NATIONAL BANK OF THE REPUBLIC OF MACEDONIA

MONETARY POLICY AND RESEARCH DEPARTMENT

Recent Macroeconomic Indicators
Review of the Current Situation

July 2014

Recent Macroeconomic Indicators
Review of the Current Situation - Implications for the Monetary Policy

The review of the current situation aims to give an overview of the recent macroeconomic data (April - June 2014) and to make a comparison with the latest macroeconomic projections (April 2013). This will determine the extent to which the current situation in the economy corresponds to the expected movements of the variables in the previous cycle projections. The review focuses on the changes in external assumptions and performance with domestic variables and the effect of these changes on the environment for monetary policy conduct.

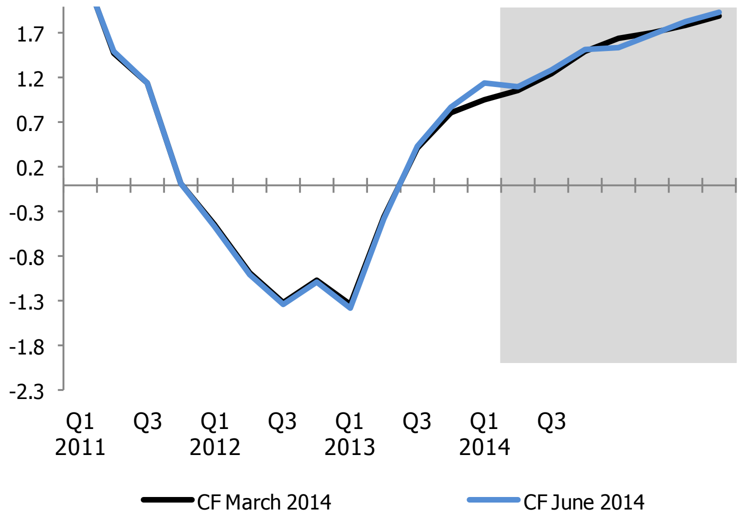
The global economic environment has not undergone major changes compared to the period of the last assessments. Recent developments in high frequency economic indicators suggest continuation of the trend of moderate economic recovery in the euro area during the second quarter of 2014. The recent ECB's growth estimates have not changed much, pointing to a gradual recovery by the end of 2016. In June, the inflation in the euro area remained at the level of May (0.5%). ECB's estimates for the next period still point to maintaining low inflation rate within a longer period, with the inflation estimates being revised downward. Under these conditions and expectations for materialization of the effects of the June set of measures in the next period, in July the ECB did not make any changes in the monetary policy setup. In its releases, the ECB again stressed its readiness to conduct accommodative monetary policy and to take additional measures in case of increased risks of deflation. **Observed from a viewpoint of the individual quantitative external environment indicators for the Macedonian economy, the assessments for the foreign effective demand for the period 2014-2015 remained almost unchanged relative to the April projection. Changes in the expectations about the prices of primary commodities move in different direction.** The latest estimates for the **international oil prices** for 2014 point to reduction of the cost of this fuel, but at a slower pace compared with the April projection. New estimates for 2015 indicate higher oil prices, versus the expected decline in the April projection, associated mainly with the upheavals in Iraq and Libya. The new assessments for **metal prices** point to more favorable developments in the terms of trade for this sector than projected in April. This movement is especially pronounced in the price of nickel, which is mainly associated with the factors on the supply side. Regarding the **food prices**, the latest estimations for 2014 indicate apparently smaller import pressures through this channel on the domestic inflation and the terms of trade, in comparison with the April projections. For 2015, a faster growth in the price of wheat is assessed, with a simultaneous downward revision in the price of corn compared with the April projection.

The comparison of latest macroeconomic indicators with their projected dynamics within the April cycle projections does not indicate larger deviation. From the aspect of individual indicators relevant for the monetary policy, **inflation data** as of May 2014 indicate further maintenance of lower inflationary pressures and lower inflation compared to the April projection. These deviations are mainly due to the food and energy component and less to the core inflation. On a monthly basis, the price level recorded a moderate growth (0.3%), which contributed to slowdown in the annual decline in the overall inflation of 0.6% in May (1.1% in April). In May, the core inflation equaled 0.7%, which is a further slowdown of the rise and below the expectations in the April projection. Hence, there are downward risks to the inflation projection associated with the latest developments and revisions of input external assumptions. On the other hand, there are also upward risks. From what is already certain, and have been creating price pressures since the beginning of July is the rising price of household electricity and bread and the upward adjustments in excise duty on cigarettes. In addition, there are risks surrounding energy prices (related to geopolitical tensions in Iraq), and possible effects of flooding in the region. We estimate that **the balance of risks, in terms of the projected price movement, is still dominated by downward risks**. Yet, dynamically observed, their dominance over upward risks has been narrowing.

According to the latest available data as of the end of June, in the second quarter of 2014, foreign reserves (adjusted for price and exchange rate differences and price changes of securities) considerably reduced compared to the April projection. Recent external sector data still indicate that the fall in foreign reserves is most likely a reflection of the weaker performances in the capital and financial account, given the possibly lower trade deficit than projected for the second quarter, and the net inflows of private transfers in the amount close to the projected one. However, it should be taken into account that the number of available external sector indicators is still limited, making it impossible to precisely identify the factors of changes in foreign reserves. The analysis of foreign reserves adequacy indicators shows that they continue to move in the safe zone. **Analyzing the real sector**, the first quarter of 2014 registered an acceleration of economic activity of 3.9% annually, which is above expectations with the April projection. Available **high frequency indicators of economic activity** point to further retention of positive trends in the second quarter of 2014, in accordance with the registered growth in the main sectors, mainly industry. **Within the monetary sector**, according to the final data as of May 2014, **total bank credits to the private sector** increased by 7.6% on an annual basis (versus 7.3% as projected for the end of the second quarter), with poorer performance in the deposit growth compared to the April projection. The latest assessments **indicate lower EURIBOR for 2014 compared to the April projection, with significant downward revision of the expectations for 2015.**

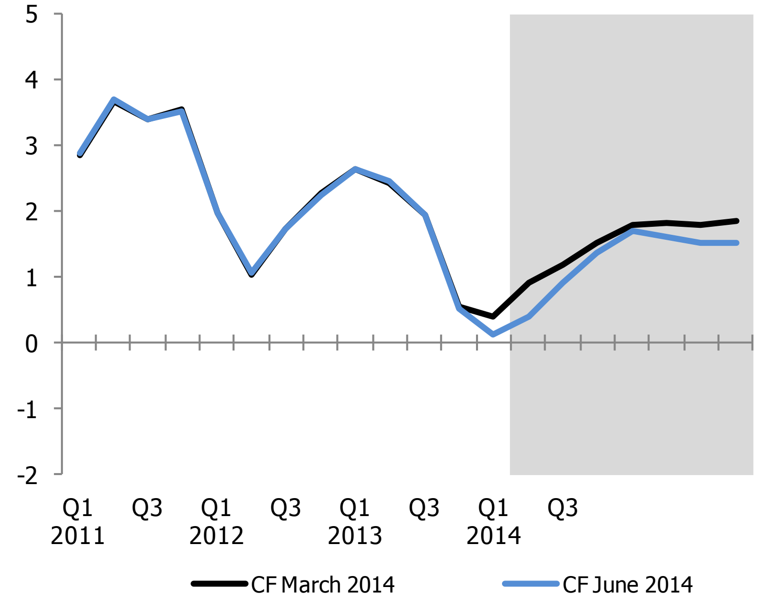
The latest macroeconomic indicators and estimates do not indicate major changes in the environment and risks perceptions compared to the assumptions provided in the April projections. Foreign exchange reserves registered a decrease, which is higher than projected for the second quarter. Analyzing the indicators of foreign reserves adequacy, they still move in the safe zone. The headline inflation in May was lower than projected, and there has been further slowdown in core inflation. The risks around the inflation projection are still perceived as predominantly downward. On the other hand, upward risks have been identified, associated with domestic and external factors that could cause instability and occurrence of major price shocks, which would be reflected on the future inflation. Indicators of economic activity suggest that the economy will continue growing in the second quarter of 2014, which is still not expected to create imbalances. Credit growth in May was above the projection, though it still takes time to assess the durability of these movements.

Foreign effective demand
(annual rates of change in %)



Source: Consensus Forecast and NBRM calculations.

Foreign effective inflation
(annual rates of change in %)



Source: Consensus Forecast and NBRM calculations.

Under the new assessments, in 2014, the growth in foreign effective demand is expected to equal 1.3%...

...which, compared with the April projection of 1.2%, is a minor upward revision...

...mostly due to the improved performance of the German economy. Additional positive contribution to the higher growth of foreign demand is expected from the recovery of the economies of Greece and Slovenia from recession, as projected in July.

On the other hand, the assessments for foreign effective demand for 2015 remain unchanged, i.e. same as April, the growth is expected to strengthen moderately and to reach 1.8%.

In 2014, the foreign effective inflation was revised downwards compared with the April projection...

...and now, it is expected to be 0.7% instead of 1%...

...which is the first time since the crisis of 2009 to go below 1%.

The lower assessment is due to the downward revision of projected inflation in almost all of our trading partners...

...with Bulgaria making the greatest contribution to the revision, where the prices are now anticipated to decline rather than to rise, coupled with the lowered contribution by the inflation in Germany.

The foreign inflation for 2015 was also downwardly revised...

...and now, it is expected to equal 1.6%, instead of 1.8% as projected in April...

...which mainly reflects the lower contribution of Serbia and Germany to the price growth.

In the second quarter of the year, it is estimated that the rise in price of crude oil is higher compared to the April projection...

...mostly due to the instability in Iraq as one of the key global oil producers, the renewed unrest in Libya and the continuing conflict in eastern Ukraine, and to a certain extent, due to the moderate growth in demand in this period.

Although it is estimated that the supply of oil will be sufficient to meet the demand[1], its price is expected to decline in 2014, but at a slower pace than projected in April, which is probably due to the unfavorable impact of the geopolitical factors.

The oil price projection for 2015 is upwardly adjusted and is projected to rise slightly, despite the April forecast for annual decline.

In the second quarter of 2014, the prices of nickel and copper were upwardly revised...

...i.e. it is now estimated that the price of copper will register a smaller decline than projected in April...

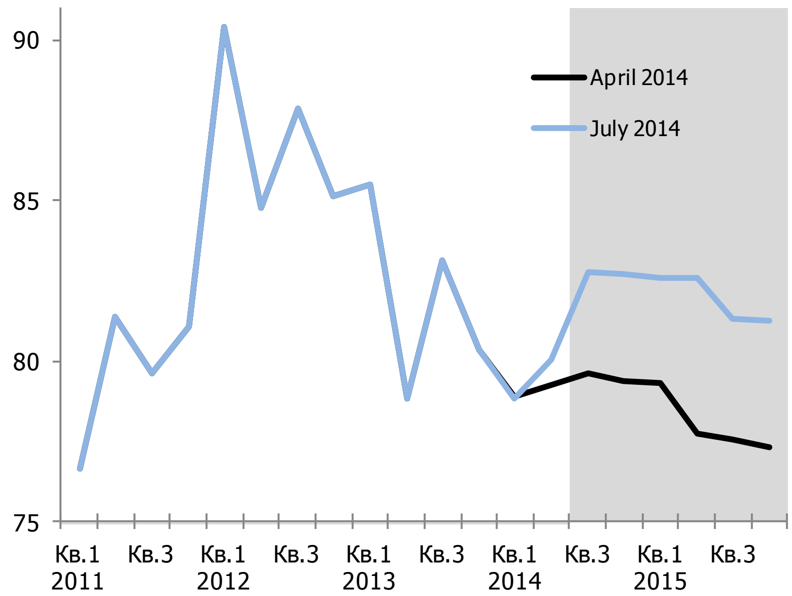
...amid gradual reduction of its inventory...

...while the rise in nickel price is significantly higher than expected, due to the negative effects on the supply of the temporary interruption of the production capacity in New Caledonia and the current ban on the export of nickel from Indonesia.

These factors, as well as the improved indicators for the Chinese economy led to upward revisions in the prices of metals for the entire 2014.

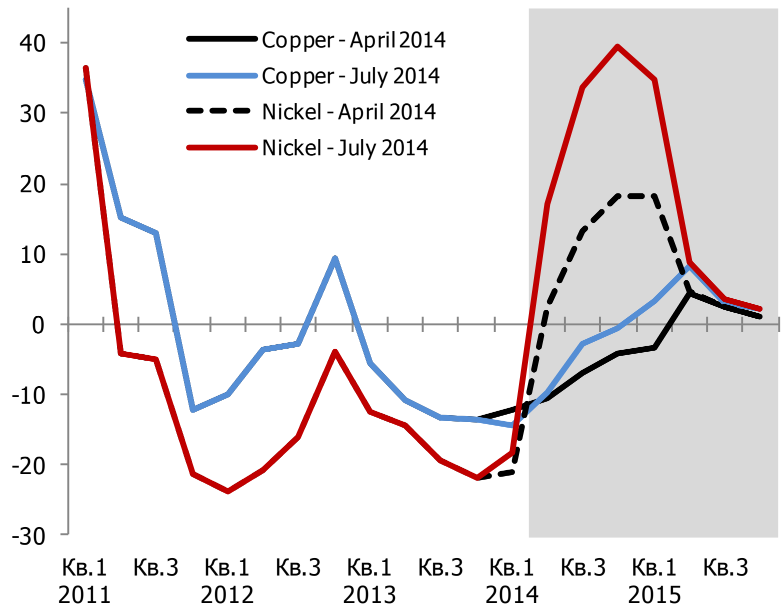
Prices of copper and nickel for 2015 were also significantly revised upwards.

Brent oil
(quarterly average, EUR/Barrel)



Source: IMF, Bloomberg and NBRM calculations.

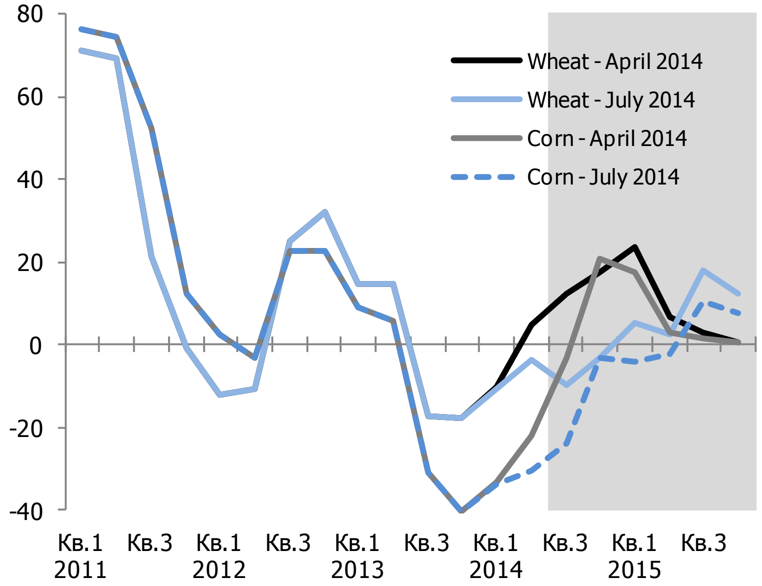
Nickel and copper prices in EUR
(annual changes in %)



Source: IMF, Bloomberg and NBRM calculations.

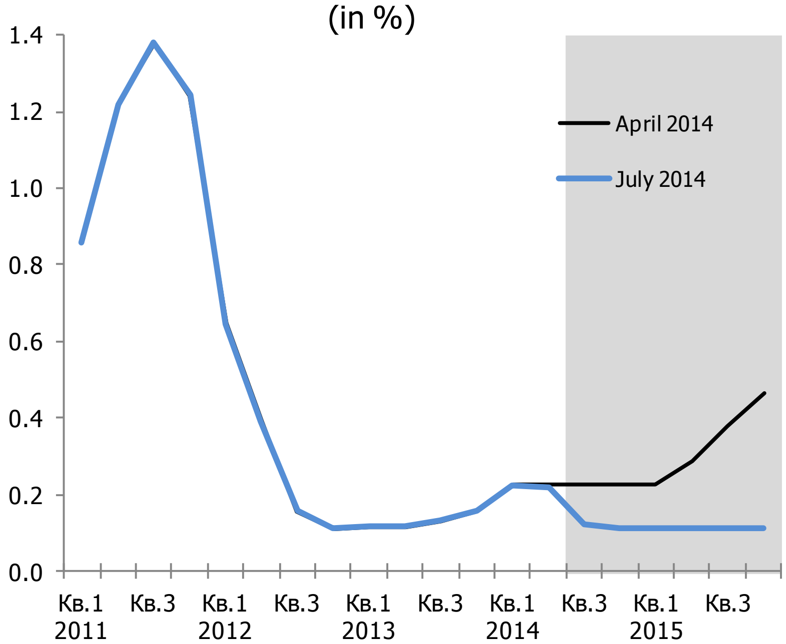
[1] OPEC Monthly Oil Market Report, June 2014.

Wheat and corn prices in EUR
(annual changes in %)



Source: IMF, Bloomberg and NBRM calculations.

1M Euribor
(in %)



Source: Consensus Forecast and NBRM calculations.

It is estimated that the decline in the corn price in the second quarter was higher than the April forecast, with the simultaneous decline, rather than increase in the price of wheat.

The new estimate of global organizations[2] points to higher crop yields and improved indicators for inventories in 2014...

...amid projection for significant decline in the price of wheat, instead of rise as expected in April...

...and almost twice as high decline in the price of corn compared to the April projection.

In 2015, it is expected that prices of wheat products will return to the zone of positive change, with upward revisions being made in the price of wheat and downward revisions in the price of corn compared with the April projection.

Since the beginning of the year until May, EURIBOR was gradually increasing, reflecting expectations for normalization of the European money market.

However, in June, EURIBOR decreased significantly, and by the end of the projection horizon, it is expected to remain low...

...as a market response to the ECB measures taken to prevent deflationary tendencies in the euro area and to support economic recovery...

...which, inter alia, include reduction of the interest rate on the main refinancing operations to 0.15%, reduction of margin between interest rates on credit facilities

[2] United States Department of Agriculture and Food and Agriculture Organization of the United Nations.

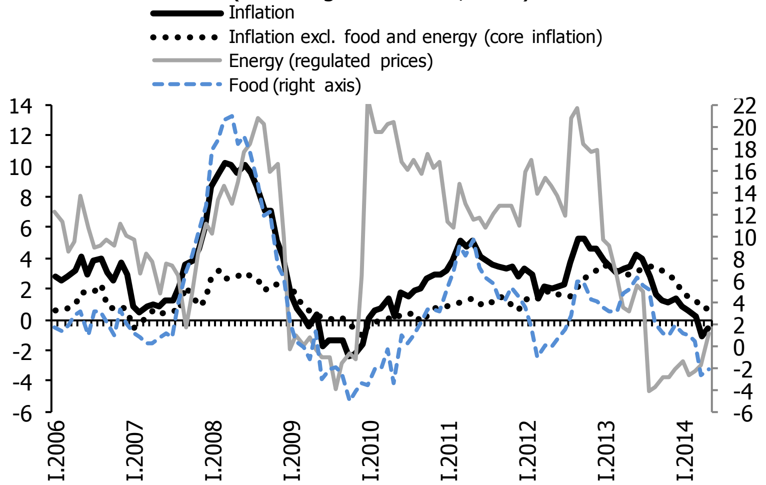
and overnight deposit facilities and introduction of a negative rate on deposit facility.

As a result, in 2014, the money market interest rate is expected to equal 0.17%, which is lower than the April projection of 0.23%.

Moreover, given the longer duration of the ultra-loose monetary policy of the ECB[3], EURIBOR was significantly revised downwards to 0.11% for 2015, instead of 0.34% as projected in April.

[3] http://www.bloomberg.com/news/2014-06-29/decoding-draghi-banks-still-puzzle-over-ecb-grand-plan.html

Inflation and volatility of food and energy
(annual growth rates, in %)



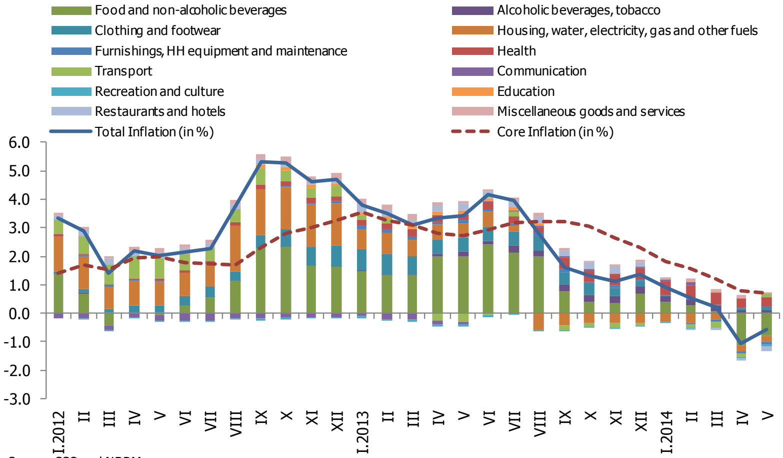
Source: State statistical office and NBRM calculations.

In May 2014, consumer prices increased by 0.3% on a monthly basis...

...for the most part associated[4] with the higher prices of footwear, food prices and the prices of liquid fuels.

The lower cost of IT equipment had a significant impact to the slowdown of monthly inflation.

Contributions to the annual inflation rate (in p.p.)



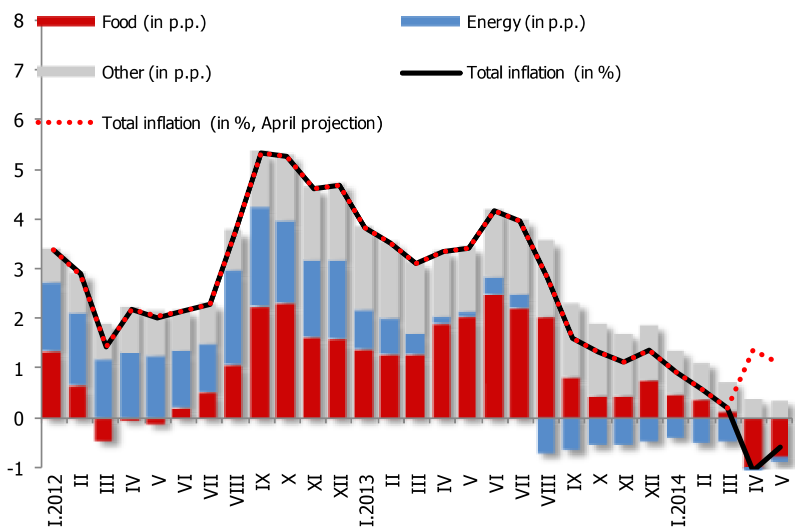
Source: SSO and NBRM.

The annual decline in consumer prices slowed down from 1.1% in April to 0.6% in May...

...which is significantly weaker inflation than expected in the April cycle projections...

...given the higher downward deviation of the actual inflation than projected in the food and energy component, and slightly smaller in the core inflation.

Inflation rate
(annual impacts to inflation, in p.p.)



Source: SSO and NBRM.

Core inflation has been stagnating for two months in a row ...

...whereby the May increase in prices of footwear, as the most important factor in accelerating core inflation, was mostly offset by the fall in prices of IT equipment, beverages, medicines, and travel package arrangements.

At the same time, the annual pace of core inflation slowed down from 0.8% in April to 0.7% in May (the eighth month in a row).

[4] Categories with the largest individual contribution to the May increase of the Consumer Price Index include footwear, with a monthly price increase of 3.7%, the price of fruit and vegetables with an increase of 3% and 1.3%, respectively, and the prices of liquid fuels that increased by 1.7% on a monthly basis.

External input assumptions for 2014, which are included in the inflation projection, are revised in a different direction.

Thus, the prices of internationally traded primary food products indicate somewhat larger decline in the aggregate price of cereals in 2014, compared with the signals obtained during the April cycle projections.

On the other hand, estimates of the oil price movement have been revised upwards...

...especially due to the increased tension in Iraq and the recent data that point to higher than expected growth of the manufacturing sector in China, as the second-largest consumer of oil in the world.

Expectations for the foreign effective inflation by the end of this year have been revised downward.

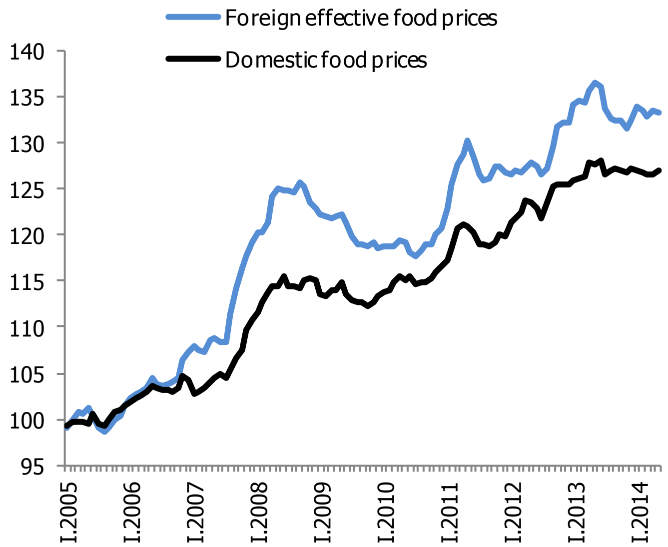
In the risk balance, in terms of the projected movement of prices, downward risks still prevail, though dynamically speaking, dominance of downward risks over upward risks narrows.

Lower initial conditions and revisions of external assumptions point to possible downward pressures on inflation projection for 2014.

However, there is uncertainty clouding such assessment, i.e. there are risk factors that create upward pressures.

Observing geo-political factors, most of those associated with the Russian-Ukrainian conflict are already anticipated, and **the situation in Iraq is pointed to be a new risk between the two**

Foreign effective food prices* and domestic food prices



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

Positive change in the US Dollar/Euro rate implies depreciation of the US Dollar.

projections[5].

From what is already certain, and create upward pressures on prices as of July, are several domestic factors such as...

...the 3.47% rise of household electricity, the rising price of bread and upward adjustments in excise duty on cigarettes.[6]

Also, the floods that hit the region could generate upward pressure on domestic food prices[7]...

...along with the risks identified during June, i.e. the potential problems associated with electricity imports from Serbia.

After the sharp fall in March due to the high base effect, the average **net wage** paid in April 2014 recorded a nominal annual growth of 0.9%...

...given the rise of wages in the construction and services, where the highest increase was registered in the real estate activities, administrative and auxiliary services and financial and insurance activities...

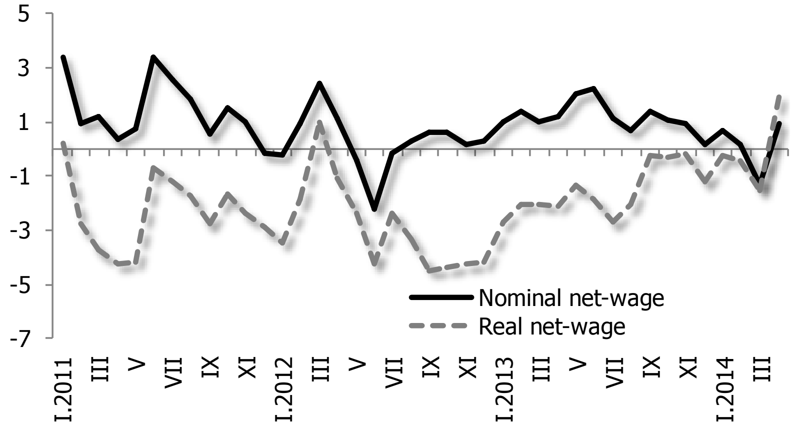
...increase is also noted in the supply of electricity, while more significant decline in wages is registered in mining.

These trends are similar to the April projection (expected growth of 1.0%).

Given the negative annual inflation of 1.1%, **in April 2014, the real wages recorded an annual growth of 2%** for the first time after two years of constant real annual decline.

The 3.9% GDP growth in the first quarter of 2014 was higher than

Average net-wage
(annual changes, in %)

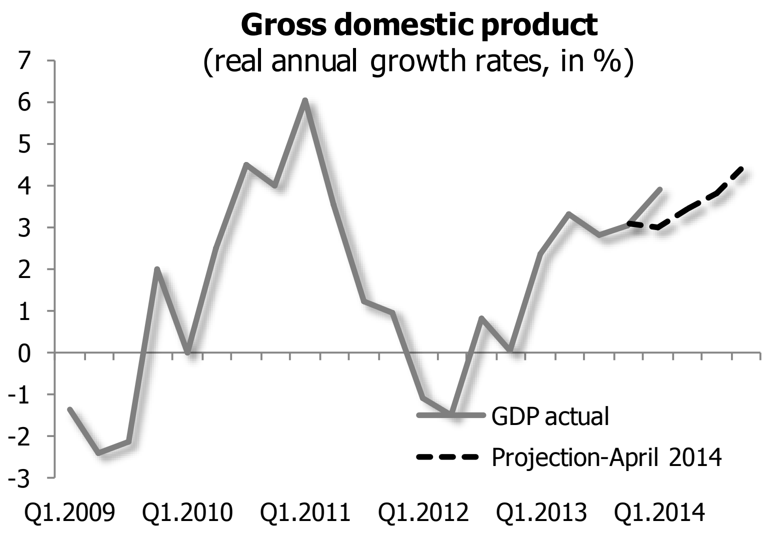


Source: SSO.

[5] The emerging conflict in Iraq, although not yet affecting the oil exports of this country, creates fears about the possible inability of the Iraqi authorities to deal with the ongoing unrest.

[6] As a result of the already adopted legal amendments that require higher excise tax each year through the end of 2023 (and which in 2014 accounted for 0.15 denars per cigarette), the price of cigarettes could be expected to increase by an average of 4 denars per pack, VAT included.

[7] Taking into account the reduced export potential of food products from Serbia (grains and cereals, meat and meat products, oil and fats), the prices could suffer some upward pressures from the reduced supply from Serbia on the regional markets. Source: FAO GIEWS Country Brief on Serbia, http://www.fao.org/giews/countrybrief/country.jsp?code=SRB, 28 May 2014.



Source: SSO and NBRM projections.

projected in April (3%)...

...where the positive deviation is a result of the higher growth of domestic demand than projected...

...as a result of growth instead of expectations for decline in the private and public consumption, and similar growth of investment demand, as expected...

...given the more negative contribution of net export demand due to the larger downward deviation of exports compared to the deviation of imports of goods and services.

Analyzing by individual components, **in the first quarter of 2014, the main drivers of annual GDP growth are the export and investment demand**...

...amid slight growth in private and public consumption...

...while the growing domestic and export demand created pressures for increased imports.

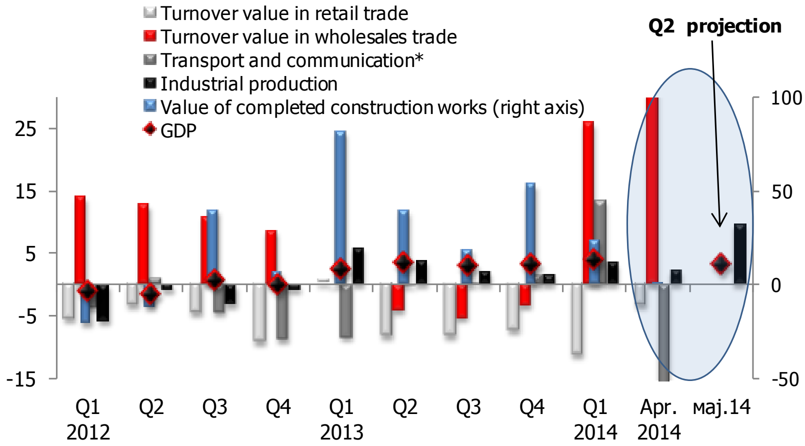
Data available for the second quarter of 2014 point to continuation of the positive developments in the domestic economy, with annual growth being recorded in the main sectors.

Industrial production registered an average annual growth of 5.8% in the first two months of the second quarter...

...mostly affected by the higher production of motor vehicles, machinery and equipment and the production of rubber and plastic products, as a result of the increased production of capacities in the technological industrial development zones...

...with additional positive contribution made by the higher production of clothing and increased extraction of coal and lignite.

Economic activities
(real annual changes, in %)



*Simple average of annual growth rates of the different types of transport and the telecommunications.
Source: SSO and NBRM calculations.

The pace of annual growth in the industry is faster than the previous quarter amid general increase in the utilization of industrial capacities[8].

Positive developments can be observed in the **trade** sector, which registered a rapid growth in April...

...which, amid annual decline in retail trade, solely results from the growth in wholesale.

Construction in April registered a minor real annual growth, versus the two-digit growth rates in the previous seven quarters.

Transport recorded downward trends in April, despite the sharp rise in the previous quarter.

Available indicators of aggregate demand also point to higher demand in the second quarter of 2014, as projected in April.

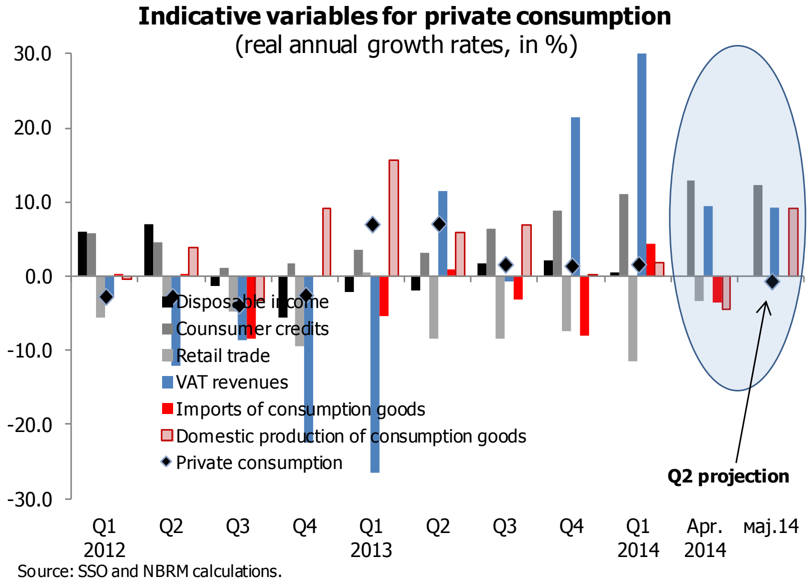
High frequency data on **consumer spending** indicate growth in the second quarter...

...amid stronger credit activity to the households, continued growth of pensions (at a slower pace though), and the perceived growth in real wages...

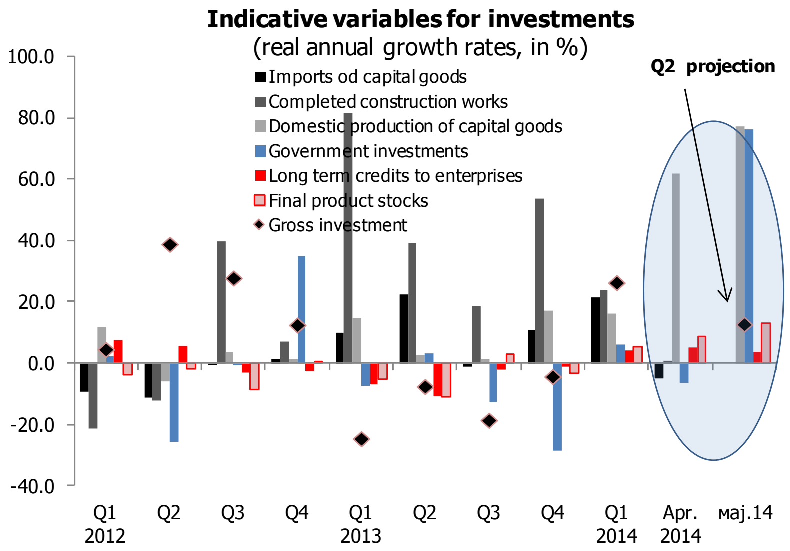
...with positive performance being present in the domestic production of consumer goods and the net revenue from VAT.

Despite these developments, in April, remittances recorded a real annual decline...

[8] SSO's Business Tendency Survey in the manufacturing industry.



Source: SSO and NBRM calculations.



Source: SSO and NBRM calculations.

...with a decrease being also recorded in retail trade (whose decline has been slowing down) and imports of consumer goods.

The latest indicators of **investment activity** suggest a growth in the second quarter...

...amid significant acceleration and high growth of domestic production of capital goods...

...further positive movement in the construction (although significantly slower)...

...further acceleration of the growth of government investment expenditures...

...continuation of the real annual growth in long-term lending to the domestic corporate sector...

...with favorable shifts being registered in the inflows of foreign direct investments that increased on an annual basis.

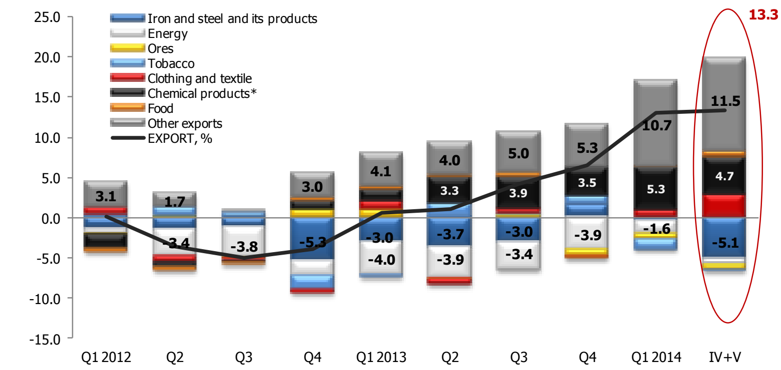
On the other hand, imports of capital goods declined on an annual basis, despite the growth in the previous two quarters.

After the expansion in the first quarter, the **foreign trade deficit** fell in the first two months of the second quarter compared to the same period last year...

...in line with the expectations in the April projection for nominal contraction of the trade balance.

Budget performance for the first two months of the second quarter point to higher **public spending**, given the increased costs for goods and services, as well as the annual growth in transfers for health care, which is consistent with the expectations from the April projection.

Exports by components
(contributions to the annual change, in p.p.)



Source: NBRM.
** The following data depict the overall exports of one major export capacity in the free industrial zone.*

In the period from April to May, the foreign trade deficit in goods narrowed by 10.2% on an annual basis as a result of the higher growth in exports relative to imports of goods...

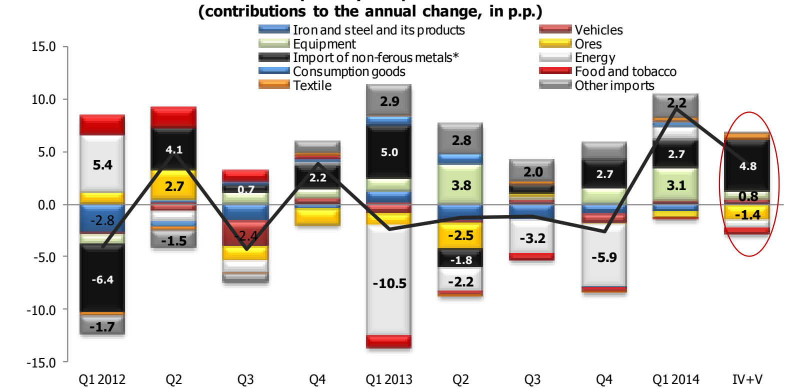
...which is in line with the April forecast for marginal annual improvement in the trade deficit.

In April and May, **export of goods** registered an annual growth of 13.3%, determined by the higher export activity of new export-oriented capacities. Additionally, positive contribution to the annual growth was made by export of clothing and textiles and less by the slightly higher export of food...

...while other categories registered an annual decline, which is still concentrated in the export of iron and steel.

Compared with the April projection for the second quarter of 2014, exports in April and May are generally in line with the expectations. There are significant downward deviations in export of tobacco, iron and steel, while the performance of all other categories was higher than expected in the April projection.

Imports by components
(contributions to the annual change, in p.p.)

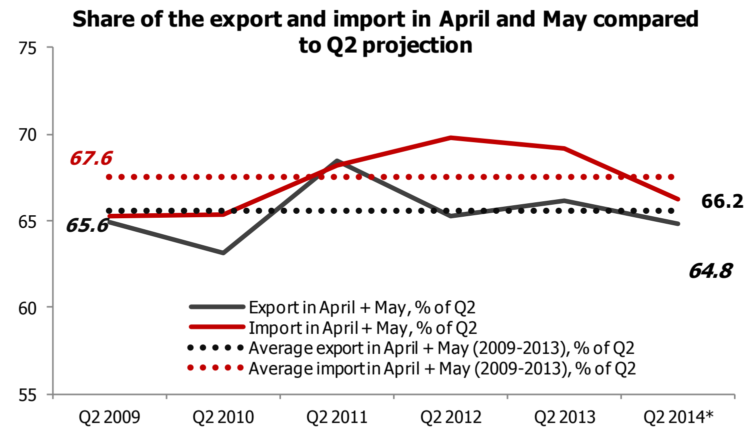


Извор: НБРМ.
** The following data depict the overall exports of one major export capacity in the free industrial zone.*

In April and May, **imports of goods** recorded an annual growth of 3.8%, which was mainly due to the increase of raw materials imported for the new export capacities. An annual growth was also registered in the import of equipment and machinery, vehicles and raw materials for the textile industry...

...while annual decline was reported in the import of ore, energy imports and food imports.

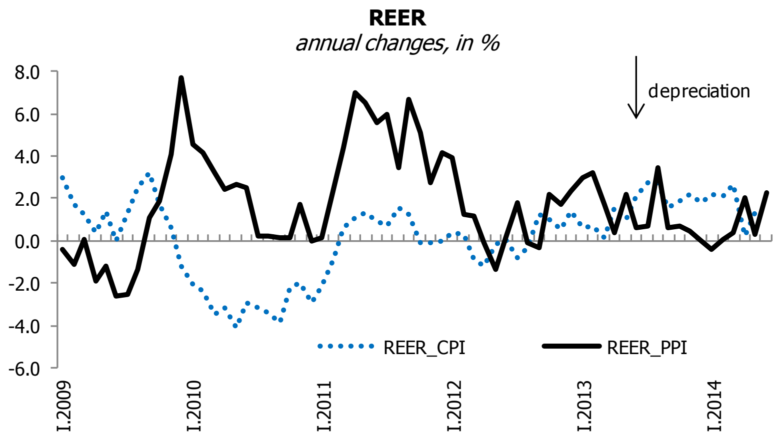
The imports in April and May suggest slightly lower import than projected for the second quarter of the year. The largest negative deviation was reported in the import of ore, food products, other imports and tobacco.



Source: NBRM.
*Share of the export/import in April in the projected export/import for Q2 2014, projection April 2014.

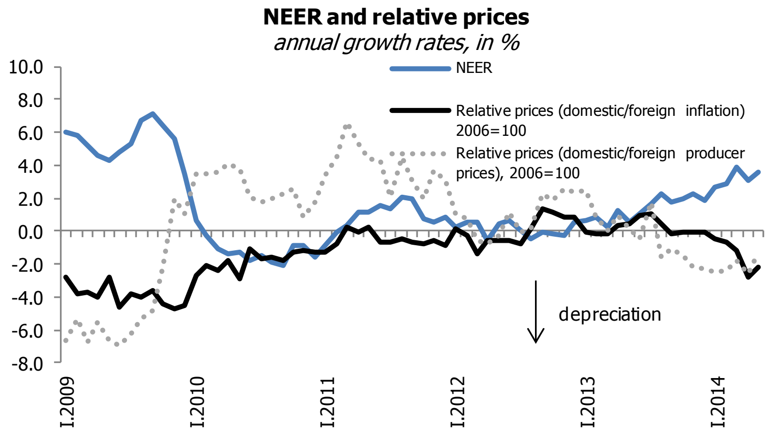
In April and May, the performances in export and import component of trade indicate a possibly lower trade deficit than projected for the second quarter of the year.

Recent assessments of crude oil prices in euros indicate less favorable trends than expected with the April projection. Therefore, lower than projected annual decline in prices is expected for 2014 and growth, rather than decline for 2015. On the other hand, favorable trends are expected for the global stock prices of metals (prices of copper and nickel) during the current and the next year.



Source: NBRM.

The trend of appreciation as measured by price competitiveness indicators of the domestic economy on an annual basis continued in May 2014. REER deflated by consumer price index appreciated by 1.3%, while deflated by the producer price index, it appreciated by 2.3%.

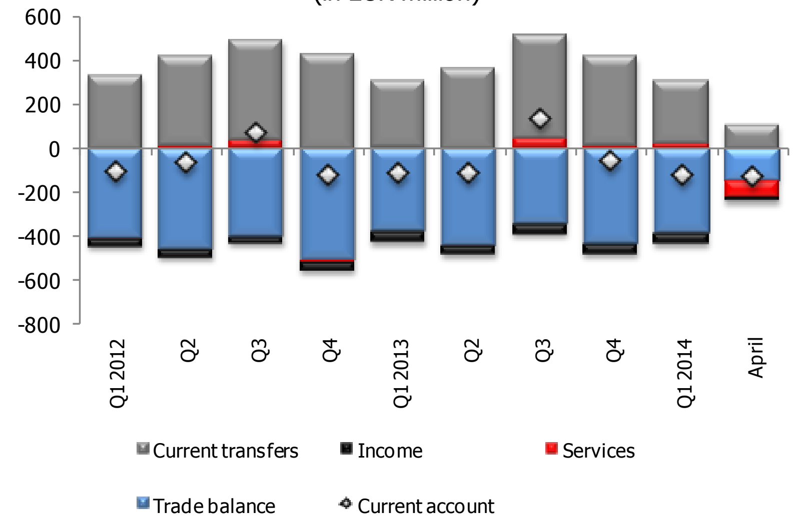


Source: NBRM.

Such movements are entirely due to the appreciation of the nominal effective exchange rate, which registered an annual growth of 3.6%, primarily due to the depreciation of the Russian ruble, Turkish lira and Ukrainian hryvnia against the denar. Favorable shifts in relative prices offset part of the NEER appreciation. The annual decline of domestic versus the growth of foreign prices (consumer prices and domestic producer prices) resulted in a decline in the relative prices by 2.2% and 1.3%, respectively.

In April 2014, the current account recorded a deficit of Euro 126.8 million (or 1.6% of GDP). The high current account deficit in April is due to

Main components of the current account
(in EUR million)

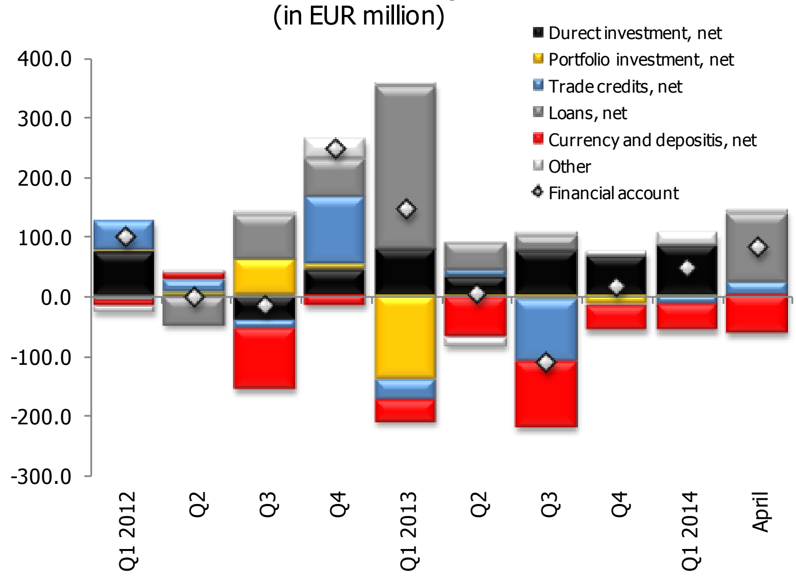


Source: NBRM.

the high outflow in services[9] as one-time outflow in the second quarter, as anticipated in the April projections. **The current account deficit is close to the expectations for the second quarter of the year.**

April performance in the current account components does not indicate significant deviations from the projection for individual components.

Financial account components
(in EUR million)



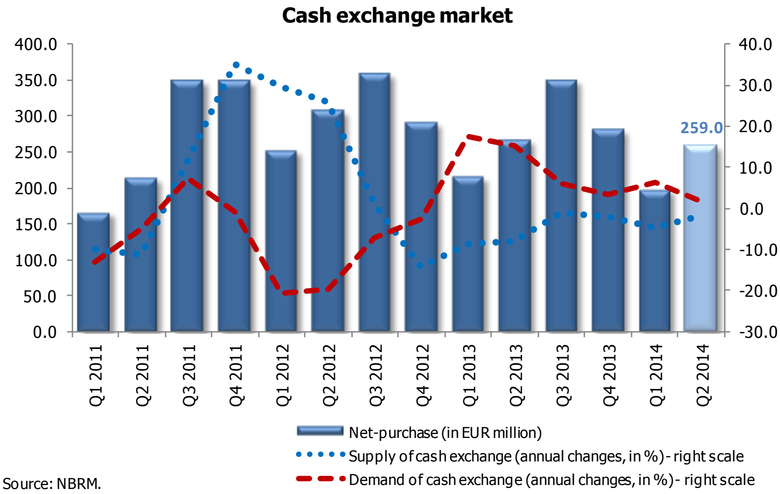
Source: NBRM.

In the fourth month of the year, the capital and financial account registered net inflows of Euro 83.1 million (or 1% of GDP), with the net inflows being slightly lower than projected for the second quarter of the year.

The deviations are mainly due to the higher net outflows in currency and deposits in the banking sector and other sectors, as well as the lower than expected net inflows of foreign direct investment.

On the other hand, April registered net inflows in trade loans, contrary to the expectations in the April projection for small outflows in this category.

[9] Services balance deficit in April is due to the high outflows in construction services, based on advances for construction-related projects to build the highways. Meanwhile, in April, the capital and financial account registered inflows based on external borrowing to finance road infrastructure, in the same amount as the outflows based on services, with the net effect on the balance of payments in the particular month being neutral.

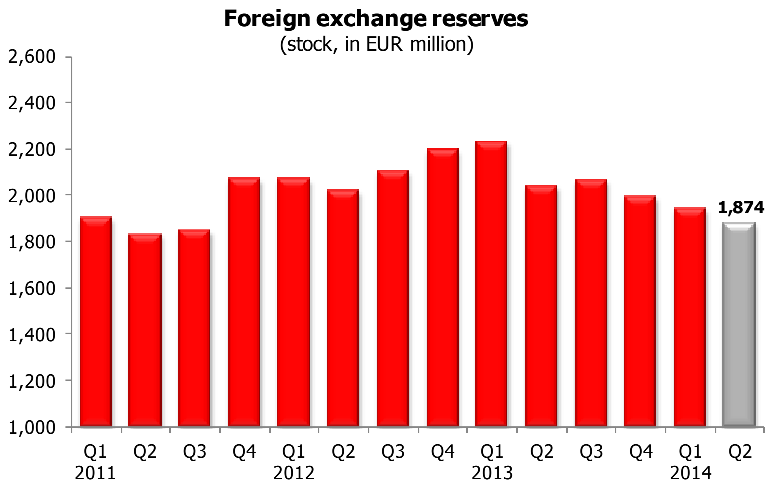


Source: NBRM.

Recent data on currency exchange operations, as of June 2014, show that the supply of foreign currency increased after four months of decline. At the same time, the foreign currency demand continued to grow.

In the second quarter of the year, the net purchase on the currency exchange market amounted to Euro 259 million, which is an annual decline of 2.9%.

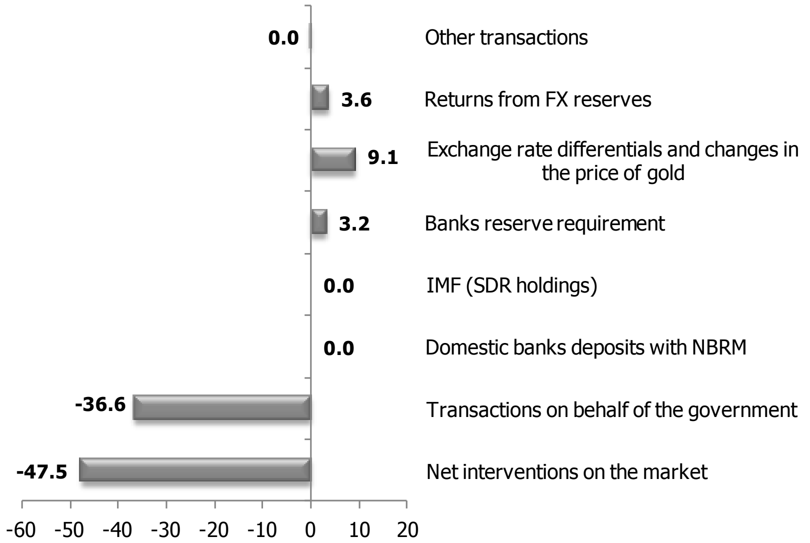
Latest information from the currency exchange market show that the net inflows of private transfers in the second quarter of 2014 are as expected in the April projection.



Source: NBRM.

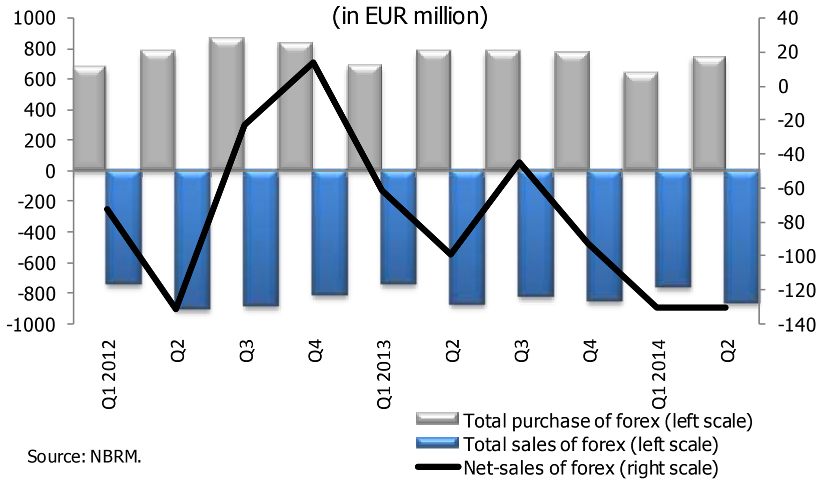
As of 30 June 2014, the gross foreign reserves totaled Euro 1,874 million, down by Euro 67 million compared to the end of March 2014. The adverse changes in foreign reserves are mostly due to net sales of foreign currency by the NBRM in the foreign exchange market and to transactions for government account.

Factors of change of the foreign reserves in the second quarter of 2014 (in EUR million)



Source: NBRM.

Forex market
(in EUR million)

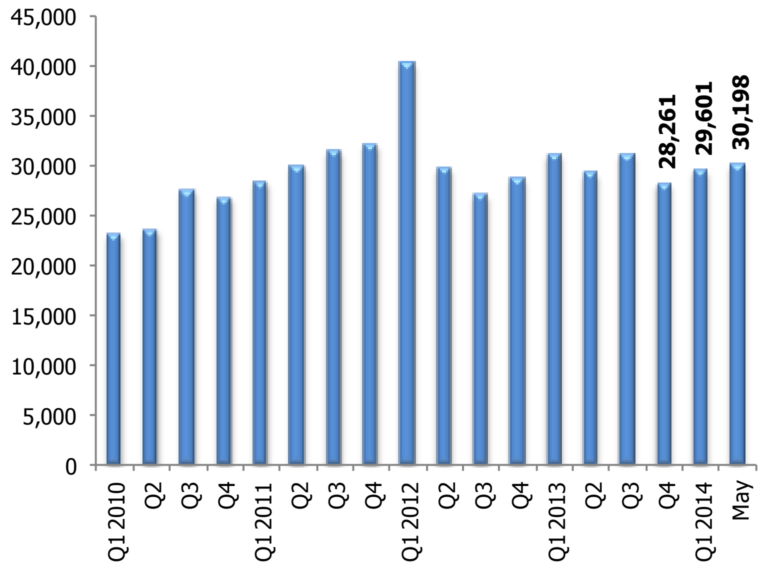


Source: NBRM.

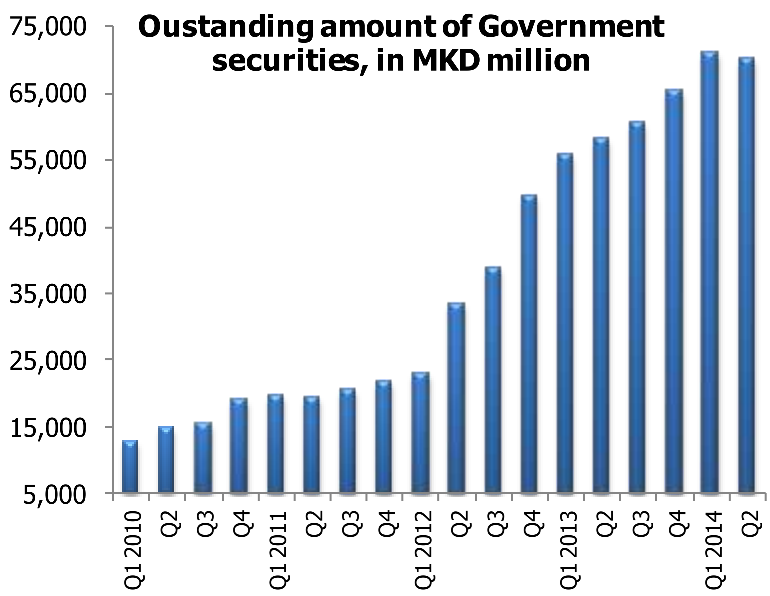
In the second quarter of 2014, the foreign exchange market with banks reported net sales of Euro 130.2 million, versus the lower net sales of Euro 31.3 million in the same period last year. This annual change stems from the faster decline in the supply compared to the demand for foreign currency (4.9% and 0.8%, respectively).

Analysis by individual components shows that the increase in net sales of foreign currency is mainly due to the higher net sales of companies compared to the same period last year.

Monetary policy instruments, in MKD million



Source: NBRM.



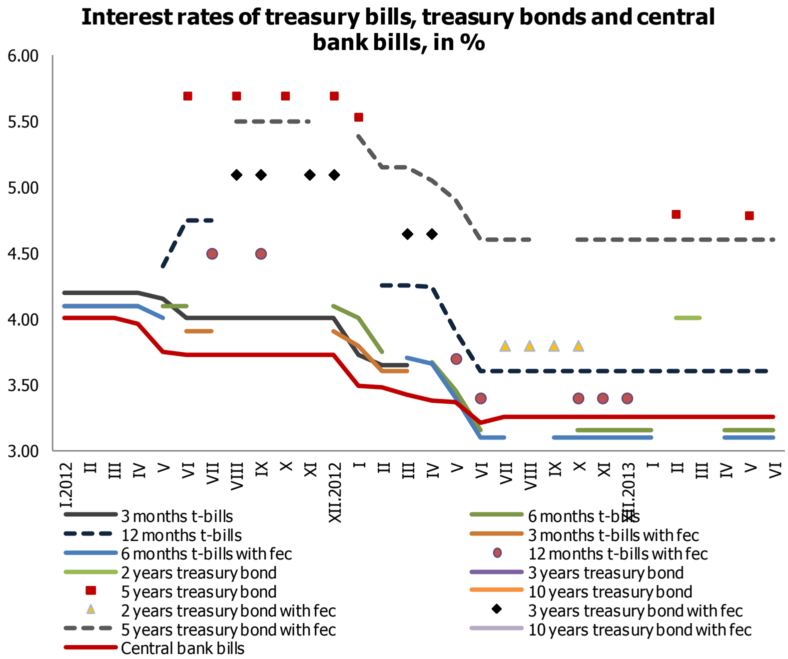
Source: NBRM.

Data as of May suggest withdrawing of liquidity through monetary instruments relative to the end of the first quarter, with intensity similar to the expected...

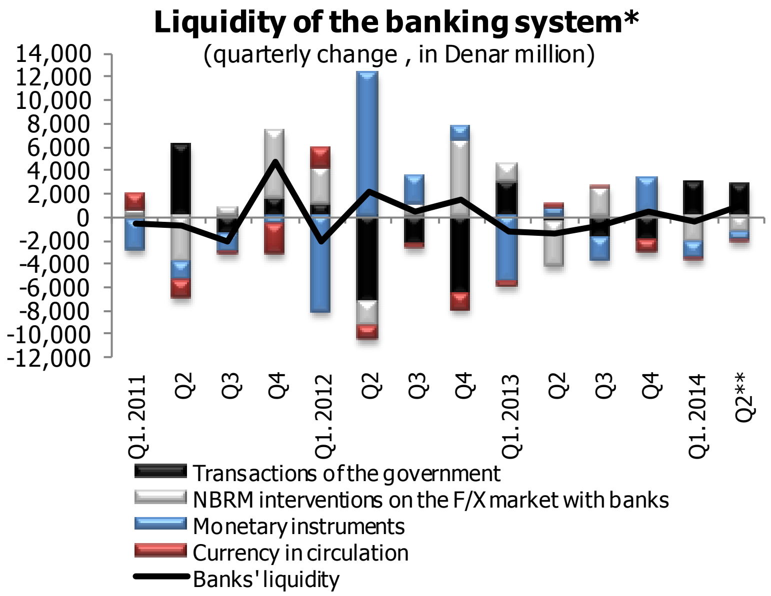
...amid a quarterly fall in net foreign assets of the NBRM, as projected in April...

...and creation of liquidity by reducing the total government deposits with the NBRM, in a similar amount as projected for the second quarter.

At the end of June, the government securities on the domestic market amounted to Denar 70,214 million, down by Denar 865 million compared to March 2014.



Source: NBRM.



*Positive change- liquidity creation, negative change- liquidity withdrawal .
** april and may

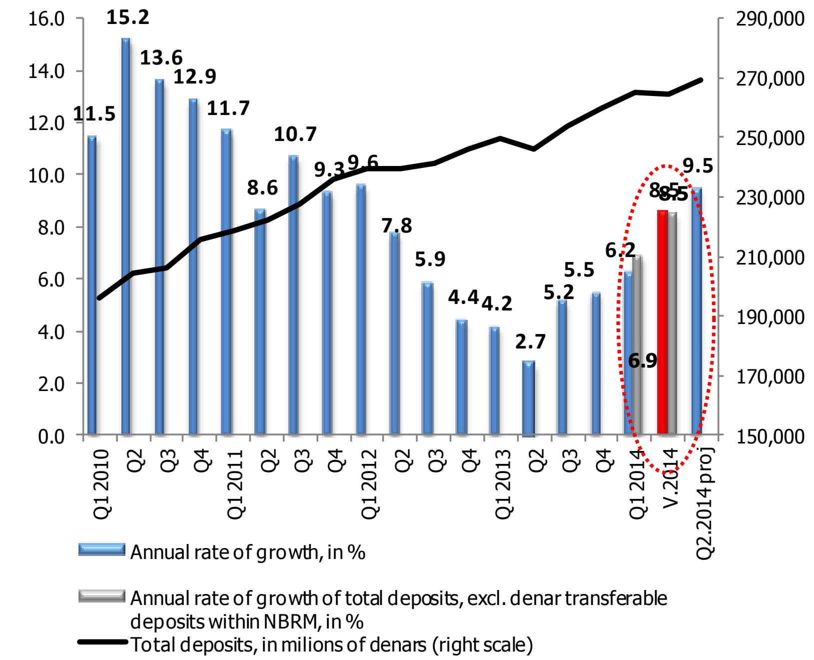
Source: NBRM.

Interest rates on the government securities market remained stable in June. The interest rates at the auctions held in June ranged from 3.1% for 6-month bills with a foreign currency clause to 5.3% for 10-year bonds.

In late May, the level of reserve money was near the level projected for the second quarter...

...given the quarterly growth of currency in circulation and total liquid assets, as projected in April.

Total deposits

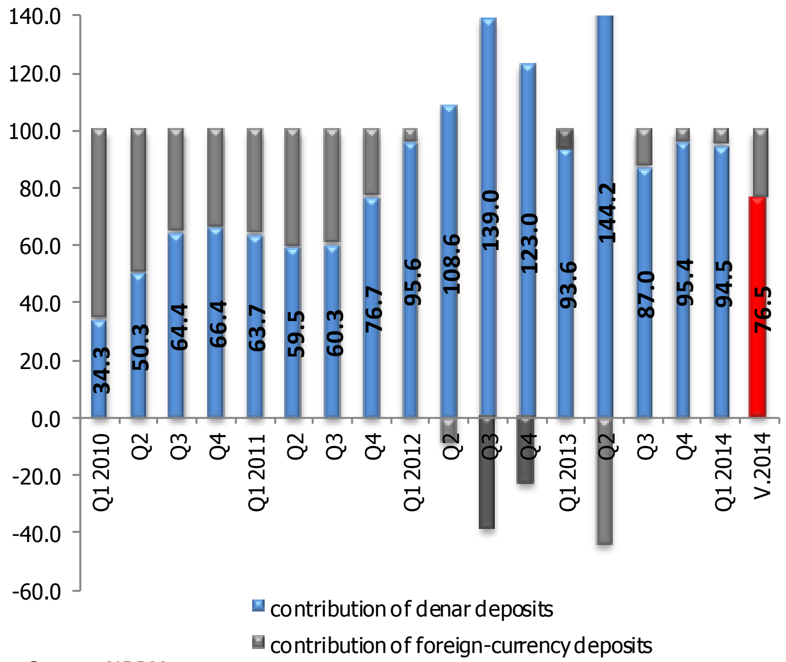


*Includes demand money
Source: NBRM.

According to data as of May, the total deposits of the banking system registered a moderate growth compared to the previous month, despite their decline registered in April (mainly as an effect of the payment of the dividend of one company). These developments are the result of the monthly increase in corporate deposits, while the household deposits slightly decreased the total deposits.

At the end of May, the annual growth rate of total deposits amounted to 8.5%[10], which is below the growth of 9.5%, projected for the second quarter. In addition, the total deposits declined by Denar 732 million, on a quarterly basis, despite the growth for the second quarter of 2014, as projected in April.

Contribution of denar and foreign currency deposits to the growth of total deposits (in %)
*Includes demand deposits.

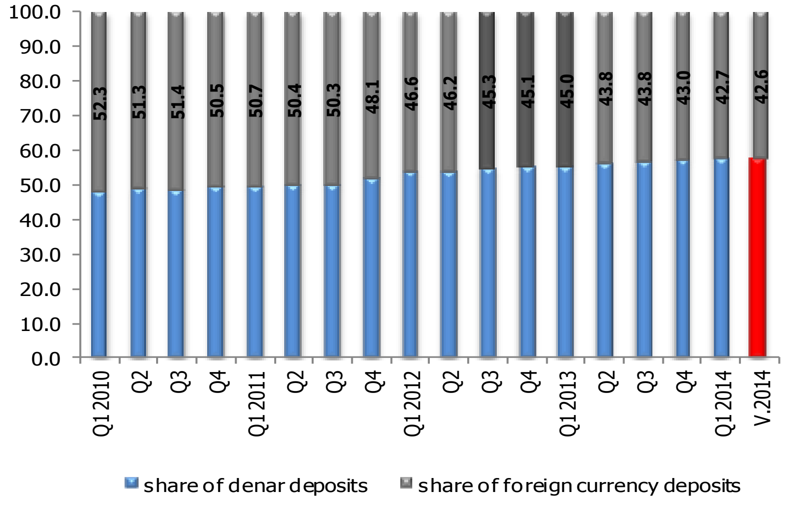


Source: NBRM.

The annual growth of total deposits is mainly due to the increase in denar deposits and the intensifying contribution of foreign currency deposits, which, however, is due to the base effect[11]. Thus after a long period of negligible contribution to the overall growth of the deposit potential, foreign currency deposits account for 23% of the annual increment. The new growth of deposits in May was completely driven by denar deposits.

[10] Refers to total deposits including transferable denar deposits of other financial institutions with the NBRM.
[11] High outflows of foreign currency deposits of the corporate sector in April 2013 are mainly due to the dividend payment of one company. In 2014, a smaller amount of dividend was paid (again in April), mainly through denar deposits of companies.

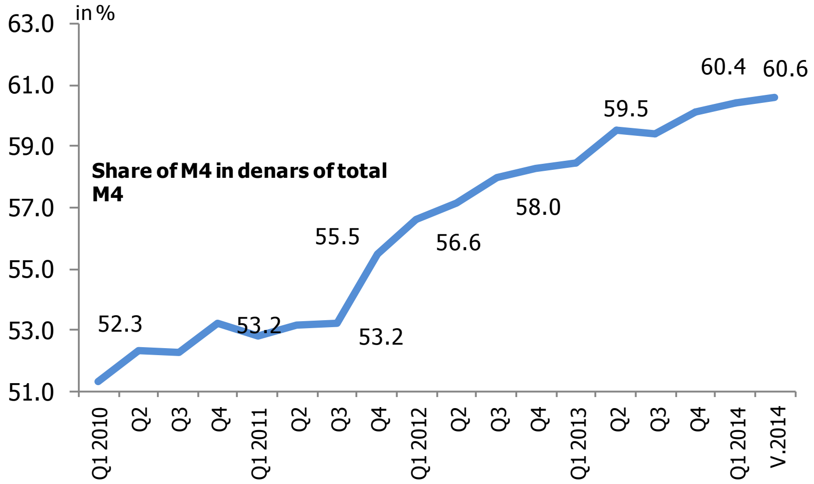
Share of denar and foreign currency deposits to total deposits (in %)
*Includes demand deposits.



Source: NBRM.

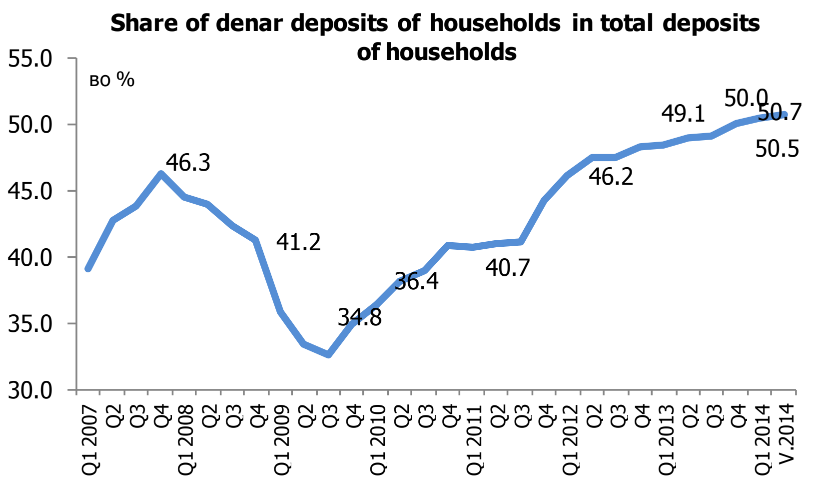
According to the final data as of May, the currency structure of total deposits remained stable compared to the previous quarter, with the share of denar deposits still dominating the total deposits.

Share of M4 denar in total M4 (in %)



Source: NBRM.

Share of denar deposits in total household deposits, in %
*Includes demand deposits.

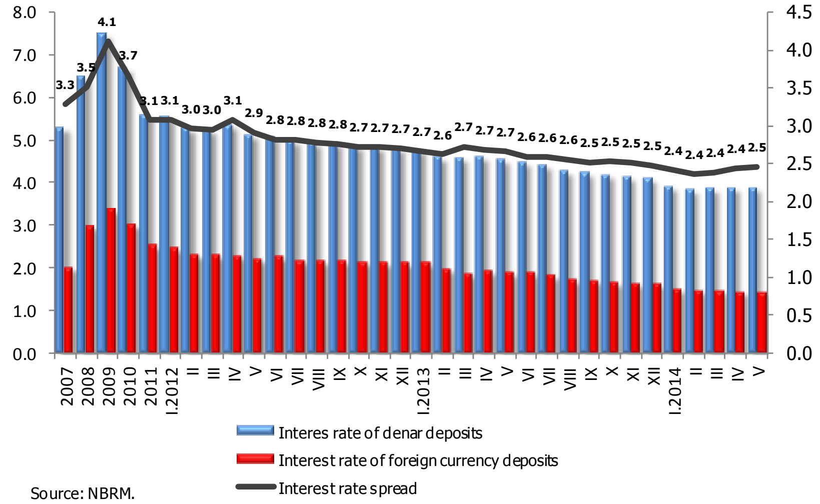


Source: NBRM.

In May, denar household deposits registered a slight monthly decrease, despite their constant increase since June 2013...

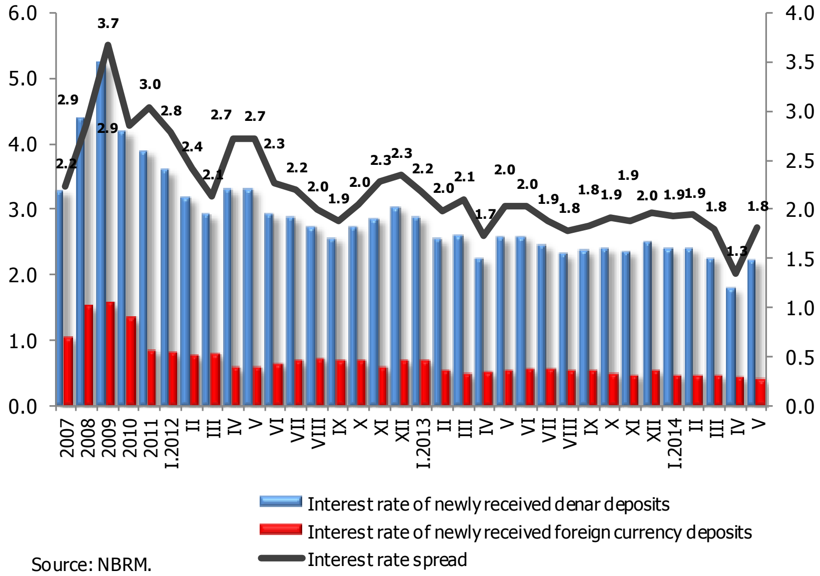
...maintaining their share in total household deposits relatively stable (50.7%). Foreign currency household deposits moderately increased compared to the previous month.

Interest rates on denar and foreign currency deposits, in %



Source: NBRM.

Interest rates on newly received denar and foreign currency deposits, in %

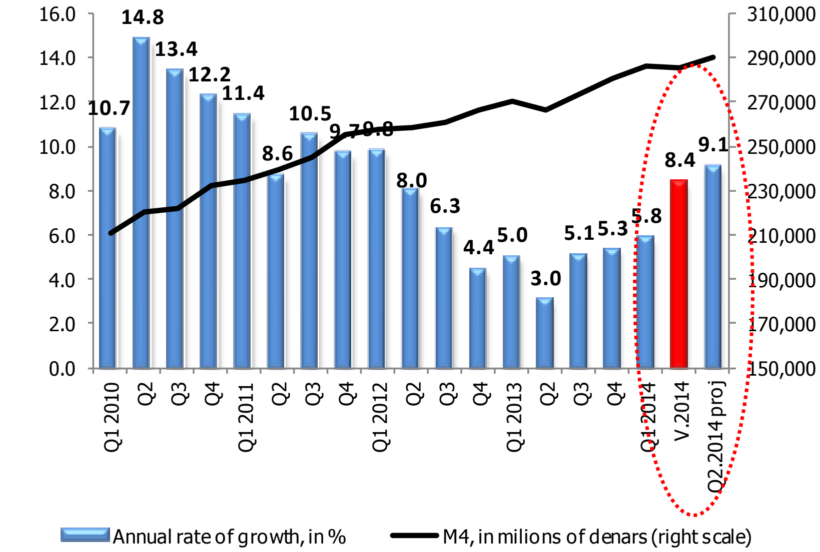


Source: NBRM.

In May, interest rates on denar and foreign currency deposits were stable compared to the previous month, maintaining the interest rate spread between denar and foreign currency deposits unchanged compared to April. On the other hand, the interest rate spread between interest rates on newly received denar and foreign currency deposits recorded a more significant expansion of 0.5 percentage points relative to April, as a result of the increasing yield on denar deposits[12].

[12] The increase in interest rate of newly received denar deposits contributed to stabilization of this interest rate after the exhaustion of the one-time effect of depositing a larger amount of deposit at a very low interest rate in April. The deposit was with maturity of one month.

Broad money, M4

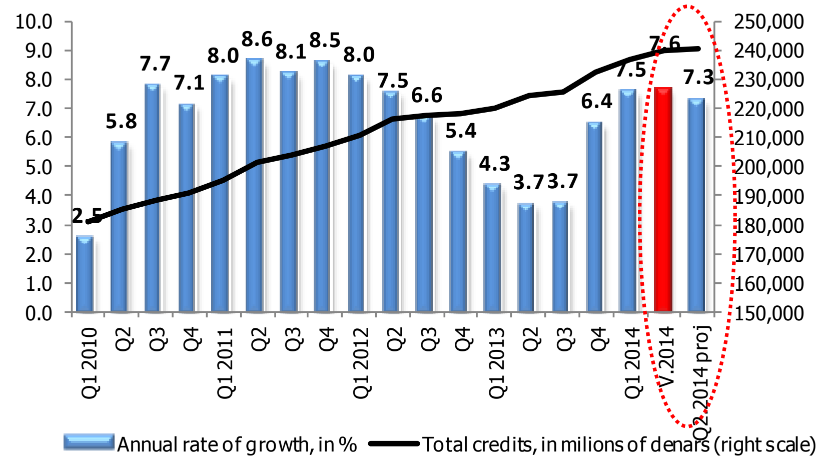


Source: NBRM.

The final data as of May show a lower monetary growth than projected...

...as a result of the weaker performances of total deposits given the higher growth in currency in circulation than projected in April.

Total loans



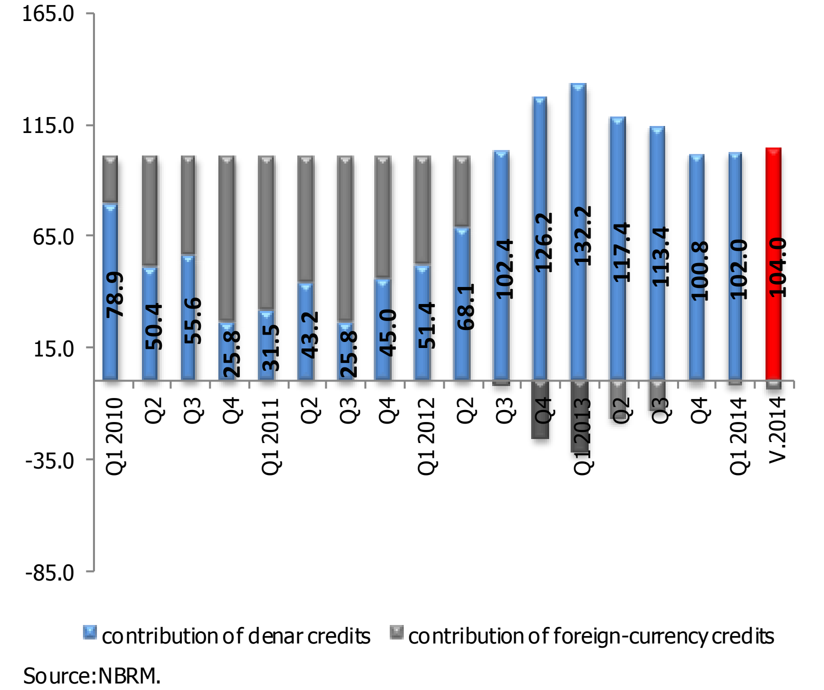
Source: NBRM.

According to the final data as of May 2014, the credit market reported significant acceleration of lending to the private sector, despite the decrease of total loans in April. Thus, credit flows in May represent the strongest monthly increase since the beginning of the crisis[13], given the higher increase in loans to corporate sector compared to loans to household sector.

At the end of May, the annual growth rate of total loans equaled 7.6%, which is above the projected annual growth of 7.3% for the second quarter of 2014, according to the April projection. On a quarterly basis, the actual increase of Denar 3,573 million makes up 91% of the projected growth for the second quarter of 2014.

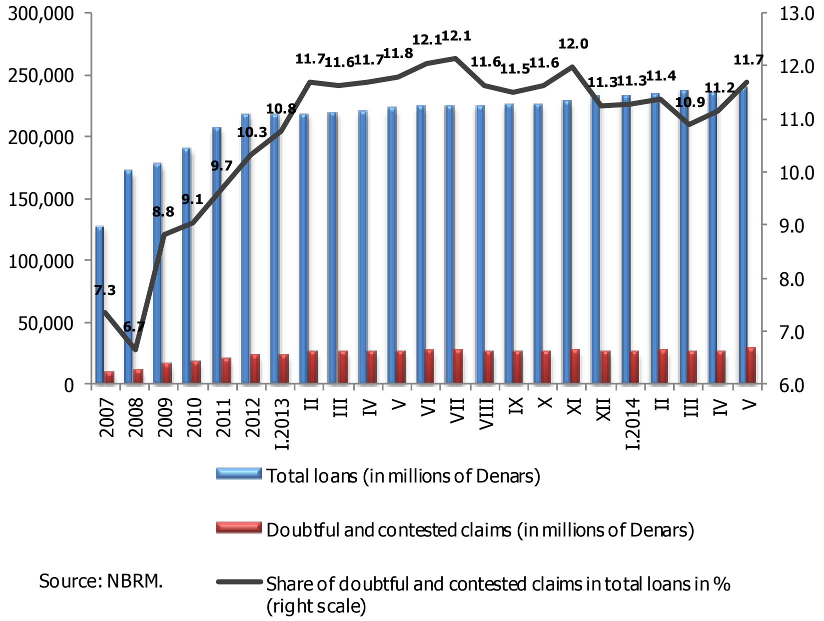
[13] The monthly credit growth registered in May is slightly higher than the growth of total loans in December 2013.

Contribution of denar and foreign currency loans to total loans, in %



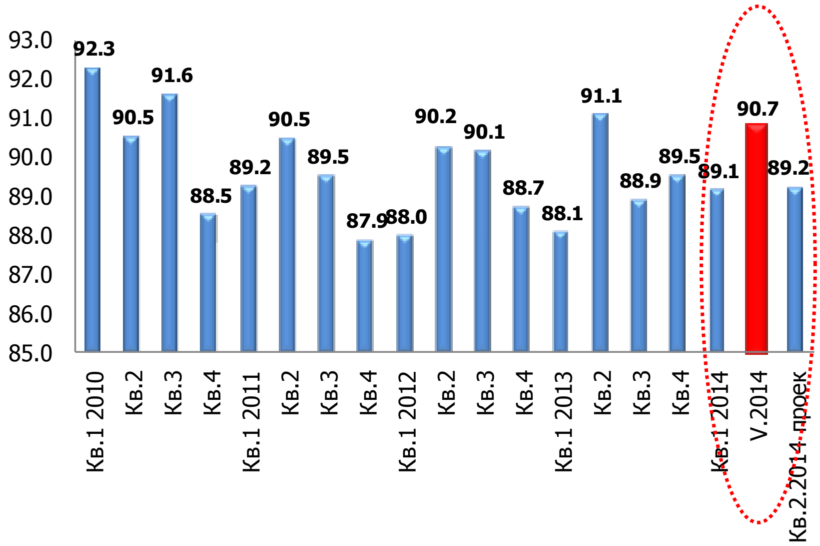
The annual growth of total loans is entirely due to the increased denar loans, amid further decline in foreign currency loans.

Doubtful and contested claims to total loans ratio, in %



In May, there was an increase in the share of doubtful and contested claims to total loans for the second month in a row. This growth was predominated by the further increase in nonperforming loans of corporate sector.

Loan - deposit ratio, in %



Извор: НБРМ.

In May, there was higher utilization of the deposit potential for lending to the private sector compared to the previous quarter...

...as a cumulative effect of the intensive increase in loans to the private sector, and the moderate quarterly decrease in the deposit base.

These developments contribute to higher utilization of deposits to finance private sector than projected.

Box 1: Timeline of changes in the monetary instrument setup of the NBRM and selected supervisory decisions adopted in the period 2013-2014

January 2013

- A Decision amending the Decision on reserve requirement (adopted in November 2012) came into force, allowing reduction of the reserve requirement base of banks for the amount of new loans to net exporters and domestic producers of electricity, as well as for the investments in debt securities in domestic currency without a currency clause, issued by the aforementioned companies. This decision fully exempts the banks from allocating reserve requirement for liabilities based on debt securities issued in local currency with an original maturity of at least two years. The Decision will apply throughout 2014, after which, depending on the results, the need for further application will be reconsidered.

- A Decision on reducing CB bill interest rate was adopted to cut the policy rate from 3.75% to 3.5%. At the same time, the interest rate on seven-day deposit facility and on overnight deposit facility was cut from 2% to 1.75% and from 1.0% to 0.75%, respectively.

March 2013

- A Decision on credit risk management was adopted, which applies from 1 December 2013.

July 2013

- A Decision reducing CB bill interest rate was adopted to cut the policy rate from 3.5% to 3.25%. At the same time, the interest rate on seven-day deposit facility was cut from 1.75% to 1.5%.

- A Decision amending the Decision on reserve requirement was adopted, which reduces the reserve requirement rate for banks' liabilities in domestic currency from 10% to 8% and increases the reserve requirement rate for liabilities in foreign currency from 13% of 15%. In addition, the amendments stipulate a reserve requirement rate of 0% for banks' liabilities to nonresident financial companies with contractual maturity of over one year, as well as for all liabilities to nonresidents with contractual maturity of over two years. A rate of 13% still applies to short-term liabilities to nonresident financial companies in foreign currency with contractual maturity of up to one year. To maintain the reserve requirement in denars and in euros relatively stable, the amendments increase the reserve requirement in euros that is fulfilled in denars from 23% to 30%.

October 2013

- A Decision amending the Decision on banks' liquidity risk was adopted. This decision reduces the proportion of time deposits assumed to outflow from banks, from 80% to 60%, and applies from 1 December 2013. This amendment makes more space for long-term bank lending to the real sector.

November 2013

- A Decision amending the Decision on reserve requirement was adopted, which exempts the NBRM from paying reserve requirement remuneration (previously, this remuneration equaled 1% for denar reserve requirement and 0.1% for euro reserve requirement). The Decision applies from 1 January 2014.
- A Decision on CB bills was adopted, which introduces a methodology for determining the potential demand for CB bills. In accordance with the established mechanism, if there is a higher demand than the potential across the overall banking system, banks that bid higher amounts of their own liquidity potential will be required to place this difference in seven-day deposits.

February 2014

- A Decision on reducing interest rate on seven-day deposit facility from 1.5% to 1.25% was adopted.

April 2014

- Decision amending the Decision on the methodology for determining capital adequacy was adopted, introducing two amendments in the current decision that are expected to contribute positively to the credit support of commercial banks to the corporate sector. In fact, the performance guarantees in this decision are of medium/low risk, since they take lower conversion factor (20%) instead of 50%. Another innovation is that it introduces a more favorable regulatory treatment of the funds established by one or several central governments, multilateral development banks or public institutions. These funds will take 0% risk weight, and the requirement will be that the funding is executed by payment in stakes, i.e. on-balance sheet and off-balance sheet activities to be covered by the fund's equity.