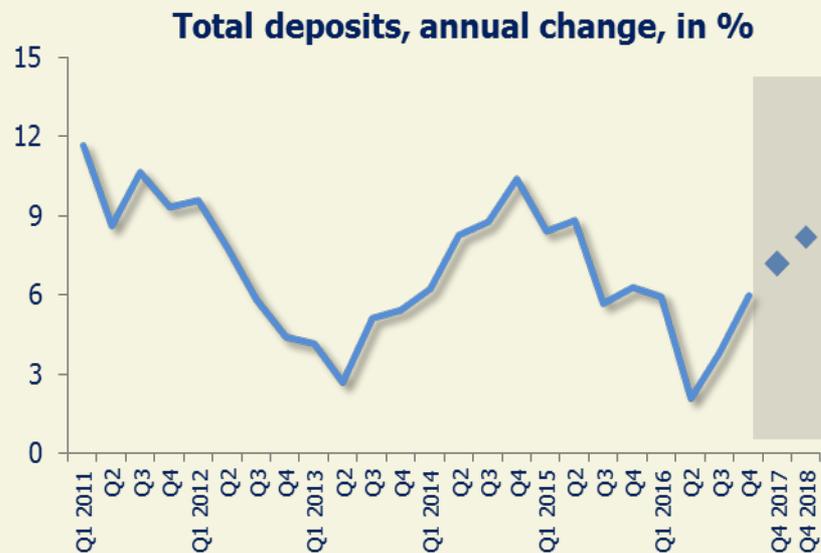
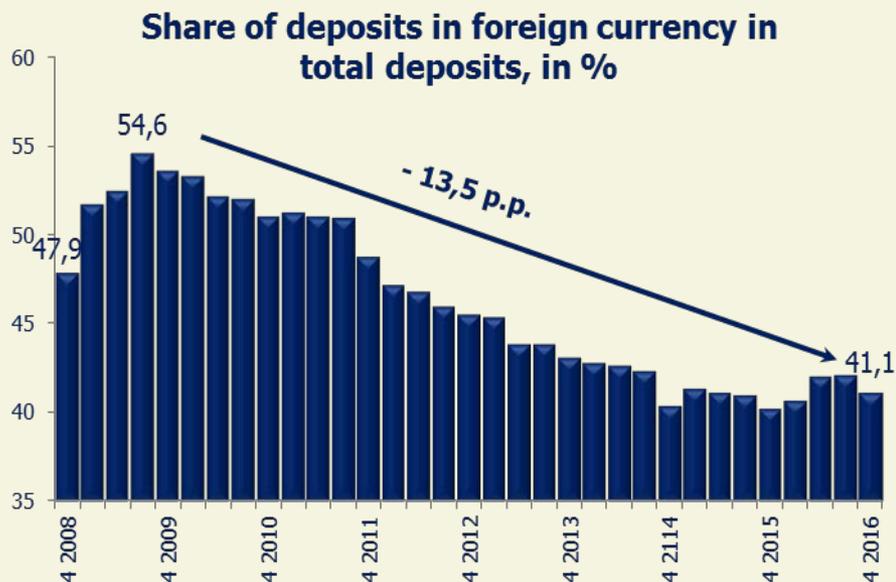
Total external liabilities picked up in the third quarter, but were forecast to stabilize in the medium term at around 72-73% of GDP... Total external assets also kept on increasing....





Monetary developments

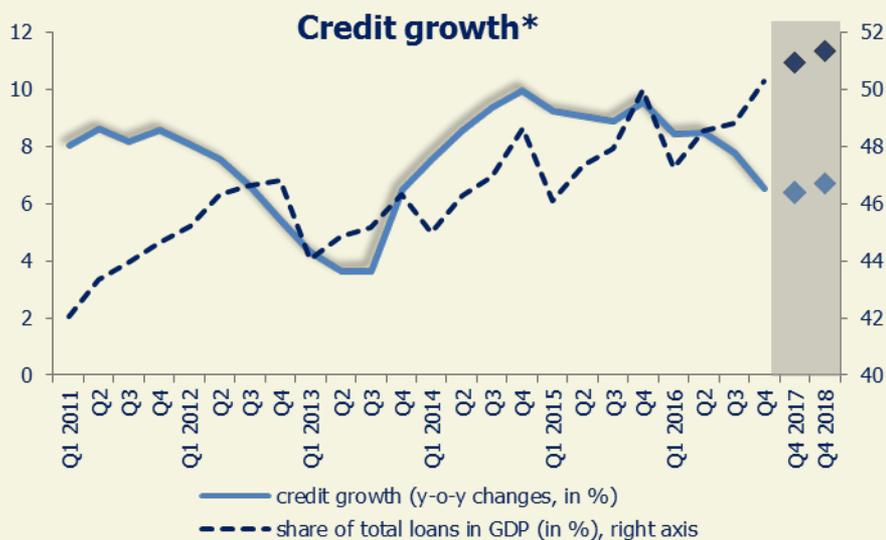
- In April-May 2016, deposits declined by 2,6%, driven by households deposits (3,7%).
- Since June, households deposits have been growing on a continuous basis, and particularly accelerated in the last quarter.
- Annual growth of total deposits of 5.7% - higher than anticipated in our forecasts
- Positive trends continue in 2017 (6.7% deposits growth)
- In the medium term, the deposits growth has gradually accelerated (around 7.5% y/y growth)
- Process of denarisation of the deposits has stalled



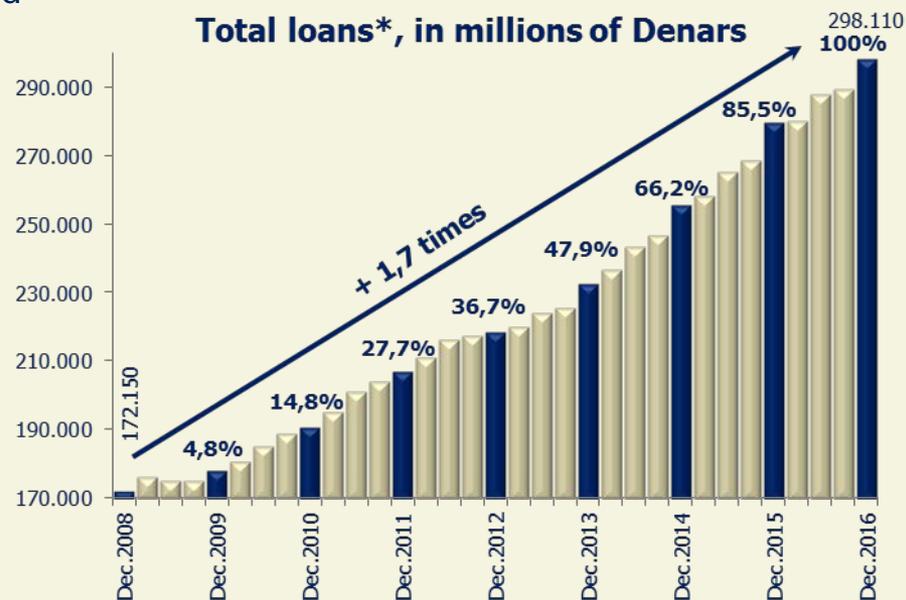


Monetary sector developments

- **Credit growth slowed down**, but remained solid 6,5% (households 10,9%, corporate 3,2%) in 2016, and 6,4% in January 2017
- In the medium term - gradual acceleration (6-7%), amidst high capital and liquidity buffers of the banking system, and expected rise in credit demand



*total loans exclude the effect of regulatory changes



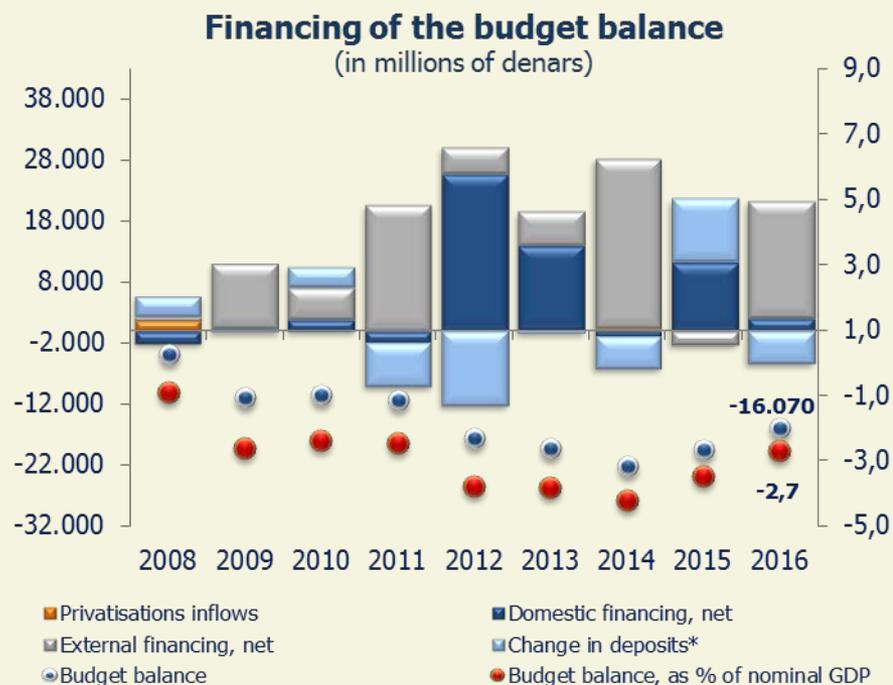
*total loans exclude the effect of the regulatory changes.

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



Fiscal developments

- Narrowing of the fiscal deficit for the second year in a row
- Deficit predominantly financed by external sources (euro bond issuance)
- General government debt increased, reflecting also front loading for debt repayments due in 2017



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



Key assumptions and risks for the medium-term forecasts

- **Key assumptions macro medium-term outlook:**

- Continuation of the recovery of global economy, and especially the EU economy (foreign demand increase of around 2%);
- Gradual pick up in global inflation in light of the expected rise of primary commodity prices (energy);
- Absence of major disruptions on international financial markets;
- Continuation of the structural reforms conducive to FDI;
- Continuation of the enhanced government investments;
- Continuation of the gradual fiscal consolidation.

Key risks:

-**external factors:** slowdown in global growth in light of the protectionist policies, geopolitical tensions, tightening US monetary policy and implications for global financial markets.

-**domestic factors:** political uncertainty



Monetary policy implications

- **In the first half of the year, tightening of the MP** in the context of pressures on the banking system and foreign exchange reserves:
 - interventions on the forex market;
 - increase of the main policy rate by 75 b.p.;
 - increase of required reserves for liabilities in domestic currency with FX clause (from 20% to 50%);
 - verbal communication with public; and
 - other macro prudential measures.
- Since June, gradual stabilization of both segments (deposit base and official reserves) that in combination with sound economic fundamentals allowed **loosening of the MP at the end of the 2016 and beginning of 2017.**
- We will continue to closely monitor economic developments and adopt appropriate measures as needed.