

National Bank of the Republic of Macedonia



Annual Report 2008

Skopje, March 2009

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Governor's foreword

On a global economic plan, 2008 was a year with dimensions of uncertainty unseen so far, a year of important turning points on the macroeconomic stage, and a year in which almost all central banks worldwide faced enormous challenges in delivering price and financial stability in the domestic economies. The crisis on the mortgage market in the USA from August 2007 has developed into a global financial and economic crisis. Large banking and non-banking financial institutions have collapsed. Main features of the money markets were the illiquidity, refraining from interbank trading and growing risk premia. Policy makers intervened by coordinated activities of providing liquidity by the central banks and government interventions in the form of guarantees, recapitalizations and nationalizations of part of the financial institutions. All these developments are indicators of "tectonic movements" in the global financial system in a very short period. Macroeconomic implications from the crisis are already visible and more than clear. This mainly pertains to the undermined confidence in the financial system, termination of the financial flows, refraining from consumption and investments, high risk aversion, which resulted in massive deceleration of the global growth and emergence of a recession in the highly-developed economies. Thus, from an environment of steady growth, galloping prices of food, energy, basic metals and growing inflation, the global economy very quickly entered a cycle of decelerated economic activity, fall in the prices of stock exchange products and decline in the inflation.

The Macedonian economy was not isolated from such global developments. Although the relatively weak financial integration and simple structure of financial instruments enabled to maintain the stability and safety of the domestic banking system, still, the implications for the financial activity and the direct effects for the real sector were intensively experienced in the last quarter of the year, signaling a clear reversal in the domestic economy. The narrowing of the sources of financing and the change in the perceptions of the risks with the banks, led to a change in the credit cycle and slower growth of the financial support for the domestic economy. In conditions of more difficult access to financing and general refraining and uncertainty, domestic demand is expected to slow down, the transmission effects of which on the imports remain to be seen. In the exports sector, global recession had a direct effect, through a decline in the prices of the main export products and reduced demand for domestic products. At the same time, risk aversion and refraining from investment decelerated the capital inflows in the country. On the other hand, in conditions of significantly lower import inflation, the pressures on the domestic inflation reduced. Such changes, which have become more evident since the last quarter of 2008, announce new macroeconomic configuration in the forthcoming period, which means slower pace of growth, stronger pressures in the external sector and exhaustion of the price shock.

In 2008, like a number of the other central banks worldwide, in conducting the monetary policy NBRM faced with shocks of various nature. During the first half of 2008, given the strong pressures from the import prices, stronger domestic demand and high inflation expectations, inflation was kept at a level higher than usual. This is a period in which the prices of food and energy on the world markets were still registering upward trends, and the uncertainty about their future trajectory, the risk of secondary effects on wages and other prices in the economy and the possibility for opening an inflation spiral were extremely high. The average inflation in the first half of the year was 9.7%, while core inflation reached 2.8%, and although relatively low and with emphasized stability in this period, still significantly exceeded the one registered in 2007. The foreign exchange market, which given the strategy of a de facto fixed exchange rate of the Denar is in the focus of the monetary policy, was relatively stable in the first half of the year, with a net-sale of foreign exchange from the official reserves being registered only in January and in April. In this period, the pressures on the side of demand for foreign exchange in conditions of further deterioration of the trade deficit and increased sale of foreign exchange on the currency exchange market, were to a large extent offset through the decline in the foreign exchange potential of the banks and the relatively high capital inflows through direct investments. However, even then one could see the risks for the external sector by the end of the year, mainly through the downward revision of the projections for the world

economic growth, the forecasts for a decline in the prices of metals and the global discussions about the effects of the crisis on the volume of the capital inflows from the developed into the less developed economies. Such a combination of growing inflation and expectations about deterioration of the external position of the economy imposed a need for monetary reaction with a rise in the key interest rate. In the first half of the year, the interest rate on the Central Bank bills was increased on three occasions, and the last increase was made in May, when it was set at 7%. **At the same time**, the rapid growth of household credits was considered to be a factor which creates pressures on the inflation and the growing imports, and therefore in June a decision on a compulsory deposit of banks with the NBRM was adopted, the aim of which was to discourage the excessive growth of household credits.

The second half of the year was, in global terms, marked by the swift reversal in the movement of the world prices of food and energy, the decline of which, together with the exhaustion of the low comparison basis from the preceding year led to a significant deceleration of the domestic inflation. The annual inflation slowed down continuously, and fell down to 4.1% in December. However, having in mind the movements in the first half of the year, the average inflation rate in 2008 was 8.3%. In the third quarter, the process of deceleration of the inflation went simultaneously with the accomplishment of high capital inflows and gradual stabilization of private transfers, which resulted in a substantial purchase of foreign exchange on the foreign exchange market by the NBRM. However, the new wave of shocks in the global finances in September implied deepening of the economic crisis in the developed economies and a significant decline in the external demand for the Macedonian exports, with emphasized effects in the last months of the year. The world crisis also created psychological pressures on the domestic entities, which became evident through the growth of the demand for foreign exchange and change in the currency structure of the savings from domestic into foreign currency. Such a condition on the markets, accompanied by the outflows of foreign exchange for payment of dividend to foreign shareholders and the smaller intensity of foreign investments, resulted into a massive sale of foreign exchange from the official reserves in the last quarter of the year. Fiscal policy created an additional pressure, which from a zone of a budget surplus in the first three quarters, in a short time registered a budget deficit in the last quarter of the year, with the budget deficit for the whole 2008 equaling 0.9% of GDP.

NBRM maintains the existing strategy of a de facto targeting of the exchange rate, assessing that the stable exchange rate, especially in periods of shocks, is the key anchor which stabilizes the expectations in the Macedonian economy and contributes to the accomplishment of price stability, as the main monetary objective. The shifts in the economy in the last quarter of 2008, showed that in the forthcoming period the main risks in conducting the monetary policy will be transferred from the inflation to the external sector. In conditions of a fixed exchange rate, the negative imbalances in the external sector undoubtedly indicate a need for continuous promptness of the central bank in offsetting the potential pressures on the foreign exchange market through the monetary policy instruments, in order to ensure a stable exchange rate and price stability.

Although the consequences from the global crisis for the Macedonian economy started to become more intensive towards the end of the year, generally, in 2008, the pace of steady growth was maintained. The achievement of a real growth rate of 5% in 2008, after the growth of 5.9% in the preceding year, indicated that the Macedonian economy is on the right way to gradually increase the degree of real convergence to the EU. Although this percentage is still low and it equals around 30% in 2008¹, it points to a continuous progress in a time frame of four years, as opposed to the relative stagnation in the preceding period. The assessed decomposition of the growth generators in 2008 indicates that growth is still far from balanced, with dominant contribution of the domestic demand and negative contribution of the net-export demand. However, the growing role of the investments and the fact that in 2007 and 2008 they registered an intensive growth, is an indicator of the possible increase in the intermediate productivity of the economy. This year is characterized also with a large volume of foreign investments, which are treated as a factor that increases the potential for growth of the economy through the transfer of know-how and modern technologies. One may say that the

¹ GDP per capita according to the Purchasing Power Parity, as a percentage of the average of EU 27.

financing of the economy through the banking credits also acted in this direction. However, the effect of this factor is partial, having in mind that the degree of financial development influences the achieved and the potential growth, depending on the aim of the credits for financing innovations, rather than for financing the households' consumption. Generally, it may be concluded that in 2008, both from a viewpoint of the intensity and from a viewpoint of the structure the movements in the field of economic growth were positive. However, it is more than clear that the consequences from the global crisis will be significantly felt next year. The decline in the external demand will definitely denote deceleration or decline in the exports, while the more difficult access to financing and the general refraining from larger investment undertakings and consumption will denote a slowdown of the growth of domestic demand.

The sensitivity of the external sector of the Macedonian economy, primarily due to the high concentration of the exports and its sensitivity to the fluctuations in the world prices, became evident in 2008. In 2008, the current account deficit reached 13.1% of GDP, which is a significant rise compared with the preceding year (7.2% of GDP). The increase in the deficit is a combination of several factors. One of them is the growth in the domestic demand, significant part of which is directed to imports. However, observed from a viewpoint of the gap between saving and investments, despite the investments growth, the broadening of the current deficit is a reflection, to a great extent, of the decrease in the saving. This points to two negative trends. **First**, for the time being the main transfer of impulses from the domestic demand to the imports has been carried out through the personal consumption, and less through the investments, and **second**, the net current transfers (the external saving), which were the main source of financing of the trade deficit, registered a decline. Additional factor are the prices of the energy products on the international markets, the growth of which in the first half of 2008 created large pressures on the import. However, the main export sector, the metal manufacturing, has great significance for the negative movements in the current account, which was affected rapidly and directly by the global crisis through the drop in the prices of metals and the reduced export demand. Thus, the sensitivity of the exports to external shocks and the large dependence on the current transfers, emphasized as key risks in the external sector for many times so far, reflected in 2008, with their additional intensification being expected for the following year.

In the first three quarters, the high current account deficit was financed, to a great extent, from the inflows based on foreign investments. **Within this domain**, partial effects of the crisis were felt in the last months of the year, when the volume of additional inflows in the economy went down. The further effects of the current crisis on the capital inflows in the Macedonian economy can hardly be estimated precisely. The emerging and less developed economies, which enjoyed a number of benefits from the entry of large capital inflows, now in conditions of large risk aversion, global liquidity problems, investors restraint and process of the so-called deleveraging, face with outflow of capital and potential problem of sudden stop of additional inflows of capital. However, it does not mean that the same scenario will happen also in the Macedonian economy, but caution and readiness for suitable adjustments are required.

In most of 2008, the process of financial convergence continued at a fast pace, representing one of the important factors of domestic demand support. The low level of international financial integration, the simple structure of the financial instruments portfolio and the dominant role of the domestic deposit potential in the sources of financing, contributed the domestic banking system to be immune to the rapid and direct effect of the global financial crisis. Thus, since the beginning of the year the credits have increased intensively, and in April they reached an annual growth rate of 44%, thus severely deepening the financial intermediation. Having in mind that large portion of the credits were directed towards the "households" sector, in conditions of increasing external imbalance and uncertain inflation dynamics, in June the NBRM adopted a decision aimed at discouraging the excessive growth of credits to households. The necessity of slower pace of the growth of credits to households has two dimensions. The **first one**, macroeconomic, i.e. prevention of "economy overheating" and the second, creation of a room for more adequate risk management by the banks. **In any case, substantial reversal in the credit policy of the banks can be perceived at the end of the year, when it became clear that the global crisis with growing dimensions, in**

certain way, will reflect on the dynamics of the activities of the banking system. There are several channels for transmission of effects. Firstly, the crisis effects on the real sector quickly changed the banks' expectations and resulted in perception for growing risk, which acted towards tightening of the lending terms, lower credits supply and enlarged possibility for more evident credit rationing in the following period. Second, the collapse of large financial institutions in the world imposed psychological pressures on the depositors, who in a very short time, although in small amounts, withdrew part of the deposited savings. This, together with the deceleration of the economic activity and the outflow of capital from the economy (on the basis of portfolio investments and high payment of dividends), significantly reduced the annual growth in the deposits from over 20%, in the largest part of the year, to roughly 10% in December 2008. However, the deposits' dynamics in 2008 was marked with clear change in the currency preferences in favor of savings in foreign currency, as a reflection firstly of the inflationary pressures, and then of the increased uncertainty and speculations in the public pertaining to the foreign exchange rate. Third, although the extent to which the banks leant on external borrowing is very small, the impediments related to the access and the deterioration of the conditions for this type of financing mean narrowing of the possible future sources. Although these factors became more intensive at the end of the year, they were strong enough to reduce the growth rate of the total credits to about 34% in December. The movements in the financial intermediation at the end of the year show that the changes in the economic environment act relatively fast also on the deposit base and the banks' perceptions, which adequately alter the dynamics of their credit activity, as well. In the following period, the attention of the banks will undoubtedly be focused on more active risk management, which in conditions of slower growth can be materialized to a great extent and thus erode the quality of the credit portfolio. In the following period, the expectations are directed towards significant deceleration of the pace of credit growth, which goes not only in favor of more adequate risk management, but represents a significant support to the macroeconomic management in coping with the anticipated external imbalances.

Ladies and Gentlemen,

This year we have witnessed financial and economic crisis, which eroded deeply in the pores of the world economy. The recession in the developed economies and the constant downward adjustments of the projected growth for the emerging economies, showed that in a global economy with integrated trade and finance there is no room for economic segregation among individual regions, i.e. the so-called process of "decoupling" is impossible. Global coordinated measures are currently undertaken around the world, the aim of which is not only to restructure the financial system, but to regain the confidence of the economic agents, as well. It means regaining of the investors' confidence in the solvency of the financial institutions, i.e. undertaking new investments and regaining the consumers' confidence, i.e. lowering the restraint from consumption. All of this would also mean better prospect of the labor market, and thus positive impetus on the investments and the consumption. However, the movement of this mechanism is not at all easy.

How long this global shock will last and how deep the consequences will be, is hard to say. But, how long and how powerfully the Macedonian economy will feel the consequences of the global crisis significantly depends exactly on this. In any case, this economic episode emphasizes once more the need of having sound basis and diversified economy, which will enable easier absorption of external shocks. Also, in such conditions, preserving of the stability of the domestic economy is of key importance and it will depend, to a large extent, on the capacity of the macroeconomic management for conducting coordinated and sustainable policies. The sustainability concept should be in the background of each adopted measure. In an environment of increased global risk, maintaining the macroeconomic stability and conducting policies which provide sustainability in a medium run can mean creation of positive perceptions for a small economy as ours. It means prevention of capital outflow from the country, but also increase in the probability for additional capital inflows, which is especially important in these conditions. As carriers of the monetary policy, we continue further to conduct a policy of foreign exchange rate and price stability. In such a manner, we consider that we give the best contribution to the welfare of the economy. As a supervisor and a regulator of the banking system, we continue to take care constantly of its soundness, stability and

safety, which is the basis for development of each economy. In any case, the maintenance of the price and the financial stability means also faster fulfillment of the European agenda, we must not forget under any circumstances.

Skopje, April 2009

Petar Goshev, M.Sc.

Governor
and President of the NBRM Council

Selected economic indicators for the Republic of Macedonia

	2003	2004	2005	2006	2007	2008
I. Real sector						
GDP (millions of Denars) ^{1/}	251,486	265,257	286,619	310,915	354,322	398,640
GDP (real growth rate, %) ^{1/}	2.8	4.1	4.1	4.0	5.9	5.0
Industrial output (average annual rate, %)	5.0	-2.3	7.2	2.5	4.1	5.9
Inflation (average annual rate, %)	1.2	-0.4	0.5	3.2	2.3	8.3
Inflation (December/December, %)	2.6	-1.9	1.2	2.9	6.1	4.1
Nominal average net wage (Denars)	11,828.2	12,297.7	12,599.8	13,517.9	14,585.8	16,094.8
Unemployment rate (%)	36.7	37.2	37.3	36.0	34.9	33.8
Employment rate (%)	34.5	32.8	33.9	35.2	36.2	37.3
Productivity growth rate (%)	n.a.	n.a.	-0.2	-0.7	2.3	1.8
Unit labor cost (ULC) growth rate (%)	n.a.	n.a.	2.8	8.7	2.5	6.8
II. Fiscal sector						
Budget balance (Central Government Budget and Funds Budget, millions of Denars)	m.c.	m.c.	657.5	-1,700.0	2,152.7	-3,852.7
Budget balance (% of GDP)	m.c.	m.c.	0.2	-0.5	0.6	-1.0
Public debt stock (millions of EUR) ^{2/}	1,843.9	1,842.5	2,191.6	2,029.5	1,927.8	1,868.0
III. Financial sector						
Reserve money (growth rate, %) ^{3/}	m.c.	-2.8	17.2	20.8	21.7	1.6
Money aggregate M1 (growth rate, %)	m.c.	2.0	6.4	17.9	30.7	14.5
Money aggregate M2-denars (growth rate, %)	m.c.	12.6	11.7	31.7	41.1	0.8
Money aggregate M4 (growth rate, %)	m.c.	16.5	15.0	25.0	29.3	11.2
Currency in circulation/M1 (%) ^{4/}	51.0	49.1	47.2	45.5	41.0	34.0
Total bank's credits to the private sector (growth rate, %)	m.c.	25.0	21.0	30.5	39.2	34.4
denar credits	m.c.	19.1	13.6	28.4	42.2	37.3
foreign currency credits	m.c.	56.6	51.2	36.8	30.3	25.3
Total deposits including demand deposits of the private sector (growth rate, %)	m.c.	20.0	17.6	27.1	32.3	12.4
Total deposits of the private sector (growth rate, %)	m.c.	24.2	18.8	27.8	28.8	10.0
denar deposits ^{5/}	m.c.	25.9	16.4	45.9	53.4	-4.5
foreign currency deposits	m.c.	23.3	20.1	18.3	12.9	22.8
Central Bank bills (stock at the end of the period, millions of Denars)	-4,379.0	-4,552.0	-8,921.0	-9,456.0	-20,995.0	-17,418.0
Interest rate on CB bills (average, %)	8.2	8.3	9.8	6.0	5.1	6.5
Lending interest rates (on annual base, average, %)	16.0	12.4	12.1	11.3	10.2	9.7
Deposit interest rates (on annual base, average, %)	8.0	6.5	5.2	4.7	4.9	5.9
Macedonian Stock Exchange turnover (millions of Denars)	n.a.	2,752.0	6,701.7	10,794.8	30,404.5	8,129.6
MBI-10	n.a.	1,351.6	2,292.0	3,702.5	7,740.8	2,096.2
MBID	n.a.	n.a.	n.a.	n.a.	8,413.6	2,213.9
OMB	n.a.	n.a.	n.a.	99.1	105.6	107.6
IV. External sector						
Current account (millions of EUR)	-168.2	-362.7	-121.3	-44.9	-414.8	-851.2
Current account (% of GDP)	-4.1	-8.3	-2.6	-0.9	-7.2	-13.1
Trade balance (millions of EUR)	-753.0	-914.3	-858.5	-1,020.4	-1,174.8	-1,736.7
Trade balance (% of GDP)	-18.3	-21.1	-18.4	-20.1	-20.3	-26.7
Export of goods (growth rate, %) ^{7/}	/	11.8	22.2	15.8	28.3	9.9
Import of goods, f.o.b. (growth rate, %) ^{7/}	/	15.5	10.7	16.9	23.7	22.2
Private transfers (millions of EUR)	556.7	572.7	799.9	923.1	988.2	931.0
Private transfers (% of GDP)	13.6	13.2	17.1	18.2	17.1	14.3
Foreign direct investment (millions of EUR)	100.1	259.7	74.9	344.6	506.9	422.0
Foreign direct investment (% of GDP)	2.4	6.0	1.6	6.8	8.8	6.5
Gross Foreign Reserves (millions of EUR)	723.0	716.9	1,122.9	1,416.7	1,524.4	1,494.9
Average exchange rate, Denar/EUR	61.3	61.3	61.3	61.2	61.2	61.3
Average exchange rate, Denar/USD	54.3	49.4	49.3	48.8	44.7	41.9
REER, deflator CPI (growth rate, %) ^{6/}	-0.7	-3.2	-4.5	-2.1	-2.3	0.6
REER, deflator PPI (growth rate, %) ^{6/}	-1.4	-3.6	-2.2	-0.4	-3.4	0.8
REER, deflator ULC (growth rate, %) ^{6/}	n.a.	-7.2	-9.5	-2.0	-13.8	-10.6
Gross external debt (stock at the end of the period, millions of EUR)	n.a.	2,070.6	2,518.1	2,495.2	2,840.2	3,350.6
public debt	n.a.	1,201.9	1,477.8	1,262.1	1,056.5	1,129.5
private debt	n.a.	868.7	1,040.3	1,233.1	1,783.7	2,221.1
Gross external debt (% of GDP)	n.a.	47.9	53.9	49.1	49.0	51.5

1/ Preliminary data for 2007 and estimated data for 2008, source SSO.

2/ According to GFS methodology (before July 2008, public debt stock was calculated according to GFS methodology, and according to the Law on Public Debt, but after the changes in the Law on Public Debt (July 2008) both calculations were equalized).

3/ Reserve money do not include reserve requirement on forex deposits.

4/ It refers to the annual average.

5/ Denar deposits do not include demand deposits.

6/ REER Index of Denar (base 2003=100, overall trade weights 2006=100); "-" denotes depreciation.

7/ The data series for export and import of goods expressed in euros starts from 2003.

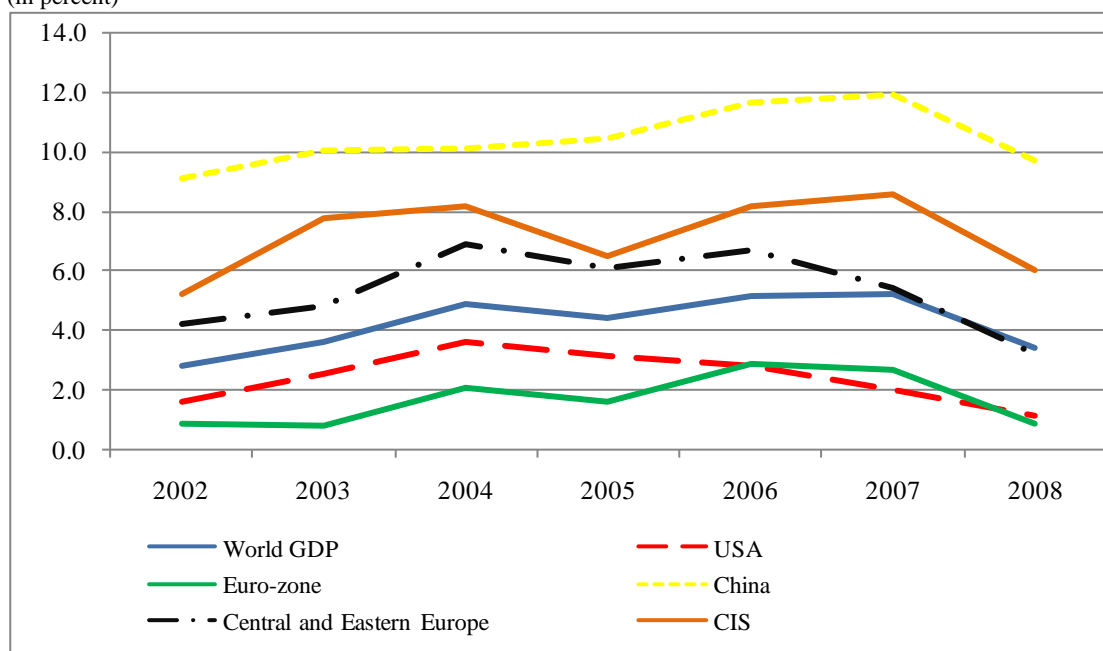
n.a. - Not available.

m.c. - Not available due to methodological changes.

I. Economic developments in the world

In 2008, the global economy² faced with sharp shifts in the trends. In the first half of the year, the growing prices of food and energy increased the inflationary pressures, and the crisis on the mortgage market, which appeared in the USA in August 2007, created uncertainty, producing potential danger from slower growth. The turn of this crisis into a global financial crisis, especially after its escalation in September 2008, meant materialization of the risks from the dramatic slowdown of the global economic activity, when part of the developed countries entered a recession, and in line with such movements the rise in the inflation rate started to slow down significantly. The crisis from 2008 is characterized with high degree of synchronization of the fall in the demand and the supply in a large number of countries, wherefore the expected growth rate of global GDP for the year was adjusted downwardly. The latest estimations indicate growth of global GDP of 3.4% in 2008, which compared with the previous year is a significant slowdown of the growth dynamics of 1.8 percentage points.

Figure 1
Real GDP growth by group of countries and individual country
(in percent)



Source: IMF World Economic Outlook Update January 2009 and European Commission D-G for Economic and Financial Affairs, Interim Forecast, January 2009.

Analyzed chronologically, the reasons for the slowdown of the world economy were mainly due to the spillover effects from the crisis in the USA in 2007, which arose from the sub-prime mortgage market and related structured products. The crisis in the USA intensified in September 2008 with the emergence of the first liquidity problems in two financial organizations on the real estate market (Fannie Mae and Freddie Mac), which was followed by government intervention. The additional intensification of the crisis led to bankruptcy of Lehman Brothers, acquisition of Merrill Lynch by the Bank of America, as well as the acquisition of the world's largest insurance company, American International Group, A.I.G., by the government, in order to avoid its bankruptcy due to the spillover effect on the other financial institutions. The implications from such changed conditions in the financial system of the USA on the global financial system are multidimensional. First, they mean

² The analysis is mainly based on data from the IMF (IMF, World Economic Outlook, November 2008; IMF World Economic Outlook Update, January 2009; IMF Regional Economic Outlook Asia and Pacific, November 2008); ECB (ECB Monthly Report, December 2008 and January 2009); European Commission for Economic and Financial Affairs (European Commission D-G for Economic and Financial Affairs Interim Forecast January 2009); EBRD (EBRD Transition Report 2008).

creating greater risk aversion among financial institutions, potential overrating of risks, followed by insufficient liquidity in the system in general, and solvency was also put in question. As a result of such a condition, the lending terms were significantly tightened and the credit supply by the credit institutions decreased. At the same time, a high degree of uncertainty appeared in the business sector and among consumers, which quickly turned into a significant slowdown of the investment and personal consumption. In such conditions, both the prices of financial and real assets reacted quickly. Thus, the prices of shares on the world stock exchanges fell rapidly, which led to a decline in the value of banks and companies, while the prices on the real estate market declined additionally, especially in the USA and the United Kingdom.

Table 1
Indicators for the world economy

	2003	2004	2005	2006	2007	2008**
				(in %)		
<i>Growth rates of the real gross domestic product</i>	3.6	4.9	4.4	5.1	5.2	3.4
Developed economies	1.9	3.2	2.6	3.0	2.7	1.0
USA	2.5	3.6	3.1	2.8	2.0	1.1
Euro-zone	0.8	2.1	1.6	2.9	2.7	0.9
China	10.0	10.1	10.4	11.6	11.9	9.7
India	6.9	7.9	9.1	9.8	9.3	7.9
Central and Eastern Europe	4.8	6.9	6.1	6.7	5.4	3.2
CIS*	7.8	8.2	6.5	8.2	8.6	6.0
Russia	7.3	7.2	6.4	7.4	8.1	6.2
<i>Growth of the world trade</i>	5.4	10.7	7.6	9.3	7.2	4.1
<i>Rate of inflation</i>						
Developed economies	1.8	2.0	2.3	2.4	2.1	3.5
USA	2.3	2.7	3.4	3.2	2.9	4.2
Euro-zone	2.1	2.1	2.2	2.2	2.1	3.3
China	1.2	3.9	1.8	1.5	4.8	6.4
India	3.8	3.8	4.2	6.2	6.4	7.9
Central and Eastern Europe	10.1	6.3	5.1	5.4	5.6	7.8
CIS*	12.3	10.4	12.1	9.4	9.7	15.6
Russia	13.7	10.9	12.7	9.7	9.0	14.0
<i>Annual change of prices</i>						
Crude oil	15.8	30.7	41.3	20.5	10.7	36.4
Primary commodities	5.9	15.2	6.1	23.2	14.1	7.4
				(in % of GDP)		
<i>Rate of savings</i>	20.8	21.9	22.9	23.9	24.1	24.0
<i>Investment</i>	21.1	22.0	22.5	23.2	23.5	23.5
<i>Nominal exchange rate (US Dollar/ EUR)</i>	1.131	1.244	1.244	1.256	1.371	1.471

Source: IMF, World Economic Outlook October 2008; IMF, World Economic Outlook Update January 2009 and European Commission D-G for Economic and Financial Affairs, Interim Forecast, January 2009.

*Mongolia is included, although it is not a member of the CIS (Commonwealth of Independent States).

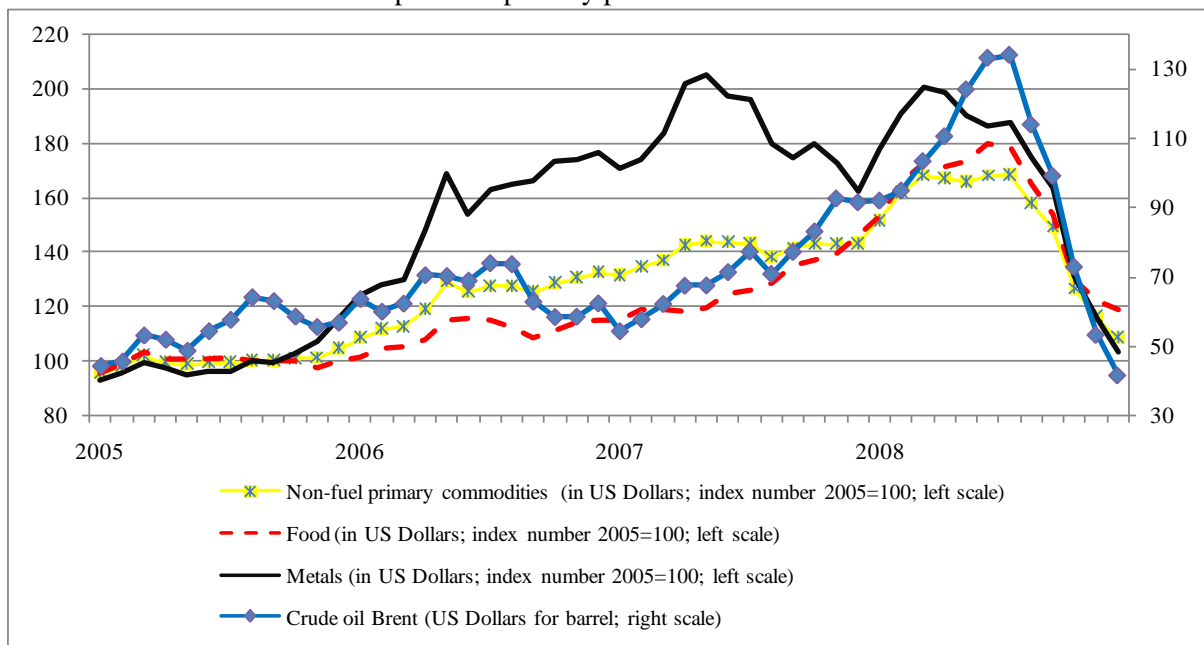
**Estimates, except for the inflation in euro-zone and the Dollar/Euro exchange rate.

The first half of the year was characterized with a trend of intensive rise in the prices of oil and primary products (food and metals), which greatly explains the rise in the inflation in a number of economies. The slowdown of the global demand as a result of the growing uncertainty, was a turning point in the price segment, i.e. it contributed for dramatic decline in the price of these products in the second half of the year. Thus, the prices of crude oil which grew continuously during the first half of the year and in July reached the historical peak in nominal and in real terms, started to descent continuously and significantly since end-August. The average nominal

price of the crude oil Brent reached US Dollar 134 per barrel in July 2008 (annual growth of 73.4%). The reasons for the rapid growth of the oil prices in the first half of the year are primarily the high demand for oil by the emerging Asian economies, primarily China and India. The increase of 1.7 million barrels in the daily production quota by the OPEC countries at the beginning of the year were not sufficient for mitigating the pressures from the demand. The insufficient production capacities of the oil-exporting countries, the low oil supply elasticity relative to the rise in the prices, and also the reduced extraction of oil from the Northern Sea and the Mexican Gulf are considered to be additional factors for the rapid growth of the oil price. Starting from end-August, oil prices began to fall continuously and in December they were reduced down to 42 US Dollars per barrel (annual fall of 54.8%), given a lower demand for oil by the OECD countries and the emerging economies, and an increase in the oil stocks in the USA.

Figure 2

Movement of the index of world prices of primary products and crude oil



Source: IMF, monthly database, February 2009.

The prices of primary products (food and non-energy products) registered the same annual dynamics, as well as the oil prices, reaching their peak in July 2008 (annual growth of 17.7%), which, along with the increased demand, partially reflects the transmission effect from the rise in the oil prices. Oil prices influence the processing and transport of these products, especially metals. Most of the rise in the index of primary products was generated by the increase in the food prices. The food prices index reached its historical peak in June 2008, with an annual increase of 44.2%. Their increase in the first two quarters of the year was primarily triggered by the higher demand from the emerging economies, but also by factors on the supply side (low stocks). Additional factor that contributed to the increase in the food prices is the rise in the production of bio fuels, as a response to the increased demand for energy products, which has caused direct increase in the prices of wheat, corn and soya. However, starting from the third quarter until the end of 2008, there was a significant decline in the food prices (annual fall of 18.4% in December), caused by the decline in the demand in the emerging economies. Prices of metals, which grew continually throughout the first quarter of the year (annual growth of 7.9%, with the highest growth in the prices of nickel, lead, metal ore and aluminum), gradually declined, starting from the second quarter of the year, which indicated weakening demand and spilling of the financial crisis over the real economy. However, more significant fall in the metal prices was registered in the last quarter of the year (average annual fall of 31.9%), with the most notable annual drop being registered in the prices of nickel, lead and zinc of 61.2%, 62.6% and 54.7%, respectively. From a viewpoint of the Macedonian economy, especially important is the movement of the prices of nickel on the world markets, due to its high share in the overall exports of the country.

Thus, in the first three months of the year, the nickel prices continually grew at an average monthly rate of 6.1%, while since April they started to fall gradually, with the most significant quarterly decline of 42.5% being registered in the fourth quarter of the year.

The changes in the economic trends during the year implied changes in the challenges that the carriers of the macroeconomic policies faced with. In the first half of the year, the main focus of the monetary authorities was the stabilization of the inflation, while in the second half the focus of the monetary and fiscal policies was moved to the stabilization of the financial markets, as well as mitigation of the effects on the decline in the economic activity. From a viewpoint of the monetary policy conduct, as a result of the increase in the inflation in the first two quarters of the year, several central banks increased the key interest rates on several occasions. However, with the escalation of the financial crisis and its spillover to the real sector of the economy, the inflationary pressures significantly diminished. Under such conditions, monetary authorities made a shift towards policy of monetary easing, when the central banks of a number of countries worldwide (USA, ECB, England, China, Japan, etc.) reduced their key interest rates on several occasions³. Such changes in the monetary policy conduct were supplemented by measures for stabilization of the financial markets, increase in the already deteriorated liquidity in the banking sector and regaining the confidence of the economic agents. At the same time, certain countries also introduced measures towards increasing the guarantees of coverage of banks' liabilities (deposits). The measures introduced by the monetary policy makers were supplemented by appropriate fiscal measures. Certain countries in the world (USA, European Union member states, United Kingdom, China, etc.) approved fiscal packages for purchasing the illiquid assets of banks and stocks of the financial institutions in jeopardy, in order to prevent further deepening of the crisis and partially reduce the created mistrust in the economic agents.

Analyzed from a viewpoint of the individual group of countries according to the level of development of the economies, the financial crisis and the negative effects arising from it, were of different intensity in different countries. Thus, the financial crisis spread most rapidly in the developed countries and very quickly it spread over the real sector of the economy, so that a number of them registered negative quarterly growth rates in the last two quarters of the year. On the other hand, in the emerging economies and the economies in transition, the crisis spilled over with a certain time lag.

1.1. Developed countries in 2008

The high level of integration of the financial markets of the developed countries led to a rapid spillover of the financial crisis from the USA to the United Kingdom and the developed countries from the Euro area. Consequently, the GDP growth dynamics in these countries in 2008, significantly slowed down and was reduced to 1%, while in the last quarter of the year a large number of the countries faced negative quarterly growth rates. The inflation rate reached 3.5% and it is significantly higher relative to the preceding year, which comes as a result of the high inflationary pressures during the first half of the year. The inflationary pressures significantly reduced in the second half of the year. Additional feature of the developed countries during 2008, is the increase of the budget deficits, which reached 3.2% of GDP, as opposed to 2.2% of GDP in 2007, which is mostly due to the undertaken fiscal measures for mitigating the negative effects from the crisis. Significant increase was registered in the unemployment rate, which was especially pronounced in some countries, such as USA, United Kingdom and Japan.

³ The central banks of USA, United Kingdom and Japan were continuously reducing the key interest rates during the entire 2008. In the first three quarters of the year, the ECB increased the key interest rate on several occasions due to the increased inflationary pressures, while in the last quarter of the year it started to reduce it gradually.

Table 2
Economic indicators for the developed countries in inflation

	GDP (real growth rates in %)			Average inflation (in %)			Unemployment rate (in %)			General government fiscal balances (% of GDP)			Current account balance of balance of payments (% of GDP)		
	2006	2007	2008*	2006	2007	2008	2006	2007	2008*	2006	2007	2008*	2006	2007	2008*
Developed economies	3.0	2.7	1.0	2.4	2.1	3.5	5.6	/	/	-2.4	-2.2	-3.2	-1.3	-0.9	-1.0
USA	2.8	2.0	1.1	3.2	2.9	4.2	4.6	4.6	5.8	-2.2	-2.7	-4.1	-6.0	-5.3	-4.6
Japan	2.4	2.4	-0.3	0.3	0.1	1.6	4.1	3.8	4.1	-3.8	-3.2	-3.4	3.9	4.8	4.0
EU	3.1	2.9	1**	2.3	2.4	3.7	8.2	7.1	7.0	-1.4	-0.9	-2.0	-0.5	-0.5	-1.0
United Kingdom	2.8	3.0	0.7	2.3	2.3	3.4	5.4	5.3	5.7	-2.7	-2.7	-4.6	-3.4	-2.8	-2.3
Euro-zone	2.9	2.7	0.9**	2.2	2.1	3.3	8.3	7.5	7.5	-1.3	-0.6	-1.7	0.2	0.2	-0.4
Germany	3.0	2.5	1.3**	1.8	2.3	2.8	9.8	8.4	7.1	-1.5	-0.2	-0.1	6.3	7.6	7.1
France	2.2	2.2	0.7**	1.9	1.6	3.2	9.2	8.3	7.8	-2.4	-2.7	-3.2	-2.1	-2.8	-3.8
Italy	1.8	1.5	-0.6**	2.2	2.0	3.5	6.8	6.1	6.7	-3.4	-1.6	-2.8	-2.0	-1.7	-2.2
Greece	4.5	4.0	2.9**	3.3	3.0	4.2	8.9	8.3	8.3	-2.8	-3.5	-3.4	-11.4	-14.0	-13.4

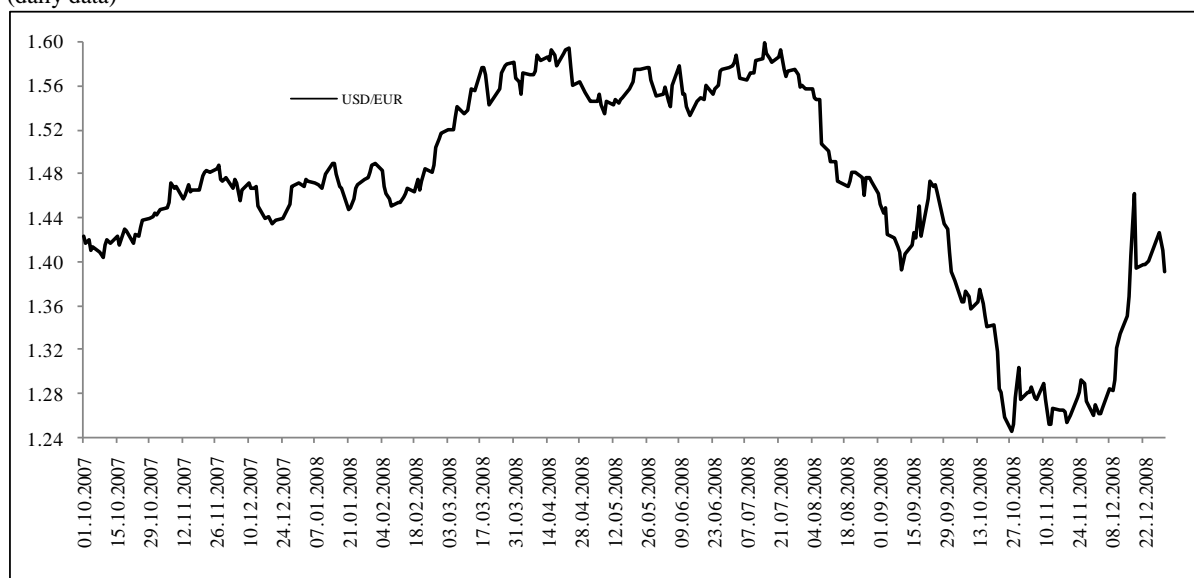
Source: IMF, World Economic Outlook October 2008; IMF, World Economic Outlook Update January 2009 and European Commission D-G for Economic and Financial Affairs, Interim Forecast, January 2009.

* Estimate.

Analyzed from a viewpoint of the individual economies, the real GDP growth rate of the USA in 2008 was 1.1%, with a simultaneous growth of the inflation rate of 1.3 percentage points relative to 2007. As for the annual dynamics, significant slowdown in the GDP growth was registered starting from the beginning of the year, while in the third and in the fourth quarters of the year, when the financial crisis intensified, an annual decline of 0.5% and 6.2%, respectively, was registered. In conditions of a more difficult access to financial assets and growing uncertainty, the consumption and investments of the private sector significantly reduced. In such circumstances, there were negative developments on the labor market, i.e. increase in the unemployment, which went up by 1.2 percentage points on annual level. As a reaction to such changes in the economy FED lowered the key interest rate on several occasions during 2008, bringing it down from 4.25% at the end of 2007 to 0.25% at the end of 2008. As a fiscal measure for improving the liquidity in the banking system, in October 2008, a package of 700 billion US Dollars was approved for purchasing illiquid assets, purchasing real estate and recapitalization of the financial institutions with problematic assets. As a result of the increased fiscal expenditures, budget deficit has deepened and reached 4.1% of GDP. Relative to the external sector, an improvement was registered in the current account deficit of 0.7 percentage points, which is partially a result of the depreciation of the US Dollar relative to the more important world currencies in the first half of the year.

In conditions of a retained trend of depreciation of the US Dollar relative to the Euro, on July 15, the US Dollar reached the historically lowest level relative to the Euro, when 1.6 US Dollars were exchanged for one Euro, which is a depreciation of 8.6% compared with the end of 2007. The reasons for the decline in the value of the US Dollar are due to the entering of the US economy into recession in 2008, turbulent movements on the financial markets, as well as the negative perceptions about the future economic growth of the USA. Additional factor for the depreciation of the US Dollar is the increase of the interest spreads between the key interest rates of FED and ECB, as a result of their divergent movements in this period of the year (continuous reduction of the interest rate by the FED as opposed to its continuous increase by the ECB). However, from the beginning of August until the end of 2008, there was a trend of gradual appreciation of the US Dollar relative to the Euro, with the average monthly exchange rate Dollar/Euro equaling 1.34 in December. Such a trend of appreciation of the US Dollar may be explained with the worsened perceptions of the economic agents about the economic growth in the Euro Area, as a result of the broadening of the financial crisis and the gradual stepping into recession of part of the Euro-area member states, as well as with the reduction of the reference interest rate of the ECB.

Figure 3
Movement of the USD - Euro exchange rate
(daily data)



Source: ECB, February, 2009

The Japanese economy entered a recession in the second half of 2008, when for the first time after 2001 two consecutive negative quarterly growth rates were registered. Thus, the annual GDP growth rate is negative and equals 0.3%. The reasons for such a decline in the economic activity are in the financial crisis, which has completely spread over the real sector of the Japanese economy. Dramatic deterioration in the business climate has been registered, which is estimated to be the worst since 1975⁴, and which has resulted in reduced output in all industrial segments, especially in the automobile industry. The significant decline in the private consumption, as well as the net exports had an additional contribution for the slowdown in the economic activity, which is partly due to the appreciation of the Yen relative to the US Dollar in the second half of the year. In accordance with such movements, the Bank of Japan reduced the reference interest rate on couple of occasions during 2008, which equaled 0.3% at the end of the year.

Similarly to the American and Japanese economies, **the effects from the financial crisis quickly spread over the real sector of the economies of the member states of the European Union and the Euro area.** The member states of the European Union and the Euro area registered negative quarterly growth rates of GDP as early as in the second quarter of the year, with the Euro area facing a recession for the first time since its establishment. The annual GDP growth rates for the European Union and the Euro area for 2008 were adjusted downwardly on couple of occasions and they equal 1% and 0.9%, respectively, which is a significant slowdown of the growth dynamics compared with the previous years. Production sectors that were most severely hit by the crisis are industrial output and construction, with negative quarterly growth rates since the second quarter of the year. Within industry, largest decline was registered in the production of intermediary and capital goods, as well as in the automobile industry where the production in several factories was temporarily stopped. The unemployment in the Euro area started to rise more rapidly from the month of July, which was followed by a decline in labor productivity. Thus, the unemployment rate in December 2008 reached 8%, as opposed to 7.2% at the end of 2007. The largest increase in unemployment was registered in Spain, France and Republic of Ireland. However, as a result of the increased employment in the first half of the year, the average annual unemployment rate remained unchanged relative to the preceding year (7.5%).

⁴ According to the Tankan survey conducted by the Bank of Japan.

The inflation in the Euro area continuously increased during the first half of the year, reaching historical peak of 4% in June and in July. Such an increase in the price level reflects the higher prices of oil and food, primarily processed food. Growing unit labor costs were an additional factor for the increase in the inflation. During the last two quarters of the year, in conditions of lower demand, the inflation rate started to decline gradually, and it was reduced down to 1.6% in December. The average annual inflation rate equals 3.3% and it is significantly larger compared with the previous two years, whereby the implicit intermediate target of ECB of 2% was exceeded. Some of the member states of the Euro area (Belgium, Slovenia and Greece) failed to fulfill the Maastricht criterion for the movement of the price level, according to which the highest inflation rate should not exceed the average of the three countries with lowest inflation in the Euro area, augmented by 1.5 percentage point.

The monetary reaction of the ECB during 2008 corresponds with the curve of movement of the inflation. Thus, in the first half of the year, as a result of the intensive growth of the inflation, ECB increased the key interest rate, which reached 4.25% in July 2008. In the second half of the year, the intensification of the financial crisis and its spillover to the real sector implied a significant reduction of the inflationary pressures. In such conditions, ECB changed the monetary policy stance, lowering the key interest rate on several occasions, which was reduced down to 2.5% in December. From a viewpoint of the measures for mitigating the negative consequences from the crisis, in November 2008 a European Economic Recovery Plan was adopted, which includes a package of measures at the level of the European Union and at the national level of individual member states. In the package of adopted measures, most distinctive was the fiscal package of measures in the amount of 200 billion Euro, i.e. 1.2% of the GDP of the European Union, which envisages increased transfers for the unemployed persons and low-income households, extended duration of the social benefits for the unemployed, as well as infrastructural investments and projects.

Similarly as in the other developed countries, the financial crisis and the negative effects were directly transferred to the United Kingdom, where a slowdown in the economic activity was registered in the second quarter of 2008. The growth rate in 2008 significantly dropped and equaled 0.7%. The reasons for decelerated economic activities arise from the lower private consumption and decreased investments in fixed assets. Despite the slower growth dynamics, in conditions of increased prices of oil and primary products, in the first half of the year the United Kingdom registered an annual inflation of 3.4%, which is a significant digression from the target of the Bank of England of 2%. However, having in mind the expectations for reduced inflationary pressures in conditions of a significant slowdown of the economic growth, the Bank of England shifted towards conducting more relaxed monetary policy. Thus, the key interest rate was continuously lowered and from 5.5% at the end of 2007 it was reduced down to 1.5% at the end of 2008. Such measures were accompanied by fiscal policy measures, so that the VAT rate was reduced by 2 percentage points. The effects from the crisis were spilled over also to the foreign exchange market, where the British Pound continually depreciated relative to the Euro during 2008, falling down to the historically lowest level of 0.98 GBP per one Euro on December 29, when their parity became almost equal.

1.2. Emerging Asian economies in 2008

The effects from the financial crisis spilled over the emerging Asian economies, with a certain delay. Unlike the developed economies which officially entered a recession in 2008, the effects from the crisis in the emerging Asian economies manifested with slower growth. The growth rate in these economies of approximately 9% in the past two years, was reduced to 7.7%. Main reasons for the slower economic growth were the rapid fall of the stock exchange indices, decline in the capital inflows and portfolio investments from the developed economies due to the intensification of the crisis, but also due to the reduced confidence of the investors. Softening of the domestic demand, weakening of the external demand and decline in the prices of real property were additional factors for slowing down the economic growth. During 2008, this group of countries faced with rapid growth in inflation which equaled 7.3% (increase of 2.4 percentage points compared with 2007), as a result of

the increase in the world oil and food prices due to the high import dependence on these products. As a result of the reduced external demand for the products from these countries, the current account surplus as a percentage of GDP reduced by 1.6 percentage points relative to 2007. From a viewpoint of the monetary policy, central banks of the emerging economies gradually increased the key interest rates in the first half of the year due to the high inflationary pressures, while in the second half of the year they made a shift towards more relaxed monetary policy. In the area of fiscal policy, most of the countries have not undertaken any measures yet, due to which the budget deficit (0.6% of GDP) does not register significant fluctuations relative to the past two years.

Table 3
Economic indicators for the emerging Asian economies

	GDP (real growth rates in %)			Average inflation (in %)			Central government budget (% of GDP)			Current account balance of the balance of payments (% in GDP)		
	2006	2007	2008*	2006	2007	2008*	2006	2007	2008*	2006	2007	2008*
Emerging economies from Asia	9.2	9.3	7.7	3.8	4.9	7.3	-1.1	0.0	-0.6	5.8	6.8	5.2
South Asia ¹	9.2	8.7	7.6	6.5	6.9	8.8	/	/	/	-1.4	-1.7	-3.3
ASEAN-5 ²	5.7	6.3	5.5	8.1	4.4	9.6	-1.0	-1.6	-1.6	4.8	5.1	2.7
Newly-industrialised economies from Asia ³	5.6	5.6	4.0	1.6	2.2	4.8	0.6	2.2	-0.1	5.3	6.2	4.7
China	11.6	11.9	9.7	1.5	4.8	6.4	-0.7	1.0	0.8	9.4	11.3	9.5
India	9.8	9.3	7.9	6.2	6.4	7.9	-3.4	-2.8	-3.8	-1.1	-1.4	-2.8

1/ Includes: India, Pakistan and Bangladesh.

2/ Includes: Indonesia, Thailand, Filipins, Malezia and Vietnam.

3/ Includes: South Korea, Taiwan (the province of China), Hong Kong and Singapore.

* Estimate.

Source: IMF, World Economic Outlook, October 2008 and IMF, Regional Economic Outlook Asia and Pacific, November 2008.

The economies of China and India, which were the main generators of the global economic growth in recent years, in 2008 they registered a significant slowdown in the economic growth, reflecting to a large extent the reduced external demand. Thus, their growth rates in 2008 were by 2.2, i.e. by 1.5 percentage points lower relative to the previous year, but they remained on a relatively high level and equaled 9.7% and 7.8%, respectively. Main generators of the economic growth are the strong domestic demand (investment and private consumption) and the net exports. However, as a result of the financial crisis in the world and the lower external demand, the current account surplus in China plunged by 1.8 percentage points compared with 2007 (still remaining on a high level of 9.5% of GDP), while in India the current account deficit deepened additionally and reached 2.8% of GDP.

1.3. Countries in transition in 2008⁵

The economic activity in the transition countries during 2008, slowed down compared with the fast economic growth in the preceding two-year period, and the effects from the financial crisis came later than in the developed countries. GDP growth rate is expected to reach 6.3%, which is a slowdown of 1.2 percentage points compared with 2007, when the largest expansion has been registered since the beginning of the transition period. From a viewpoint of the annual

⁵ It refers to the Central-Eastern European and Baltic countries (CEB) - Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, Slovenia, South-Eastern Europe (SEE) - Bulgaria, Croatia, Romania, Albania, Bosnia and Herzegovina, Macedonia, Montenegro, Serbia and the Commonwealth of Independent States - Russia, Armenia, Azerbaijan, Belarus, Georgia, Moldova, Ukraine, Kazakhstan, Kyrgistan, Mongolia, Tadjikistan, Turkmenistan, Uzbekistan, including Mongolia (CIS).

dynamics, strong economic growth in majority of the transition economies was registered in the first three quarters of the year, while in the last quarter the economic activity decelerated significantly, reflecting the spillover effects from the global crisis. Main generators of the economic growth in the first three quarters of the year were the strong domestic demand, boosted by foreign investments and high credit expansion, and exports. In the last quarter of the year, however, the effects from the world financial and economic crisis in most of the transition economies were felt through a significant decline in the industrial output and the activity in construction, reduced inflow of foreign direct investments and downward trends on the financial markets. The effects from the crisis reflected significantly on the banking system and credit activity. Due to the increased risk in the world, banks were faced with smaller opportunities and increased costs of external financing (increase in foreign interest rates). Such changes were reflected through reduced inflow, primarily of syndicated loans, which was especially evident in the countries of South-Eastern Europe, Baltic countries and the Commonwealth of Independent States. Under such conditions, domestic banks have tightened the lending terms and have increased the interest rate spreads due to the higher costs for their financing. Thus, in 2008 (especially in the last quarter), credit growth, as one of the main sources of financing the economic entities in this group of countries, significantly reduced, while the risk premia went up and the average maturity of the issued banking loans was reduced.

Table 4
Economic indicators for the countries in transition

	GDP			Average inflation		
	(real growth rates in %)			(annual change in %)		
	2006	2007*	2008**	2006	2007*	2008**
Transition economies	7.3	7.5	6.3	6.4	7.4	12.0
<i>Central and Eastern Europe</i>	6.4	6.3	4.3	3.7	5.3	8.1
<i>South Eastern Europe</i>	6.6	6.2	6.5	4.9	4.2	8.4
<i>Commonwealth of Independent States</i>	8.0	8.5	7.3	8.5	10.4	16.9

Source: EBRD, Transition Report 2008.

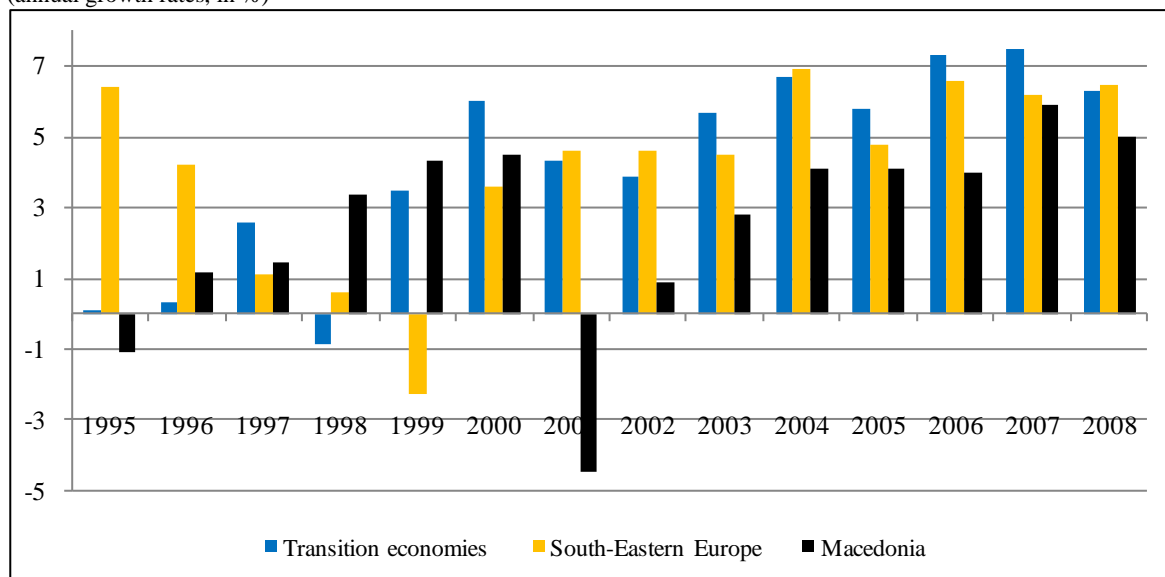
* Estimate.

** Projection.

*** The data for inflation are final.

The average inflation in the countries in transition in 2008 reached 12%, which was a significant increment of 4.6 percentage points compared to the preceding year. The increase in the price level is mainly due to the world rise in the prices of food, energy products, but also the rise of core inflation as a result of the pressures from the labor market, i.e. the rise in wages and credit expansion. From a viewpoint of the monetary policy conduct, most of the transition countries conducted more restrictive monetary policy during 2008, gradually increasing the key interest rates due to the intensified inflationary pressures.

Figure 4
Gross domestic product
(annual growth rates, in %)



Source: EBRD, Transition Report, 2008.

Analyzed from a viewpoint of the individual group of countries within the transition economies, the effects from the financial crisis were most evident in the Central-Eastern Europe and the Baltic countries (CEB). The GDP growth rate in this group of countries is 4.2% and it declined by 2 percentage points relative to the preceding year, which is the largest decline in the annual GDP growth dynamics in the past 15 years. The largest deceleration of the economic activity was registered in the Baltic countries, among which most distinguished was Estonia with a negative GDP growth rate of 0.1% in 2008. The reasons for the decelerated economic growth in the CEB countries were mostly due to the effects of the world crisis, which have directly affected all segments of the economy. The effects mainly pertain to the decline in the external demand, tightening of the lending terms, and significant deceleration of the inflow of foreign capital. At the same time, the prices of real property on the real property market declined, which had an adverse effect on the construction and industrial output.

The CIS countries (Commonwealth of Independent States) registered the highest GDP growth rate among the transition economies (rise of 7.3%), again in 2008. The relatively high rate of economic growth was mostly a result of the increased foreign exchange inflow in the first half of the year on the basis of the export of natural resources (oil, gas and metals). However, since the second half of the year, as a result of the reduced demand and the fall in the prices of energy products and primary products on the world markets, their foreign exchange inflow was significantly reduced, which acted toward slowing down the growth dynamics of the domestic consumption. Reduced foreign exchange inflow resulted in slower GDP growth dynamics by 1.2 percentage points, compared with 2007. Additional factors for deceleration of the intensity of the economic activity are the reduced domestic lending by banks due to the effects from the financial crisis, but also the significant outflow of foreign capital from this region, especially after the conflict between Russia and Georgia in August 2008.

Unlike the CEB countries, **the effects from the world crisis came with greater delay also to the countries of South-Eastern Europe (SEE), slowing down the growth dynamics in the last quarter of the year.** The effects from the crisis were most prominent in several segments of the economy, stock exchanges, banking system and the foreign exchange market. Thus, rapid decline in the stock exchange indices, which started at the end of September and in the beginning of October 2008, was registered in almost all SEE countries, partially caused by the lower stock exchange turnover, as well as by the significantly lower inflow of portfolio and foreign direct investments.

Additional effect from the crisis was felt also in the banking sector, where due to the decelerated economic growth there was a significant increase in the non-performing loans, which acted toward tightening of the lending terms. At the same time, the banking system was faced with rapid deposit withdrawal, especially of natural persons, as a result of the increased uncertainty and fear from additional deterioration of the overall economic activity. Reduced activity was registered also in the interbank money market, where liquidity and confidence for interbank trading significantly declined. The increasing mistrust and uncertainty of the economic agents from the SEE countries, as well as the weakening of the external demand and exports, resulted in an increased demand and reduced supply of foreign exchange, which increased the pressures for depreciation of the exchange rates in this group of countries.

Table 5
Economic indicators for the transition economies, by country

	GDP			Average inflation			Current account balance of the balance of payments			General government fiscal balance		
	(real growth rates in %)			(in %)			(in % of GDP)			(in % of GDP)		
	2006	2007*	2008**	2006	2007	2008	2006	2007*	2008**	2006	2007*	2008**
Albania	5.5	6.0	6.1	2.5	3.1	3.4	-6.5	-10.6	-10.7	-3.3	-3.4	-5.2
Bosnia and Herzegovina	6.7	6.8	6.0	6.1	1.5	7.5	-8.5	-12.8	-14.7	2.6	1.3	-2.3
Bulgaria	6.3	6.2	6.0	7.4	7.6	12.0	-17.9	-21.7	-21.2	3.0	3.4	3.7
Macedonia***	4.0	5.9	5.0	3.2	2.3	8.3	-0.9	-7.2	-13.1	-0.5	0.6	-1.0
Romania	7.9	6.0	7.5	6.6	4.9	7.9	-11.8	-14.4	-13.3	-2.2	-2.5	-2.8
Serbia	5.5	7.5	7.0	11.8	6.8	12.9	-9.8	-12.9	-17.3	-2.6	-2.7	-2.5
Croatia	4.8	5.6	3.8	3.2	2.9	6.1	-7.9	-8.6	-9.9	-3.0	-2.3	-2.0
Montenegro	8.6	10.3	7.0	2.9	4.2	8.4	-24.7	-32.5	-36.8	4.2	6.3	0.9

Source: EBRD, Transition Report 2008, the data on inflation are taken from each country's statistical office respectively.

* Estimate, except for Macedonia where the data refer to the actual accomplished real macroeconomic indicators.

** Projection.

*** The data on the Republic of Macedonia are taken from the respective official institutions.

From a viewpoint of the real economy, common for this group of countries is the fact that during the first half of the year most of the SEE countries registered exceptionally high quarterly GDP growth rates, i.e. one of the highest quarterly growth rates since the beginning of the transition period (Albania, Bosnia and Herzegovina, Macedonia, Montenegro, Serbia, Bulgaria and Romania). Thus, the average annual GDP growth rate for the SEE countries in 2008 additionally intensified by 0.2 percentage points compared with the previous year and reached 6.5%, which points to the fact that the effects from the financial crisis have not spilled over the real segments of the economy. The high rise in this group of countries was mainly generated by the exports and the domestic consumption, primarily investments. From among the SEE countries, the highest annual GDP growth rate of 7.5% was registered in Romania, generated mainly by the domestic consumption, supported by the high credit expansion. From a viewpoint of the other SEE countries, the economic activity during 2008 was additionally accelerated in Albania with an annual GDP growth rate of 6.1%. Countries that were most severely hit by the financial crisis, the effects of which on the real sector of the economy were felt as early as in the second half of the year, were Montenegro and Croatia. Their annual GDP growth rates are 7% and 3.8%, and were reduced by 3.3 percentage points, i.e. 1.8 percentage points compared with 2007. From a viewpoint of the price level, the average inflation rate in the SEE countries additionally intensified in 2008 and reached 8.1%, and it was generated primarily by the growth in the prices of food and oil. However, the reduced world prices of these products significantly reduced the inflationary pressures in the second half of the year. The rise of core inflation as a result of the higher labor costs and reduced unemployment but also of the credit expansion, put an additional pressure on the rise of the price level. The rise in the inflation was boosted by the conduct of a procyclical budget spending in some of the SEE countries. As a result of the higher inflationary pressures, central banks in these countries were generally oriented toward conducting restrictive monetary policy through gradual increase in the key interest rates.

Table 6
Indicators of progress in the transition in 2008

	Enterprises			Markets and trade			Financial institutions		Infrastructure
	Large-scale privatisation	Small-scale privatisation	Corporate & enterprise restructuring	Price liberalisation	Trade & foreign exchange system	Competition policy	Banks' reforms and liberalisation of the interest rates	Markets of Securities & and non-banking financial institutions	Infrastructural reforms
Albania	3+	4	2+	4+	4+	2	3	2-	2+
Bosnia and Herzegovina	3	3	2	4	4	2	3	2-	2+
Macedonia	3+	4	3-	4+	4+	2+	3	2+	2+
Serbia	3-	4-	2+	4	4-	2	3	2	2+
Croatia	3+	4+	3	4	4+	3-	4	3	3
Montenegro	3+	4-	2	4	4	2-	3	2-	2

Source: EBRD, Transition Report 2008.

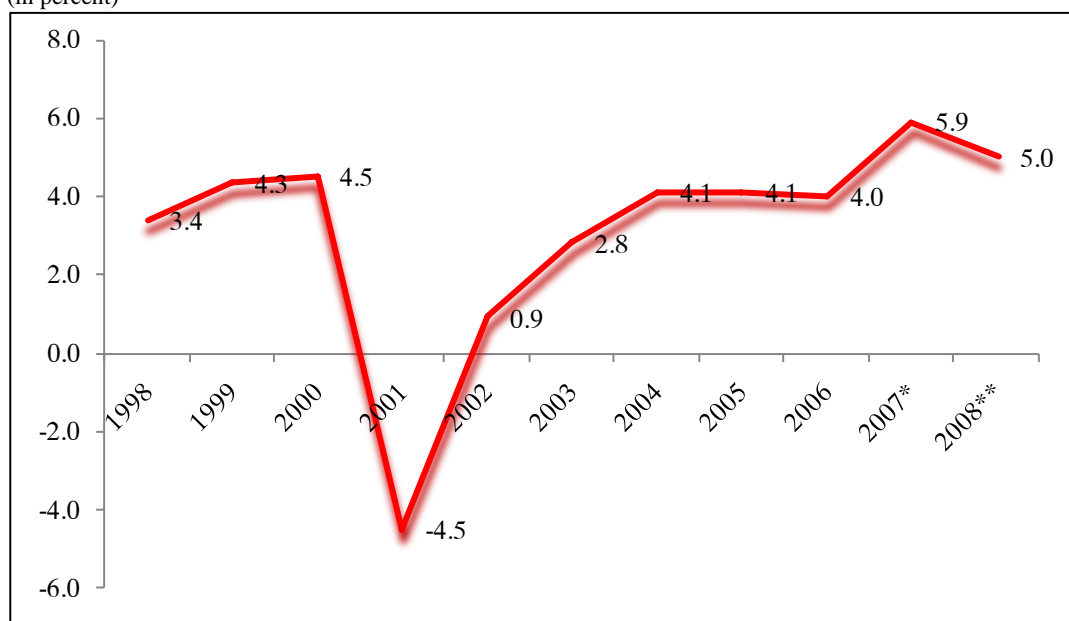
The pace of structural and institutional reforms in the transition countries continued during 2008, and it was estimated that better progress was made in adopting and implementing the reforms, compared with the previous year. From a viewpoint of the individual groups of countries, this year the greatest progress was made in the SEE countries. Such changes were expected having in mind the fact that the CEB countries already are in a more advanced transition stage and at the same time they are members of the European Union, whereas a significantly smaller progress was made in the CIS countries. From among the SEE countries, the greatest progress was made in Romania and in Bulgaria, in accordance with their accession to the European Union, with the greatest reforms being made in the liberalization of the banking sector and the other financial institutions (insurance and leasing companies). In the countries of the Western Balkans, the greatest reforms were made in Bosnia and Herzegovina, Montenegro and Serbia, in accordance with signing of the Stabilization and Association Agreement with the EU. Progress in the reforms was registered also in Albania in the area of privatization of large companies, through the sale of the AMRO oil company. In the Republic of Macedonia, the greatest reforms were made in the banking sector, by adopting and implementing the new Banking Law, but also by the overall improvement of the banking operations.

II. Economic developments in the Republic of Macedonia

2.1. Economic activity

In 2008, the economic growth rate in the Macedonian economy reached 5%, with high growth rates in the first three quarters of the year. Unlike the previous year, when services sectors were the main generators of GDP growth, in 2008, besides in trade, good results were achieved in primary and secondary activities (agriculture, industry and construction). However, positive trends were interrupted in the last quarter, when the world economic crisis started to affect the real sector more severely. The external shock mainly hit the industrial sector and significantly affected the expectations of the economic agents.

Figure 5
Real GDP growth rates
(in percent)



Source: State Statistical Office.

* Preliminary data.

** Estimated data.

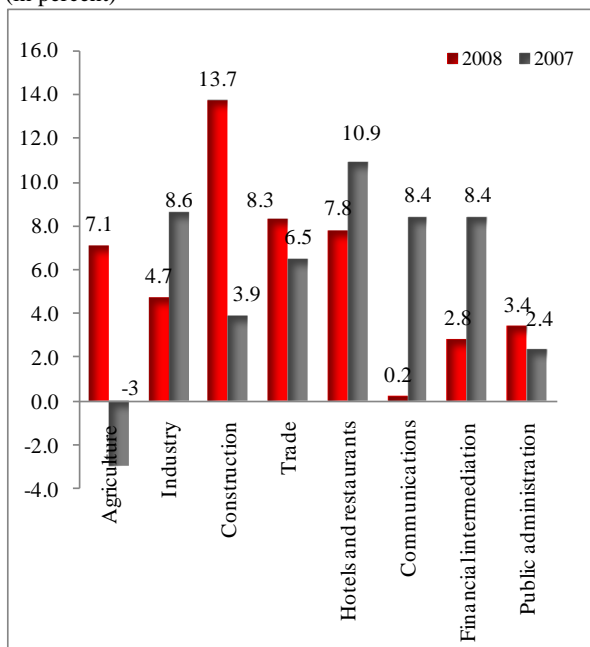
The optimistic expectations in the first three quarters of the year, significantly supported by bank credits, were a reason for continuous growth of the personal consumption and were a basis for the accelerated investment cycle. At the same time, government's behavior significantly contributed to the growth of domestic demand, through increased public consumption and growth of government capital investments. In the same period, the high consumption combined with the increased import prices of energy products and food, created pressures on the imports, which significantly deteriorated the trade balance. In the last quarter of the year, perceptions for reduced future income contributed to a decline in the investment consumption. At the same time, in this period the lower external demand caused a decline in the exports, too. Due to the high dependence of export on import and slower domestic demand, a decline was registered also in the imports.

2.1.1. Domestic supply

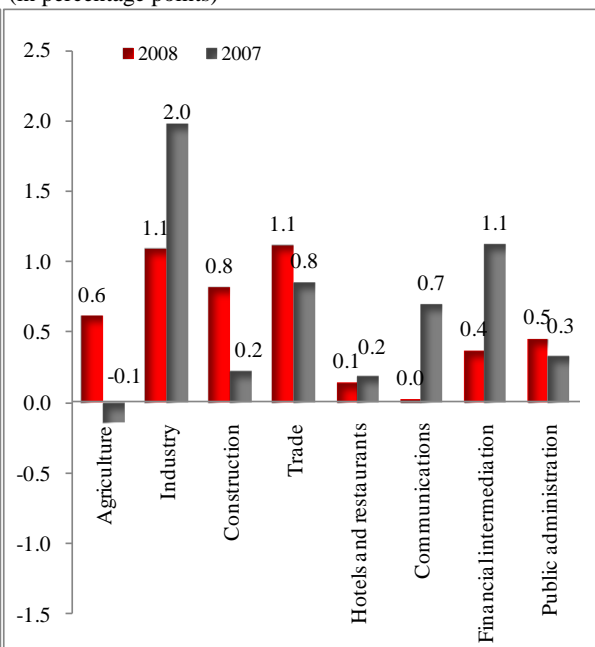
In 2008, the contribution to the growth was dispersed among several sectors of the domestic economy. In general for the entire year, domestic trade had the largest contribution to the GDP growth, while growth dynamics was primarily led by the developments in industry. Favorable weather conditions, together with the increased government subsidies caused favorable developments

in the agriculture, while construction, under the influence of government capital investments and foreign direct investments intensified significantly. Contrary to the good results achieved in these activities, the growth in some services (transport and communications and financial intermediation) registered a significant deceleration relative to the preceding year.

Figure 6
Real growth of individual sectors
(in percent)

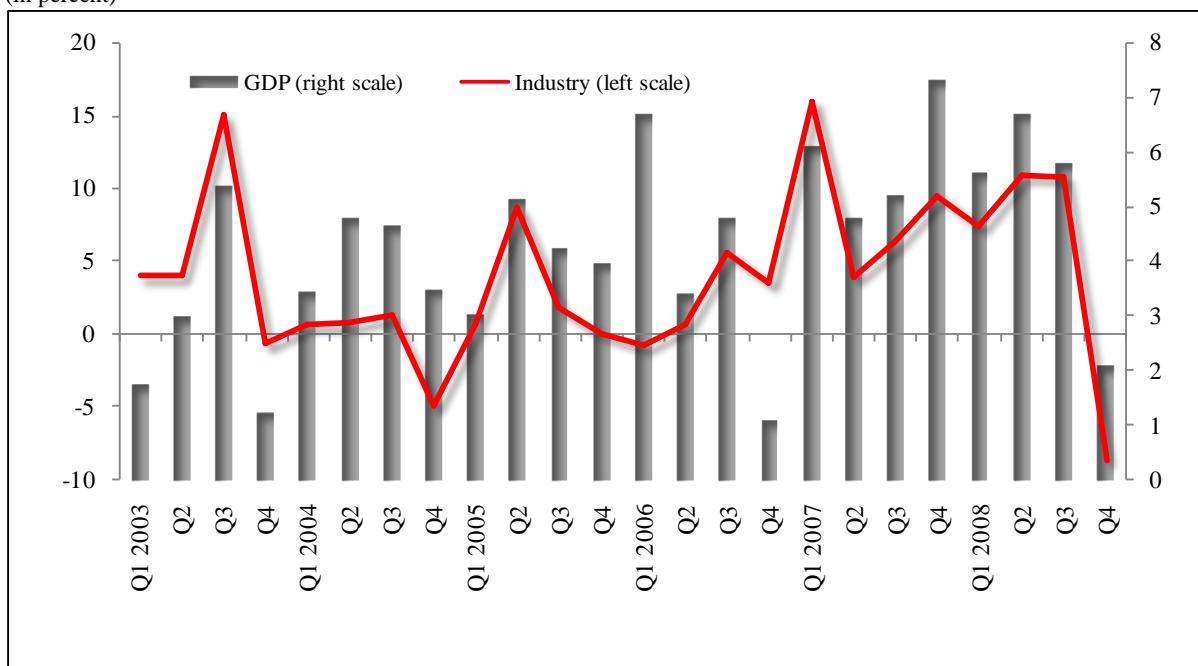


Shares in the real GDP growth
(in percentage points)



Source: State Statistical Office and calculations of the NBRM.

Figure 7
Annual rates of real growth of value added in industry and GDP
(in percent)



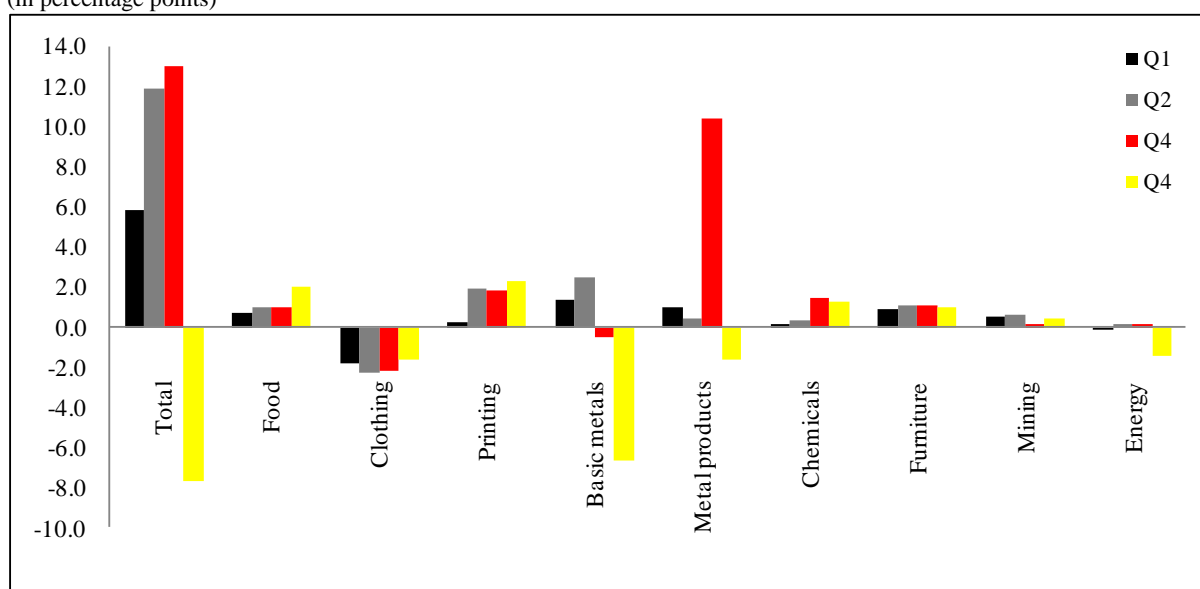
Source: State Statistical Office.

Economic growth dynamics during 2008 primarily reflects the results achieved in the industrial sector. Positive tendencies in the industrial production registered in 2007 continued in the first half of 2008, under the influence of the still high prices of metals and the demand for metals, so that the volume of industrial output grew significantly, which had a notable effect on the overall growth of the economy in the same period. In the third quarter of the year, the high growth of the production of metal products was the reason for maintaining the high growth rate of the overall industrial output and of GDP. Consequently, for the first three quarters, the real growth rate of value added in industry equaled 9.8% on annual basis, while the real GDP growth rate reached 6.0%. In the last quarter of the year, when the crisis spilled over the Macedonian industry, value added in industry registered the sharpest decline in the past few years of 8.6%, with the GDP growth rate being reduced to 2.1%. Generally, the growth of value added in industry in 2008 is positive and it equals 4.7%.

Figure 8

Quarterly distribution of the contributions of the individual manufacturing branches to the growth of the industrial output in 2008

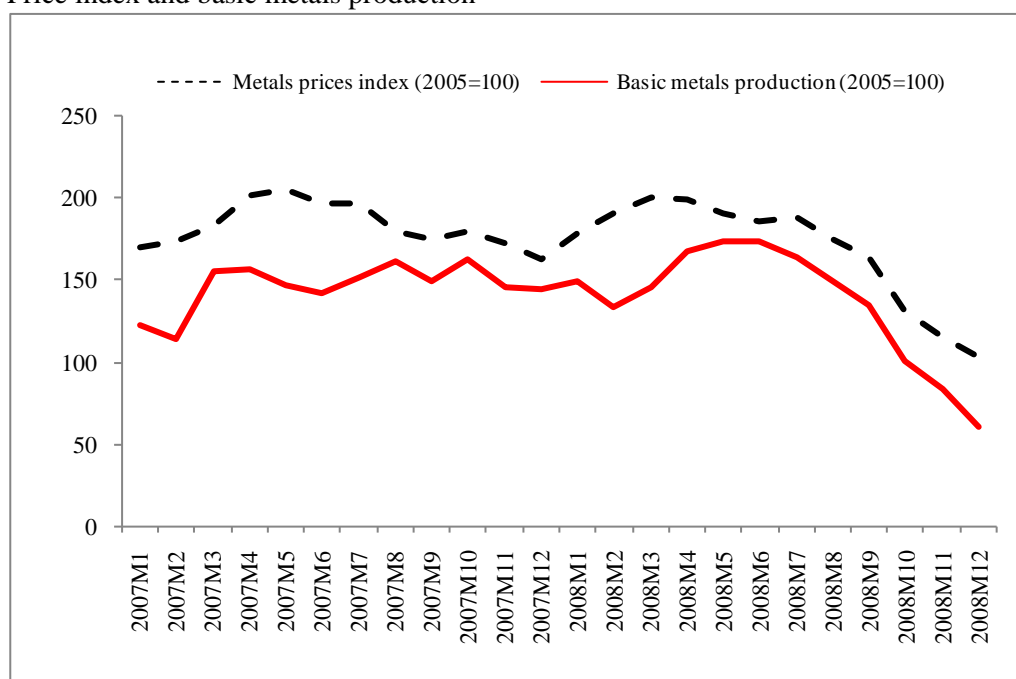
(in percentage points)



Source: State Statistical Office and calculations of the NBRM.

Manufacturing activities had the largest contribution to the growth in industry. Of the total number of twenty manufacturing branches, thirteen, which comprise 58% of the production in the manufacturing industry, registered positive annual results. However, in the last quarter, annual growth in the production was registered only in seven branches, which all together comprise 44% of the production in the manufacturing industry, which indicates strong influence of the global economic crisis. The fall in the world prices of metals and the weakened foreign demand had a significant impact on the domestic export-oriented branches.

Figure 9
Price index and basic metals production

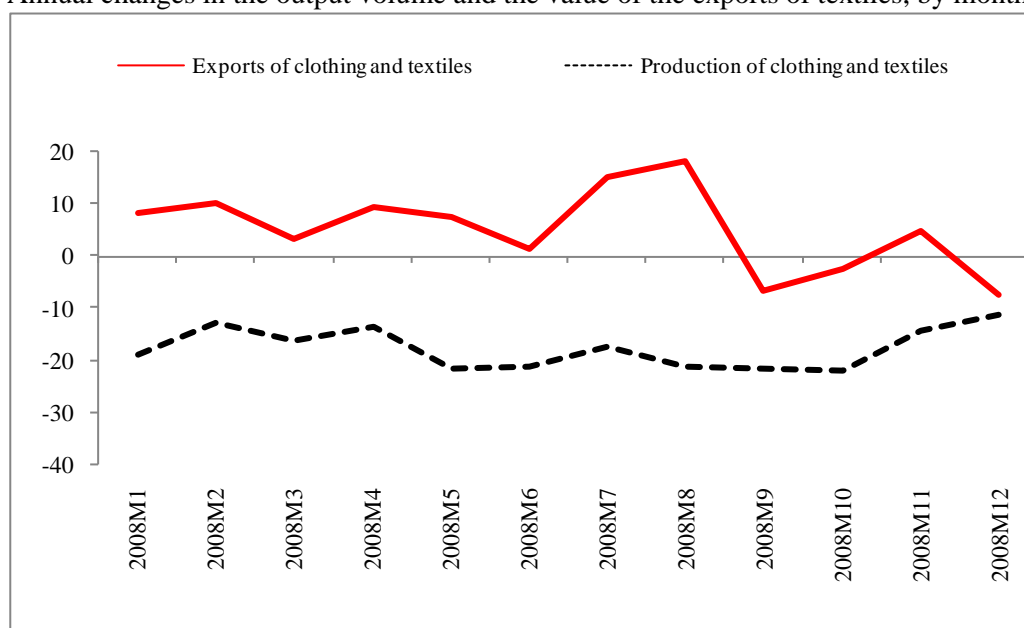


Source: State Statistical Office and IMF.

The impact of the crisis was most severe in the metal industry, which grew steadily until the middle of 2008. The production of *basic metals*, in conditions of still high prices of metals on the world markets, from the beginning until the middle of 2008, registered an annual growth (of 12.8%), while in the second half of the year, it dropped substantially (by 24.3% on annual basis). On the other hand, *production of metal products* registered good results in the three quarters of the year, with an exceptionally high result being registered in the third quarter, when there was a significant export of these products on the Kosovo market. In the fourth quarter of the year, this manufacturing branch of the metal industry was taken by the crisis. In general for the entire 2008, the largest part of the growth of the total industrial output (48%) was due to the increase in the production of metal products.

Food industry, the branch with the largest share in the industrial output index, registered good results throughout the entire year and significantly contributed to the growth of the industrial output (23%). Having in mind that it is an industry with relatively weak income elasticity, greater effects from the global crisis on this economy were not felt. By the end of the year, *printing, chemical industry and production of furniture* were not hit by the crisis. Their production was growing throughout the whole year. In the chemical industry and production of furniture, the increase was mainly generated by the exports, which did not decelerate even in the last quarter of the year.

Figure 10
Annual changes in the output volume and the value of the exports of textiles, by month



Source: State Statistical Office and IMF.

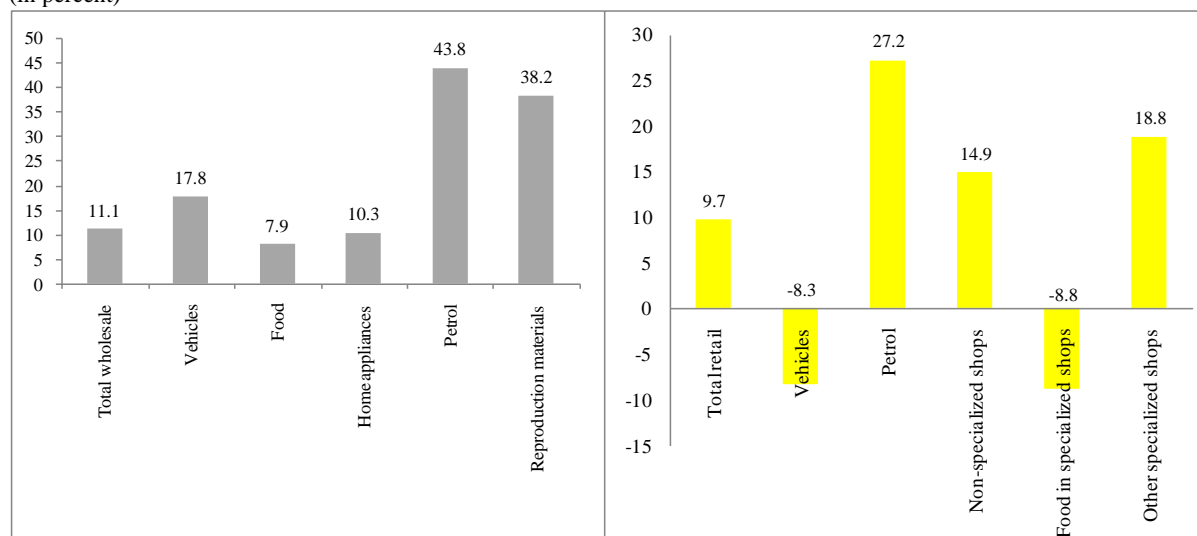
Textile industry, which employs the largest portion of the employees in industry (32%), registered lower volume of output throughout 2008, compared with the previous year. On the other hand, there was an annual rise in the value of the exports of textiles of 4.5%. Such a discrepancy in the dynamics of the output and exports could be partially due to the cycle of production of textile products and their export. The higher exports could be due to the already contracted deals and products produced in the preceding months, while the decline in the production during the year could be a result of the reduced or non-renewed contracts.

Observations of the managers from the manufacturing industry⁶ only confirm the opinions about the condition and the dynamics in industry during 2008. According to those observations, business condition of the companies has continuously deteriorated since the end of the third quarter of the year, and it worsened at the end of the year. Unlike the first period, when the most restrictive factors for the production were the lack of raw materials, energy and qualified labor force, in the last three months of the year more important were the lower foreign demand, the uncertainty in the region and lack of finances.

In 2008, sound results were registered in mining, while the energy sector registered negative trends. The fact that all most important mines were in operation brought about good results in mining (growth of 9.9% in real terms, on annual basis), and it is important to note that despite the lower production of metals in the world, the extraction of metal ore did not register any decline. Unlike mining, the production of electricity dropped by 3.1% in real terms, on annual basis, which was mostly a result of the decline registered in the last quarter. At the same time, there was a significant decline in the quantity of imported electricity (by 65% on annual basis), which together with the reduced domestic output indicates slower industrial activity, but also a slowdown in the overall economy.

⁶ According to the Survey on Business Tendencies in Manufacturing of the State Statistical Office from December 2008.

Figure 11
Nominal growth rates in the wholesales and retail trade*
(in percent)

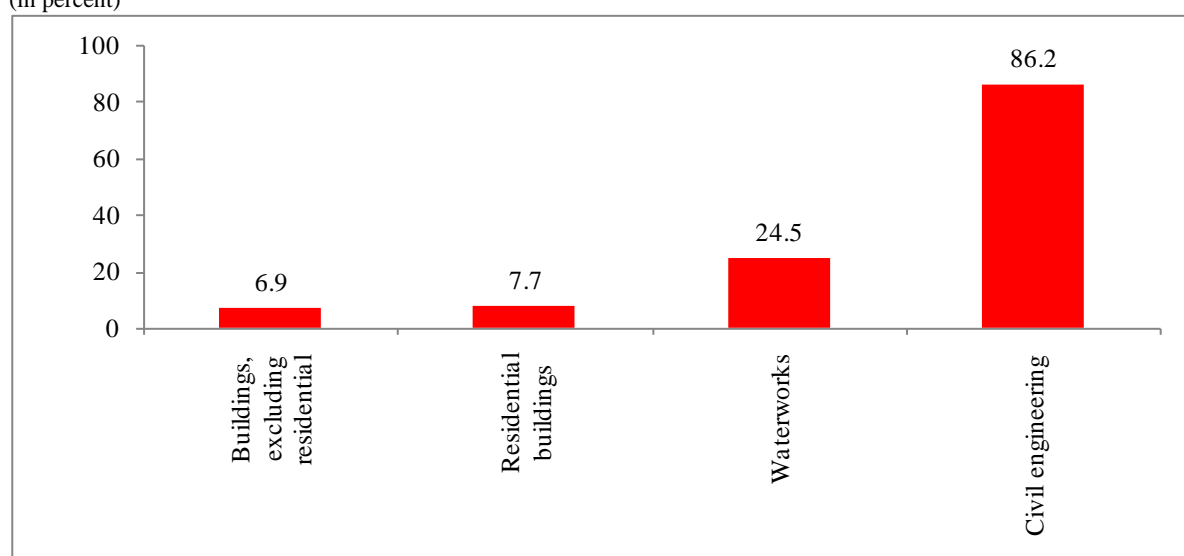


Source: State Statistical Office.

* Data on the sub-categories are as of the third quarter of 2008.

As in the previous year, also in 2008 trade maintained the high contribution in GDP growth. The annual growth of value added in trade of 8.3% in real terms, was mostly generated in the first three quarters of the year under the pressure of the increased domestic demand. In the same period, the nominal growth of trade was enhanced by the higher inflation rate and higher prices of oil derivatives. Two thirds of the increase in the trade turnover were generated by the wholesales (especially of fuels and raw materials, having rising prices), whereas the growth in retail trade was more moderate, in circumstances of increased trade of fuels and sale in specialized and non-specialized stores. The growing influence of the world economic crisis in the last quarter of the year, in conditions of still emphasized personal consumption, was passed on to the activity in the wholesales.

Figure 12
Annual rates of nominal growth in construction, by construction type*
(in percent)

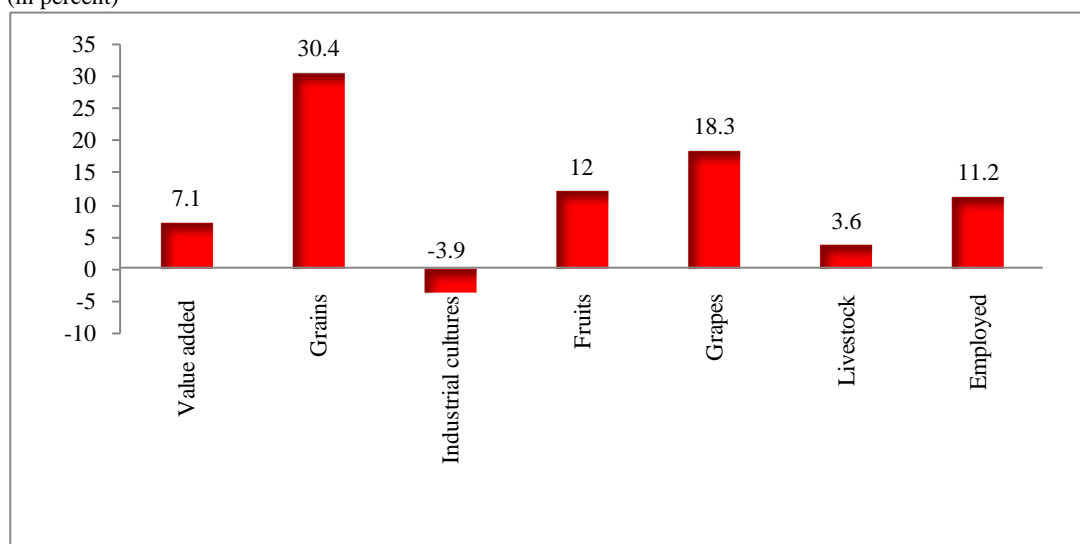


Source: State Statistical Office.

Data are as of the third quarter of 2008.

The investment cycle which started in the middle of 2007, continued in 2008, which had a significant impact on construction. Value added in construction registered an annual growth of 13.7% in real terms, and significantly contributed to the overall GDP growth. The policy of more intensive public investments in infrastructural projects, which started in 2007 and continued in 2008, contributed significantly to the intensification of the construction activity. In the first half of the year, along with the government investments in construction activities, the entry of certain foreign direct investments accelerated the construction growth, but starting from the third quarter, private investments in this activity registered a decline, under the influence of the crisis (according to the data on completed buildings). On the other hand, government investments were increased at the end of the year, which indicates the possibility for acceleration of the activity in this sector also in the forthcoming period. According to the type of the construction activity, the most notable increase of the construction activity was registered in the infrastructure - civil engineering and waterworks, while buildings construction (excluding residential homes) and building of residential homes registered a moderate increase relative to the preceding year.

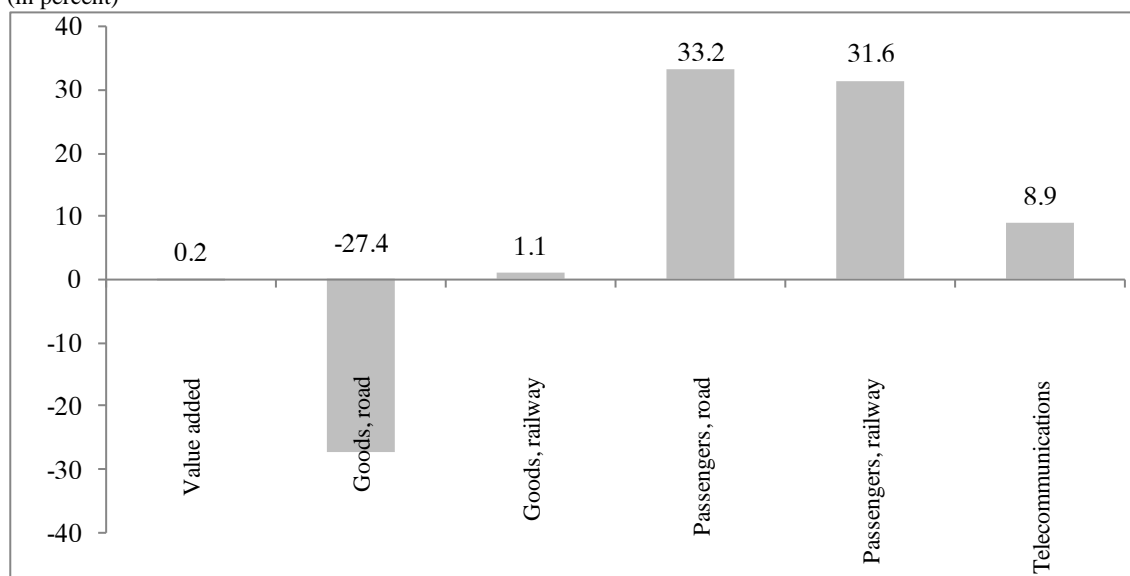
Figure 13
Annual real growth rates in agriculture*
(in percent)



Source: State Statistical Office.

The agricultural sector had an increased contribution to the GDP growth in 2008. Contrary to the decline in the agricultural production in 2007 (mainly due to the unfavorable weather conditions), in 2008 value added in the agriculture registered an annual increase of 7.1%. The production of cereals and viticulture had the largest contribution to the growth of the agricultural output. Besides the favorable weather conditions, additional factor for the accelerated agricultural activity in the Republic of Macedonia were the government subsidies, which contributed to the stimulation of the production. In accordance with the increased agricultural activity, there was a rise in the number of employees in this sector (by 11.2% on annual basis).

Figure 14
Annual real growth rates in communications
(in percent)



Source: State Statistical Office.

Unlike the previous two years, when the GDP growth was mainly determined by the increased activity in the sectors "transport and communications" and "financial intermediation", in 2008 this trend was interrupted. The activity in the sector "transport and communications" stagnated in 2008 (annual growth of value added of 0.2%), in conditions of reduced freight transport and increased passenger transport and telecommunications. Despite the positive annual changes in the first three quarters of the year, in the last quarter there was an annual decline in the value added in this sector (of 3.9%). The same movements were common for the "financial intermediation and other business activities", where value added registered a moderate annual increase of 2.8%. In the last quarter of the year, this sector also registered an annual decline in the activity (of 0.4%). Such trends are completely compatible with the emergence of the crisis, which has caused a decline in the export of industrial products (transport), as well as a decline in the activity of the banking sector.

2.1.2. Domestic demand⁷

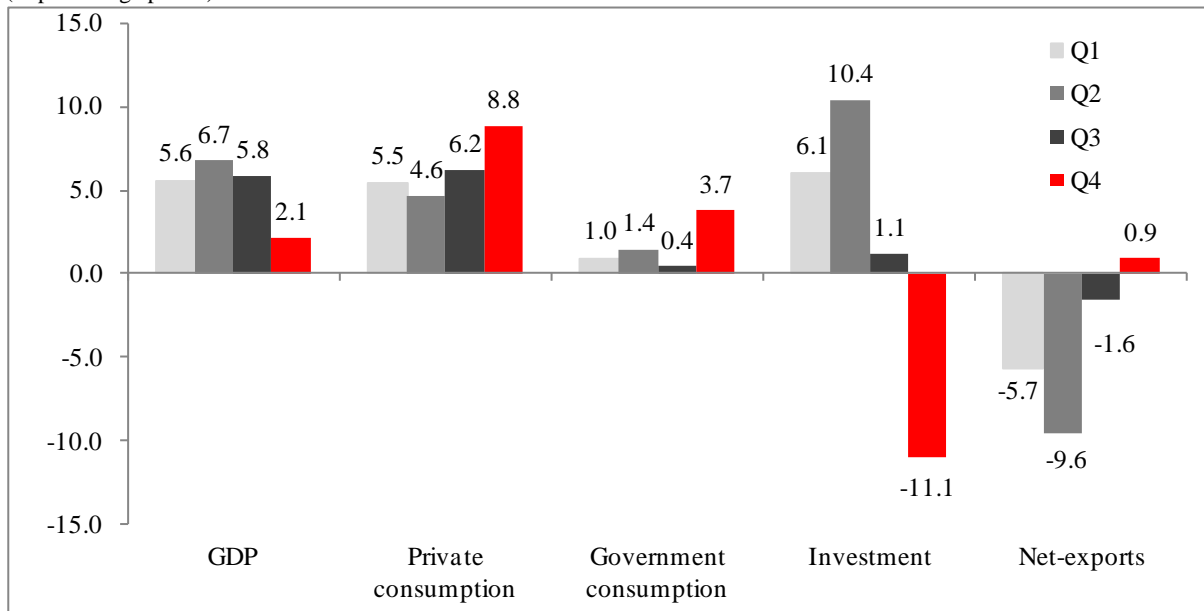
The strong trend of growth of the domestic demand continued in the first three quarters of 2008, as a result of the growth in personal and public consumption and intensified investment activity. The investment cycle which started in mid-2007, was intensified in the first half of 2008, in conditions of increased government investments in the infrastructure and increased foreign direct investments. At the same time, the substantial increment of the households' disposable income from the preceding year created positive expectations about the future income, which were evident in the increased spending and borrowing of the households from the financial sector. The decline in interest rates and the easier access to bank credits was in favor of the increase in the personal and investment consumption. Expanded absorption intensified the imports, which in condition of slower growth of the exports caused an increase in the trade deficit. With the emergence of the first more significant consequences from the global economic crisis, the situation in the domestic economy changed. The initial effects from the crisis were evident as early as in the third quarter in the slower investment activity, followed by a decline in the investments in the last quarter of the year. On the other hand, the initial indications about the slower income in future and the more restrictive credit policy in the last

⁷ Data on the expenditure aggregates of GDP are available as of the third quarter, therefore the comments pertain to this period. For the last quarter of the year, except for investments, regarding the other expenditure aggregates (personal, public consumption, exports and imports) there are estimations of the NBRM.

quarter of the year, did not have an immediate effect on slowing down the households' consumption. In line with the lower pressures by the domestic demand on the external sector (mostly due to the investment demand) in the last quarter, positive contribution of the net exports in GDP was registered.

Figure 15

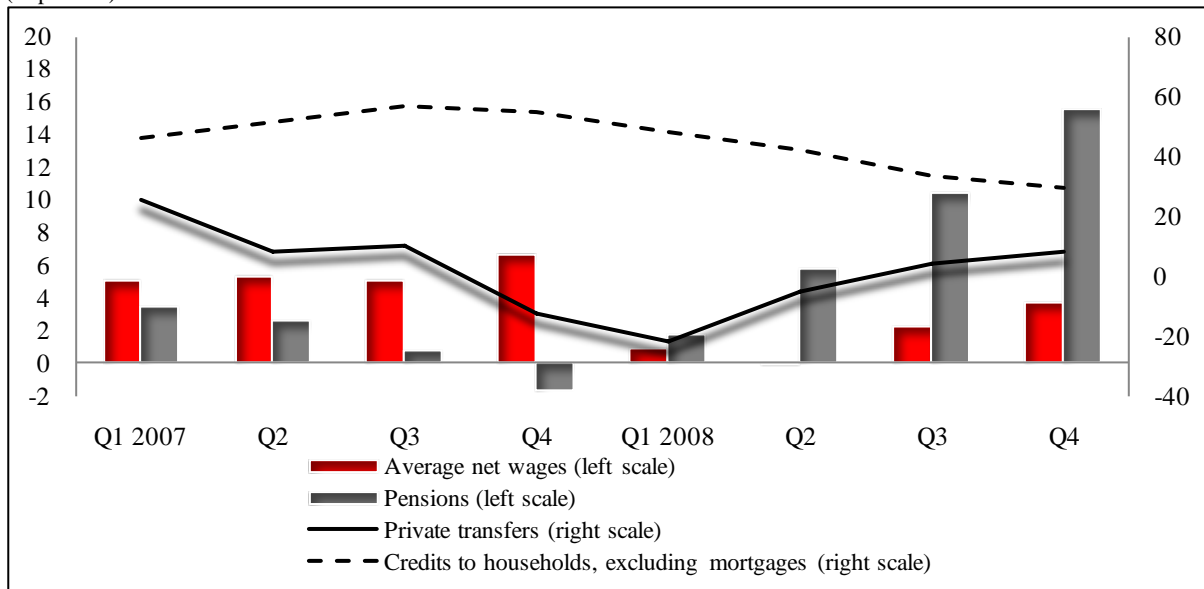
Contribution of the expenditure aggregates to the real GDP growth in 2008
(in percentage points)



Source: State Statistical Office and calculations of the NBRM.

In 2008, personal consumption registered annual growth of 7.8%, in real terms. The substantial growth of households' consumption was maintained until the end of the year, despite the emergence of the crisis. The increase in personal consumption during the year, was rather a result of the optimistic expectations for growth of the future income than of the true movement of the income, which acted towards additional indebtedness. In general, in conditions of higher annual inflation rate, in 2008 the real growth of the average net wage (as the most important segment of the disposable income) and of the net wage bill (which depicts also the dynamics of employment) slowed down and was reduced to 1.9% and 4.1%, respectively, as opposed to 5.5% and 5.7%, respectively, registered in the previous year. On the other hand, the real growth of the paid pensions bill of 8.4% (as opposed to 1.2% in the previous year) significantly supported the households' consumption. In contrast to the increase registered in these segments of the disposable income, the inflows from private transfers registered an annual decline of 3.9%, although after the dramatic decline in the first two quarters, in the remaining period they recovered to some extent. However, the fall in the inflows from private transfers significantly intensified in the last month of the year, which could be related to the decline in the world income and to the increased uncertainty in the domestic economy, caused by the rising dimensions of the world crisis.

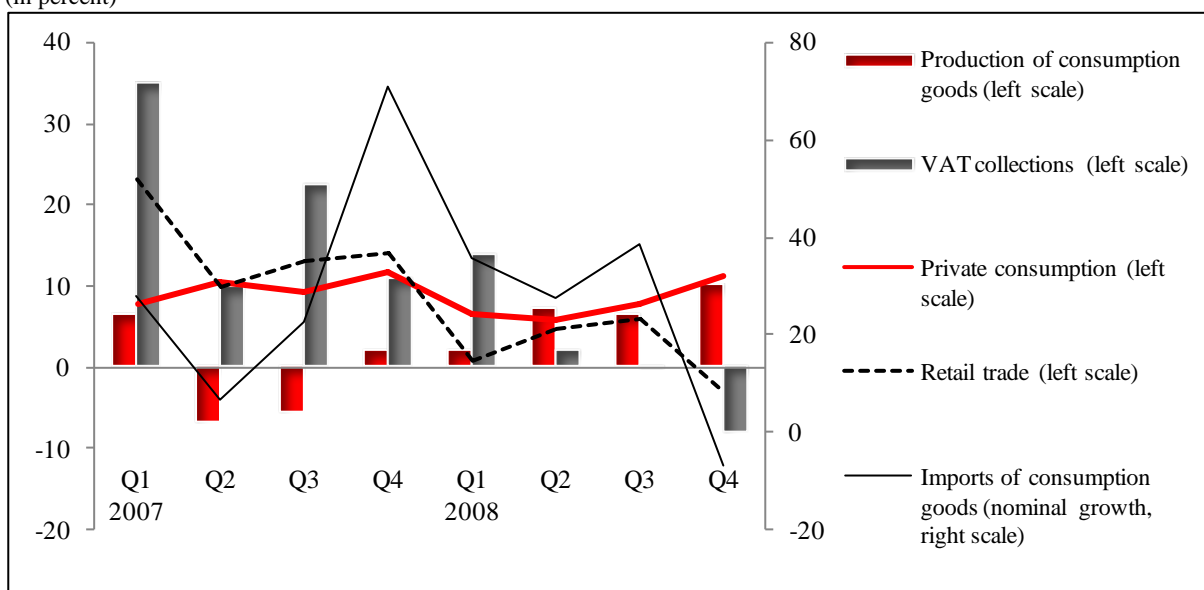
Figure 16
Annual real growth rates in the sources of financing personal consumption
(in percent)



Source: State Statistical Office.

Banks' expansive credit policy significantly supported the increased households' consumption during the year. In 2008, credits to households (excluding housing credits) were higher by 48% in nominal terms, relative to 2007, whereas real growth, in conditions of high inflation rate, was lower and equaled 37%. Large portion of the credit growth was realized in the first three quarters of the year, while towards the end of the year, tightening of the lending terms, reduced supply of and demand for credits (in conditions of growing uncertainty), resulted in slower growth of lending to households.

Figure 17
Annual real growth rates of the categories related to personal consumption
(in percent)



Source: State Statistical Office.

The movement of personal consumption during 2008 reflected on the retail trade turnover, income from the value added tax (VAT), imports and production of consumption

goods. The high households' consumption in the first three quarters of the year caused a rise in retail trade turnover and increased the imports and domestic production of consumption goods. In this period, significant increase was registered in the revenues from VAT, which relative to 2007 were higher by 14.2% in nominal terms (4.6% in real terms). In the last quarter of the year, there was a slowdown in the imports of consumption goods, lower realized volume of retail trade, as well as a real decline in the revenues from VAT on annual basis.

The movements in the Macedonian economy during 2008 and the influence of the crisis are most explicitly reflected in the investment demand, the annual real growth of which reached 16.5%. The fast economic growth until the last three months of the year was mostly a result of the increased investment demand, which significantly incurred the construction business. In the first half of the year, when business expectations were led by the positive developments in 2007, gross investments registered extremely high growth rates. Equally important was the influence of the government, which continued with the policy of important investments in the infrastructure. Such developments, besides the rapid growth of completed construction works, reflected on the rise in the imports and the domestic production of means of production in this period. The effects from the crisis were first signaled by the investments, which due to the changed business expectations slowed down in the third quarter. The lower growth rate of the investments from the third quarter was a result also of the lower investment by the government. Investment consumption registered an annual fall of 33.6% in the last quarter of the year, due to the reduced private investments, the witness of which is the slower growth of the import of means of production and the decline in the domestic production of capital products. This is also indicated by the results of the Survey on banks' credit activity for the last quarter of 2008, where there is an increased percentage of banks which consider the investments in fixed assets a factor influencing the decline in the demand for corporate loans. In this period, however, the high government spending⁸ for capital projects contained the fall in private investments.

Annex 1

Econometric analysis of the investments in Macedonia⁹

Investments, defined as an increase in the level of capital in the economy are crucial factor for the economic growth. Even though their share in the gross domestic product is not dominant, the investments, as the least stable component, are one of the major factors for the cyclical development of GDP. With respect to the macroeconomic policies, investments, as a part of the aggregate demand, are a category under the influence of the monetary and fiscal policy, thus affecting the real economy.

In Macedonia, on average, the investment consumption makes up 15.3% of GDP in the 1997-2007 period, which is relatively low investment activity compared to the other economies in transition. Historically, this situation could be explained with the insufficient accumulation of domestic capital due to the unfavorable financial results of the corporations and high real interest rates of the banks, i.e. low capital productivity, and insufficient inflow of foreign direct investments in comparison with other transitional countries. Hence, the achievement of higher real growth of the investments, as one of the main prerequisites for higher and sustainable economic growth rates, remains a challenge for the Macedonian economy.

⁸ Government capital investments are estimated according to the data from the Budget of the Republic of Macedonia.

⁹ Summary of the NBRM paper, B. Petkovska "Estimation of the investment function in the Republic of Macedonia", still unreleased.

Table 7
Gross fixed capital formation, as % of GDP¹⁰

	Bilgaria	Czech Republic	Estonia	Latvia	Lithuania	Hungary	Poland	Romania	Slovenia	Slovakia	Macedonia
1997	9.4	28.9	24.7	16.9	20.0	20.4	21.7	-	23.3	32.8	16.4
1998	12.2	28.9	28.9	26.0	22.5	22.1	23.6	-	24.5	34.3	15.5
1999	14.4	27.6	24.4	23.5	21.5	22.4	24.1	18.3	26.7	28.9	14.6
2000	15.7	28.0	26.0	24.2	18.8	23.0	23.7	18.9	26.1	25.8	13.8
2001	18.6	29.1	26.5	25.0	19.9	23.2	21.2	19.7	25.5	28.2	13.2
2002	19.3	30.0	30.4	26.5	20.6	24.5	19.6	20.3	24.7	27.0	15.4
2003	21.0	29.1	33.8	27.8	21.2	24.0	18.8	21.0	26.0	25.0	15.1
2004	22.3	29.0	32.9	31.7	22.9	24.7	19.0	21.4	26.3	25.0	16.1
2005	25.9	27.7	32.7	35.4	23.6	25.8	19.5	23.7	26.2	27.6	14.7
2006	28.0	27.6	35.6	36.7	26.1	23.2	21.1	26.4	27.3	27.7	15.8
2007	32.0	27.8	36.0	35.9	29.0	23.3	23.3	32.0	28.6	27.3	17.7
average for the period	19.9	28.5	30.2	28.2	22.4	23.3	21.4	22.4	25.9	28.1	15.3

Source: Eurostat, State Statistical Office and own calculations. Gross fixed capital formation includes investments in nonfinancial companies, financial companies, government, households and nonprofit institutions that serve to the households.

Taking into account the relevance of the investments to the long-term economic growth, and their importance to the implementation of the macroeconomic policies, an attempt has been made to identify factors that influence the investments, by testing the two major macroeconomic investment theories - Accelerator Theory and Neoclassical Theory of investment. According to the Accelerator Theory, investments only depend on the aggregate demand. In other words, in environment of higher demand on the market, the companies accelerate their investment activity, due to the increase in the output. The Neoclassical Theory emphasizes the significance of the capital cost as an additional factor that influences the investment consumption. Thus investment depends in direct proportion on the output and in inverse proportion on the capital cost, which, on the other hand, depends on the interest rates, depreciation and taxes. The both macroeconomic theories pertain to the companies' investments, and the analysis for Macedonia has been made for the gross fixed capital formation including the household and government sectors. Yet, taking into account that in 2002-2007 period, the companies account for roughly 50%, on average, of the total investments, the gross fixed capital formation could be considered a relatively efficient indicator for the corporate investments.

The analysis was made by using cointegration technique for the 1997-2006 period and the method of ordinary least squares (OLS) for the 2003-2007 period, employing the following series: real gross domestic product at 1997 prices as an indicator for the domestic demand, real gross fixed capital formation¹¹ as an indicator for the company investments, the real lending interest rate as an indicator for the capital cost and the inflation as an indicator for the macroeconomic stability¹². The long-term relations are as follows¹³:

Table 8
Estimated long-term relations

Accelerator Theory	Log (investment) = 0.96*Log (GDP) +short term dynamics (0.139)*
Neoclassical Theory	Log (investment) = 0.73*GDP - 0.03*Log (interest rate) - 0.01*Log (inflation) (0.304)* (0.064) (0.006) + short term dynamics
Relationship between the investment and the interest rate for the 2003-2007 period:	Log (investment) = constant -0.02 interest rate (0.004)*

* = the coefficient is statistically significant at 5% degree of confidence.

¹⁰ The data on gross fixed capital formation and on GDP on foreign countries are realistic, at 2000 prices. The data on GDP and investments for Macedonia are realistic, at 1995 prices.

¹¹ The gross fixed capital formation is interpolated to obtain quarterly data.

¹² All data, except for the interest rate, are taken from the State Statistical Office.

¹³ The cointegration technique enables calculation of the long-term relation between variables and of the factors which affect the variable on a short run. Because the analysis pertains to testing of economic theories which apply over a long period, the short-term dynamics has not been interpreted.

The estimated theories show 0.96% increase in the investments according to the Accelerator Theory, and 0.73% increase according to the Neoclassical Theory, with 1% growth in the GDP. More important, the relation is statistically significant at the conventional degrees of confidence. Just for comparison, the estimated coefficient for Macedonia is relatively close to the coefficient for other countries (table 2). The inflation proved to be statistically insignificant factor to the investment decisions. Taking into account that the price stability in the Republic of Macedonia over the entire period under observation, except for 2000, is relatively high, it is possible the economic agents to overlook the inflation when making investment decisions. In other words, in environment of low and stable inflation, the investment decisions are driven by other factors, such as expectations for higher economic growth or political uncertainty in the country and the region.

Table 9
Coefficient prior to GDP in other studies

	estimated GDP coefficient
Albania	0,940
OECD	0,926 - 1,230
Iran	1,430
Namibia	0,991

Source: Dushku E., Binaj G., Kota V.: 2006); (Pelgrin, F., S. Schich, A. de Serres: 2002); (Valadkhani A.: 2004) and (Eita J. H. and Du Toit C.: 2007).

The analysis of the monetary policy points to the influence of the capital cost as most important, because the monetary policy could affect the real economy exactly through this category. In the 1997-2006 period, the real interest rate had a statistically insignificant influence on the corporate investments. Yet, this result is not surprising, considering that most of the half of the analyzed period is characterized with high real interest rates, and over the most of this period, the credit supply was relatively low. Such situation pushed out the bank credits as a source of funding investments. According to the official data, as well, only about 16% of the fixed assets in the 1999-2006 period were procured by the means of borrowing¹⁴. The fast decrease in the interest rates over the last few years, and the accelerated lending activity of the banks to the private sector since 2003, reflects the increasing importance of the cut in the interest rates on the investments and production. Thus, the lower interest rates over the last few years resulted in a higher share of the credits in the total sources of funding the investments (from 15.3% in 2004 and 17.2% in 2006 to 19.3% in 2007). The econometric estimation of the relation between investments and interest rate for the 2003-2007 period, as a period of acceleration of the lending activity to the private sector, shows statistically significant and negative influence of the interest rate on the investments (one percentage point higher interest rate induces 2% lower investment activity).

¹⁴ Data are taken from the State Statistical Office.

Figure 18
Development of the sources of funding investments and indicative categories, annual nominal growth rates*
(in percentages)

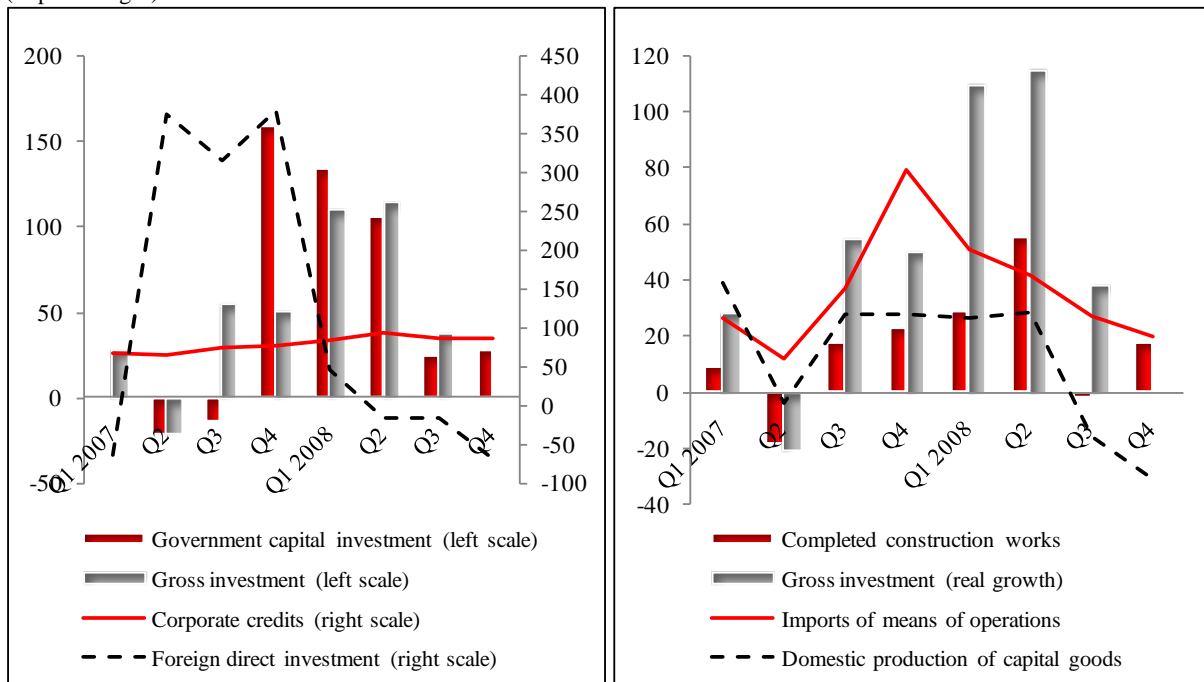
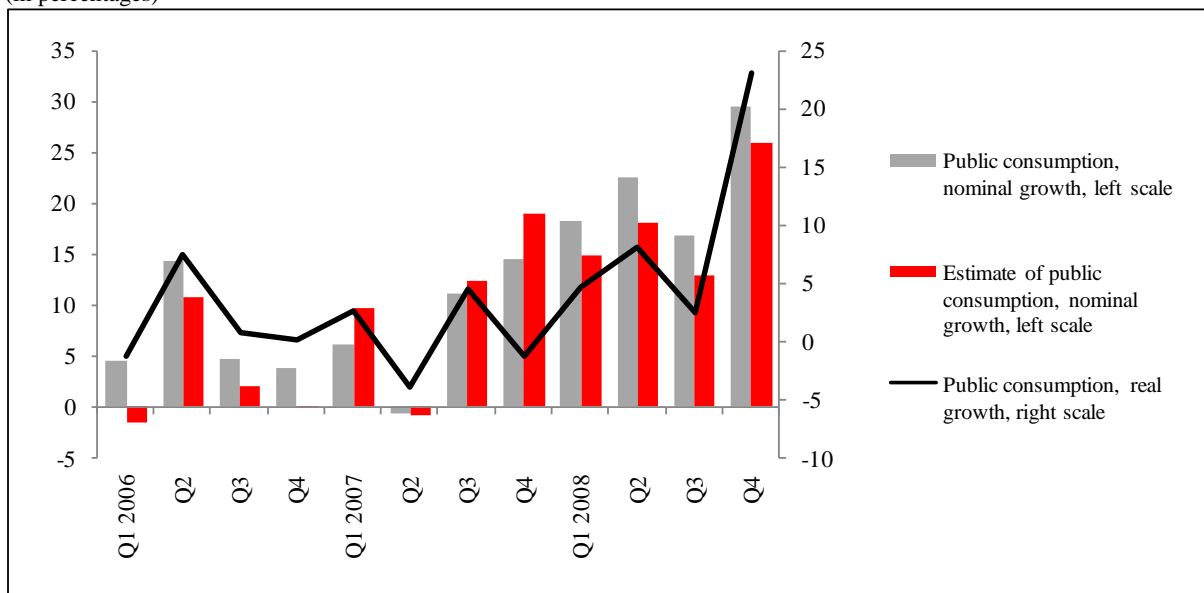


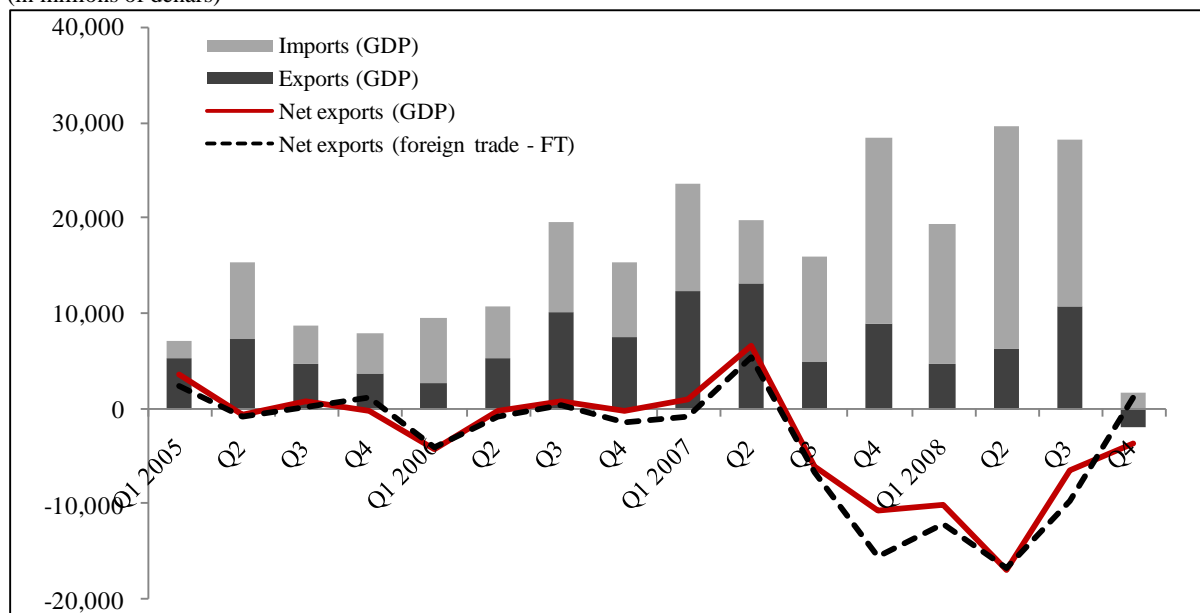
Figure 19
Annual growth rates of the public consumption
(in percentages)



Source: State Statistical Office and NBRM.

The policy of intensive public consumption carried on in 2008. The real annual growth in the public consumption reached 9.5%, and the nominal growth was more significant, equaling 22.1% given the higher inflation. The increase in the public consumption mostly reflects the growth in the wages of the public administration. Still, the high real growth indicates that the public consumption in 2008 had stimulating effect on the overall domestic demand.

Figure 20
Annual nominal changes in the exports and the imports
(in millions of denars)



Source: State Statistical Office.

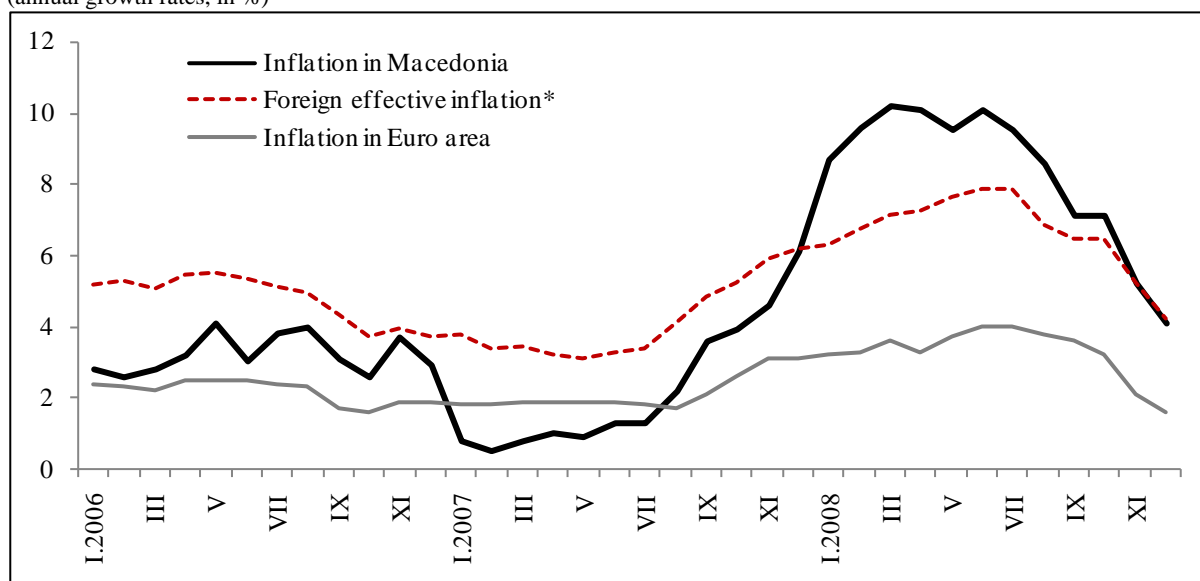
The developments in the net-exports in 2008 are a mix of a number of factors. The steep growth in the domestic demand in the first half of the year, besides its stimulating effect on the domestic output, also contributed to the deepening of the trade deficit. In this period, additional factor that deepened the deficit was the deteriorated terms of trading, due to the increase in the prices of food and energy sources and the decrease in the metal price. The slower investment demand in the third quarter, together with the reduction in the prices of energy sources, contributed to deceleration of the annual growth in the trade deficit, relative to the preceding two quarters. In the fourth quarter, the escalation of the global crisis led to a rapid decrease in the external demand, which, along with the lower metal prices contributed to lowering the exports. Moreover, the slower domestic demand, the fall in the prices of energy sources and the lower import component contributed to the fall in the imports. In line with such developments, over the last quarter, the negative contribution of the net-exports to the annual growth entered a positive zone.

2.2. Inflation

The average inflation rate in 2008 increased, mainly due to external factors, reaching 8.3%. The drastic price growth was typical for the first quarter of the year, whereas in the second quarter, it registered a certain slowdown, which was particularly significant in the second half of the year. Major drivers to the inflation in the first half of the year were the higher food and energy prices, as translated effects of the developments on the international markets, although there was a presence of higher pressures by the domestic aggregate demand. The rise in the domestic prices corresponded with the intensification of the inflation in many other economies in the world as well, thus proving the impact of the global factors.

Figure 21

Domestic inflation, effective foreign inflation* and inflation in the Euro area
(annual growth rates, in %)



* The effective foreign inflation is a weighted sum of the inflations in the most important trading partners of the Republic of Macedonia.

Source: State Statistical Office and Eurostat.

In the second half of 2008, our domestic economy, same as the most of the countries, also registered slowdown in the inflation. The global economic crisis tamed the oil price shock from the previous period, and the food prices started decreasing steeply. These global developments (along with the effect of the higher comparison base of the second half of 2007, when the food prices registered an uptrend) transferred to the domestic inflation which in the last quarter reduced to 5.4%. In December, the annual inflation rate equaled 4.1%, which is the lowest since the beginning of the year.

Observing the structure of the inflation index, all major categories registered a price growth in 2008. The steepest annual growth was registered in the prices of food, restaurant and hotel services and housing services.

Table 10

Structure of inflation index (CPI-Consumer Price Index)

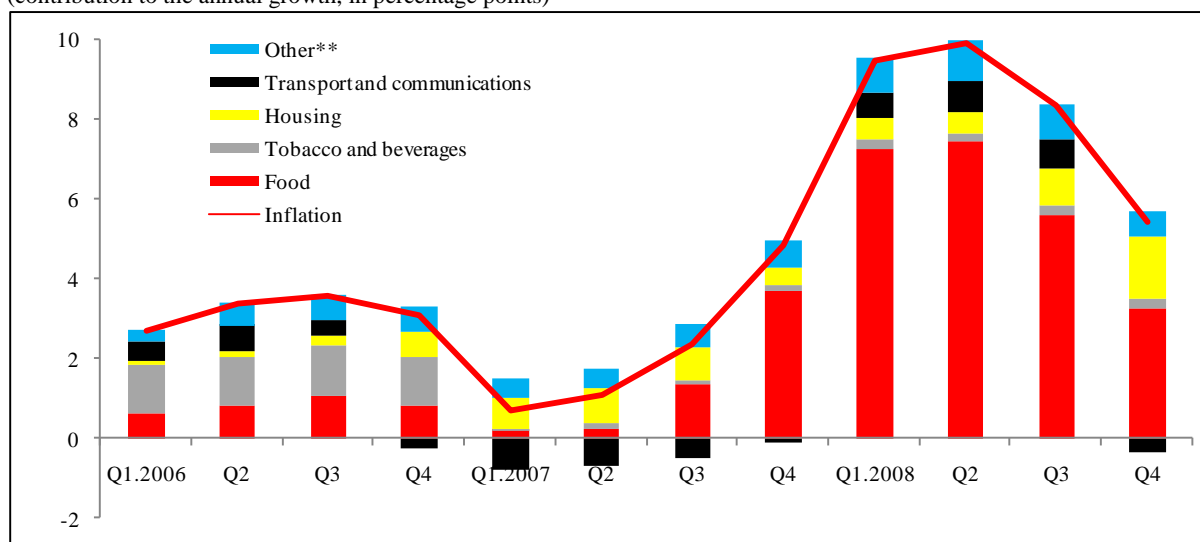
	annual changes in %		contributions in p. p.		contributions in %	
	XII.2008	2008	XII.2008	2008	XII.2008	2008
	XII.2007	2007	XII.2007	2007	XII.2007	2007
Total	4.1	8.3	4.1	8.3	100.0	100.0
Food	6.3	15.3	2.4	5.8	58.81	70.65
Tobacco and beverages	4.4	4.0	0.2	0.2	5.66	2.56
Clothing and footwear	-0.5	1.8	0.0	0.1	-1.05	1.70
Housing	11.2	5.9	1.7	0.9	41.59	10.87
Hygiene and health	1.7	1.5	0.1	0.1	3.44	1.44
Culture and entertainment	0.8	0.2	0.0	0.0	1.10	0.15
Transport and communications	-5.4	3.2	-0.8	0.5	-19.01	5.52
Restaurants and hotels	6.8	11.4	0.3	0.6	8.51	7.04
Other services n.e.c.	-6.0	2.2	0.0	0.0	-0.47	0.08

Source: State Statistical Office.

Most of the growth in the general price level, i.e. 71% was due to the higher food prices, which is dominant category in the inflation index. The rise in the food prices, which started at the end of 2007 and continued in the first half of 2008, resulted from the lower domestic supply (due to the unfavorable weather conditions in 2007), the higher import prices of the agricultural inputs (fodder, energy and artificial fertilizers) and from the import prices of food products. In the second half of 2008, the good weather conditions contributed to higher domestic supply of food, and led to

lower quantitative import of food commodities, and globally, the food prices went down. Consequently, the prices of fresh food and processed food products started falling down, thus halving their contribution to the inflation (from 4.6 p.p. and 2.9 p.p., respectively, in the first half of the year to 2 p.p. and 1.3 p.p., respectively, in the last quarter of the year).

Figure 22
Inflation and major CPI categories*
(contribution to the annual growth, in percentage points)



*CPI- Consumer price index is a measure for the inflation.

**The remaining includes the categories of wearing apparel and footwear, hygiene and health, education, culture and recreation, restaurants and hotels and other services n.e.c.

Source: State Statistical Office and NBRM calculations.

Along with the higher food prices, significant contribution to the overall inflation was also made by the growth in the price of energy sources. The higher oil derivative prices constituted 6.7% of the total price growth, whereas the increase in the prices of thermal energy¹⁵ and electricity¹⁶ for households accounted for 5.9% and 1.8%, respectively, of the overall inflation. Generally speaking, the higher energy prices made the housing and transport costs higher. The developments of the domestic prices of energy sources reflected the dynamics of the counter-prices on the international markets. The drastic increase in the price of crude oil on the international markets at the beginning of the third quarter of the year resulted in a fast increase in the domestic prices of oil derivatives, whereas the steep fall in the crude oil price at the end of the year (particularly in October) resulted in reduction of the domestic prices. However, the deflationary impact of the prices of oil derivatives in the last quarter of the year was partially offset by the higher price of electricity for households in November. In general, in the last quarter of the year, the contribution of the energy prices to the overall inflation reduced, compared to the contribution in the preceding period, characterized with the adverse effect of the oil shock and the increase in the thermal energy.

¹⁵ The price of thermal energy increased in February and August 2008 by 13.2% and 45.3%, respectively, on average.

¹⁶ In November 2008, based on the REC's decision, the average sale price of the electricity at which EVN Makedonija supplies the tariff retail consumers increased by 13.61%.

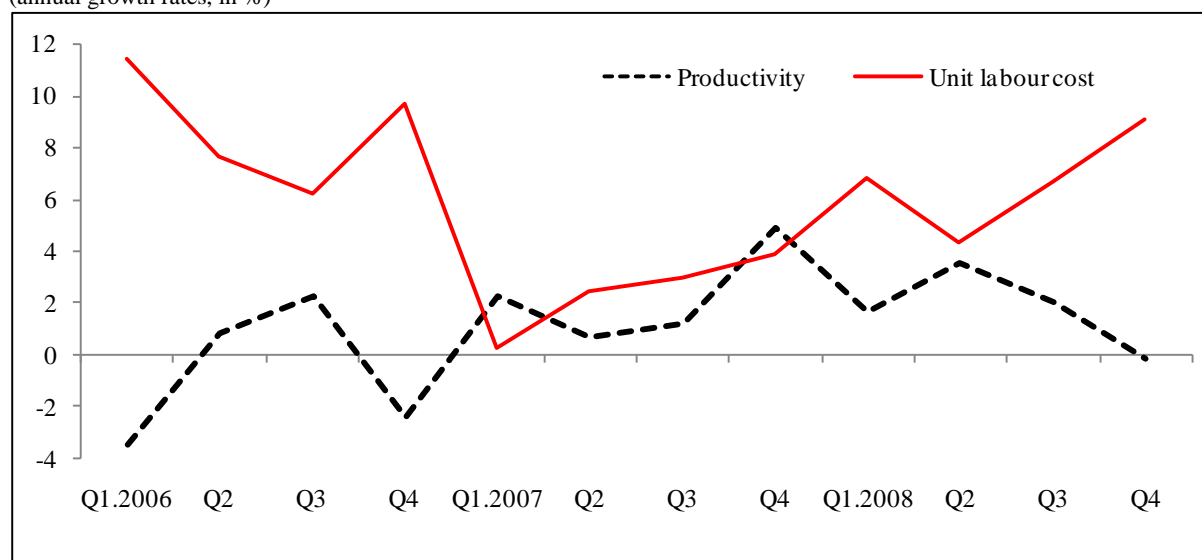
Table 11
Price categories
(annual changes in %)

	Q1 2007	Q2 2007	Q3 2007	Q4 2007	2007	Q1 2008	Q2 2008	Q3 2008	Q4 2008	2008
Inflation (CPI)	0.7	1.1	2.4	4.9	2.3	9.5	9.9	8.4	5.4	8.3
Food	0.7	0.7	3.8	10.4	3.9	19.0	19.5	14.7	8.5	15.3
Fresh food	-0.7	-0.6	4.1	12.4	3.8	26.4	25.2	16.0	11.0	19.7
Processed food	1.9	2.0	3.7	8.9	4.1	13.3	15.2	13.2	6.3	12.0
Energy	4.9	4.9	3.9	4.0	4.4	7.4	9.2	12.5	8.3	9.3
Oil derivatives	-4.6	-2.4	-1.3	11.0	0.7	18.6	22.6	23.6	-6.2	14.6
Electrical power	9.7	11.4	8.2	2.4	7.9	1.6	0.0	0.0	8.7	2.6
Heating power	7.1	1.5	1.9	-1.3	2.3	4.6	10.9	23.2	25.3	16.0
Food and energy (volatile prices)	1.8	1.8	3.8	8.7	4.0	16.1	16.9	14.1	8.5	13.9
Goods	1.3	1.6	3.0	6.2	3.0	11.0	11.4	9.0	5.4	9.2
Services	-1.1	-0.5	0.2	0.4	-0.3	3.9	4.5	6.1	5.8	5.1
Core inflation (inflation excl. food and energy)	-0.2	0.5	1.1	1.2	0.6	2.9	2.8	2.5	2.2	2.6
Producer prices	1.1	0.7	1.4	7.0	2.6	10.5	13.6	15.1	2.2	10.3

Source: State Statistical Office and NBRM calculations

The increase in the food and energy prices had an effect on the prices of catering services, which made up 7% of the total price growth. Along with these remarkable price growths, 2008 witnessed moderate growth in the prices of beverages, rents, footwear and hygiene agents. On the other hand, the prices of telecommunications services (due to the higher competition) and the prices of medicines (due to the introduction of single prices of medicines) registered a decrease and had deflationary effect on the overall index.

Figure 23
Unit labor and productivity costs
(annual growth rates, in %)



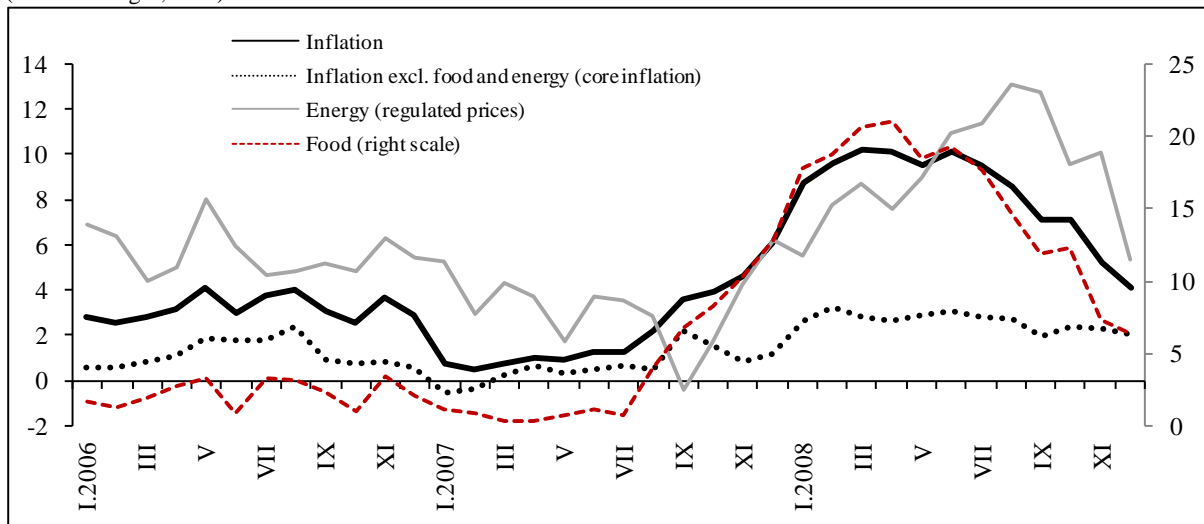
Source: State Statistical Office and NBRM.

Alongside the influence of the imported supply factors, the higher labor costs were also significant domestic supply factor to the inflation. In 2008, the labor unit costs went up annually by 6.8%, given the high nominal growth in the gross wages and lower productivity growth. The higher labor hiring costs pointed to inflationary pressures by the real sector, taking into account that the wages are significant input in the pricing of the products of domestic producers.

Besides the influence of the supply factors, the price developments in 2008 were also affected by the growth in the total demand. The intensified aggregate demand from mid-2007 to the last quarter of 2008 resulted in a significant widening of the positive production gap and strengthened the inflationary pressures. Major driver of the aggregate demand was the final consumption (personal and public) but since the end of 2007, the investment demand also intensified.

This period, in line with such developments, also witnessed high exploitation of the production capacities¹⁷ and positive developments in the labor market. Yet, since the last quarter of the year, the aggregate demand registered a certain slowdown, in environment of uncertainty and intense effects of the global economic crisis on the domestic economy. Such developments of the demand led to gradual narrowing of the positive production gap and alleviation of the inflationary pressures of this kind.

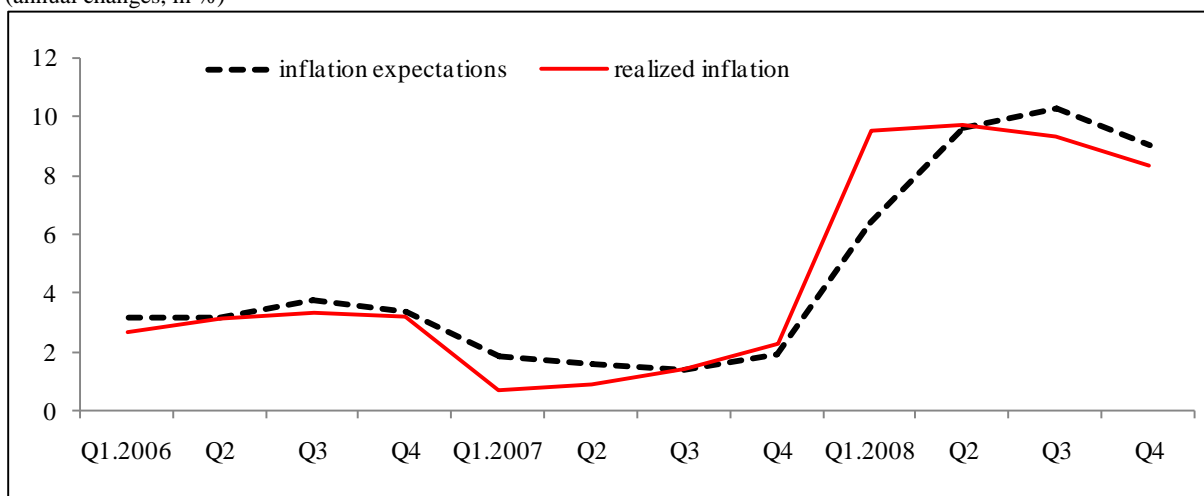
Figure 24
Food and energy volatility and core inflation
(annual changes, in %)



Source: State Statistical Office and NBRM.

In 2008, the core inflation rate also went up. The pressure of the higher aggregate demand, the increase in the labor costs and the indirect effect of the higher energy prices resulted in higher core inflation rate (excluding food and energy), reaching 2.6%, compared to 0.6% in the previous year. The above points to the fact that, in spite of the growth in the variable prices, the long-term and permanent inflation component also went up this year. This was also one of the reasons for the NBRM to take measures, including the increase in the reference interest rate.

Figure 25
Actual and expected inflation rate
(annual changes, in %)

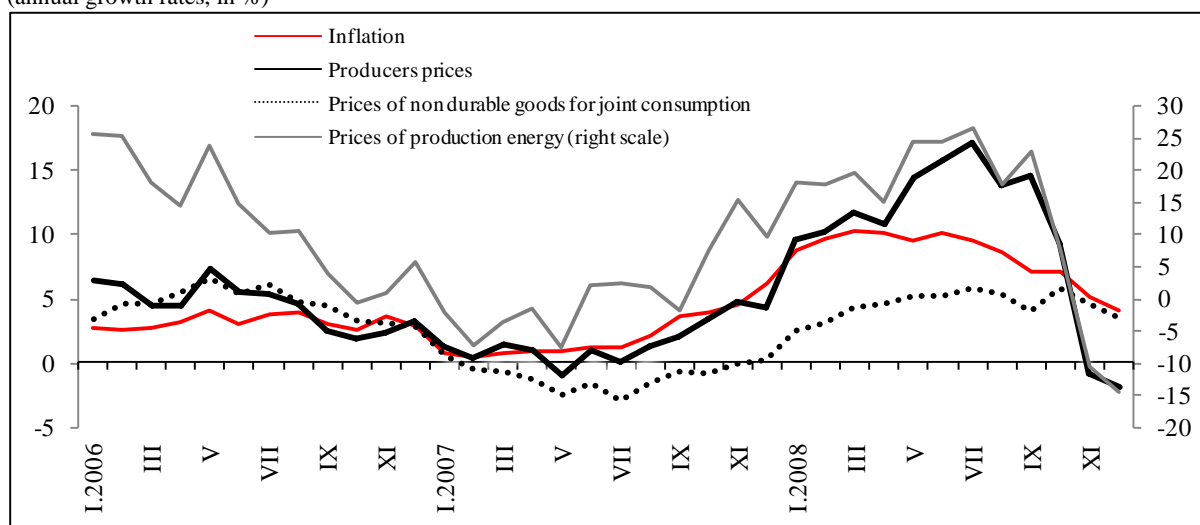


Source: State Statistical Office and NBRM Inflationary Expectations Survey.

¹⁷ From the survey on business tendencies in the manufacturing industry.

The inflation developments in 2008 primarily correspond with the inflationary expectations of the economic agents subject to the survey. Notwithstanding the higher number of economic agents who stated, in the surveys, that they expected high inflation rate, in the second half of the year this number went down, which corresponds with the developments of the inflation rate. In the first half, the expectations for higher inflation were based on the expected growth in the prices of oil, food, electricity, the higher public consumption and the higher wages. On the other hand, in the second half of the year, the expectations for lowering the inflation were based on the stabilization of the oil and food prices, the lower demand resulting from the global financial and the economic crisis, and the expected fall in the lending activity in the domestic economy.

Figure 26
Inflation and producer prices
(annual growth rates, in %)



Source: State Statistical Office and NBRM.

The higher prices of raw materials and labor costs in 2008 resulted in higher producer prices. In 2008, the producer prices registered two-figure growth rate of 10.3%, primarily caused by the higher producer prices of the oil derivatives and food products and beverages. The uptrend of these prices which started in the last quarter of 2007 and reached its maximum in the third quarter of 2008, reflected the pressure of the domestic manufacturing sector on the consumer price level. In the last quarter of 2008, the fall in the producer prices of oil derivatives (by 16.5% annually) and the slower growth in the non-durable prices resulted in lower prices of industrial products, which was translated to the retail prices.

In 2008, the economies of Southeast Europe were also not immune to the global inflationary pressures. In these economies, inflation rate also surged mainly due to the global upward price developments in the primary products and energy. The highest (two-digit) inflation rate was registered in Serbia (12.9%) and Bulgaria (12%). Significant increase in the level of consumer prices was also registered in Bosnia and Herzegovina, Kosovo and Croatia, whereas lower inflation rate and moderate growth was registered only in Albania. The average inflation rate in the Southeast European countries of 8.4%¹⁸ was significantly higher than the inflation rate in the Euro area (3.3%). As a response to the intense inflationary pressures, the Southeast European countries and the Euro area undertook numerous monetary and fiscal measures.

¹⁸Source: Eurostat and national statistical offices.

Table 12
Inflation in the Euro area and the Southeast European countries
(in %)

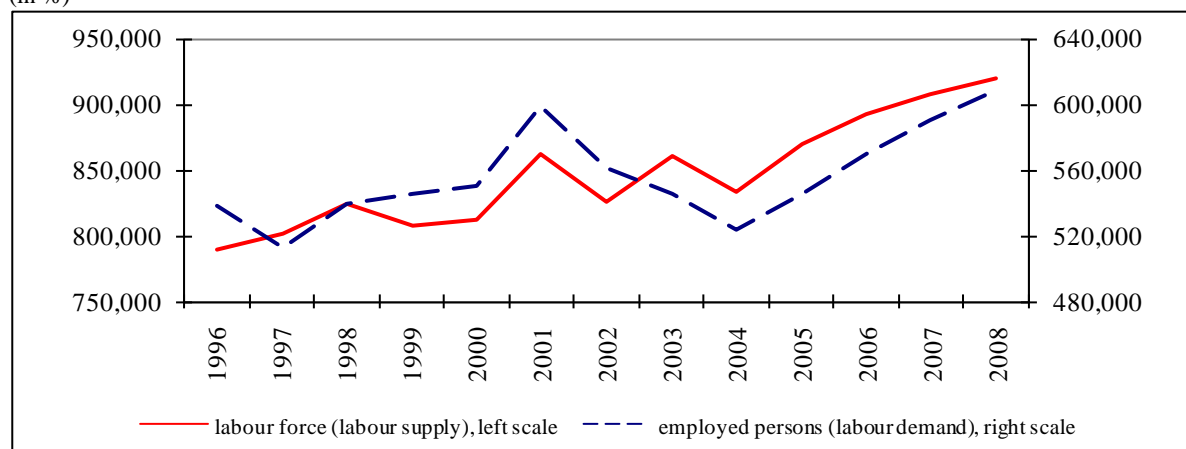
	Inflation (annual average rate of change)						
	2002	2003	2004	2005	2006	2007	2008
<i>Euro area</i>	2.3	2.1	2.1	2.2	2.2	2.1	3.3
<i>Southeast Europe</i>	8.8	5.2	3.8	4.6	4.9	4.2	8.4
Albania	1.7	3.3	2.2	2.0	2.5	3.1	3.4
Bosnia and Herzegovina	1.0	0.6	0.4	3.8	6.1	1.5	7.5
Bulgaria	5.8	2.3	6.1	6.0	7.4	7.6	12.0
Montenegro	16.4	6.8	2.2	2.4	2.9	4.2	8.5
Croatia	1.7	1.8	2.1	3.3	3.2	2.9	6.1
Kosovo	-	-	-1.1	-1.4	0.7	4.3	9.4
Macedonia	1.8	1.2	-0.4	0.5	3.2	2.3	8.3
Romania	22.5	15.3	11.9	9.0	6.6	4.9	7.9
Serbia	19.5	10.0	11.0	16.1	11.8	6.8	12.9

Source: Eurostat and national statistical offices.

2.3. Labor market and wages

The developments on the labor market in 2008 largely correspond with the pace of the economic activity in the current year. Thus, according to the Labor Survey, in the first three quarters, the unemployment rate registered steady decrease, and in the fourth quarter, the positive trend ceased. The unemployment rate in 2008 equaled 33.8%, on average, which is by 1.2 percentage points less compared to the preceding year. On the other hand, the employment rate reached 37.3% on average in 2008 (annual growth of 1.1 percentage point), given the simultaneous growth in both the demand and the supply of labor. The ceased downtrend of the unemployment in the last quarter, compared to the preceding quarter, indicates more intense slowdown in the unemployment compared to the usual seasonal slowdown in the fall months due to the termination of the employment of part time employees in the hotels, construction and trade sector. Hence, these data indicate a change in the trends on the labor market, as a direct effect of the slowdown on the growth of the domestic economy in the last quarter of the year, due to the global crisis and particularly high exposure of labor-intensive activities to this shock.

Figure 27
Labor market
(in %)

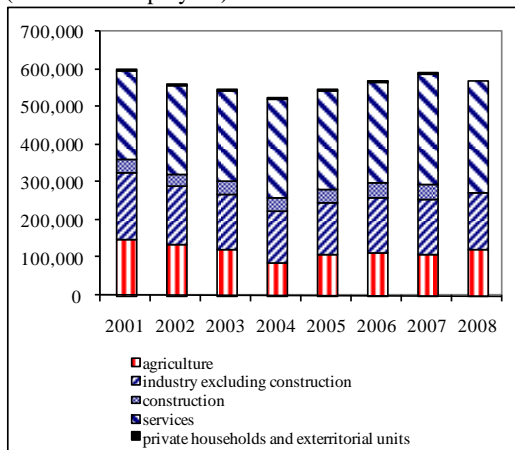


Source: SSO, Labor Survey, according to the definition of the International Labor Organization (ILO) for labor (or economically active population).

The sector-by-sector distribution of the increase in the employment, indicated in the surveys, in 2008 (of 3.2%), compared to the preceding year points to the agriculture, trade and manufacturing industry as main sectors that create this growth. On annual basis, these sectors registered an increase in the employment of 11.2%, 4.3% and 2.2%, respectively. The increase in the employment in the agriculture accounts for 64.1% of the increase in the number of employees in 2008 relative to the preceding year. The increase in the number of employees in the trade sector indicates the need of hiring more manpower, given the higher output. Steep increase was also registered in the number of employees in the mining sector, in line with the accelerated activity of ore extraction. Additionally, although the construction in 2008 did not registered fall in the employment, having in mind that globally it is one of the sectors which were the most affected from the slowdown in the lending activities and the external demand, the next period could witness a downtrend in the number of employees in this sector. However, the expected adverse effects from the recession could alleviate if there are public capital investments the next year, leading to higher engagement of domestic construction companies. On the other hand, although the average employment in the metallurgy in 2008 compared to 2007 was higher, the effects from the global recession on this industry are expected to intensify at the beginning of 2009, for which mass compulsory leaves and definite dismissals were announced.

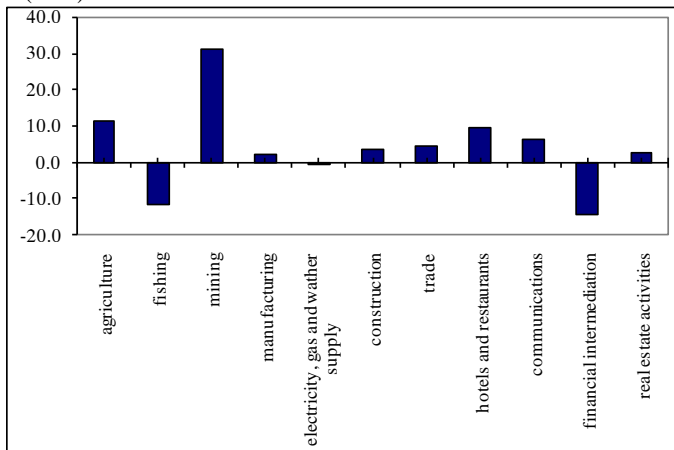
On the other hand, the faster fall in the employment, indicated in the surveys, was also registered in the other service activities, primarily the public utilities. A decrease was also registered in the employment in the financial intermediation, education and health and social works. Observing the overall public administration (which includes the narrower public administration and defense, health, social works and education), the employment was almost unchanged on annual basis.

Figure 28
Sector-by-sector employment
(number of employees)



Source: SSO, Labor Survey.

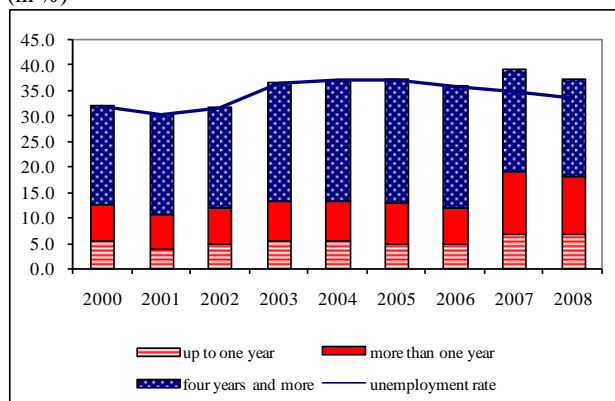
Figure 29
Annual growth rates of the employees by sector
(in %)



Notwithstanding the positive short-term developments, the labor market did not register significant developments in the unemployment structure with respect to its duration. Still, most of the unemployment is of long-term nature, i.e. most of the persons are unemployed over a year (82.1% in 2008, relative to 82.5% in 2007). On the other hand, the short-term unemployment (persons unemployed up to one year) registered minor upward development of the structural share in the total unemployment (from 17.5% in 2007 to 17.9% in 2008). In 2008, the number of persons unemployed up to one year and over one year reduced by 1.7% and 5.4%¹⁹, respectively.

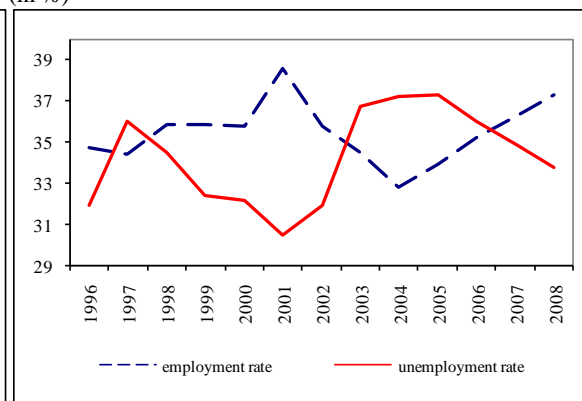
¹⁹ Source: Employment Agency of the Republic of Macedonia.

Figure 30
Unemployment structure with respect to duration
(in %)



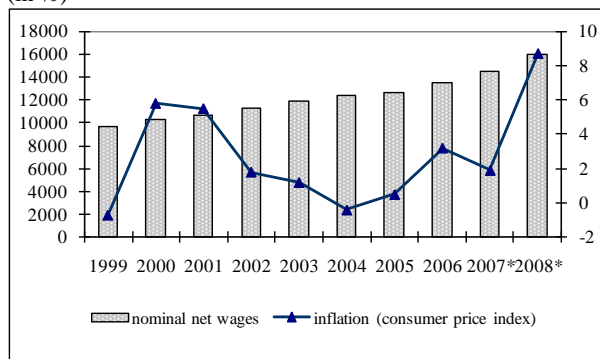
Source: SSO, Labor Market.

Figure 31
Employment rate and unemployment rate
(in %)



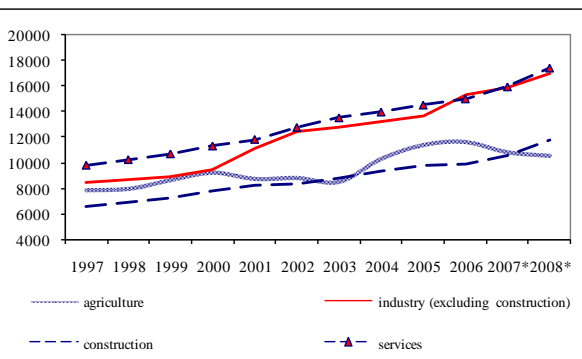
The uptrend of the wages kept on in 2008. Thus the average gross²⁰ and net paid wages per employee registered a nominal annual growth of 8.7% and 10.3%, respectively. In real terms, in environment of annual inflation rate of 8.3%, the average net wages registered a real growth of 1.9%, and the gross wages went up by 0.3% in real terms. The higher nominal wages in the public sector reflect the 10% increase in the wages of the public administration, starting with the wage in September 2008. Accordingly, an increase in the net paid wages was registered in the public administration and defense (12.9%), education (10.2%) and health and social works (13.8%). On the other hand, analyzing the private sector, the fastest increase in the net paid wages was registered in the construction (by 12%), agriculture, hunting and forestry (by 10.8%), and in the transport, storage and communications (by 9.9%).

Figure 32
Annual nominal changes in the gross and the net paid wage and inflation rate
(in %)



Source: State Statistical Office.

Figure 33
Average net paid wage by employee, by sector
(in denars)

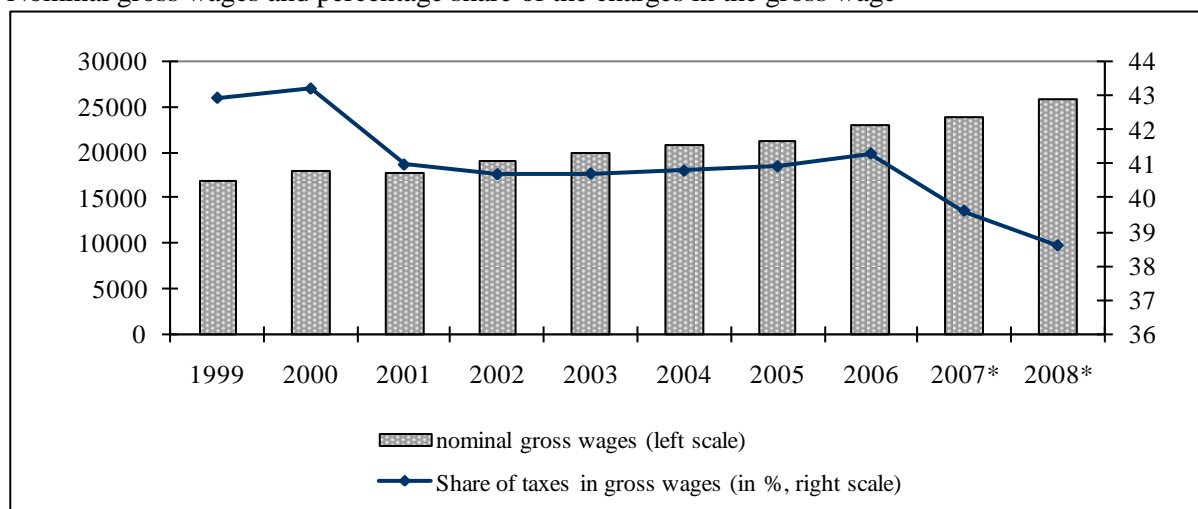


The slower nominal increase in the gross wages paid in 2008 relative to the growth in the net wages is due to the changes in the tax area. At the beginning of the year, the personal income tax rate went down²¹, which resulted in lowering the share of the charges on taxes and contributions in the gross wage and narrowing the gap between the net and the gross wage by 1 percentage point.

²⁰ Source: State Statistical Office. The total gross paid wages include net paid wages for the reporting period, paid personal income tax and paid contributions (for pension and disability insurance, for health insurance, for employment, for professional illness and for water supply). The different rates of nominal growth in the gross and the net wages result from the decrease in the personal income tax rate from 12% in 2007 to 10% in 2008.

²¹ At the end of 2006, measures were undertaken for lowering the wage costs in the Republic of Macedonia, so the progressive personal income rates of 24%, 18% and 15% were replaced with the "flat tax" concept, i.e. a single tax rate for all income categories, which from early 2007 equaled 12%, and at the beginning of 2008 this rate was reduced to 10%.

Figure 34
Nominal gross wages and percentage share of the charges in the gross wage



Source: State Statistical Office.

Observed by region, the average net wage per employee in the Republic of Macedonia remains the lowest. In 2008, the Republic of Macedonia registered the lowest real growth rate of the nominal net wages, which means further broadening of the gap compared to the regional average net wages. In 2008, the highest net wages were paid in Slovenia and in Croatia. The Republic of Macedonia still has the lowest average gross salary per employee, i.e. the lowest labor costs, also indicating competitive advantage of Macedonia relative to the other countries in the region. In 2007, Macedonia, Montenegro, Serbia and Bosnia and Herzegovina radically changed their labor tax systems. These four countries are facing similar economic and fiscal challenges and labor market challenges. Moreover, they have one of the highest unemployment rates in Europe and large informal employment. However, the reforms in these countries are much more focused on lowering the personal income tax, rather than on the social contributions. As a result of the labor tax reform in Macedonia, the implicitly calculated burden on the gross wages with taxes and social contributions reduced by 2.7 percentage points or from 41.3% prior to the reform (in 2006) to 38.6% in 2008, solely due to the decrease in the personal income tax (the contributions in 2007 and 2008 remain at the level before the reform which started in 2007). However, while there is a modest income tax rate of 10% (amongst the lowest in Europe) in Macedonia, even though there is no legally set minimum wage, there is a legally set minimum base for calculating the social contributions (the minimum base has been set at 50% of the average gross national wage). Such high input costs trigger distortive effects when taxing the lowest wages, resulting in lower registration of low-wage workers.

The rates and the contributions will be cut at the beginning of 2009²², with the increase in the tax deduction being important (the amount of gross wage which is free of tax). The new measures should be an incentive, particularly to the employers and potential investors in the labor-intensive sectors.

²² The pension insurance contribution reduced from 21.2% in 2008 to 19% in 2009; the health insurance contribution will be reduced from 9.2% to 7.5%, and the employment contribution from 1.6% reduced to 1.4%. The additional professional health insurance contribution of 0.5% became compulsory, i.e. since 2009 it will be included in the group of compulsory social contributions. Starting from 2009, the water supply contribution of 0.2% will no longer be included. This means that the burden on the gross wage with contributions from 32.7% in 2008 will be reduced to 28.4% in 2009.

Table 13
Wages by country

	in EUR	2008					
		2007	2008	nominal increase of wages in % (2008/2007)	inflation***** in %	real increase of wages in % (2008/2007)	personal income tax and contributions, % of the average gross wage
Macedonia**	average gross wage	390	423	8.3	9.0	-0.6	38.6
	average net wage	236	260	10.1	9.0	1.0	
Slovenia***	average gross wage	1279	1385	8.3	6.0	2.2	35.3
	average net wage	831	896	7.9	6.0	1.7	
Croatia**	average gross wage	951	1034	8.8	6.6	2.0	31.4
	average net wage	654	709	8.5	6.6	1.8	
Bulgaria*	average gross wage	405	506	24.9	13.5	10.0	
Bosnia and Herzegovina***	average gross wage	485	565	16.5	7.8	8.1	32.5
	average net wage	328	382	16.5	7.8	8.1	
Serbia****	average gross wage	484	559	15.4	12.6	2.5	28.3
	average net wage	347	401	15.4	12.6	2.5	
Montenegro****	average gross wage	496	609	22.8	9.0	12.6	31.8
	average net wage	337	415	23.3	9.0	13.1	
Romania***	average gross wage	416	469	12.7	8.0	4.3	26.4
	average net wage	308	345	12.0	8.0	3.7	

* average for the first nine months of the year.

** average for the first ten months of the year.

*** average for the first eleven months of the year.

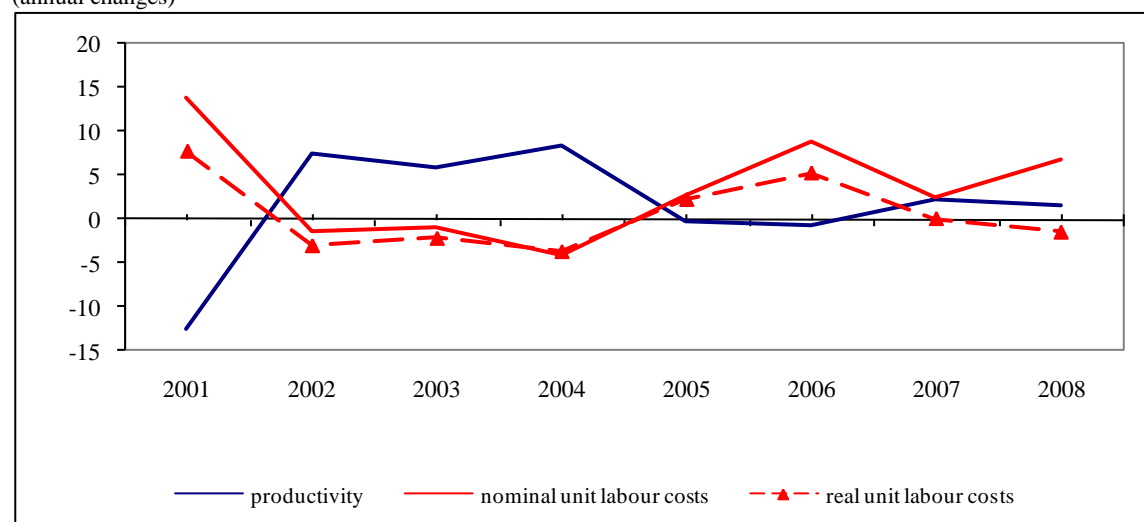
**** average for the whole year.

***** the consumer prices, as an inflation measure, have been taken aggregately for the period they refer to and the calculations for the average wages.

Source: Vienna Institute for International Economic Studies (wiiw, Monthly Data Base on Central, East and Southeast Europe). Date of using the base: 25.02.2009.

The labor productivity in 2008 was by 1.8% higher, as a result of the faster increase in the output compared to the increase in the employee number. Taking into account the increase in the average gross salaries of 8.7%, the nominal unit labor costs went up by 6.8% relative to the preceding year. If we insulate the effect of the inflation, the unit labor costs will fall by 1.4%²³.

Figure 35
Productivity and unit labor costs
(annual changes)



Source: State Statistical Office and NBRM calculations.

²³ The productivity and the unit labor costs for the overall economy have been calculated on the basis of GDP data, for the total number of employees, according to the Labor Survey of SSO and the data on the average gross wages.

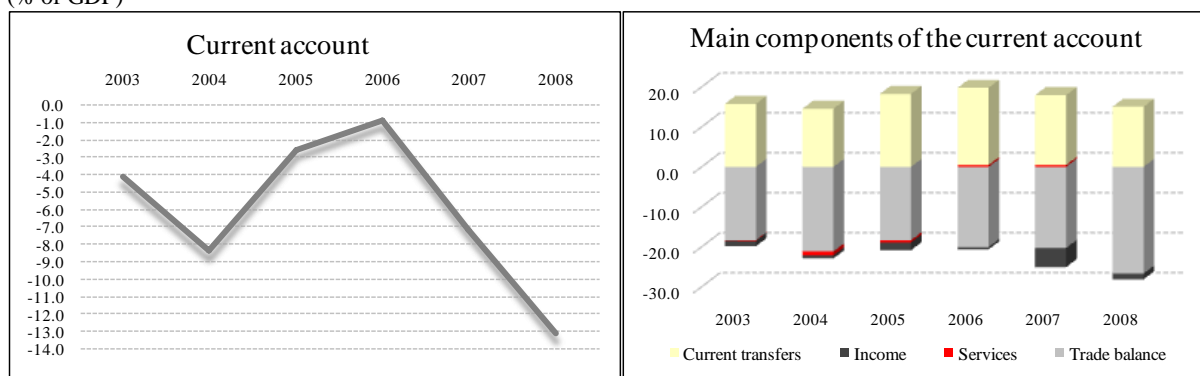
2.4. External sector

2.4.1. Balance of payments

In 2008, the changes in the trends in the international economy had a proportional effect on the external position of the domestic economy, as small and highly open. Thus the *current account* of the balance of payments registered historically highest negative gap of Euro 851.2 million, or 13.1% of the estimated GDP, which is an annual broadening of 5.9 percentage points. Such change in the current account mostly reflects the permanent increase in the negative trade balance, given the decrease in the net inflows from private transfers, which constitute traditional surplus item in the current account of the balance of payments. The capital and financial account in 2008 registered higher net inflows, primarily as a result of the higher net borrowing from abroad and the fall in the net foreign assets.

Figure 36

Dynamics of the balance and components of the balance of payments current account of the Republic of Macedonia
(% of GDP)

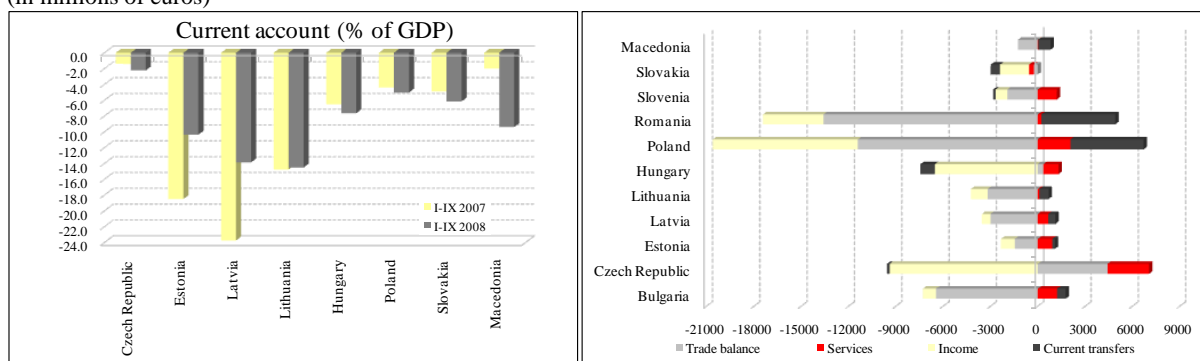


Source: National Bank of the Republic of Macedonia.

The comparison of the current account of the balance of payments of some new EU member-states (who accessed in 2004 and 2007), in the January- September 2008 period, shows further annual broadening of the negative gap, except for the Baltic countries. Observing the constituent components, the trade deficit prevails in all analyzed countries. Exception is the Czech Republic with its trade surplus, and Slovakia and Hungary, where the current accounts are dominated by the negative contribution of the income sub-balance.

Figure 37

Dynamics of the balance and the current account components of some countries in 2008
(in millions of euros)



*In absence of full data for 2008, the data for January - September 2008 period will be used for the balance of payments of the analyzed countries.

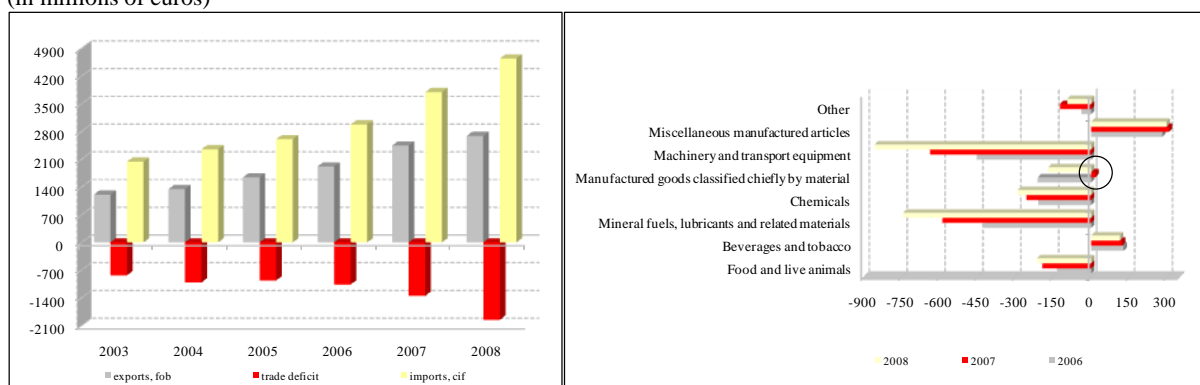
Source: NBRM and Eurostat.

2.4.1.1. Foreign trade of the Republic of Macedonia

The developments in the foreign trade were largely under the influence of the events in the global economy, mainly characterized with high degree of volatility in 2008. Additional effect came from the developments in the domestic economy, where the positive expectations of the entities and the robust support through the banking sector considerably increased the domestic consumption of imported goods over the most of the period. In the first half of the year, the deteriorated terms of trading and the intensified domestic personal and investment consumption were dominant factors driving the foreign trade of goods. The deterioration of the terms of trading was a mixed effect of the increasing trend of the oil prices (which reached its peak in July 2008) and the continuation of the downtrend of the nickel prices, which started in the second half of 2007 and brought about significant increase in the import and fall in the export of metals (dominant export branch). The second half of the year witnessed rapid shift of the global trends. The escalation of the financial crisis implied considerable slowdown in the global growth. Under such conditions, the world oil prices drastically decreased, thus alleviating the pressures on the domestic trade deficit. On the other hand, it meant essentially lower external demand, with drastic effects on the real sector, through the lower domestic production and consequently, lower export of goods. Hence, the total foreign trade²⁴ in 2008 went up by 17.5%, given the faster increase in the imports compared to exports (22.4% and 9.9%, respectively). The two components of trade reached their peak in July 2008, in environment of solid growth in the domestic economy and increasing oil prices. The share of foreign trade in GDP in 2008 is by 4.9 percentage points higher relative to the preceding year and equals 112.7%, thereby proving the high degree of openness of the domestic economy.

Figure 38

Exports, imports and trade balance by category*
(in millions of euros)



* According to the Standard International Trade Classification (SITC).

Source: State Statistical Office.

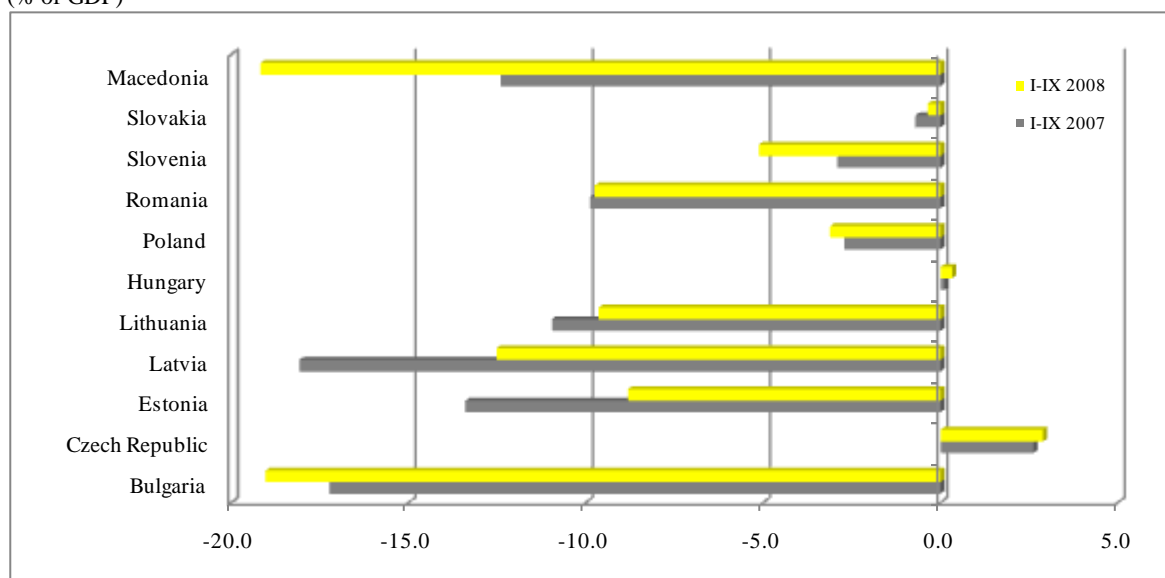
In the first half of the year, the gap in the foreign trade was widening steeply, given the deterioration of the terms of trading and the faster growth in the domestic demand. In the second half, after the slowdown in the growth in the third quarter, the deficit in the last quarter of the year registered moderate annual decrease, in line with the drastic fall in the oil price and the slowdown in the growth of the domestic economy. However, the trade deficit (on c.i.f.-basis) for the entire 2008 was the highest ever, and its share in GDP reached 30% (23.3% of GDP in 2007)²⁵. The faster growth in the imports relative to the exports brought about historically record level of the trade deficit of Euro 1,954.2 million, or 44.9% more relative to 2007. The structure of the components, as major contributors to the trading gap, is similar as in the preceding year, with significantly higher intensity. Thus, the largest contribution to the widened negative trade balance was

²⁴Source: Preliminary data of the State Statistical Office. The export of goods is on f.o.b.-basis, whereas the import of goods is on c.i.f.-basis. The exports and the imports differ from the amounts in the balance of payments of methodological reasons (including the time adjustment of the import of electricity in 2008 in the statistics of the balance of payments, unlike the SSO's data on the imports which have not been corrected on this basis).

²⁵ On f.o.b.-basis, the trade deficit in 2008 constituted 26.7% of GDP, compared to 20.3% of GDP in the previous year.

made by the higher trade deficit in the categories of machines and transport devices²⁶ and mineral fuels and lubricants (of 36% and 25.8%, respectively). The swing in the direction is evident in the category of products classified by material, which from surplus registered in 2007 switched to deficit in the current year. Within this category, the trade balance of the iron and steel (its dominant item) is still in surplus, but compared to the previous year, the surplus is by 31% lower. The export-import coverage ratio in 2008 went down by 6.5 percentage points and equals 57.9%.

Figure 39
Trade balance by country
(% of GDP)



Source: Eurostat and NBRM.

The comparative analysis with some of the new EU member states, based on the share in the trade deficit²⁷ in GDP, shows that relative to the preceding year, the share is additionally extended in Bulgaria, Slovenia and to a lower extent, in Poland. On the other hand, changes towards improving the negative trade balance were registered in Latvia, Estonia, Lithuania, Slovakia and Romania. Within this group of countries, trade surplus was typical only in the Czech Republic and Hungary, and the share of surplus in GDP in 2008 went up annually.

The increase in the export of goods (9.9%) in 2008 is primarily a result of the higher export of oil derivatives and metal ore and scrap. Thus the export of oil derivatives went up by 78.3%, due to the increase in both the quantities and the prices (52% and 17.3%, respectively). In this year, the path of development of the export of oil derivatives followed the trend of the international oil prices, which were going up till July, upon which they started falling down. Such effects from the changes in the international oil prices on the domestic exports were additionally deepened with the temporary termination of the work of the domestic refinery, thus contributing to the lowest export of goods in December ever. In the first half of the year, positive trend was also registered in the export of ores, which peaked in June. However, in the last four months of the year, the effects of the global crisis, primarily the drastic fall in the international copper prices, adversely affected the domestic output, resulting in closedown of the major mine facility in the country. It could be said that the conclusion regarding the trends in this branch also applies to most of the activities in the industry. Thus, the Business Tendency Survey in the manufacturing industry shows lower volume of output in the last months of 2008 (and consequently, the opportunities for placing the products intended for export), due to the lower external demand. Notwithstanding the negative developments in the exports

²⁶ Classified by SITC's sectors. The contribution of the vehicle deficit to the widening of the deficit of the machines and transport devices category equals 32.3%, and its contribution to the total deficit equals 11.6%.

²⁷ The export and import of goods are on f.o.b.-basis.

at the end of the year, the industrial output of ores registered growth rate in the entire 2008, where the export of metal ore and scrap registered an uptrend of 62.6% relative to 2007.

Table 14

Contribution to the overall growth in the export of goods by group of products*

groups of products	2007	2008	2008-2007	2008/2007	2007	2008	2008/2007
	in EUR millions		changes in absolute amount (in millions of Euros)	change (in %)	structure (in %)		contribution to the growth of exports (in %)
EXPORT OF GOODS	2,446.4	2,689.2	242.8	9.9	100.0	100.0	
<i>Food and live animals</i>	<i>180.5</i>	<i>210.1</i>	<i>29.6</i>	<i>16.4</i>	<i>7.4</i>	<i>7.8</i>	<i>12.2</i>
of which: cereals and cereal preparations	21.8	28.2	6.4	29.2	0.9	1.0	2.6
fruits and vegetables	103.5	112.7	9.3	9.0	4.2	4.2	3.8
<i>Beverages and tobacco</i>	<i>151.0</i>	<i>148.8</i>	<i>-2.2</i>	<i>-1.5</i>	<i>6.2</i>	<i>5.5</i>	<i>-0.9</i>
of which: beverages	74.0	65.0	-9.0	-12.2	3.0	2.4	-3.7
tobacco and tobacco manufactures	77.0	83.8	6.8	8.8	3.1	3.1	2.8
<i>Crude materials, inedible, except fuels</i>	<i>123.9</i>	<i>181.2</i>	<i>57.3</i>	<i>46.2</i>	<i>5.1</i>	<i>6.7</i>	<i>23.6</i>
of which: metalliferous ores and metal scrap	92.2	149.8	57.7	62.6	3.8	5.6	23.7
<i>Mineral fuels, lubricants and related materials</i>	<i>120.0</i>	<i>210.7</i>	<i>90.7</i>	<i>75.5</i>	<i>4.9</i>	<i>7.8</i>	<i>37.3</i>
of which: petroleum and petroleum products	114.9	204.8	90.0	78.3	4.7	7.6	37.0
<i>Goods classified by material</i>	<i>1,097.0</i>	<i>1,075.9</i>	<i>-21.1</i>	<i>-1.9</i>	<i>44.8</i>	<i>40.0</i>	<i>-8.7</i>
of which: iron and steel	921.2	867.5	-53.7	-5.8	37.7	32.3	-22.1
manufactures of metals, n.e.s.	44.6	70.5	25.9	58.0	1.8	2.6	10.7
<i>Others</i>	<i>774.0</i>	<i>862.5</i>	<i>88.6</i>	<i>11.4</i>	<i>31.6</i>	<i>32.1</i>	<i>36.5</i>
of which: clothes	499.0	521.6	22.6	4.5	20.4	19.4	9.3

* According to SITC.

Source: State Statistical Office.

With respect to the export of iron and steel, as a major export component, for the first time since 1999, 2008 witnessed a negative contribution of this branch to the increase of the total exports (of 22.1%). The rapid decrease in the global demand and its effects on the real sector of the economy (evident through lowering the industrial production of metals and the employment in this sector), as well as the negative developments in the metal prices, are factors which caused such developments. The export of iron and steel fell by 5.8%, and within this category, faster annual fall of roughly 46% was registered in the export of ferronickel²⁸.

The export structure registered higher share of the oil derivatives and the metal ore and scrap, whereas compared to the preceding year, the share of the export of iron and steel and the export of wearing apparel and textile is lower.

From the aspect of the concentration indicators, according to the Herfindahl-Hirschman index, 2008 registered lower degree of concentration²⁹ on the side of export of goods (0.266), compared to the preceding year, when it equaled 0.307.

²⁸ Source: www.worldbank.org; commodity price index; the calculations have been made at NBRM. The average nickel price dropped by 43.3% in 2008 compared to the preceding year. On the other hand, the average price of the hot-rolled products surged by 48.6% (the share of these products in the export, compared to the ferronickel, is higher on annual basis, whereby their exports rose by about 28%).

²⁹ Herfindahl-Hirschman index over 0.18 indicates high degree of concentration.

Table 15

Contribution to the overall growth in the import of goods by group of products*

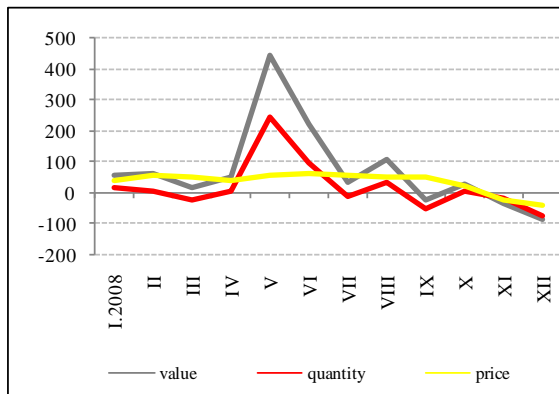
groups of products	2007	2008	2008-2007	2008/2007	2007	2008	2008/2007
	in EUR millions		changes in absolute amount (in millions of Euros)	changes (in %)	structure (in%)		contribution to the growth of exports (in %)
IMPORTS OF GOODS	3,795.0	4,643.4	848.4	22.4	100.0	100.0	
<i>Mineral fuels, lubricants and related materials</i>	<i>708.3</i>	<i>955.0</i>	<i>246.7</i>	<i>34.8</i>	<i>18.7</i>	<i>20.6</i>	<i>29.1</i>
of which: petroleum and petroleum products	459.0	626.9	168.0	36.6	12.1	13.5	19.8
- crude oil	413.9	564.2	150.3	36.3	10.9	12.2	17.7
volumes in tons	1,063,614.4	1,056,671.1	-6,943.3	-0.7			
price in euro for 1 kg	0.39	0.53	0.14	37.2			
electric energy	180.8	234.9	54.1	29.9	4.8	5.1	6.4
<i>Crude materials, except fuels</i>	<i>212.6</i>	<i>235.9</i>	<i>23.3</i>	<i>10.9</i>	<i>5.6</i>	<i>5.1</i>	<i>2.7</i>
of which: metalliferous ores and metal scrap	155.2	173.2	18.1	11.7	4.1	3.7	2.1
<i>Manufactured goods classified chiefly by material</i>	<i>1,080.1</i>	<i>1,244.7</i>	<i>164.6</i>	<i>15.2</i>	<i>28.5</i>	<i>26.8</i>	<i>19.4</i>
of which: iron and steel	396.4	505.2	108.8	27.5	10.4	10.9	12.8
manufactures of metals	82.7	97.6	14.9	18.0	2.2	2.1	1.8
<i>Machinery and transport equipment</i>	<i>746.4</i>	<i>981.1</i>	<i>234.7</i>	<i>31.4</i>	<i>19.7</i>	<i>21.1</i>	<i>27.7</i>
of which: power generating machinery and equipment	18.1	65.8	47.7	262.7	0.5	1.4	5.6
general industrial machinery	99.7	139.7	40.0	40.1	2.6	3.0	4.7
road vehicles	232.1	302.2	70.1	30.2	6.1	6.5	8.3
<i>Other</i>	<i>1,047.5</i>	<i>1,226.7</i>	<i>179.2</i>	<i>17.1</i>	<i>27.6</i>	<i>26.4</i>	<i>21.1</i>

* According to SITC.

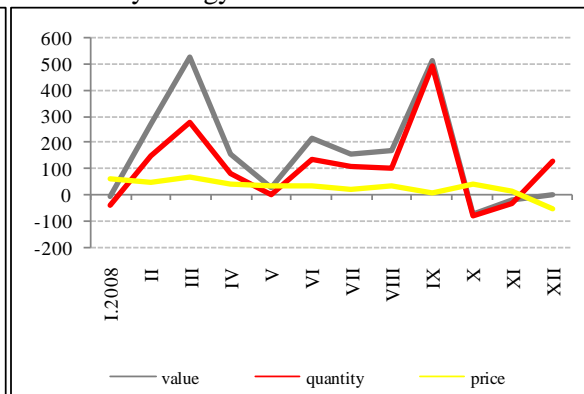
Source: State Statistical Office.

The solid growth rates of the domestic economy, the relatively high volume of direct investments, the fast growth of the credits and the high prices of energy sources over the most of the year, contributed to the substantial increase of 22.4% in the imports in 2008. Thus, the growth in the domestic economy, given its high energy dependence and the significant growth in the prices of energy sources, created pressures on the import of **energy**, which have a dominant contribution to the increase in the overall imports. The import of oil and oil derivatives surged by 36.6% on annual basis, and within its frameworks, the import of crude oil went up (by 36.3%), due to the price effect. Additionally, the higher import of electricity of 29.9% is due to 28.8% increase in the prices. However, the spillover of the global crisis on the volume of the domestic output and the decrease in the oil prices substantially mitigated the pressures of the imports through this channel over the last quarter of the year. Given the high growth rates of the domestic investments and the relatively large inflows from direct investments, considerable contribution to the increase in the total imports in 2008 was made by the **machines and transport devices**. Moreover, the joint contribution of the import of energy and the import of machines and transport devices was relatively high in 2008 and equaled 56.7%. In 2008, considerable contribution (12.8%) to the annual growth of the imports was also made by the imports of **iron and steel**, which is in line with the high raw material import component in the export of these products. The imports concentration according to the Herfindahl-Hirschman index in 2008 indicates higher concentration of the imports (0.103, compared to 0.094 in 2007).

Figure 40
Annual changes in the import of energy
(in %)
Crude oil



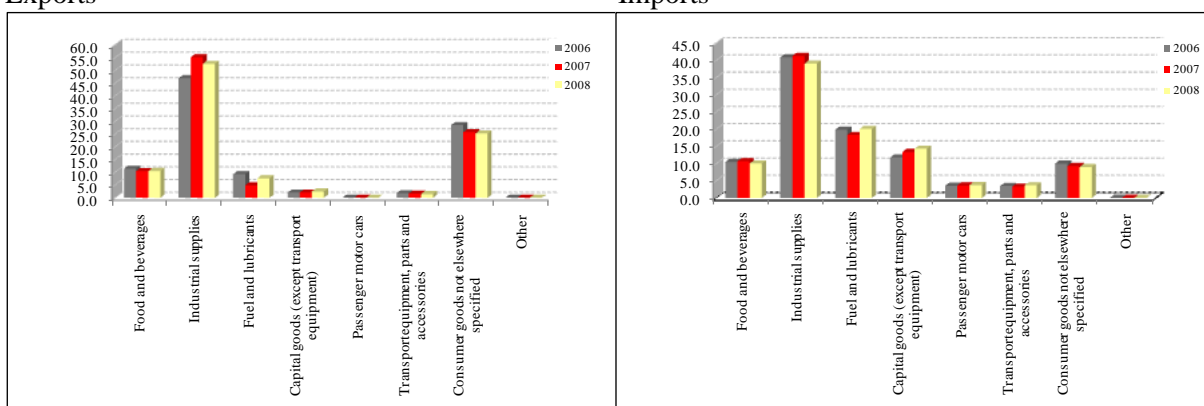
Electricity energy



Source: National Bank of the Republic of Macedonia.

The analysis of the foreign trade by economic purpose of the categories shows that in 2008 the industrial procurements and goods for joint consumption has the highest share in the exports, whereas the industrial procurements and fuels and lubricants has the highest share in the imports. On the export side, the dominant share of the industrial procurements dropped by 2.6 percentage points compared to the preceding year, for the account of the increase in the share of fuels and lubricants of 2.8 percentage points, when the export of energy sources is considered a driving force of the increase in the total exports. If the breakdown by economic purpose is reclassified, in order to connect it to the sectors in the real economy, it could be noted that most of the exports is directed towards the foreign manufacturing sectors, followed by the consumption of the foreign households. Also, within the imports, the share of fuels and lubricants is higher (by 1.7 percentage points), whereas the share of industrial procurements falls (by 2.2 percentage points) compared to 2007, which is in line with the developments of the share of these products on the export side. As to the imports by economic purpose, the import of products for the manufacturing industry dominates, which corresponds with the higher domestic industrial output, on average, in 2008. The share of energy sources in the imports goes up, in line with the higher prices of energy sources and lower domestic production of electricity.

Figure 41
Structure of the foreign trade of the Republic of Macedonia by economic purpose of the products
(in %)
Exports



Source: State Statistical Office.

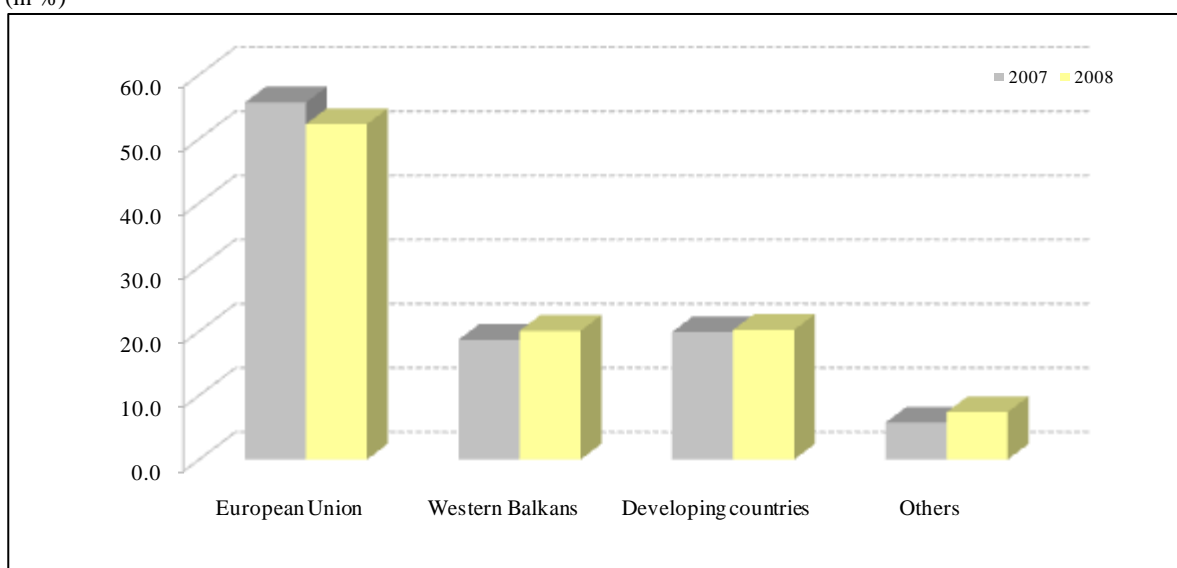
With respect to the currency structure, in 2008, the Euro still dominates the foreign trade (higher annual share of 4.4 percentage points), for the account of the US Dollar, the share of which dropped by 4.3 percentage points on annual basis. The analysis shows that the share of

the Euro and the US Dollar in the export of goods is 78.4% and 21%, respectively, and in the import of goods it is 72.8% and 26.3%, respectively. The higher share of the US Dollar in the imports accounts for the growth of the value of the import of crude oil, paid in this currency.

Regionally, the foreign trade of the Republic of Macedonia in 2008 is mostly directed towards the EU countries. The analysis of the geographic distribution of the exports and the imports indicates lower share of the EU countries in the total trade (by 3.4 percentage points). This could partially account for the lower share of the exports to EU, as a reflection of the effect of the global economic crisis on the export-oriented domestic production of iron and steel and the start of the recession in the countries - trading partners from EU at the end of the year. Thus the share of the export of goods to EU was cut by 5.7 percentage points, and the import of goods from EU fell by 1.4 percentage points. On the other side, higher share in the foreign trade is evident in the Western Balkan countries and the developing countries.

Figure 42

Geographic direction of the foreign trade of the Republic of Macedonia
(in %)



Source: State Statistical Office.

The largest trading partners of the Republic of Macedonia in 2008 are Germany, Greece and Russia, making up 29.7% of the foreign trade. The statistical data show that the first largest partner in the foreign trade is Serbia, but these data also include the trade with Kosovo. If the trade with Kosovo³⁰ is excluded from this data, Serbia will no longer hold the position of largest trading partner. The highest surplus was registered in the trade of goods with Kosovo, totaling Euro 355 million. The highest deficit balance (Euro 601.1 million) was registered in the foreign trade with Russia, due to the import of crude oil (90.8% of the total imports from Russia).

2.4.1.2. Other current account components

The foreign trade in services also contributed to further deepening of the current account deficit in 2008. The category of services registered equilibrated balance, relative to the net-inflows of Euro 25.5 million in 2007. These developments primarily result from the lower net-inflows from investment activities abroad (by 35.1%), in environment of global economic crisis and slower construction activity of the Macedonian companies abroad, i.e. decrease in the completed construction works primarily in Ukraine, followed by Russia, Serbia and Montenegro³¹. Moreover, the higher import of goods resulted in higher net-outflows for transport services (by 20.2%). On the other hand, a

³⁰ Estimated data on foreign trade with Kosovo.

³¹ According to the data of the State Statistical Office.

positive balance, contributing to marginal annual increase of 2.8%, was registered in the tourism/travelling item, i.e. it witnessed higher inflows compared to the inflows from the games of chance and the turnover from nonresidents' payment cards, proved with the increase in the number of foreign tourists and overnight stays on annual basis (by 10.8% and 13.4%, respectively)³².

Figure 43
Dynamics of the balance of services by component, net in the Republic of Macedonia (in millions of euros)

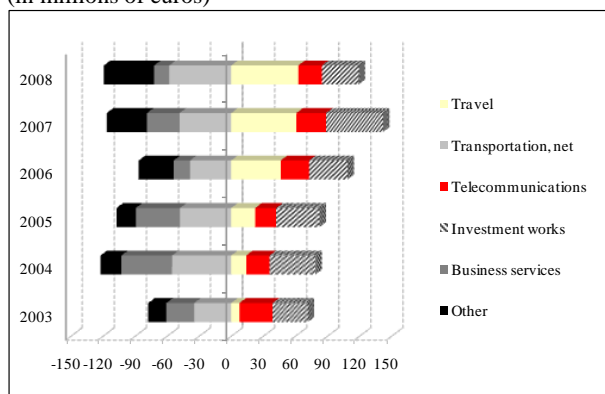
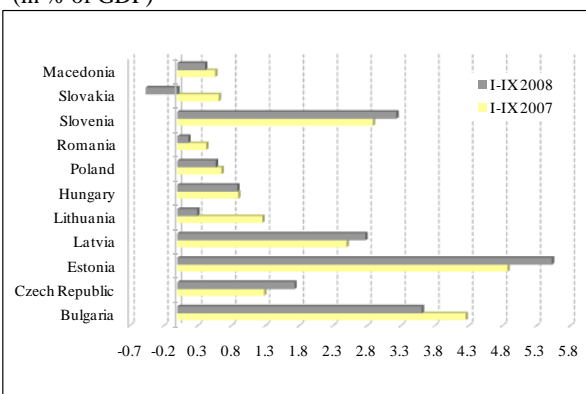


Figure 44
Dynamics of the balance of services on net basis by country (in % of GDP)



* In absence of full data for 2008, the data for January - September 2008 period are used for the balance of payments of the analyzed countries.

Source: NBRM and Eurostat.

The comparative analysis of this component of the current account with some new EU member states shows that almost all of them, except for Slovakia, register net-inflows. Structurally observed, most of the inflows from transport services flow to the Baltic countries and Poland, whereas the net-inflows from tourism are typical for Bulgaria, Czech Republic, Hungary and Slovenia. With respect to the dynamics, Macedonia, together with Lithuania, Bulgaria, Romania and Poland, moves towards decreasing the surplus balances based on services on annual basis, whereas all other analyzed countries registered annual growth rate (except for Slovakia, which switch towards deficit).

Positive contribution to the decrease in the current account deficit was made by the income balance, considering that the net-outflows in the amount of Euro 93.4 million fell by 66.4% annually, given the lower outflows for direct investments. Thus the net-outflows based on the income from direct investments registered annual fall of 45.4%, with considerably lower outflows³³ based on reinvested and undistributed gain. Nevertheless, this item registered higher dividends paid to foreign investors (by 7.6%), mainly due to the payment of dividend to foreign investor in one large company. Contribution to the decrease in the deficit income balance was made also by the higher net-inflows from portfolio-investments (primarily created by the placement of the foreign reserves in securities) and the net-inflows from contributions for employees - residents.

³² According to the data of the State Statistical Office.

³³ Preliminary 2008 data.

Figure 45
Dynamics of the income balance by component, net, Republic of Macedonia (in millions of euros)

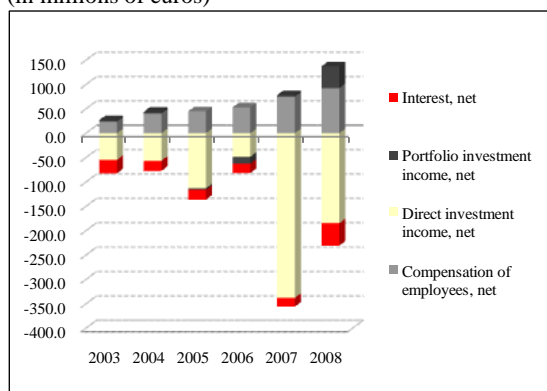
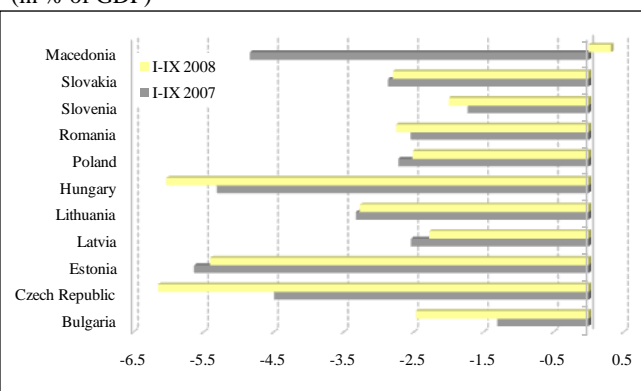


Figure 46
Dynamics of the income balance on net-basis by country (in % of GDP)

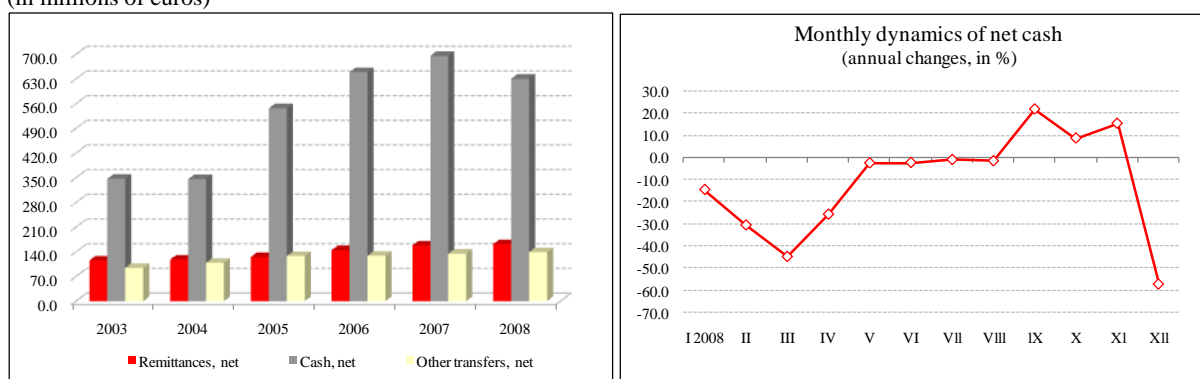


* In absence of full data for 2008, the data for January - September 2008 period are used for the balance of payments of the analyzed countries.

Source: NBRM and Eurostat.

The comparative analysis of the income sub-balance with some new EU member states shows that the basic feature in this category of balance of payments is the high deficit, which additionally deepened on annual basis (in absolute amounts). According to the structural analysis, the outflows based on income from direct investments constituted a dominant component in the income, which corresponds with the high foreign direct investments in these countries in the past period. Exception to this trend is Slovenia, where the outflows based on income from portfolio-investments have the highest share in the structure of the income category.

Figure 47
Balance and dynamics of private transfers and its integral components (in millions of euros)



Source: NBRM.

For the first time since 2004, the traditionally surplus item within the current account of the balance of payments of the Macedonian economy, the net-inflows from current transfers, fell by 3.3% on annual basis. Within this sub-balance, 95.1% of the net-inflows are private transfers, whereas the remaining net-inflows are official transfers, which were as twice as higher on annual basis. The net-inflows from private transfers fell by 5.8% on annual basis, totaling Euro 931 million, making up 14.3% of GDP, which is by 2.8 percentage points less compared to 2007. The lower private transfers in combination with the rapidly increasing trade deficit brought about only 53.6% trade deficit coverage with private transfers, which is considerably less compared to the coverage rate of 84.1% in the preceding year. The monthly balance of the private transfers is closely connected with

the development of its basic component - net private transfers in cash³⁴, which with its annual fall of 9.3%, is the only driving force of the unfavorable movements of the private transfers. Thus, in 2008, the path of development of the net-cash was fairly turbulent. In the first few months of the year, they registered significant annual fall (due to the increasing inflation and inflationary expectations, accompanied with the uncertainty for the region and the country) which slowed down gradually and starting from September, they started increasing on annual basis (due to seasonal effects and stabilization of inflationary expectations). However, given the steep worsening of the global economic crisis (recession in most developed countries, these inflows mostly come from), the increasing trend of the inflows from net-cash was terminated in the last month of the year, registering an annual fall of 56.7%. The other components of private transfers, remittances and other transfers (rents, pensions, disability pensions), which are relatively stable, in 2008 witnessed insignificant growth rates of 2.2% and 3.1%, respectively.

Figure 48
Dynamics and structure of current transfers by component in the Republic of Macedonia (in millions of euros)

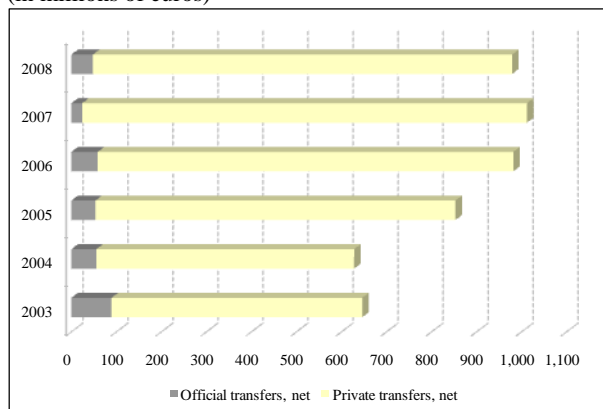
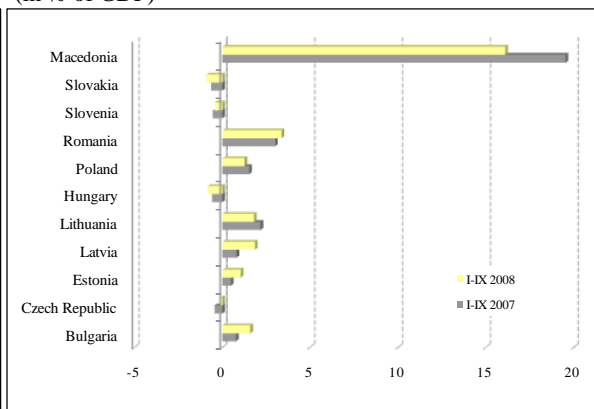


Figure 49
Dynamics of current transfers on net basis by country (in % of GDP)



* In absence of full data for 2008, the data for January - September 2008 period are used for the balance of payments of the analyzed countries.

Source: NBRM and Eurostat.

In spite of the decrease in the current transfers by 2.4 percentage points of GDP on annual basis (constituting 14.5% of GDP), Macedonia, compared to the analyzed EU member-states, registers the highest inflow on this basis. Decrease in the positive balance, as in the case of our country, was also registered in Poland and Lithuania, unlike Bulgaria, Romania, Estonia and Latvia, which register increasing surplus. On the other hand, negative balances in this component of the current account was registered in four country, of which in Slovakia and Hungary this deficit deepens, whereas in Czech Republic and Slovenia, the net outflows go down on annual basis. The countries in the region, same as Macedonia, register significant inflows from current transfers, and in 2007 these inflows in Albania accounted for 13% of GDP, and in Serbia 10% of GDP. In 2008, mainly due to the recession in the developed economies, the net inflows from current transfers in Serbia reduced to 7.9% of GDP, and in Albania in the first nine months of the year, they made up 7.6% of GDP.

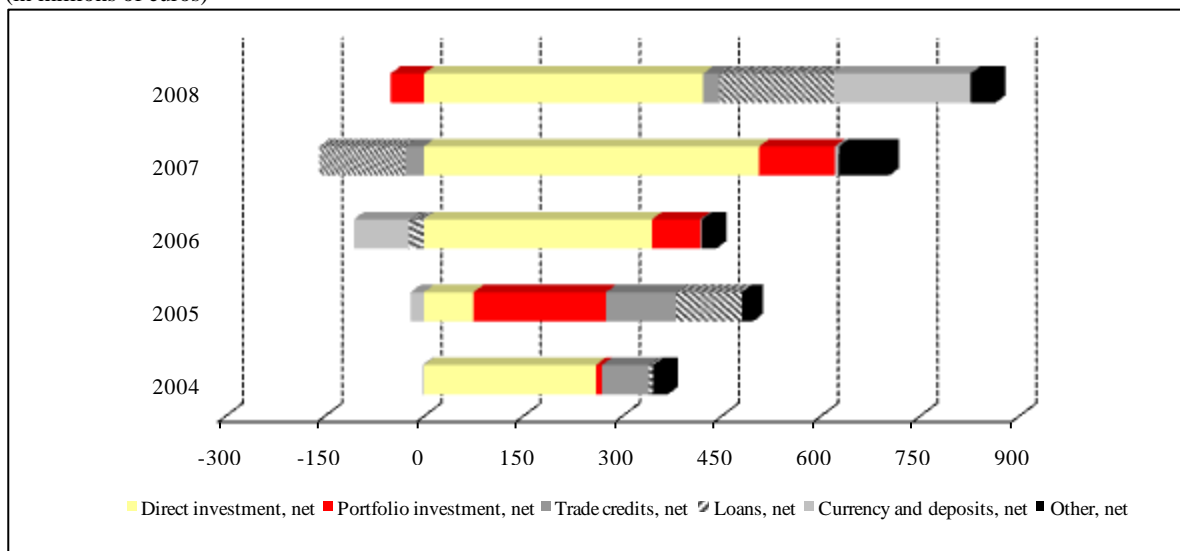
2.4.1.3. Capital and financial account

The increasing current account deficit is primarily financed by the net inflows of the capital and financial account and, in small portion, by the gross official reserves. The capital and financial account surplus (without official reserves) equals Euro 801 million, and the gross official reserves fell by Euro 51.6 million, on annual basis. Comparing with 2007, in 2008, the net-inflows in

³⁴ In the compilation of the balance of payments of the Republic of Macedonia, the net private transfers in cash was calculated on the basis of data from the currency exchange market on the net cash which flows into the banking system, because it is assumed that most of it originates from inflows from private transfers in cash through informal channel.

the capital and financial account surged by Euro 251.6 million, due to the increase in the inflows from used loans and trade credits.

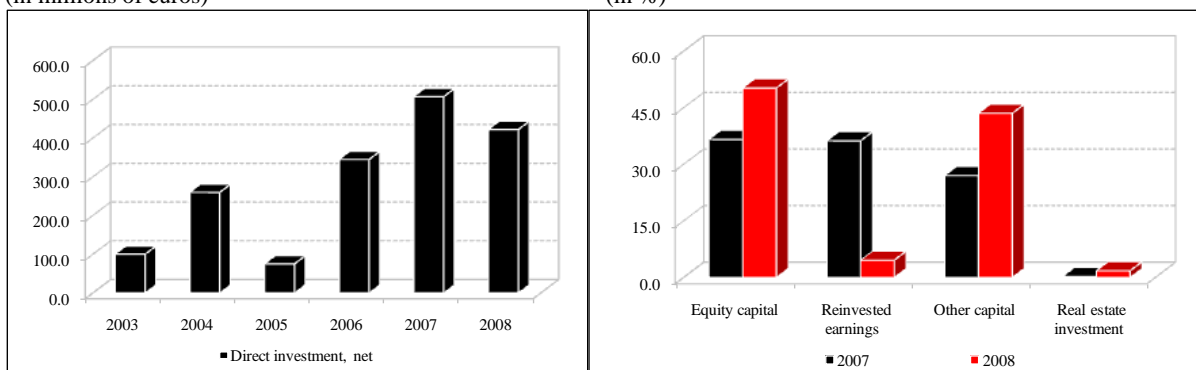
Figure 50
Components of the financial account
(in millions of euros)



Source: National Bank of the Republic of Macedonia.

While the direct investments registered considerable inflows of Euro 422 million on net basis, they decreased by 16.7% on annual basis, thus funding 49.6% of the current account deficit (in 2007, this ratio equaled 122.2%). The monthly dynamics of the direct investments shows that 82.6% of the total amount was made in the first nine months of 2008, followed by a slowdown in the next months, primarily due to the growing global uncertainty, international lack of liquidity, high reluctance of the foreign investors to take risk, and postponement of the already planned investments. The structure of the net direct investments indicates that most of the inflows constitute a contribution to the capital (50.2%) and credits and loans among connected entities (43.5%). Over the entire year (except for July), the portfolio-investments witnessed a disinvestment trend, i.e. sale of domestic equities by foreign investors, in environment of global lack of liquidity and uncertainty. Thus, the net-outflows based on portfolio-investments total Euro 50.6 million, compared to the preceding year which registered inflows from portfolio-investments of Euro 114.4 million. Simultaneously, the capital account registers net-outflows (Euro 12.8 million), mainly due to the purchase of embassies in Austria, Czech Republic and Russia.

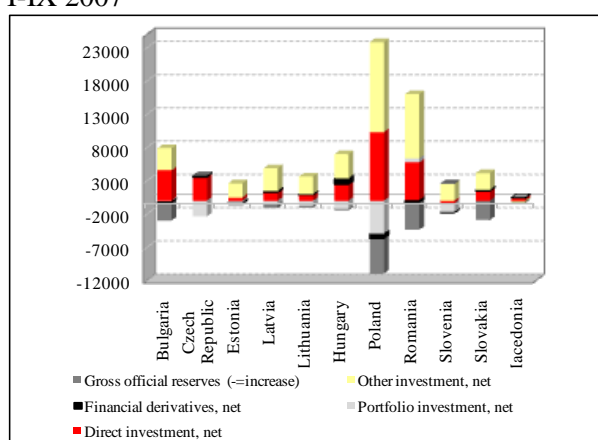
Figure 51
Dynamics and structure of foreign direct investments, net
(in millions of euros) (in %)



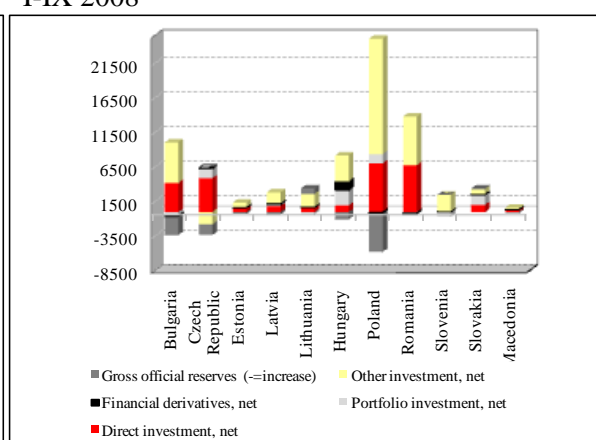
Source: National Bank of the Republic of Macedonia.

Of the remaining financial account components, the currencies and deposits on net-basis registered an annual decrease of Euro 207.5 million, largely due to the reduction in the net foreign assets of the banks of Euro 234.6 million (due to the orientation of the banks to reduce their foreign assets abroad in order to fund the credits). The net foreign assets of the households outside the banking sector went up in slower pace compared to the increase in the preceding year, surging by Euro 43.4 million on annual basis, largely resulting from the developments in the last quarter which registered faster outflows from the banks, in environment of higher uncertainty. Observing the loans, the net-repayments registered in 2007, became net borrowings in 2008 in the amount of Euro 172.4 million, given the higher amount of used foreign loans and lower annual repayments. Consequently, due to the volatile developments triggered by the global recession and the remarkable deterioration on the current and the capital and financial account in the balance of payments in 2008, compared to the end of the preceding year, the gross official reserves went down by Euro 51.6 million³⁵.

Figure 52
Financial account components by country
(in millions of euros)*
I-IX 2007



I-IX 2008



* The other investments category, net, is an aggregate review of loans (short-term and long-term) and currencies and deposits.

Source: Eurostat and NBRM.

If a comparative analysis is made of the capital and financial account of the balance of payments of some new EU member-states, it should be noted that the net-inflows in the financial account of almost all countries are higher compared to the preceding year (except for Latvia and Estonia, where they went down on annual basis), with the highest share of the net-inflows in GDP³⁶ being registered in Bulgaria (19.9% of GDP), and the lowest in Czech Republic (2% of GDP). In 2008, in Macedonia, the net-inflows in the capital and financial account (excluding the official reserves) constituted 12.3% of GDP. In all countries, the largest capital and financial account component is the item of other investments, i.e. borrowings from abroad, except for Czech Republic and Macedonia (where most of the inflows come from foreign direct investments) and Slovakia (dominant role of the inflows from portfolio-investments). In environment of global uncertainty and restraint from investment, lower inflows from direct investments were registered in Poland, Latvia, Slovakia, Lithuania and Bulgaria. At the same time, net-outflows for portfolio-investments are registered in Slovenia, Bulgaria, Lithuania, Romania and Macedonia.

2.4.2. Gross external debt

In 2008, the external debt of the economic agents went up compared to the preceding year. Thus, the net external debt on December 31, 2008 stood at Euro 878.8 million, and compared to the end of the preceding year, it surged by 4.5 times, due to the increase in the gross external debt.

³⁵ The gross official reserves data recognized in the balance of payments differ from the gross foreign reserves data, since the statistics of the balance of payments excludes the cross-currency differentials and the monetary gold.

³⁶ Eurostat's projections for GDP by country were used for 2008.

Simultaneously, the claims on gross basis went down due to the decrease in the claims of the monetary authority and the banking sector.

Table 16
Dynamics of the external debt

	2005	2006	2007	2008	2005	2006	2007	2008	2005	2006	2007	2008
	in millions of euros				annual changes							
					in absolute amount				in %			
Gross external debt	2,518.1	2,495.2	2,840.2	3,350.6	447.5	-22.9	345.0	510.4	21.6	-0.9	13.8	18.0
General Government	1,282.8	1,066.9	905.9	936.8	266.4	-215.9	-161.1	30.9	26.2	-16.8	-15.1	3.4
Monetary Authorities (NBRM)	52.7	42.4	0.0	0.0	6.7	-10.3	-42.4	0.0	14.5	-19.5	-100.0	
Banks	192.0	269.9	387.9	384.0	68.8	77.9	118.0	-3.8	55.8	40.6	43.7	-1.0
Other Sectors	721.0	786.7	1,115.7	1,380.7	120.6	65.7	329.0	265.0	20.1	9.1	41.8	23.7
Foreign direct investment: Intercompany lending	269.6	329.3	430.8	649.1	-14.9	59.7	101.5	218.3	-5.3	22.2	30.8	50.7
Gross external claims	2,026.2	2,427.4	2,634.9	2,437.8	496.2	401.2	207.5	-197.0	32.4	19.8	8.5	-7.5
General Government	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0				
Monetary Authorities (NBRM)	1,040.5	1,327.0	1,416.3	1,361.2	375.8	286.5	89.3	-55.1	56.5	27.5	6.7	-3.9
Banks	635.9	668.3	648.1	390.6	16.3	32.4	-20.2	-257.5	2.6	5.1	-3.0	-39.7
Other Sectors	253.9	336.5	447.4	551.6	56.2	82.6	110.9	104.2	28.4	32.5	32.9	23.3
Foreign direct investment: Intercompany lending	95.9	95.6	123.1	134.5	47.9	-0.3	27.5	11.3	99.8	-0.3	28.8	9.2
Net external debt	491.9	66.4	197.2	878.8	-48.7	-425.5	130.7	681.6	-9.0	-86.5	196.7	345.7

* The net external debt is a difference between the gross external debt and the gross external claims, at market value of the securities.

Source: NBRM.

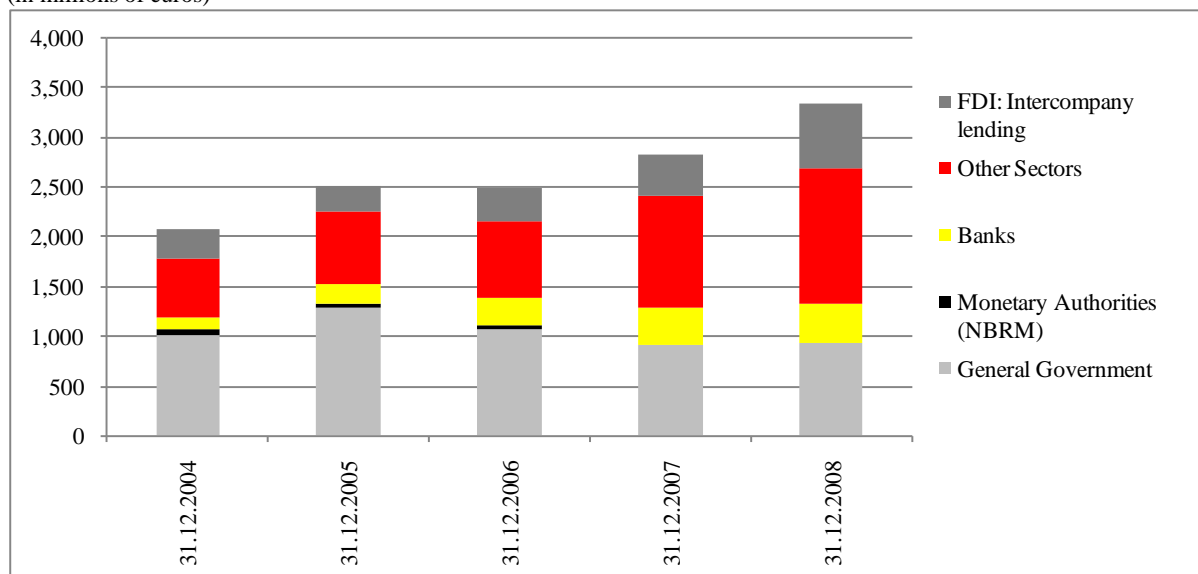
The uptrend of the gross external debt, which started in the previous year, carried on in 2008. The gross external debt³⁷ totals Euro 3,350.6 million, or 51.5% of GDP, and compared to the end of 2007, it rose by 18%. The dynamics of the external debt is primarily triggered by the higher gross borrowing of the private sector from abroad given the global economic crisis, with most of it being debt of the corporate sector. Furthermore, as to the external debt of the public sector, withdrawal of foreign loans was registered, and according to the data on the state budget for 2008, the last quarter of the year registered withdrawals from EBRD (PDPL II) and EIB.

The sector-by-sector analysis of the gross external debt shows that its increase is largely triggered by the higher debt of the other sectors in the economy and the cross-company debt. *The remaining sectors in the economy*³⁸ have an increasing share in the total gross external debt, contributing with 51.9% to the increase. At the same time, their structural share of 41.2% is by 1.9 percentage points higher compared to the end of the preceding year. Within other sectors, the debt based on long-term loans and short-term commercial credits is the highest. Most of the short-term commercial credits are trade credits, reflecting the deterioration in the external trade, indicating more received credits for import of goods, compared to the credits made for exports. As to the long-term loans, within the corporate sector, there is an accelerating activity of the leasing companies (dominant portion of their capital is owned by foreign financial institutions), most of which are funded externally. At the same time, 19.4% of the structure of the external debt on gross-basis, is *loans among connected entities*, which is an upsurge of 4.2 percentage points, compared to December 31, 2007. This is also proved with the developments in the foreign direct investments, showing that, notwithstanding the outflows in September, October and December 2008 (in line with the decrease in the international liquidity in environment of global crisis), the gross debt based on these loans in 2008 compared to 2007 is higher.

³⁷ The analysis of the gross external debt was made on the basis of data on the gross external debt in nominal value. On December 31, 2008, the market value of the gross external debt stood at Euro 3,316.6 million, which is by 17.1% more relative to the previous year.

³⁸ Constituting part of this category are the nonbanking financial intermediaries, nonfinancial trade companies, households and nonprofit institutions.

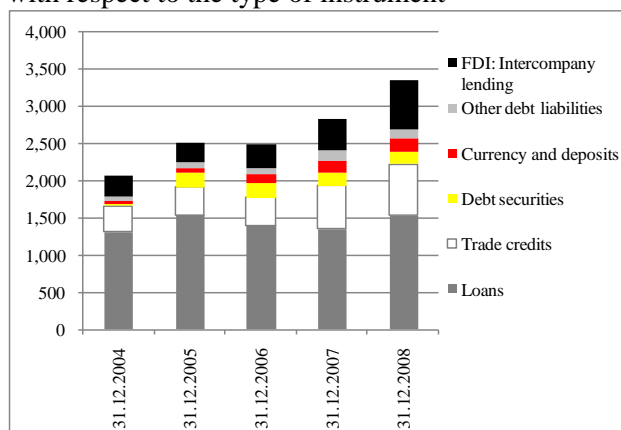
Figure 53
Structure of gross external debt with respect to the basic institutional sectors
(in millions of euros)



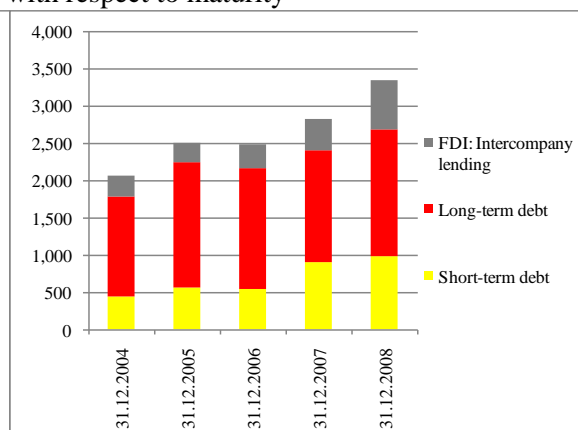
Source: NBRM.

On annual basis, the gross external debt of the government sector registered higher indebtedness, and in the banking sector it was lower. The gross external debt of the *government sector*, most of which consists of liabilities on used long-term loans from abroad and issued Eurobonds, registers a growth rate of 3.4% relative to December 31, 2007 (at the end of 2007 it decreased, due to the early repayments to some foreign creditors). On the other hand, due to the net-repayments by the banks and the harder access to foreign sources of lending, as well as the general restraint from lending in crisis, the debt of the *banking sector* to abroad on December 31, 2008 went down relative to the end of the preceding year, characterized with lower structural share (reduction of 2.2 percentage points). Most of the banks' gross external debt is long-term debt, 94.6% of which are withdrawals based on loans. After the full repayment of the debt to IMF in 2007 and the absence of new arrangement, in 2008 *the monetary authority has no external debt*.

Figure 54
Structure of the gross external debt
with respect to the type of instrument



with respect to maturity



Source: NBRM.

Observing the instruments, on December 31, 2008, loans dominate, whereas according to the maturity, this role is played by the long-term borrowings. Thus, loans have dominant share in the debt instruments (45.8%) notwithstanding the lower share in the total gross debt, having

simultaneous increase in the shares of trade credits and loans to connected entities. Observing the maturity, although lower on annual basis, the share of the long-term debt is the highest (50.9%).

Table 17
External debt indicators
(in %)

Indicators	31.12.2004	31.12.2005	31.12.2006	31.12.2007	31.12.2008
Gross external debt/GDP (criterion: moderate indebttness 30-50%)	50.0	57.6	53.2	54.8	57.8
Gross external debt/Export of goods and services (criterion: lower indebttness 0-165%)	118.8	128.0	109.7	102.9	103.1
Debt servicing/Export of goods and services* (criterion: moderate indebttness 18-30%)	11.4	9.7	18.2	16.0	6.7
Repayment of interest/Export of goods and services* (criterion: lower indebttness: 0-12%)	2.2	2.3	2.9	2.3	1.9

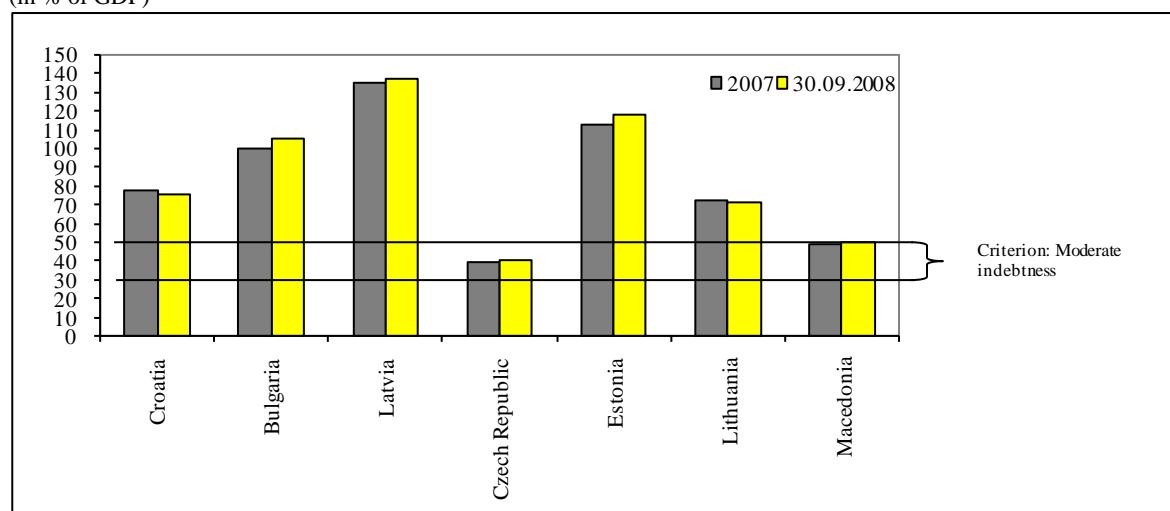
* The data on Debt servicing and Repayment of interest are not revised.

The data on Export of goods and services refers to january-december 2008.

According to the Methodology of the World Bank, the data on GDP and Export of goods and services refer to three-year averages.

The indicators of the relative external debt of the Republic of Macedonia show moderate deterioration relative to 2007. According to the gross external debt - to - GDP ratio, the moderate indebtedness limit is exceeded by several percentage points. On the other hand, according to all other indicators, the ratios of the gross external debt -to- export of goods and services, debt servicing -to- export of goods and services and interest payment -to- export of goods and services, ranks the country in the less indebted countries.

Figure 55
Comparative analysis of the gross external debt
(in % of GDP)

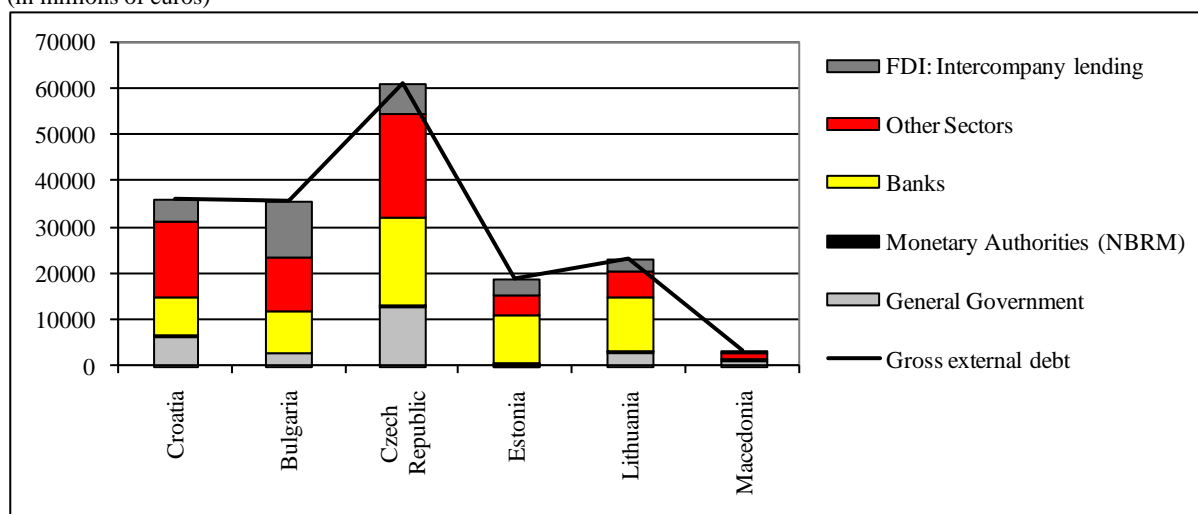


* The indebtedness criterion is based on the World Bank Methodology.

Source: NBRM and data on the gross external debt from the websites of the central banks of the countries, and on GDP from Eurostat.

The comparative analysis of the share of the gross external debt in GDP of some southeast European and Baltic countries shows that typical for most of them is the high external indebtedness. Compared to the end of the preceding year, given the higher need for external funding, the share of the gross external debt in GDP is higher in all countries, except for Croatia and Lithuania.

Figure 56
Comparative analysis of the gross external debt structure and its integral components
(in millions of euros)



Source: NBRM and data from the websites of the central banks of the countries.

The sector-by-sector comparison of the gross external debt by country as of September 30, 2008 shows dominant share of the debt of the other sectors in the economy (nonbanking private sector) in the total debt on gross basis in Macedonia, Croatia and Czech Republic, and of the intercompany debt in Bulgaria. On the other hand, most of the debt of Estonia and Lithuania is debt of the banking sector. Also, in Macedonia, Czech Republic and Croatia the share of the government debt in the total gross debt is significant.

2.5. Public finances

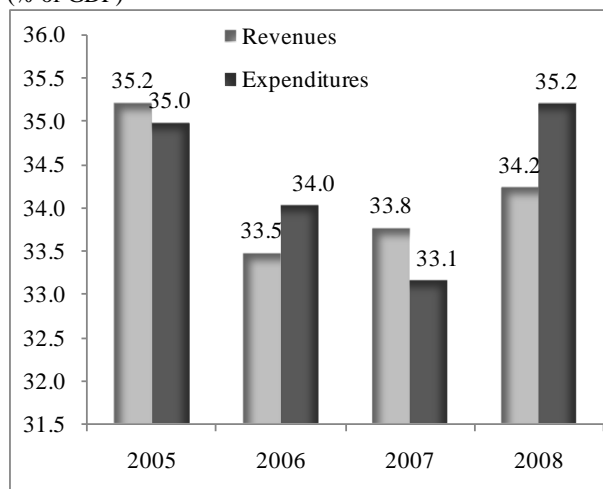
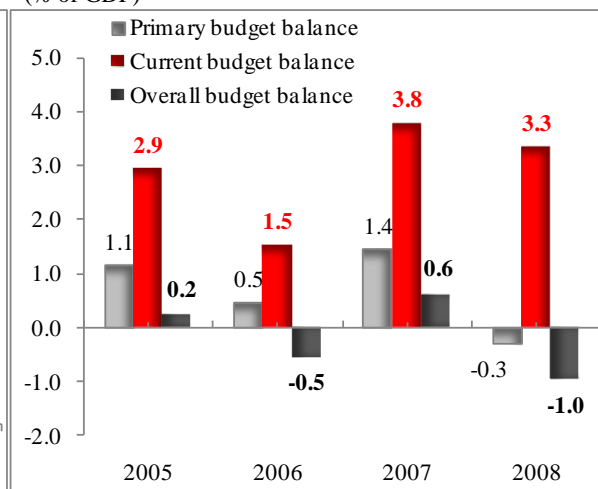
Unlike the previous year which registered a surplus, 2008 registered a budget deficit of 1% of GDP. The budget deficit is lower than the projection of 1.5% of GDP, given the lower realization relative to the plan³⁹ of both the budget revenues (by 5.7%) and the budget expenses (by 6.7%). The primary budget balance⁴⁰, after a longer time period entered the deficit zone (0.3% of GDP), whereas the efficient coverage of the current expenses with current revenues led to surplus in the current budget balance⁴¹ (of 3.3% of GDP).

³⁹ Concerns the budget revision in July 2008.

⁴⁰ Primary budget balance is a difference between the total revenues and the total expenses corrected by the interest payments.

⁴¹ The current budget balance is a difference between the current revenues (tax revenues, contributions and non-tax revenues) and current expenses.

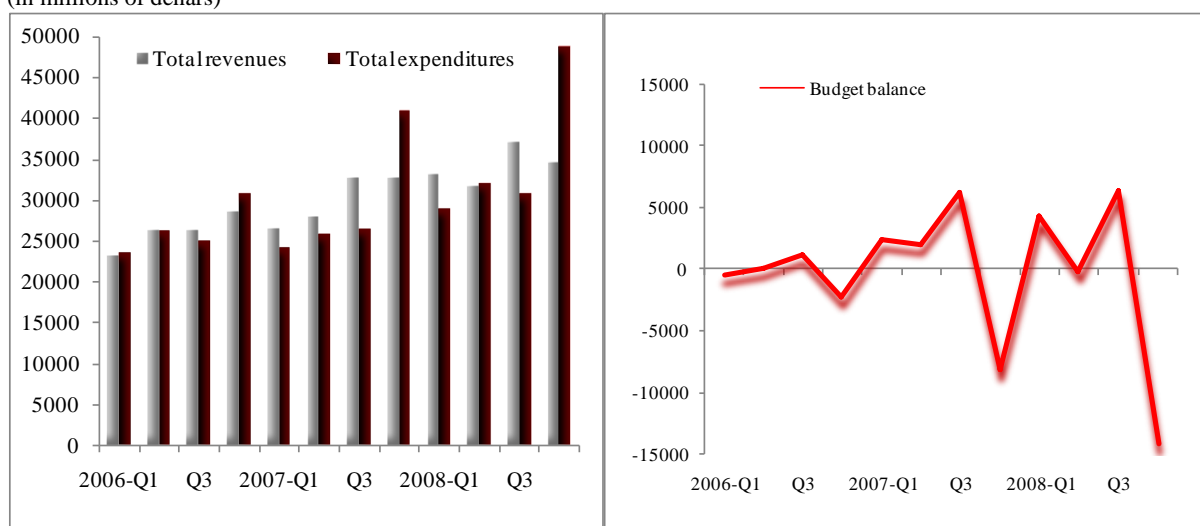
Figure 57

Budget revenues and expenses
(% of GDP)Primary, current and total balance
(% of GDP)

Source: Ministry of Finance of the Republic of Macedonia.

In 2008, the total budget revenues reached Denar 136,412 million, which is by 14% higher compared to the preceding year, whereby their share in GDP rose and reached 34.2%. The revenues registered annual growth in spite of the lower tax rates⁴². Most of the growth was registered in the first quarter of the year given the accelerated economic activity, higher inflation rate and stricter administrative control of the budget taxpayers. The higher revenues in the first half of the year than planned was a reason for the budget revision in July 2008, which led to redirection of the raised funds to capital investments, pensions, purchase of goods and services and for subsidies. The solid revenue performances exceeded the growth of the budget spending in the first and the third quarter of the year, resulting in high budget surplus, whereas in the second quarter, the higher budget spending in the period of parliamentary elections brought about moderate budget deficit.

Figure 58

Quarterly distribution of the budget revenues and expenses and the budget balance
(in millions of denars)

Source: Ministry of Finance of the Republic of Macedonia.

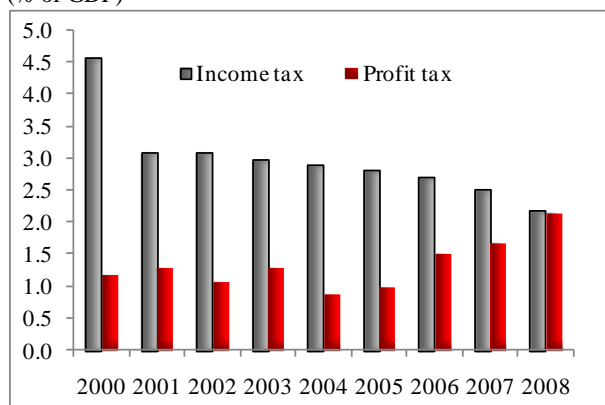
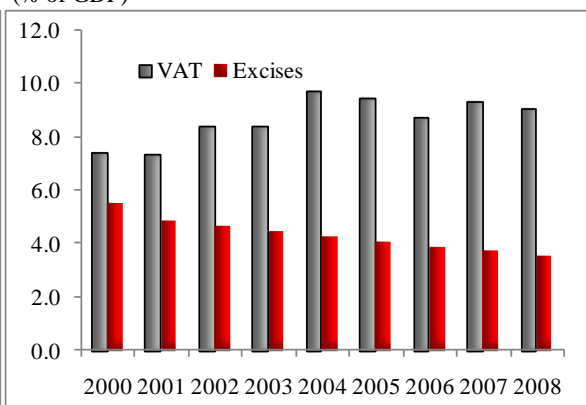
While in the first three quarters of the year the revenues registered remarkable performances (average annual growth of 17.2%), in the last quarter their growth slowed down

⁴² The tax reform in 2006 introduced a flat rate, reducing the personal income tax rate from 15%, 18% and 24% to a single tax rate of 12% in 2007 and 10% in 2008. It also cut the profit tax from 15% to 12% in 2007 and to 10% in 2008.

(annual growth of 5.6%), mainly as a result of the slowdown in the tax revenues and contributions, and nontax revenues. The external shock of the financial and the economic crisis spilled over the domestic economic activity and the perceptions of the economic agents, which along with the stabilization of the inflation led to lower revenues from value added tax (VAT) and customs duties. Additionally, the annual decrease in the revenues from the personal income tax which started in the preceding quarter continued, whereas the revenues from the profit tax and excises kept registering an uptrend.

However, in spite of the decrease in the tax revenues in the last quarter of the year, in 2008, the taxes (42%) were the largest contributors to the annual growth of the total revenues. The tax revenues were by 10% higher on annual basis, mostly due to the higher revenues from domestic taxes on goods and services (accounting for approximately 12.7% of GDP). The first three quarters of the year witnessed 9.7% increase in the annual VAT revenues, given the accelerated domestic demand⁴³ and the higher inflation rate, whereas the inverse effect⁴⁴ of these factors led to lower VAT revenues in the last quarter. While the VAT revenues oscillated, the excise revenues kept increasing to the end of the year (7.6% on annual basis). The higher import of motor vehicles⁴⁵, alcoholic drinks and cigarettes creates revenues on this basis. On the other hand, in spite of the significant growth in the import value in the first three quarters of the year, the reduction in the customs duties (in line with the WTO⁴⁶ Agreement) and the fall in the imports in the last quarter of the year resulted in a marginal increase in the revenues from customs duties (by 1.2% on annual basis). In addition, these revenues considerably diverged from the projections (by 15.4%). Within the taxes, substantial inflow was also made from the other taxes, which registered an annual growth of 11.4% and exceeded the amount planned with the revision by 11%.

Figure 59

Income tax revenues
(% of GDP)Tax revenues from goods and services
(% of GDP)

Source: Ministry of Finance of the Republic of Macedonia.

The effects of the 2006 tax reform, which decreased the tax burden of the employers for engaging production factors (labor and capital), started to be felt in 2008. The lower corporate profit tax rate and the stricter tax control of the companies, in environment of higher profit performances in 2007 brought about considerable revenues from profit tax (annual growth of 45.5%). Consequently, the contribution of these revenues to the growth of the total revenues reached 16%, whereas their share in GDP equated with the share of the personal income tax (2.2% of GDP). The high performance of these revenues in the first half of the year substantially exceeded the plan, which was one of the reasons for budget revision in July 2008. However, in spite of the budget revision, the

⁴³ In the first three quarters of 2008, the value of the import of goods and of the turnover in the domestic trade registered an annual growth of 35% and 17%, respectively.

⁴⁴ In the last quarter of 2008, the value of the import of goods fell by 5.5% annually, whereas the turnover in the domestic trade in the first two months of the last quarter decreased by roughly 2% on annual basis.

⁴⁵ In 2008 compared to the previous year, the value of the import of motor vehicles went up by 30.2%, of alcoholic drinks by 77.8%, of cigarettes by 10.6% and of the import of oil and oil products by 36.6%.

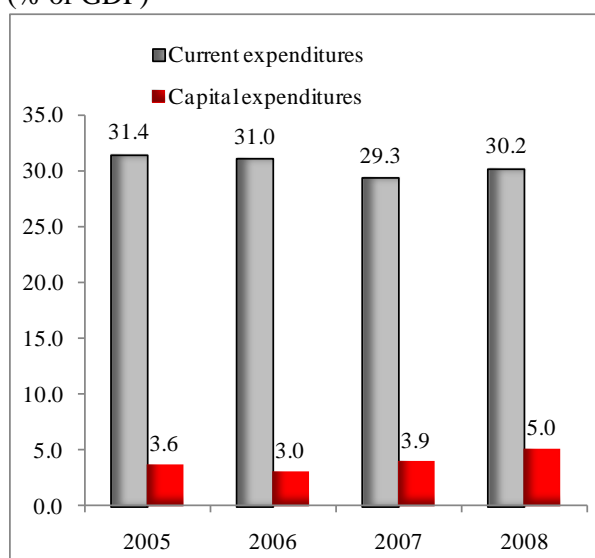
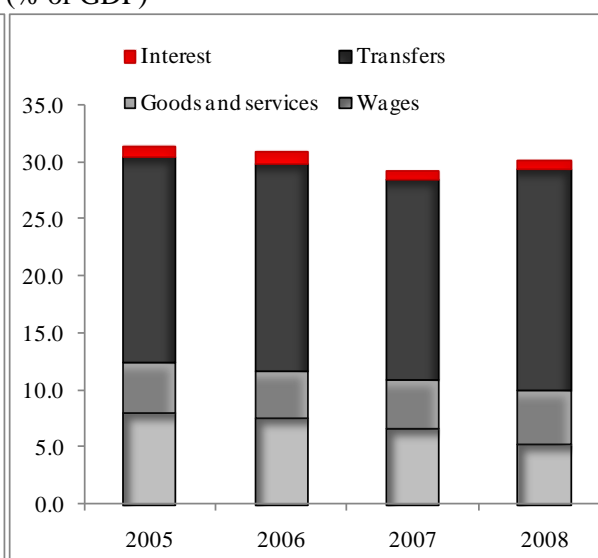
⁴⁶ The average weighted customs rate in 2008 reduced to 1.62%, compared to 1.99% in 2007.

revenues from the profit tax exceeded the plan (by 4.7%). Besides the improved collection of profit tax, the tax release of the reinvested profit was considered to have effect on the investment activity of the private sector, which accelerated in 2008. While the entire year registered positive tendencies of the profit tax revenues, since the second half of the year, the **personal income tax revenues** went down (annual fall of 2.2%). Such dynamics of the personal income tax revenues was anticipated with the initial budget plan, but it was reduced with the revision (by 2.3%). In 2008, the **contribution** revenues went up by 14.4% on annual basis (contribution of 29% in the growth of the total revenues) and the amount was by 15.3% higher than the initial plan, and by 1.4% higher than the budget revision. Such tendency, in environment of unchanged contribution rates indicates higher discipline of the employers in the settlement of their liabilities to the employees and to the government.

Besides the effective realization of tax and contribution revenues, in 2008 the nontax revenues also had a significant contribution to the growth in the total revenues (of 27%). The revenues from these sources went up by 32% annually, mainly due to the higher collection of dividend from one large state-capital company and higher amounts of transferred profit from NBRM. Within the nontax revenues, considerable annual growth was also registered in the revenues on the own accounts and other nontax revenues, the amount of which, notwithstanding the growth, significantly underperformed compared to the initial projection and the budget revision. In 2008, the foreign donations were additional sources of revenues, which registered annual growth of 46.5%, and the capital revenues were almost at the level of the preceding year.

The solid revenue performances supported the higher budget spending, which in 2008 reached Denar 140,265 million, which is by 19.4% more compared to 2007, therefore increasing the share in GDP by 2 percentage points, and reaching 35.2%. The policy of higher support to the household income is demonstrated through the increase in the pension and wage transfers, while the determination of the government for higher participation in the investment cycle is effectuated through increasing the capital expenses. Yet, notwithstanding the higher capital government spending, the lower performance of the capital expenses, as of the third quarter of the year relative to those planned with the budget revision, led to redistribution of the assets in November. With the redistribution, a portion of the previously allocated funds for capital investments, procurement of goods and services and pensions, were mostly redirected for subsidies and for the Health Fund⁴⁷.

Figure 60

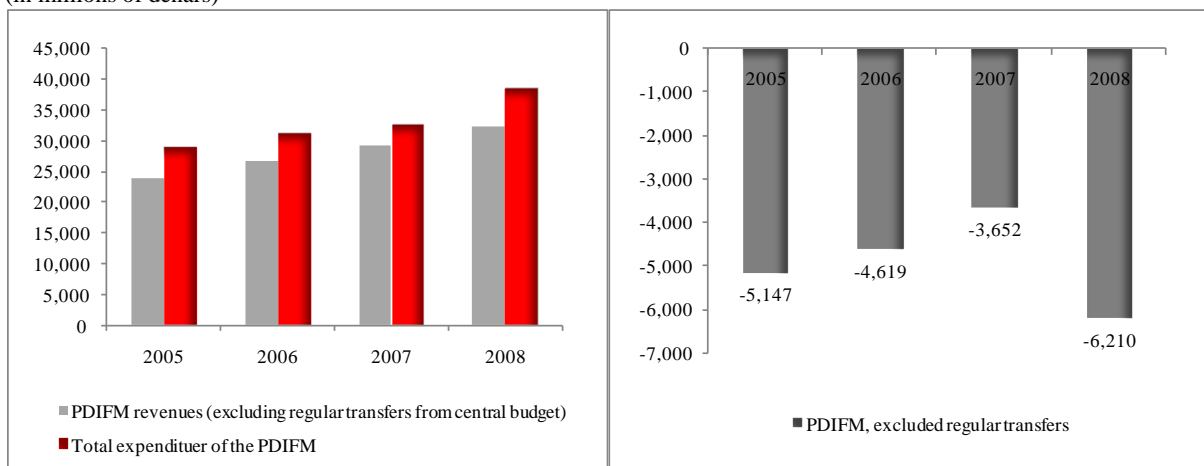
Expense redistribution
(% of GDP)Current expense redistribution
(% of GDP)

Source: Ministry of Finance of the Republic of Macedonia.

⁴⁷ Funds, primarily intended for settling outstanding liabilities.

The increase in the current spending accounts for two thirds of the growth of the total budget expenses. The higher current government spending primarily resulted from the increased transfers (by 25% on annual basis), as a dominant expense category, prevailed by the social transfers. In 2008, the change in the pension calculations⁴⁸ and the decision on increasing the pensions⁴⁹ brought about higher pension transfers (by 18.4%). The increase in the pensions and the reform of the pension system widened the gap between the revenues from contributions for the Pension Fund and its expenses, which led to higher transfers from the government budget to PDIFM (Pension and Disability Insurance of Macedonia). Within the social transfers, the transfers to the Health Fund (18.7%) also registered significant annual growth.

Figure 61
Pension and Disability Insurance Fund of Macedonia (PDIFM)
(in millions of denars)



Source: Ministry of Finance of the Republic of Macedonia.

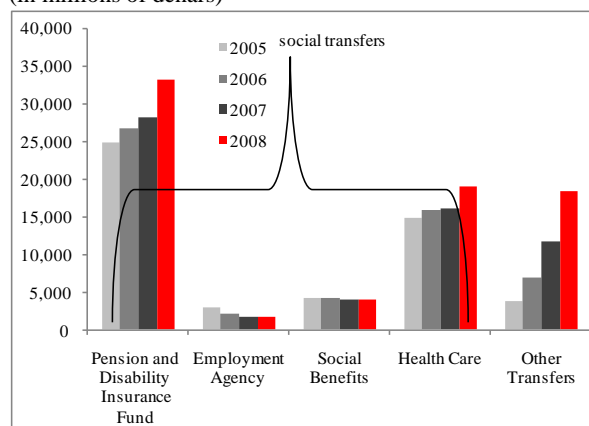
In 2008, besides the growth in the social transfers, an increase was registered in other transfers as well, mainly due to the higher transfers to the local authorities (by 3.3 times on annual basis). Such growth of transfers to the local authorities corresponds with the second stage of the fiscal decentralization process⁵⁰, joined by total of 62 municipalities as of 2008. Most transfers to these municipalities in the form of block-donations (about 70%) are intended for payment of wages, and smaller portion are for covering the municipalities' financial expenditures. Thus, a part of the growth of these transfers is a reflection of the conduct of active policy for increasing the public administration wages. On the other hand, the transfer of funds for payment of wages to the local authorities led to lower costs for wages and compensations paid directly from the budget (by 11.8% on annual basis). Along with the active policy for increasing the income of a certain segment of employees, the agriculture support policy also continued. In 2008, the subsidy transfers went up by 60% compared to 2007. Additionally, the Agency for Financial Support of the Agriculture and Rural Development started operating actively.

⁴⁸ Since January 2008, the pensions have been calculated by a new indexation formula, on the basis of an equal part of the inflation rate and the wage increase. In the old formula for calculating the pensions, the inflation rate had larger weigh (80:20).

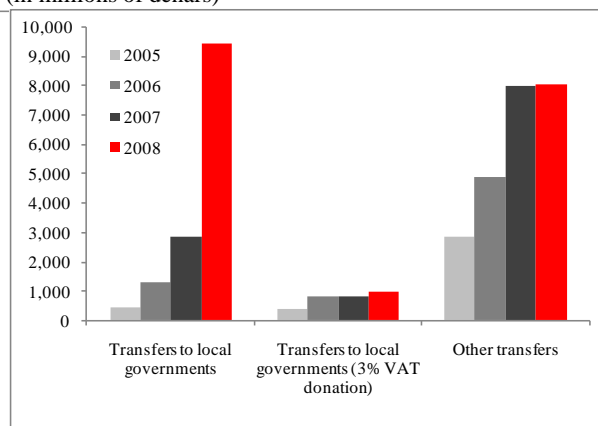
⁴⁹ The Government decision (adopted at its session held on July 29, 2008) provided higher alignment of the pensions, as follows: 3.54% for pension beneficiaries whose pension on January 1, 2008 was up to Denar 6,000; 2.58% for pension beneficiaries whose pension on January 1, 2008 was from Denar 6,000 to 10,800; 1.62% for pension beneficiaries whose pension on January 1, 2008 was from Denar 10,800 to 15,000; and 0.66% for pension beneficiaries whose pension on January 1, 2008 was over Denar 15,000.

⁵⁰ According to the Government decision passed in July 2007, the employees' compensation and wage costs at four sectors of the local public administration (education, social policy and child protection, culture) are funded through block-donations at the municipalities which met the respective criteria.

Figure 62
Transfer distribution
(in millions of denars)



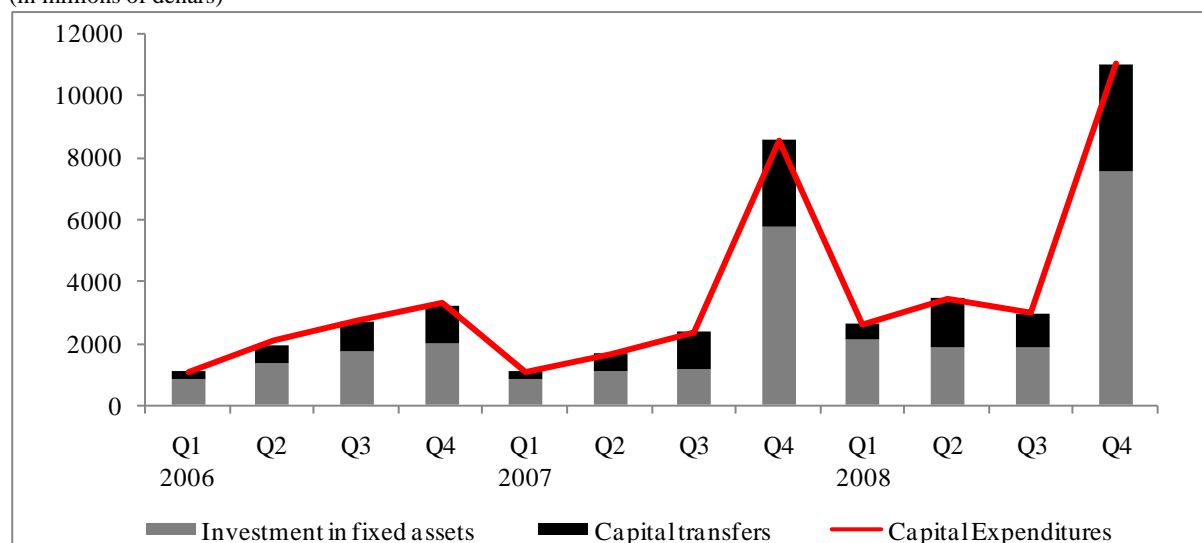
Other transfer distribution
(in millions of denars)



Source: Ministry of Finance of the Republic of Macedonia.

In spite of the increase in the wages of the public administration, the higher public consumption in 2008 refers to higher current spending for goods and services (by 26.6% on annual basis). While the performance of these costs was within the framework of the initial projection for 2008, it considerably underperformed relative to the redistribution made in November (by 11%).

Figure 63
Quarterly distribution of capital expenses
(in millions of denars)



Source: Ministry of Finance of the Republic of Macedonia.

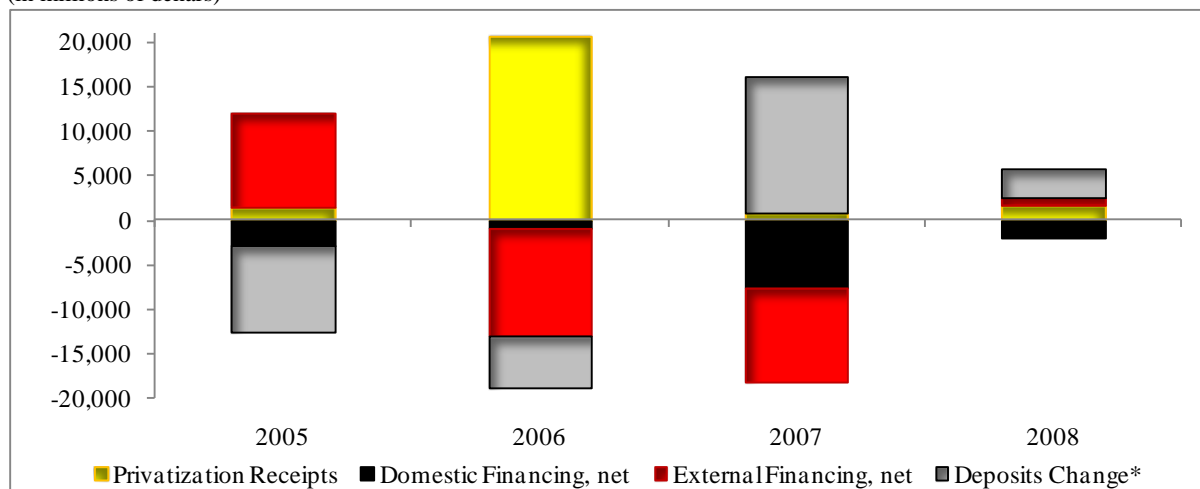
Alongside the intensified public consumption, in 2008 the government largely supported the investment cycle. The capital expenses in 2008 registered fast annual growth of 46%, two thirds of which is due to the higher gross fixed capital formation. Yet, in 2008, same as in the previous year, most of the government capital expenses were effectuated in the last quarter of the year. Additionally, their performance considerably diverged from the initial projection and from the redistribution adopted in November, indicating the need of more rational planning and exploitation of these resources.

Table 18
Consolidated budget (central government and funds)

	2007	2008	Annual change 2008/2007	Contribution to annual growth	Realization of the rebalance (with reallocation)
	in millions of denars		in %		
TOTAL REVENUES	119,608	136,412	14.0	14.0	94.3
Tax Revenues and Contributions	103,218	115,142	11.6	10.0	96.9
Tax Revenues (SRA)	247	295	19.4	0.0	72.0
Tax Revenues	69,514	76,559	10.1	5.9	94.9
Personal Income Tax	8,892	8,695	-2.2	-0.2	97.7
Profit Tax	5,898	8,580	45.5	2.2	95.3
VAT	32,962	36,173	9.7	2.7	93.6
Excises	13,265	14,276	7.6	0.8	99.4
Import Duties	6,199	6,275	1.2	0.1	84.6
Other Taxes	2,298	2,560	11.4	0.2	111.3
Contributions	33,457	38,288	14.4	4.0	101.4
Pension and Disability Insurance Fund	21,936	25,586	16.6	3.1	102.5
Employment agency	1,523	1,829	20.1	0.3	110.8
Health fund	9,998	10,873	8.8	0.7	97.5
Non Tax Revenues	13,901	18,363	32.1	3.7	82.4
Non Tax Revenues (SRA)*	5,912	7,178	21.4	1.1	74.5
Profit of Public Financial Institutions	3,532	5,538	56.8	1.7	104.8
NBRM	258	1,289	399.6	0.9	100.0
Asset Management Agency	164	250	52.4	0.1	
Other Property Income	12	7	-41.7	0.0	
Interest on Deposits with NBRM	218	187	-14.1	0.0	62.3
Dividends	2,880	3,805	32.1	0.8	103.0
Administrative Taxes and Charges	1,683	1,856	10.3	0.1	88.4
Health co-payment	367	390	6.3	0.0	78.0
Other Administrative Taxes and Charges	324	561	73.1	0.2	107.9
Other Nontax Revenues	466	897	92.6	0.4	37.3
Road Fund Fees	1,617	1,943	20.2	0.3	106.0
Capital Revenues	1,397	1,390	-0.5	0.0	107.0
Foreign Donations	906	1,327	46.5	0.4	59.6
Revenues from repayment of loans	186	190	2.2	0.0	190.0
TOTAL EXPENDITURES	117,455	140,265	19.4	19.4	93.3
Current Expenditures	103,714	120,201	15.9	14.0	96.4
Wages and Allowances	23,607	20,828	-11.8	-2.4	92.1
Goods and Services	14,806	18,749	26.6	3.4	88.9
Transfers	62,386	77,980	25.0	13.3	99.7
Transfers (SRA)	637	1,283	101.4	0.5	83.9
Social Transfers	49,996	58,104	16.2	6.9	99.4
Pension and Disability Insurance Fund	28,185	33,366	18.4	4.4	99.5
Employment Agency	1,659	1,626	-2.0	0.0	92.3
Social Benefits	4,047	3,990	-1.4	0.0	98.6
Health Care	16,105	19,122	18.7	2.6	100.1
Other Transfers	11,679	18,526	58.6	5.8	101.7
Refugees	74	67	-9.5	0.0	91.8
Interest	2,915	2,644	-9.3	-0.2	97.5
Domestic debt interest	1,053	942	-10.5	-0.1	98.4
Foreign debt interest	1,862	1,702	-8.6	-0.1	96.9
Capital Expenditures	13,741	20,064	46.0	5.4	78.1
Investment in Fixed Assets	8,817	13,470	52.8	4.0	63.8
Capital Transfers	4,920	6,594	34.0	1.4	143.4
BUDGET DEFICIT/SURPLUS	2,153	-3,853			
FINANCING	-2,153	3,853			
Inflow	19,303	10,830			
Privatisation Receipts	661	1,652			
Foreign Loans	3,643	2,672			
Deposits	15,401	3,370			
Treasury Bills	-464	3,038			
Sell of Shares	62	97			
Outflow	21,456	6,977	0.33		
Repayment of Principal	21,456	6,977	3.08		
Foreign debt	14,188	1,879	8		
Domestic debt	7,268	5,098	73		

Source: Ministry of Finance of the Republic of Macedonia.

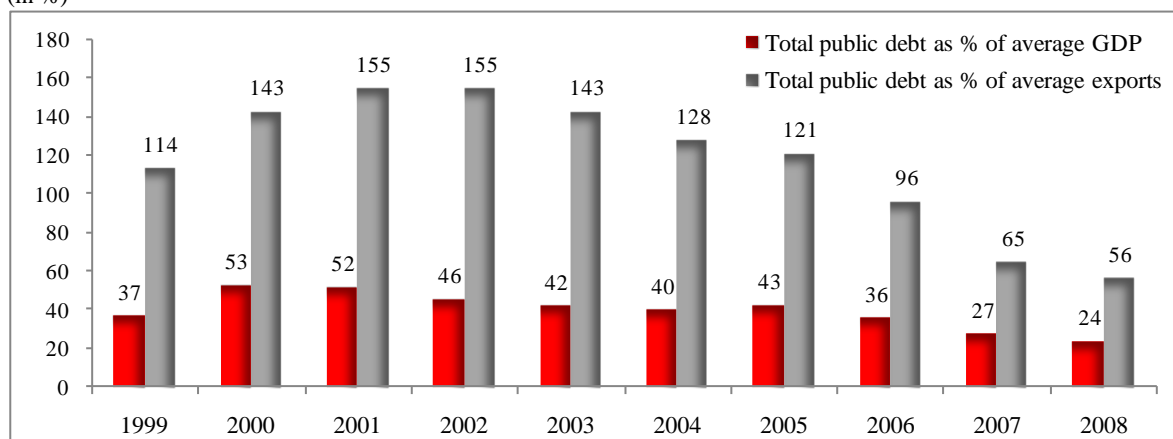
Figure 64
Financing of budget balance
(in millions of denars)



Source: Ministry of Finance of the Republic of Macedonia.

The performances in the government budget, which considerably fluctuated in 2008, led to different trajectory of movement at the financing, as well. The high budget surplus in the first and the third quarter of the year resulted in substantial accumulation of funds on the government account, whereas the high budget deficit in the last quarter of the year was primarily covered by withdrawal of these funds. Thus, in 2008, the budget deficit was primarily financed by withdrawing the *government deposits*. Second source of funds were the *privatization inflows* (mostly due to the issued concessions), whereas on a net basis, the *external borrowing* had a marginal contribution to the financing. The external debt principal was repaid in this year, and compared to the preceding year, when a large portion of the government's external debt principal was early repaid, it was by eight times lower. Although the primary government securities market registered a net inflow with the sale of treasury bills, the higher repayment of the principal of the structural⁵¹ and continuous⁵² bonds relative to the inflow from the treasury bills made the *domestic funding negative*.

Figure 65
Public debt
(in %)



Source: Ministry of Finance of the Republic of Macedonia.

⁵¹Structural bonds are long-term securities issued by the government in the economy restructuring reform. These are denationalization bonds, bonds for old foreign currency savings, bonds for privatization of Stopanska Banka, bonds for selective credits. These securities are not issued on a regular basis, i.e. they are intended for already known owners and are not of market nature.

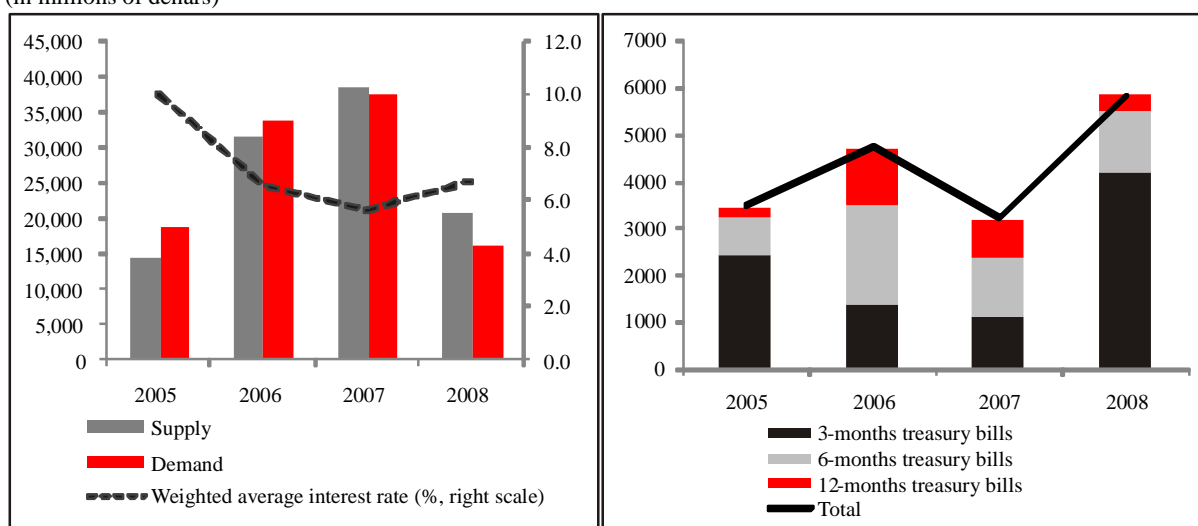
⁵²The continuous bonds are long-term government securities intended for the public and issued on a regular basis at auctions.

At the end of 2008, the public debt⁵³ of the central authority, funds and public enterprises was at the level of the preceding year, totaling Euro 1,583 million. However, with respect to GDP, the public debt went down by 3 percentage points and reduced to 24%. Structural developments were registered towards increasing the share of the external borrowing relative to the share of the domestic debt⁵⁴. The increase in the share of the external debt results from the funds withdrawn by the government in the amount of approximately Euro 45 million, in the form of loans from IBRD (PDPL II in the amount of Euro 16.7 million), the loan from EIB (of Euro 13.1 million) and other (in the amount of Euro 9.4 million). Along with the increase in the central government debt, the public enterprises also entered into debt in the amount of Euro 42 million. On the other hand, the lower share of the domestic debt is in line with the pace of repaying the regular installments of the structural bonds and the continuous securities.

The primary securities market in 2008 narrowed. Such changes are predominantly due to the fast annual fall of the total supply and the lower demand for treasury bills, thus resulting in 56% lower realization relative to the preceding year. The total supply exceeded the total demand by 27%. The most significant motion on the securities market was registered in the last quarter of the year, when the government budget showed high budget deficit, and consequently, greater need of additional funding.

Figure 66

Total supply and demand of treasury bills (in millions of denars) and average weighted interest rate and investments in treasury bills (by maturity) (in millions of denars)



Source: Ministry of Finance of the Republic of Macedonia.

The supply of government securities in all maturities exceeded the demand, with the gap being more evident in the longer maturities. In 2008, same as in the previous years, most of the investments are demand for government securities with the shortest maturity, i.e. three-month treasury bills. The total supply of three-month treasury bills exceeded the total demand by around 11%, and the interest rate on these bills went up by 1.1 percentage point, equaling 6.7% at the end of the year. Lower investment was registered in the six-month treasury bills, where the supply exceeded the demand by 65%, and the interest rate went up, reaching 6.8%. Low performance was registered in the twelve-month bills, with the supply considerably exceeding the demand (3.8 times). The trend of lower demand for government securities was also registered in the government bonds. Four two-year

⁵³ The public debt analysis includes the debt of the central government, the funds and the public enterprises (the debt of the municipalities is 0). This analysis corresponds with the national methodology for calculating the public debt (excluding the NBRM debt), rather than with the government finance statistics (of IMF) which also includes the NBRM debt. Since July 2008, the amendments to the Law on Public Debt requires the public debt calculation to be consistent with the IMF's government finance statistics, but for the purposes of the analysis, only the fiscal authority debt is used, without the debt of the monetary authorities.

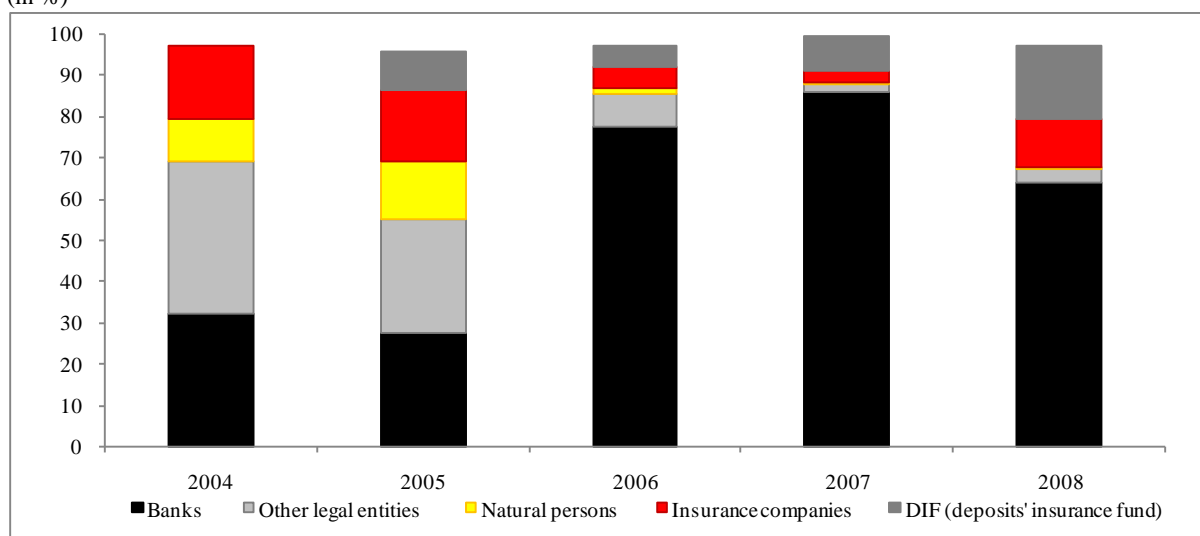
⁵⁴ The domestic debt of the central government refers to the structural and continuous securities.

government bonds auctions were held in the year (February, May, August and October), realizing 39% of the total supplied amount, except for the first auction (in absence of demand). In addition, three issues of three-year government bonds were launched (March, June and September) realizing only 7.8% of the total offered amount.

Analyzing the investors, in 2008, the banks again acted as a dominant participant in the trade on the primary government securities market. However, their share in the total investments reduced compared to 2007 (by 22 percentage points), whereas the share of the Deposit Insurance Fund (DIF) and the insurance companies rose (by 10 and 9 percentage points, respectively). On the other hand, this is the second subsequent year in which the participation of the corporate sector and the natural persons in this market segment is insignificant.

Figure 67

Structure of investments in treasury bills by investor
(in %)



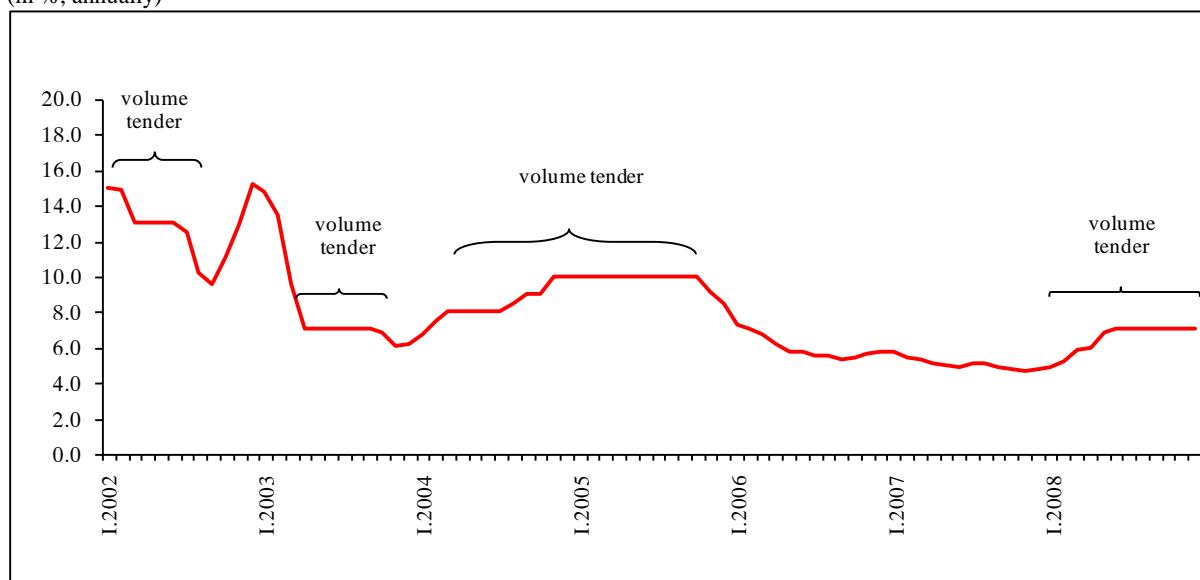
Source: Ministry of Finance of the Republic of Macedonia.

III. Monetary movements in the Republic of Macedonia

The enhanced inflation pressures, the constant deepening in the external misbalance, as well as the high level of uncertainty related to the effects of the global financial and economic crisis, were the main features of the environment in which the monetary policy was carried out in 2008. Namely, the negative financial and economic shocks that have stricken the global market reflected also on the domestic economy causing disturbances with different intensity with the key macroeconomic segments. In the first months of 2008, the trend of constant upward trend of the world prices of food and oil (that commenced in the second half of 2007) continued, which together with the pressure of the domestic demand caused enhanced increase in the general price level in the country. Simultaneously, the deepening in trade deficit in environment of worsen trade conditions and higher domestic consumption, in combination with lower inflows based on private transfers and outflows of portfolio investments, created pressures on the foreign exchange market..

In conditions of a strategy of de facto fixed foreign exchange rate of the Denar relative to the Euro, such movements imposed a need of changes in the monetary policy towards stabilization of the inflation, the inflationary expectations and maintenance of the stability of the domestic currency. In that direction, in the first half of the year, several changes in the monetary instruments layout were made. Thus in February the NBRM has transferred from the "interest rate tender" to CB bills auctioning according to the "volume tender" principle (unrestricted amount and fixed interest rate), and in the first half of the year, the interest rate went up in three turns. Also, on June 12, 2008, the NBRM adopted a Decision on compulsory deposit⁵⁵, pursuant to which the banks and the savings houses are required to allocate compulsory deposit with the NBRM, if the growth in the their lending to households exceeds the anticipated growth rates.

Figure 68
Interest rate on CB bills (28 days)*
(in %, annually)



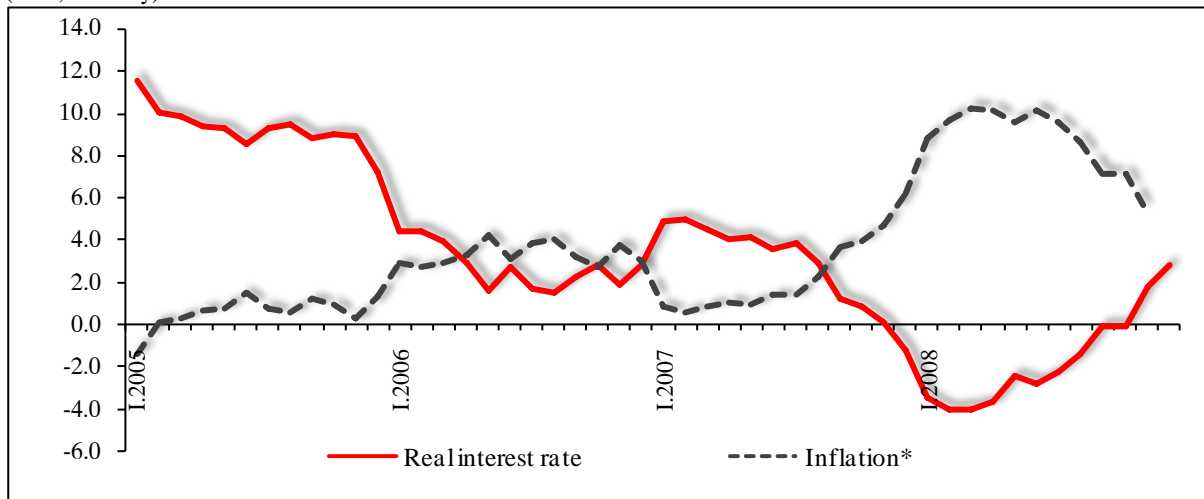
*In the unmarked periods, interest rate tender has been applied.
Source: National Bank of the Republic of Macedonia.

The undertaken monetary measures, together with the gradual stabilization of the food prices on global level, resulted in certain delay of the inflation in the second quarter. Such

⁵⁵ The growth rates of the households' credits for each month are given on cumulative basis in the Decision relative to the households' credits on May 31, 2008. The allowed annual growth rate of the households' credits equaled 40% in December 2008, while the NBRM pays interest on the compulsory deposit of 1%, annually.

movements, with more evident dynamics continued also in the second half of the year, supported by the initiated trend of decrease in the price of oil. Thus in 2008, average inflation rate of 8.3% was registered, while in December 2008 the annual growth rate reduced to 4.1%.

Figure 69
Interest rate on CB bills and inflation
(in %, annually)



*Current month compared to the same month of the previous year.

Source: National Bank of the Republic of Macedonia and State Statistical Office of the Republic of Macedonia.

In 2008, significant widening of the interest rate differential between the yields from domestic and foreign financial instruments was registered. Namely, in 2008, the dynamic changes in the global environment imposed a need of appropriate adjustment of the monetary policy of the European Central Bank. Thus in the first three quarters of the year, as a response to the higher risks to the price stability, the ECB continued to tighten the monetary conditions in the Euro area. Until mid-September 2008, with the escalation on the world financial crisis, dramatic deterioration in the liquidity position on the international financial system and higher non-confidence among market entities was registered, as a result of which record leaps through the entire Euribor maturity spectrum were evidenced. The high oscillations of the interbank interest rates, given simultaneous sharp worsening in the expectations for the future economic developments on the global level, were the reason for relaxation of the ECB monetary policy in the fourth quarter⁵⁶. It had an adequate reflection on the Euribor dynamics, which registers a downward trend since mid-October. In such conditions, the interest rate differential between the CB bills and the ECB reference interest rate⁵⁷, of 0.8 percentage points, as it equal in December 2007, went up to 4.5 percentage points in the last month of 2008, increasing the attractiveness of the financial instruments in domestic currency. However, the average demand for CB bills in 2008 was almost on the level of the due amount, and after the constant sterilization of the liquidity of the banking system that lasted for several years, in 2008 the CB bills acted towards creation of liquid assets. However, the total amount of issued liquid assets through the monetary instruments⁵⁸ in 2008 equaled 1.7% of the GDP. Such a situation can be partially explained with lower inflow of foreign assets from abroad, which were the main factor for liquidity creation in the banking system in the previous three years.

⁵⁶ On October 8, 2008, ECB, in coordinated action with the central banks of the USA, Canada, the Great Britain, Switzerland, Sweden and Japan, reduced the reference interest rate by 0.5 percentage points. Additional downwards correction of the reference interest rate of the ECB was performed in new two turns (on November 06, 2008 and on December 4, 2008) by 0.5 percentage points and 0.75 percentage points, respectively, and in December it reduced to 2.5%.

⁵⁷ It pertains to the interest rate of the repo transactions of the ECB.

⁵⁸ It pertains to the CB bills, the Treasury bills for monetary purposes and the compulsory deposit with the NBRM.

Figure 70
Interest rate differential between the CB bills - 28 days and the reference interest rate ECB* (in percentage points)

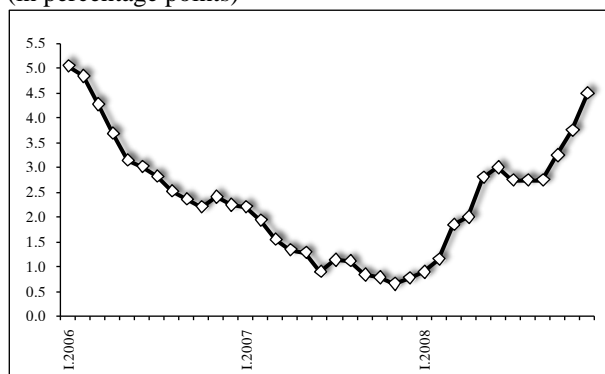
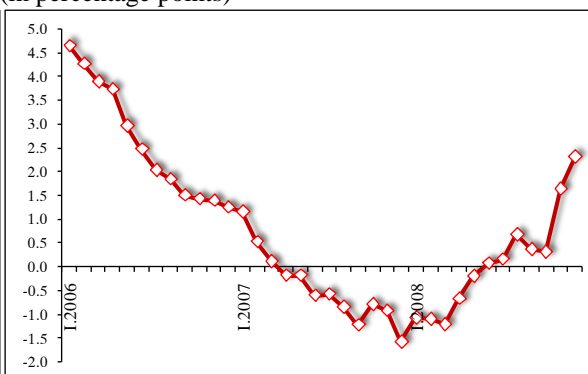


Figure 71
Interest rate differential between MBKS** and Euribor - one month (in percentage points)



* It pertains to the interest rate of the repo transactions of the ECB.

** Interbank interest rate on the domestic Money Market.

Source: National Bank of the Republic of Macedonia, Central Bank of the Netherlands (www.statistics.dnb.nl) and European Central Bank (www.ecb.int).

The widening of the interest rate differential was also registered between the interbank interest rate on the domestic Money Market and the one-month Euribor, which reached 2.3 percentage points in December 2008 (in December 2007, the domestic interbank interest rate was lower than the one-month Euribor by 1.6 percentage points).

In 2008, the changes in the direction and the intensity of the interventions of the NBRM on the foreign exchange market corresponded to the changes in the macroeconomic trends. The widening of the current account deficit and intensified psychological pressures, in conditions of growing inflation, resulted in NBRM interventions in January and in April by net sell of foreign assets (in February and March, no interventions were made). The undertaken monetary measures by the NBRM, which influenced towards calming of the inflationary expectations down, together with the rise in the capital inflows in the economy, contributed to stabilization on the foreign exchange market, with the NBRM interventions being again in direction of net purchase of foreign assets since the end of the second quarter. Since the beginning of the fourth quarter, the situation on the foreign exchange market significantly changed. In conditions of escalation of the world financial crisis, the psychological pressures for its potential spill over also on the domestic banking system strengthened, which in combination with the lower foreign exchange inflows from abroad and the presence of certain extraordinary factors in November (performed repatriation of high amount of dividend by one large company) caused big pressures on the side of the demand for foreign exchange. The NBRM interventions on the foreign exchange market with net sale of foreign assets in the fourth quarter reduced such pressures, with the nominal foreign exchange rate of the Denar relative to the Euro being retained on a stable level. The total net sell of foreign exchange on the foreign exchange market by the NBRM in 2008 equaled 0.9% of the GDP⁵⁹.

⁵⁹ Estimated data for the GDP.

Figure 72
NBRM interventions on the foreign exchange market
(cumulative amount in the quarter, in millions of euros)

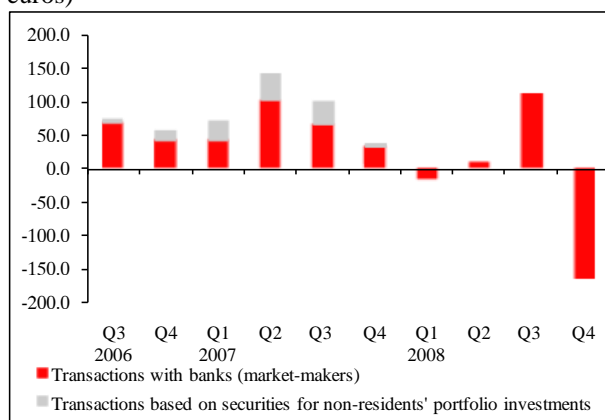
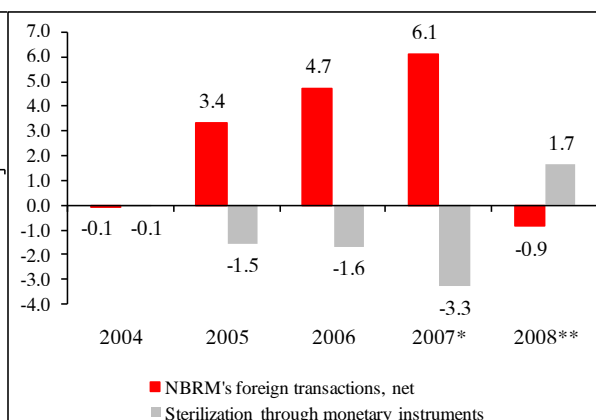


Figure 73
Foreign exchange transactions and sterilization
(share in BDP in %)



* Preliminary data for the BDP.

** Estimated data for the BDP.

Source: National Bank of the Republic of Macedonia.

The dynamics of the Government Denar deposits with the NBRM was mostly conditioned by the changes in the budget consumption, which was unequally allocated also in 2008. Namely, in the first three quarters of the year, as a result of the improved realization of tax income and realized payment of dividend by one large company (in September 2008), high surplus in the Budget was registered, which enabled cumulating deposits on the Denar account of the Government with the NBRM. The direction of the fiscal policy significantly changed in the fourth quarter, when with the adoption of the Decision on the assets redistribution among the budget users and among funds⁶⁰, the budget balance entered the deficit zone. Having in mind that the negative gap between the budget income and expenditures in this quarter was financed mostly through deposits withdrawal from the NBRM, the cumulative annual change of the Government's Denar deposits with the NBRM in 2008 was in direction of moderate liquidity withdrawal from the banking system.

⁶⁰ "Official Gazette of RM" no. 137/2008.

Table 19
Flows of liquidity creation and withdrawal*
 (in millions of denars)

	As of 31.12.2007	Quarterly changes				Total	As of 31.12.2008
		Q. 1	Q. 2	Q. 3	Q. 4		
Banks' liquid assets (banks' accounts with the NBRM)	10,415	-2,544	3,513	-1,193	-262	-486	9,929
Liquidity creation						3,577	
1. Net domestic assets	-64,034	-3,790	3,213	-9,273	13,119	3,269	-60,765
<i>of which:</i>							
Central bank bills	-20,995	-691	117	1,553	2,598	3,577	-17,418
Treasury bills for monetary purposes	-4,560	2,784	1,776	0	0	4,560	0
Compulsory deposit with the NBRM	0	0	0	-1,467	-61	-1,528	-1,528
Net Government position with the NBRM ¹	-14,400	-5,274	2,436	-6,721	11,519	1,960	-12,439
3. Banks' reserve requirement in foreign currency (banks' accounts with the NBRM)	-7,277	-1,283	-456	-743	-44	-2,526	-9,803
Other items, net	-16,828	674	-660	-1,895	-893	-2,774	-19,603
2. Currency in circulation	17,936	2190	-434	-372	-1076	308	17,628
Liquidity withdrawal						-4,063	
1. Net foreign assets	94,343	-856	962	8520	-11476	-2,850	91,493
3. Banks' cash in vaults	1,958	-88	-228	-68	-829	-1,213	3,171

¹ Treasury bills for monetary purposes

* Positive change - liquidity creation; negative change - liquidity withdrawal.

Source: National Bank of the Republic of Macedonia.

At the end of 2008, the reserve money⁶¹ went up by 1,4%, compared to the end of the previous year, in conditions of decrease in the currency in circulation and the banks' liquid assets⁶² (of 1.7% and 4.7%, respectively, annually), given simultaneous increase in the cash in vault of the banks (of 1.6 times, annually).

Table 20
NBRM review
 (in millions of denars)

	As of 31.12.2007	Quarterly changes				Annual change		As of 31.12.2008
		Q. 1	Q. 2	Q. 3	Q. 4	in millions of denars	in %	
Reserve money	30,309	-4,646	4,175	-753	1,643	419	1.4	30,728
Currency in circulation	17,936	-2190	434	372	1076	-308	-1.7	17,628
Banks' accounts with the NBRM	10,415	-2,544	3,513	-1,193	-262	-486	-4.7	9,929
Banks' cash in vaults	1,958	88	228	68	829	1,213	62.0	3,171
Net foreign assets	94,343	-856	962	8,520	-11,476	-2,850	-3.0	91,493
Foreign assets	94,343	-856	962	8,902	-11,474	-2,466	-2.6	91,877
Foreign liabilities	0	0	0	382	2	384		384
Net domestic assets	-64,034	-3,790	3,213	-9,273	13,119	3,269	-5.1	-60,765
1. Banks credit, net	-25,529	2,093	1,893	86	2,537	6,609	-25.9	-18,920
- credit	26	0	0	0	0	0	0.0	26
-instruments ¹	-25,555	2,093	1,893	86	2,537	6,609	-25.9	-18,946
2. Net Government position with the NBRM	-14,400	-5,274	2,436	-6,721	11,519	1,960	-13.6	-12,440
-Claims to Government	1,039	0	0	0	0	0	0.0	1,039
-Government deposits ²	-15,439	-5,274	2,436	-6,721	11,519	1,960	-12.7	-13,479
3. Banks' compulsory reserves in foreign currency (banks' accounts with the NBRM)	-7,277	-1,283	-456	-743	-44	-2,526	34.7	-9,803
4. Other items, net	-16,828	674	-660	-1,895	-893	-2,774	16.5	-19,603

¹ It includes the CB bills, Treasury bills for monetary purposes and compulsory deposit with the NBRM.

² Treasury bills for monetary purposes are excluded.

Source: National Bank of the Republic of Macedonia.

Analyzed from the aspect of the NBRM balance sheet, in 2008, the net domestic assets of the NBRM acted towards moderate creation of reserve money. On the other side, in conditions of registered net sale of foreign exchange on the foreign exchange market by the MBRM and registered outflows based on regular servicing of the Government's liabilities to foreign creditors, the net foreign assets of the NBRM represented a flow of reserve money withdrawal.

⁶¹ The analysis refers to the reserve money without reserve requirement of the foreign currency deposits. By including this component, the annual change in the reserve money equals 7.8% in December 2008.

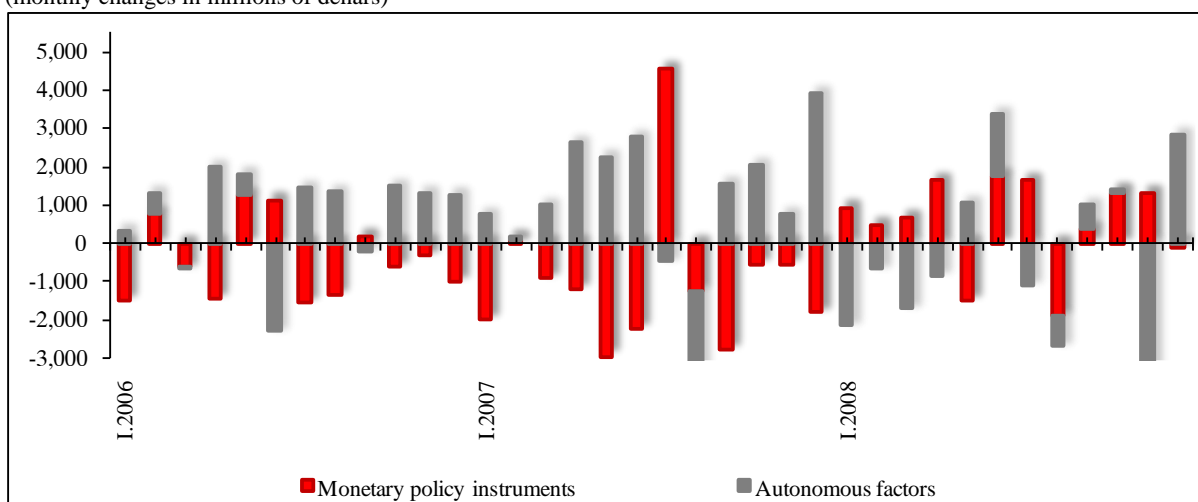
⁶² It pertains to the banks' Denar accounts with the NBRM.

3.1. Monetary instruments

In 2008, the monetary instruments of the NBRM were in function of adequate liquidity management in the banking system, stabilization of the inflationary expectations and maintenance of the foreign exchange rate stability, as an indirect objective of the monetary policy. In that regard, the NBRM continued with open market operations conduct and active implementation of the compulsory reserve instrument, with a measure for slowing down of the credit growth with the "households" sector being also introduced. Having in mind the structural position of the banking system (excess liquidity), the CB bills represented the core monetary instrument of the NBRM also in 2008, basically intended for liquidity sterilization from the banking system. Besides the active liquidity management in the banking system, when implementing the strategy of fixed foreign exchange rate, this instrument contributes also to re-direct the Denar liquidity from the foreign exchange market, thus lessening the pressures on the domestic currency.

Figure 74

Monetary policy instruments and autonomous factors of liquidity creation and withdrawal*
(monthly changes in millions of denars)

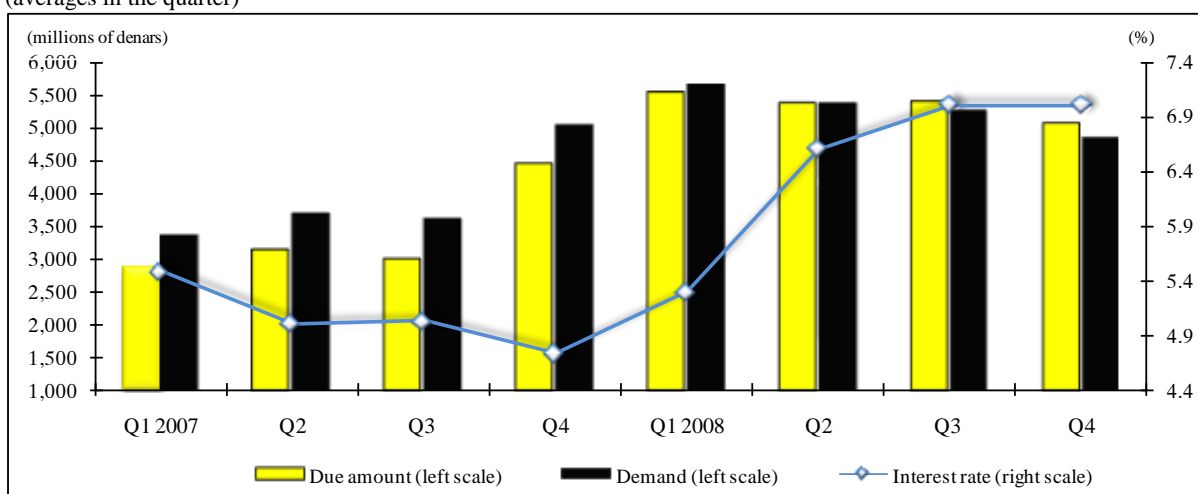


*Positive change - liquidity creation; negative change - liquidity withdrawal.

Source: National Bank of the Republic of Macedonia.

Figure 75

Due amount, demand and interest rate on CB bills
(averages in the quarter)



Source: National Bank of the Republic of Macedonia.

With regard to the specific circumstances, several changes in the monetary instruments layout were made in 2008, which were directed towards stabilization of the movements on the foreign exchange market and calming down of the inflation and the inflationary expectations of the market entities. Thus, after the registered outflow of foreign exchange based on NBRM interventions on the foreign exchange market in the first month of the year and the percentages pertaining to the increased risks for the stability of the prices on a medium term basis, on February 19, 2008 the NBRM transferred from "interest rate tender" to auctions of CB bills on the principle "volume tender" (unrestricted) and fixed interest rate. Also, the reference interest rate of the NBRM increased from 5.08%, as it equaled on the last auction before the tender was changed, to 5.25%. In the following months, the NBRM continued to increase gradually the interest rate on the CB bills and on March 06, 2008 it augmented to 6% and on May 7, 2008 it was incremented by additional 1 percentage point, and reached 7%. Such a monetary reaction was conditioned by the presence of several risks, manifested through the growing external misbalance and the pressures created on the foreign exchange market, the rise in the inflationary expectations, as well as the pressures coming from the banking system through the too fast growth in households crediting. Additionally, on June 12, 2008, the NBRM adopted a Decision on a compulsory deposit with the NBRM, that the banks allocate, if the households' crediting exceeds the established growth rates for this type of crediting. In December 2008, the allowed growth rate for the households' credits equals 40%, with the NBRM paying an interest on the compulsory deposit of 1% annually. Such a decision is aimed at deceleration of the households' credit growth and thus to enable prevention from the potential future risks on the internal and external balance equilibrium in the economy, arising from the sharp growth in the credits extended to households.

On the CB bills auctions held in 2008, the average demand was almost at the level of the due amount, with total of Denar 3,577 million being issued, on cumulative basis, through this monetary instrument. Liquidity issue (in the amount of Denar 4,560 million) has also been performed through CB bills for monetary purposes, in conformity with the decision on gradual decrease in their supply, after which in June 2008, they were no longer used as a monetary instrument.

From the aspect of the reserve requirement, in 2008 the trend of further decrease in the allocated excess liquidity over the reserve requirement continued. Thus in 2008, at the end of the calculation period, the banks, allocated, on average, 4.1% over the reserve requirement (in Denars)⁶³, which is lower by 4.2 percentage points compared to the last year average. In conditions of constant maintenance of adequate liquidity level in the banking system, in 2008, no Lombard credits were used⁶⁴.

Annex 2

Chronology of the changes in the monetary instruments layout in 2008

February 11, 2008

The Decision on a compulsory deposit (adopted on December 27, 2007) was enforced, which broadened the basis for calculating reserve requirement by including new accounts categories from the banks' balance sheets. However, more significant effect was registered with the compulsory reserve in foreign exchange.

February 19, 2008

NBRM introduced change in the CB bills auctions' layout, and it moved from the "interest rate tender" to the CB bills auctions according to the "volume tender" principle (tender with fixed interest rate and

⁶³ The period for maintaining (fulfilling) the banks' reserve requirement covers the period from the 11th in the current month to the 10th in the following month. The excess pertains to funds allocated to the banks' accounts with NBRM over the reserve requirement.

⁶⁴ Collateralized short-term credits for overcoming the temporary liquidity problems of the banks, entering the monetary instruments group - available instruments ("standing facilities").

unrestricted amount of CB bills). Also, the NBRM adopted a decision on increasing the interest rate on the CB bills from 5.08%, as it equaled on the last auction before the tender was changed, to 5.25%.

March 06, 2008

NBRM adopted a decision on increasing the interest rate on the CB bills from 5.25% to 6%.

May 07, 2008

NBRM adopted a decision on increasing the interest rate on the CB bills from 6% to 7%.

June 12, 2008

The NBRM Council adopted the Decision on a compulsory deposit with the National Bank of the Republic of Macedonia. However, the banks and the savings houses are obliged to allocate compulsory deposit with the NBRM, if their growth in the credits to households exceeds 40% annually at the end of December 2008. The allocation of the compulsory deposit will be performed monthly for the amount for which the banks will possibly exceed the growth rate of the credits to households, prescribed in the Decision. The growth rate of the credits extended to households for each month in the Decision are given on cumulative basis, compared to the stock of credits to households on May 31, 2008. The decision shall pertain to the July - December 2008 period, and the NBRM pays interest on the compulsory deposit of 1%, annually.

June 12, 2008

NBRM adopted a decision on increasing the interest rate on the Lombard credit from 7.5% to 8.5%.

December 25, 2008

The NBRM Council adopted the Decision on a compulsory deposit with the NBRM (which enters into force on January 01, 2009), thus continuing the implementation of the measure that envisages monthly growth rates on the credits extended to households. In line with the Decision, if the stock of the credits extended to households exceeds the envisaged growth rate for each month, the banks and the savings houses will be obliged to allocate deposit with the NBRM in the amount equal to the amount of the excess. The anticipated annual growth rate of the credits to households equals 11.3% in 2009, on cumulative basis, while the NBRM pays interest on the compulsory deposit of 1%, annually.

Annex 3

On the basis of the total current movements in the Macedonian economy caused by the global financial and economic crisis, the NBRM Council adopted several decisions focused on further strengthening of the safety and the soundness of the banking sector. Although such measures have prudent character, still, part of them has macroeconomic effects, as well. This especially refers to the Decision on managing banks' liquidity risk, which effectively means necessity for allocation of larger amount of liquid assets and thus shrinking the space for alternative investments, such as lending to the private sector.

March 06, 2008

The NBRM adopted amendments to the Decision on the methodology for determining capital adequacy of banks, which increased the risk weight of used overdrafts based on current accounts and used credits based on credit cards by natural persons. The main objective of this prudent measure is to determine the size of the credit risk of the banking sector, arising from the credits to households, on acceptable level. Also, having in mind that for such credit products the banks will have to allocate

larger part of their capital, it can contribute also to slowing down of the credit expansion to households.

December 25, 2008

On the basis of the total current movements in the Macedonian economy caused by the global financial and economic crisis, the NBRM Council adopted the following decisions directed towards further strengthening of the safety and soundness of the banking system in the Republic of Macedonia:

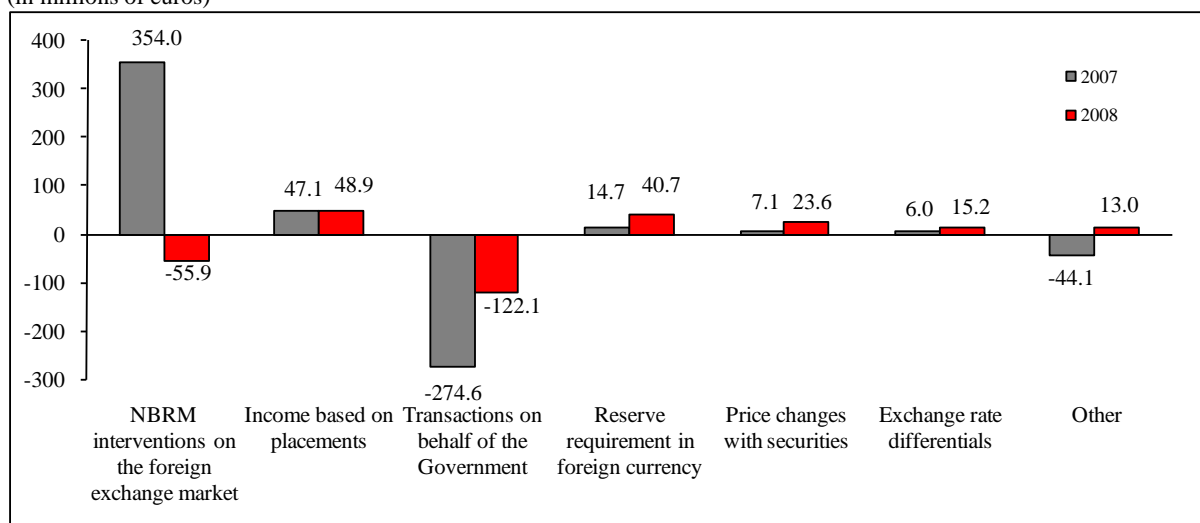
1. Decision on managing banks' liquidity risk, which introduces an obligation for the banks for maintenance of certain minimal level of liquid assets for covering the liabilities falling due in the following 30 and 180 days, in both Denars and foreign exchange. Such a prudent measure on a shorter term will influence towards increase in the banks resistance to possible unfavorable effects resulting from the current global financial and economic crisis, having in mind that the crisis reflected through liquidity problems of the banks in the world. On a longer term basis, this measure will enable higher certainty and viability of the banking sector's operations.
2. Decision on the foreign currency deposit with the NBRM, which enables the banks to deposit foreign assets with the NBRM. In conformity with the Decision, the banks have the possibility to deposit their foreign assets with the NBRM, thus avoiding the credit risk if placing foreign assets abroad. The interest rates on the foreign currency deposits placed with the NBRM will be equal to the interest rates on the foreign assets placed in the central banks in the Euro area, in the international financial institutions or to the yields based on the Treasury bills of the Euro area member states.
3. Amendments to the Decision on the exposure limits, which envisages inclusion of the exposure of the domestic banks to foreign first class banks in the calculation of the exposure limits in full amount, instead of 20% of the amount, as it was envisaged in the so far practice.
4. Decision on managing the interest rate risk in the banking book, which prescribes the minimum necessary elements for managing the interest rate risk in the banking book, as well as the manner of measuring the banks' exposure to this risk.
5. Decision on determining the type of securities, which the authorized banks can purchase and sell abroad, which, inter alia, provides rise in the lowest allowed long-term credit rating of securities, in which one authorized bank can invest abroad.

All these decisions will become effective from January 01,2009.

3.2. Foreign reserves and foreign exchange rate

On December 31, 2008, the gross foreign reserves amounted to Euro 1,494.9 million, which is a decrease of Euro 29.4 million compared to the previous year. The decrease in the reserves is explained with the high net outflows for the needs of the Government, as well as with the NBRM interventions on the foreign exchange market. The intensity of the net outflows on the basis of the transactions for the account of the Government is smaller, compared to the preceding year, while the direction of the NBRM interventions on the foreign exchange market is opposite from that in the previous year, when the NBRM intervened with net purchase of foreign exchange. The remaining factors acted towards increase in the foreign reserves.

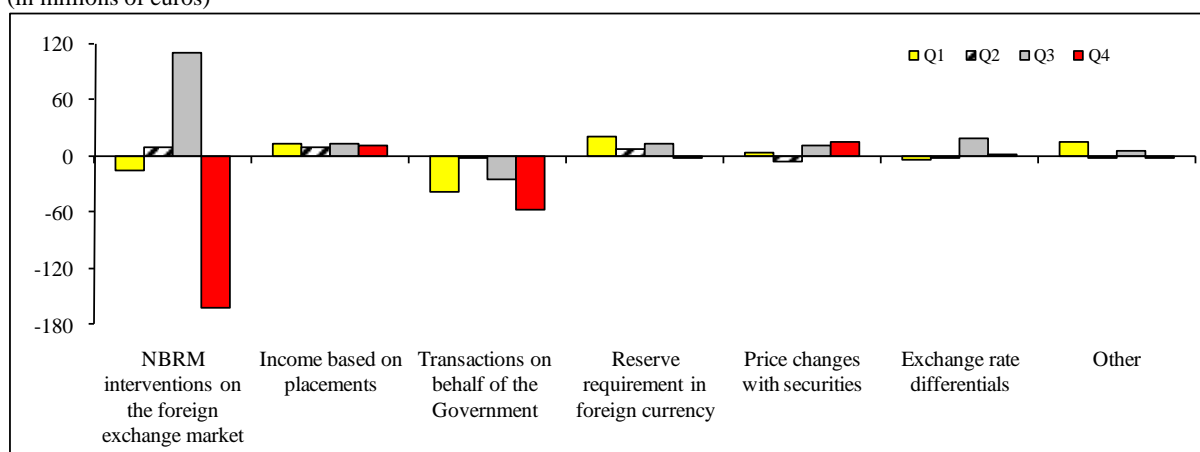
Figure 76
Factors of change in the gross foreign reserves in 2007 and 2008
(in millions of euros)



Source: National Bank of the Republic of Macedonia.

The analysis from the aspect of the dynamics shows unequal distribution of the effects of these factors during the year. Thus, *the foreign exchange outflows for the needs of the Government* correspond to large extent to the changes in the fiscal policy course during the year. In the first three quarters, these outflows are relatively stable, which is characteristic also of the public consumption volume. The expansion of the budget expenditures in the last quarter of the year matches the growth in the foreign outflows for the needs of the Government, which went up by almost 2.5 times in this period compared to the average for the first three quarters. Having in mind that in 2008 the payments based on external debt represent small segment of the total payments of the Government, the foreign outflows from the Government's account shows, to great extent, the direct fiscal stimulus for the import of goods and services, as well as for other balance of payments' components, which are not related to the foreign indebtedness. In 2008, this category equals about 2.6% of the GDP, which is on the same level as in the previous year.

Figure 77
Quarterly distribution of the factors of change in the gross foreign reserves in 2008
(in millions of euros)



Source: National Bank of the Republic of Macedonia.

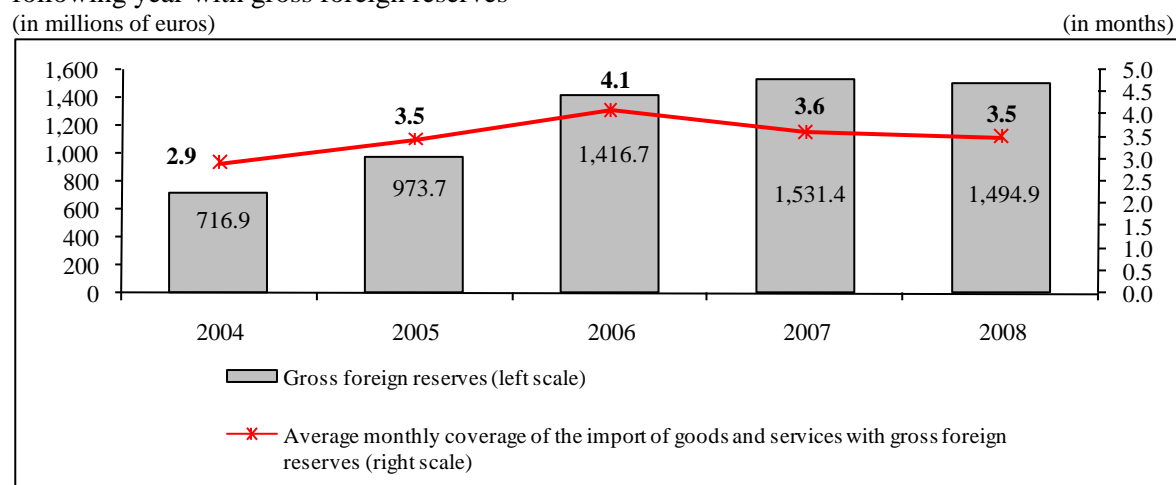
From the aspect of the NBRM interventions on the foreign exchange market, short cycles can be isolated in 2008, which were synchronized, to large extent, with the change in the macroeconomic trends in the domestic economy. In the first half of the year, the inflation continued to speed up, heating the inflationary expectations and the speculations for possible Denar devaluation.

In such environment, the investments in foreign currency were alternative for preservation of the income value, which resulted in increase in the demand for foreign exchange. The non-receiving of invitation for NATO membership also influenced in this direction. However, in conditions of solid dynamics of the capital inflows and active utilization of the foreign assets by the banks for satisfying the demand on both foreign exchange and currency exchange market, the NBRM performed net sale of foreign exchange only in January and April. The gradual stabilization of the inflation and the higher capital inflows enabled the NBRM to perform net purchase on the foreign exchange market in the second quarter. This trend especially intensified in the third quarter, given stabilization on the currency exchange market. Significant rise in the foreign reserves in this period was registered, which equaled Euro 1,689 million at the end of September. Such a trend failed to continue to the end of the year, when the effects of the global crisis became stronger in the Macedonian economy. The decrease in the external demand, the impeded dynamics of the foreign direct investments, the intensified outflow of portfolio investments, as well as the incremented demand for foreign exchange on the markets (because of the psychological factors on the currency exchange market, as well as the high payments of dividends to foreign investors), caused again pressures for depreciation of the domestic currency and significant NBRM interventions, thus resulting in net sale of foreign exchange of Euro 162.3 million.

The decrease in the level of foreign reserves does not have to mean increase in the external sensitivity of the economy, if the indicators of the reserves adequacy are not jeopardized. Having available an adequate level of foreign reserves means maintenance of satisfactory liquidity, as well as larger room for the economy to cope with shocks. In such stages, when the global economy faces with crisis, the foreign reserves adequacy is of key importance for small and open economies with fixed exchange rates in order to maintain the total stability. **For economies, such as Macedonian, which are directed, to large extent, towards the international capital market, the coverage of the import of goods and services with foreign reserves is commonly the main indicator for the capital adequacy. Thus at the end of 2008, besides the annual decrease in the reserves, their level is adequate, providing coverage of 3.5 months of the import projected for 2009, which is insignificant decline compared to the previous year.**

Figure 78

Gross foreign reserves and monthly coverage of the import of goods (f.o.b.) and services from the following year with gross foreign reserves*



* The data on the import of goods (f.o.b.) and services from the following year after the 2005 - 2008 period are given according to the realized amounts, while they are projected for 2009.

Source: National Bank of the Republic of Macedonia.

The macroeconomic movements in the Macedonian economy in 2008, as well as the political developments in the country and in the region, had direct reflection on both foreign exchange and currency exchange market. For the entire 2008, net purchase of foreign exchange of Euro 602.9 million was realized on the currency exchange market, which is drop of 12.3%, compared

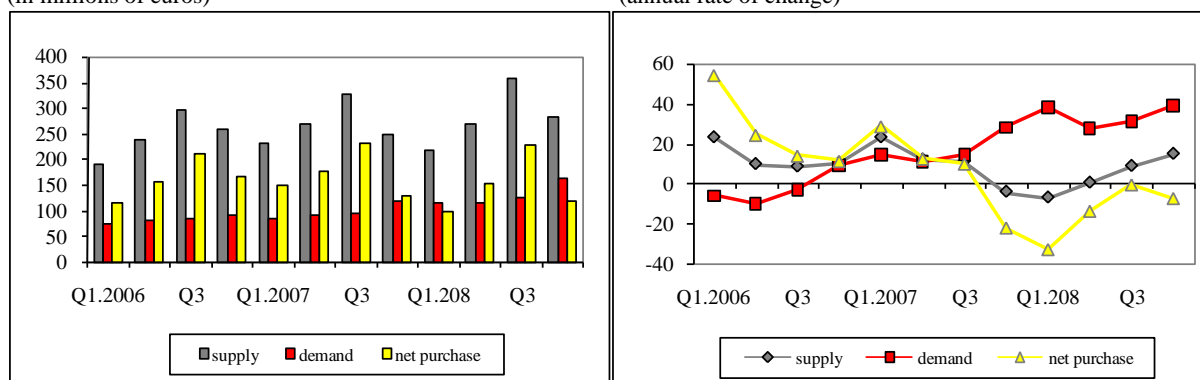
to the preceding year, while the registered turnover reached Euro 1,656.2 million (annual increase of 12.5%). Main contribution to these developments accounts for the sale of foreign exchange which incremented by 34.2%, whereas the purchase which augmented (but still less than in the previous year) by 4.6%. In the first half of 2008, the movements on the currency exchange market were conditioned by the worsened balance of payments position, inflation strengthening and political instability in the region. In such conditions, for the purpose of safeguard from the currency risk, the households' preference to keep the available funds in foreign exchange increased, with significant demand, and simultaneously, lower supply of foreign currency on the currency exchange market being registered. In the September - November period, certain positive movements were registered. Low comparison base from the previous year and stabilization in the expectations, resulted in a three-month trend of positive annual change in the net purchase on the currency exchange market. However, in December, the psychological pressures arising from crisis spill over in our country stirred again the demand for foreign exchange. It reached its record level of Euro 72.5 million (with exception to the Euro conversion period), with the lowest net purchase (Euro 19.7 million) since January 2004 being registered in this month.

Figure 79

Components dynamics on the currency exchange market

(in millions of euros)

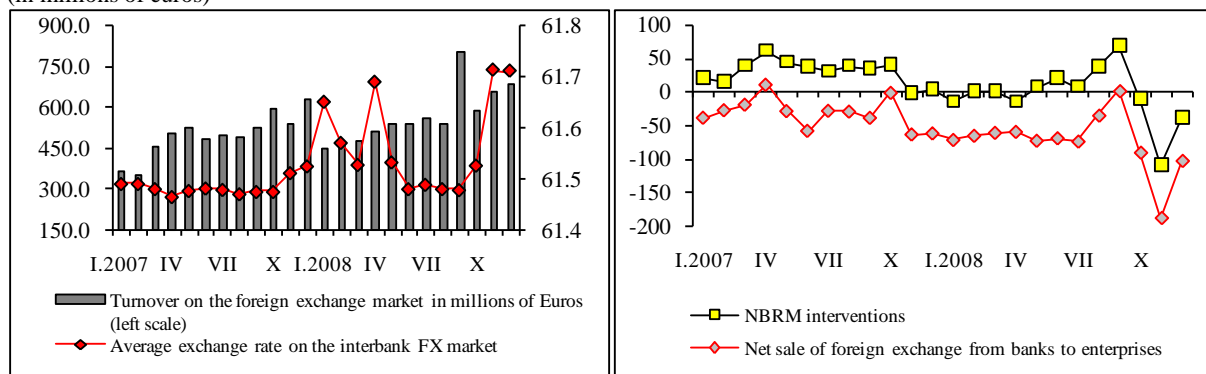
(annual rate of change)



Source: National Bank of the Republic of Macedonia.

The movements on the currency exchange market and generally, the movements in the external sector reflected on the foreign exchange market, where in 2008 turnover in the amount of Euro 6, 811.3 million was registered, which is growth of 13.4% in comparison with the previous year. The largest turnover was registered with the "banks-enterprises" segment, and in conditions of higher demand for foreign exchange by the enterprises, at the end of the year the banks registered net sale of foreign currency in the amount of Euro 908.7 million, which is higher by 2.4 times compared to 2007. The deepening of the gap between the supply - demand of foreign exchange of the "banks-enterprises" segment reflected on the "banks-banks" segment where, in certain months, a lack of foreign exchange and pressures for Denar depreciation was registered, resulting in the NBRM interventions on the foreign exchange market towards net sell of foreign exchange.

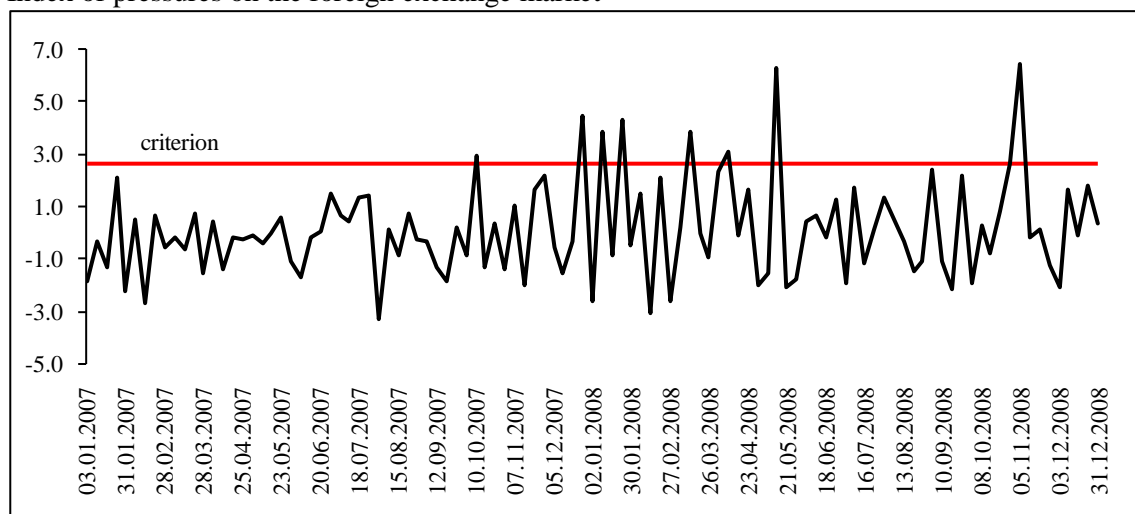
Figure 80
Movements on the foreign exchange market
(in millions of euros)



Source: National Bank of the Republic of Macedonia.

In 2008, the index of pressures on the foreign exchange market⁶⁵ exceeded the critical threshold in several turns. Thus, in 2008, six signals for pressures on the foreign exchange market were registered (from 53 observations), and almost all in the first half of the year, with one being registered in November 2008. However, the largest portion of the signals arises from the pressures for depreciation of the domestic currency, while two of the signals reflect the change in the interest rate policy of the NBRM as a result of the pressures on the foreign exchange market (in March by 0.75 p.p. and in May by 1 p.p.).

Figure 81
Index of pressures on the foreign exchange market*



* Value over criterion (2,66), means pressure on the foreign exchange market.

Source: National Bank of the Republic of Macedonia.

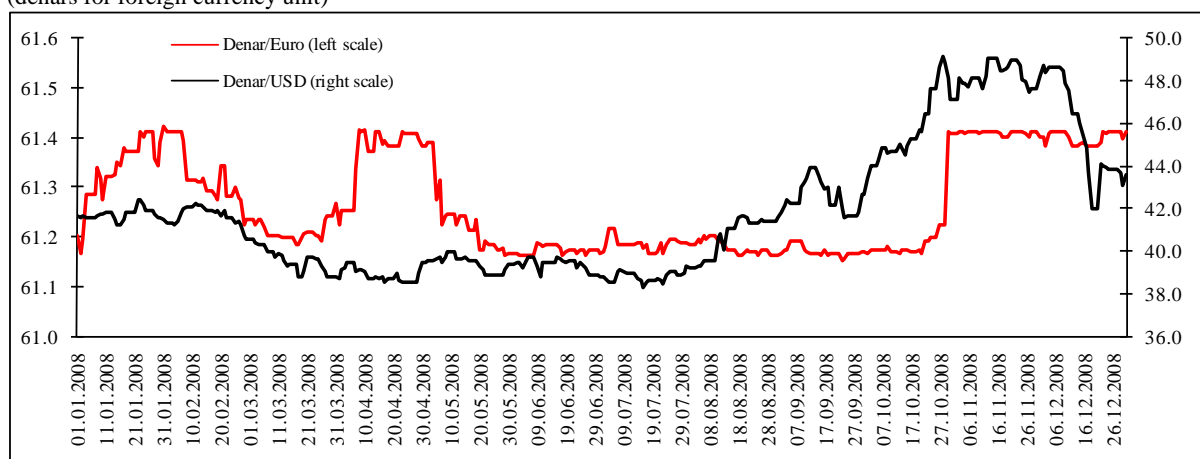
The pressures on the foreign exchange market were suppressed through the interest rate policy and the NBRM interventions, with the Denar exchange rate against the Euro remaining on stable level. During the year, the level of the foreign exchange rate was more volatile, so the NBRM intervened adequately on the foreign exchange market in order to maintain the stability of the foreign exchange rate. The deteriorated external position and the higher inflationary expectations

⁶⁵ EMP index is composite of the percentage changes in the interest rate on the CB bills, the nominal Denar-Euro exchange rate and the foreign exchange transactions of the NBRM, i.e. $EMP_{mk} = \alpha\% \Delta ER_{mk/eur} + \beta \Delta MMIR - \lambda\% \Delta (FXT / MO)$, where $R_{mk/eur}$ is nominal foreign exchange rate MKD/EUR, $MMIR$ is the average weighted interest rate of the CB bills and FXT/MO is the correlation between the NBRM interventions on the foreign exchange market and reserve money. The exceeding of the critical threshold points to pressures on the foreign exchange market, which are manifested through larger NBRM interventions on the foreign exchange market, larger changes in the interest rates, as a respond to the movements on the foreign exchange market, or larger changes of the nominal foreign exchange rate.

resulted in pressures on the foreign exchange market, and the banks supporters of the foreign exchange market registered lack of foreign exchange, especially in January and April. At the end of January and April, Denar 61.42 and 61.39 per one Euro, respectively were traded (compared to Denar 61.20 per one Euro at the end of 2007). On the other hand, the foreign exchange inflows in the following months supplemented the supply of foreign exchange on the foreign exchange market, because of which this is a period of more stable movement of the foreign exchange rate, which equaled Denar 61.19 per one Euro, on average. However, in the last quarter, the increase in the demand for foreign exchange, especially at the end of October and the beginning of November resulted in a pressure for lowering the Denar value and NBRM intervention through net sale of foreign exchange. The foreign exchange rate remained on a stable level, with the average Denar exchange rate against the Euro on the foreign exchange market in 2008 being equal to Denar 61.27 per one Euro (compared to Denar 61.18 per one Euro in 2007), while the average foreign exchange rate on the foreign exchange market equaled Denar 61.45 per one Euro (Denar 61.41 per one Euro in 2007).

Figure 82

Nominal foreign exchange rate of the Denar against the Euro and the US Dollar on the foreign exchange market
(denars for foreign currency unit)

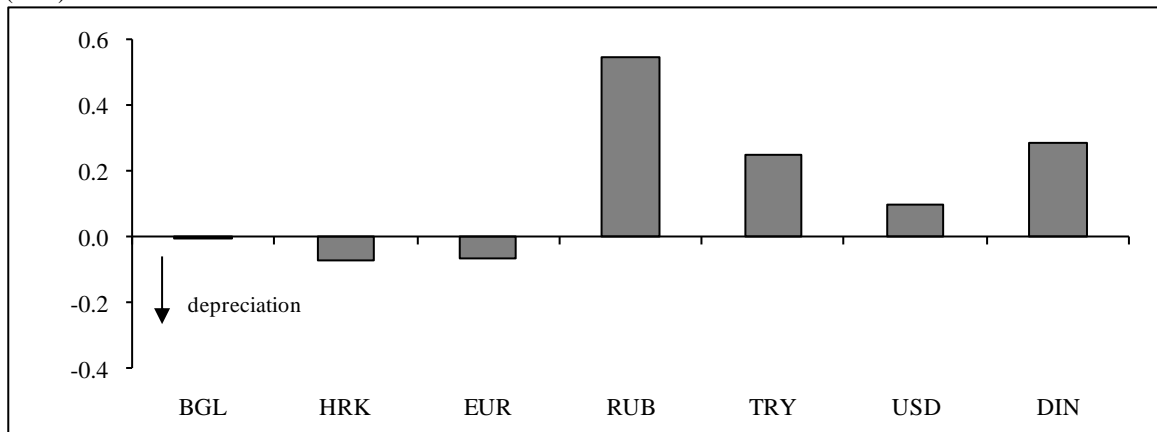


Source: National Bank of the Republic of Macedonia.

The movement of the Euro / US Dollar correlation on the international stock exchanges conditioned the movement of the Denar / US Dollar exchange rate. Namely, in conditions of appreciation of the Euro in the first seven months of 2008, the value of the Denar relative to the US Dollar also strengthened. Although the Denar appreciated in the remaining part of the year, the average foreign exchange rate in 2008 registered a significant annual appreciation of 6.4% and it equaled Denar 41.86 per one US Dollar. The same level of the average foreign exchange rate was registered also on the currency exchange market and in comparison with 2007, it appreciated by 6.5%.

In conformity with the dynamics of the nominal foreign exchange rate and the relative prices, the REER of the Denar, deflated with the consumer price index and the prices of the producers of industrial products, points to moderate changes towards deterioration in the competitiveness of the Macedonian products on foreign markets. Different trend was shown only by REER deflated with index of labor force costs per product unit. However, during the entire 2008, the NEER constantly registers an appreciation trend, with the average NEER of the Denar being registered annual appreciation of 1%, primarily due to stronger appreciation of the Denar/US Dollar exchange rate compared to the Russian Ruble/US Dollar and Serbian Dinar/US Dollar exchange rate.

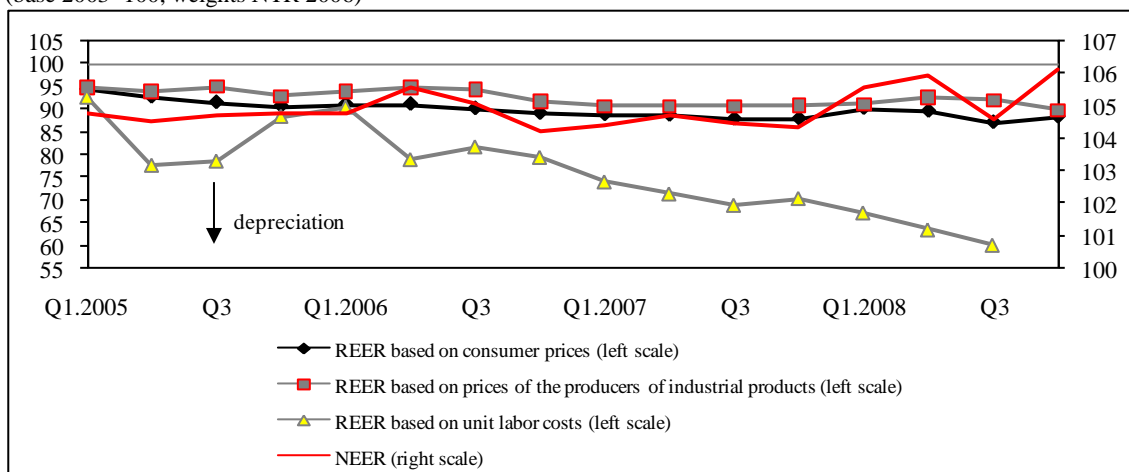
Figure 83
Contribution to the NEER of the denar *
(in %)



* Aggregated weight out of the weights of the Euro area countries is used for the Euro, which is included in the calculation of REER.
Source: National Bank of the Republic of Macedonia.

Opposite to the appreciation of the NEER of the Denar, the relative prices index registered an increase (larger increase in the index of foreign than domestic prices⁶⁶), which partially relativized the influence of the NEER. In the first months of the year, the external shocks influencing on the inflation had larger effect on the domestic prices, than on the foreign ones. Thus in this period the REER of the Denar deflated with the consumer price index registered an appreciation. By calming the domestic inflation down, in the third quarter, in conditions of depreciation of NEER and increase in the relative prices, REER registered depreciation on annual basis. However, this trend ceased in December given strong appreciation of the NEER. As a result, in 2008 the average REER of the Denar deflated with the consumer prices registered slight appreciation of 0.6% on annual basis.

Figure 84
REER and NEER indices of the denar
(base 2003=100, weights NTR 2006)



Source: National Bank of the Republic of Macedonia.

Similar dynamics was registered with the REER, deflated with the index of the producers of the industrial products, with the higher price level being registered in the second quarter, which conditioned more apparent trend of appreciation of REER in this period. In the following period, the dynamic of this trend slowed down, and at the end of the year REER depreciated, in conditions of decrease in the domestic and increase in the index of foreign prices. In line with such a dynamics, the average REER deflated with the index of the prices of the producers of

⁶⁶ Changes in prices with base of 2003=100.

industrial products appreciated by 0.8% relative to 2007. However, **REER of the Denar calculated according to the index of the labor force costs per product unit** has been registering constantly a depreciation trend. In the first three quarters⁶⁷ it registered annual depreciation of 10.9%, on cumulative basis, which is a result of the increase in the index of relative prices of 13.3%, in conditions of significant rise in the foreign and decrease in the domestic of labor force costs per product unit in industry.

3.3. Monetary aggregates

Although the shocks the Macedonian economy faced with in 2008 were of different nature, however, they influenced on the monetary growth in similar manner, i.e. in direction of its deceleration. In the first half of the year, in conditions of further inflation acceleration, the uncertainty related to its future trajectory and thus high inflationary expectations, the economic agents most probably redistributed part of the savings in the banks into other forms of property, such as foreign exchange cash. The rise in the demand for foreign exchange on the currency exchange market in this period is in favor of such a conclusion. The rise in the import process meant also allocation of larger amounts in order to pay the import of certain products, which means also a decrease in the part of the income intended for saving. Hence, besides the registered nominal increase in the wages and the increased economic activity in this period, the growth intensity of the saving began to decrease. In the second half of the year, with the stabilization of the prices of food on global level and the decrease in the prices of oil, the fears for inflation growth reduced, but the effects of the global financial crisis started to feel more heavily in the region, and consequently in the domestic economy. This especially refers to the last three months of the year, when the collapse of one world financial giant in the USA and the massive Government intervention in the financial sector in large number of states caused psychological pressures on the depositors and in the Macedonian economy. However, the volume and the duration of such pressures in our country were significantly smaller in comparison with the more developed economies. Also, in this period, the effects of the crisis on the export sector became evident, while the global aversion to the risk delayed the capital inflows, which resulted in decrease in the enterprises' deposits. These three elements can be identified as the main factors contributing to lower saving in the banking system. Also the impeded credit activity of the banks acted towards lower deposit growth.

Table 21
Components of the monetary aggregates*
(in millions of denars)

	stock					quarterly changes				Total
	31.12.2007	31.03.2008	30.06.2008	30.09.2008	31.12.2008	I	II	III	IV	
Currency in circulation	17,936	15,746	16,180	16,552	17,628	-2,190	434	372	1,076	-308
Demand deposits	27,822	26,874	31,189	31,064	34,258	-948	4,315	-125	3,194	6,436
M1	45,758	42,620	47,369	47,616	51,886	-3,138	4,749	247	4,270	6,128
Quasi Denar deposits	55,057	55,902	57,007	57,662	49,359	845	1,105	655	-8,303	-5,698
Quasi foreign currency deposits	64,042	67,360	70,971	75,551	74,972	3,318	3,611	4,580	-579	10,930
M2	164,857	165,882	175,347	180,829	176,217	1,025	9,465	5,482	-4,612	11,360
Nonmonetary Denar deposits	5,670	6,378	7,454	8,307	9,449	708	1,076	853	1,142	3,779
Nonmonetary foreign currency deposits	4,504	5,069	5,623	6,913	8,957	565	554	1,290	2,044	4,453
M4	175,031	177,329	188,424	196,049	194,623	2,298	11,095	7,625	-1,426	19,592

*The foreign exchange categories are evaluated according to the current foreign exchange rate.

Source: National Bank of the Republic of Macedonia.

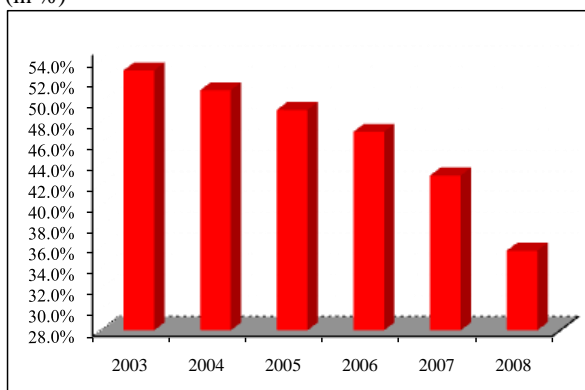
In such circumstances, the annual increase in the broadest money supply (M4) at the end of the year reduced to 11.2%, which is the lowest growth registered in the last three years. However, generally for the entire year, the intensified economic activity in the first three quarters of the year dominates over the effects of the global crisis, which began to feel more intensively in the banking sector in the last quarter of the year. Thus if compare the average annual monetary growth in 2008 (of 21.5%) and the averages registered in the previous several years, except to 2007 (when it equaled 28.6%), it can be perceived that the increase in the supply of money still exceeds the average registered in the previous years (in 2006, the average monetary growth equaled 18.7%, while in 2005

⁶⁷ Last available data.

16.7%). In any case, it is clear that during the following year, the consequences from the global crisis on the saving in domestic banks, will be felt to great extent, additionally slowing down the money supply growth rates.

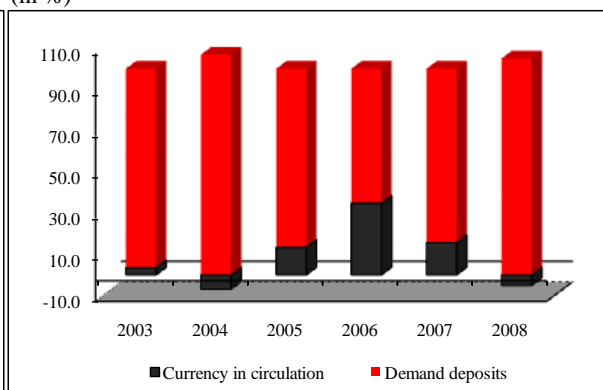
From the aspect of the additional money supply components, in the second half of the year a trend of more significant deceleration of the annual growth of the most liquid monetary aggregate M1 (which includes currency in circulation and transaction deposits) was registered. Having in mind that it is an aggregate reflecting the demand for money for transaction needs, the slowing down of the growth can be explained, in one hand, with the significant impediment of the price growth and thus smaller need for increment in the available sources for realization of the transactions. However, it can be stated that large portion of these changes are due to the gradual deceleration of the economic growth dynamics, the trade deficit deepening, as well as to the change in the currency preferences of the entities towards larger preference to have foreign assets on their disposal. In December 2008, the narrowest monetary aggregate M1 is higher by 13.4%, annually, which is fully due to the rise in the transaction deposits, given decrease in the demand for cash. The decrease in the currency in circulation is followed also by decline in its share in the structure of monetary aggregate M1 (in 2008, the share equaled 35.7%, on average, compared to 42.9% in 2007). In conditions of uncertainty, such movements most probably mean conversion of the Denar into foreign currency cash. However, also the constant innovations in the cashless payment instruments can have influence in this direction.

Figure 85
Average share of the currency in circulation in M1
(in %)



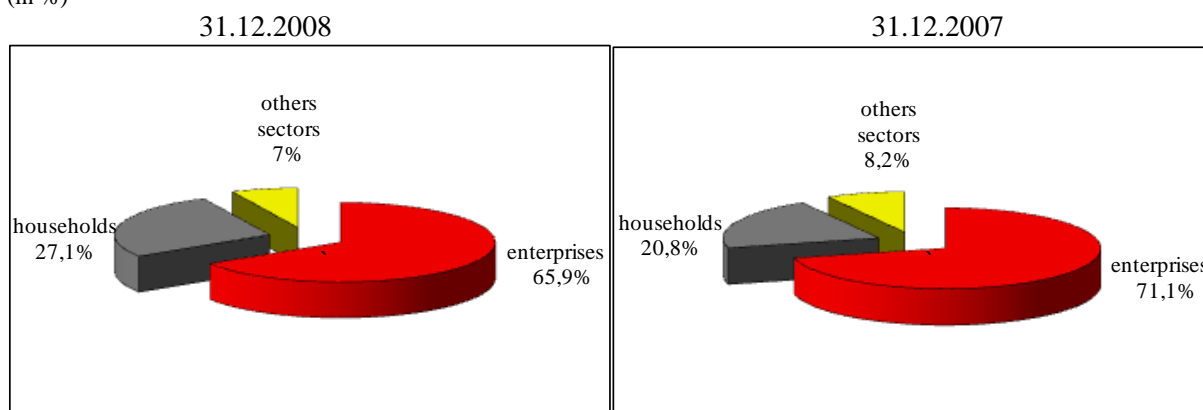
Source: National Bank of the Republic of Macedonia.

Figure 86
Contribution to the annual growth in the money supply M1
(in %)



The contribution of the change in the stock of the transaction accounts of both households and enterprises to the annual growth in the demand deposits (of 23.1%) is almost equilibrated, with the share of the first ones being equal to 54.7%. However, the slowing down of the demand deposits growth during the year is registered with the corporate sector, the average growth of which equaled 37.8% in 2008 (33.7% in 2007). On the other hand, the average annual rise in the transaction households' deposits in 2008 equaled 69.9%, compared to 35.5% in the preceding year. This matched the nominal increase in the wages, but it can also mean cautious spending of the households in conditions of tightening of the credit conditions and large uncertainty about the future movements on the labor force market. However, it can be stressed that besides the intensification of the average annual growth, significant deceleration of the growth in the households' demand deposits was registered in the last two years.

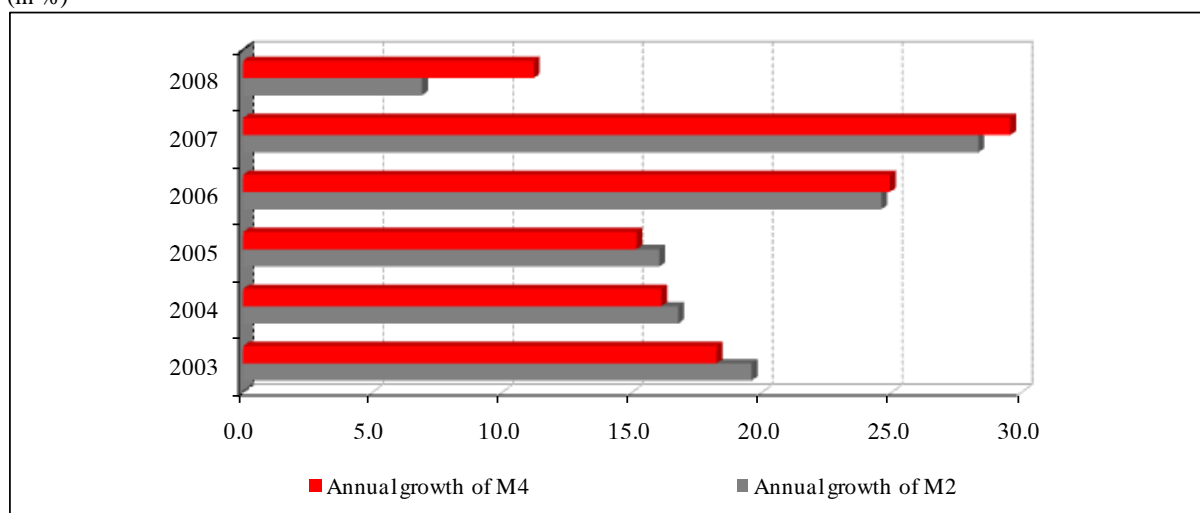
Figure 87
Structure of demand deposits by sectors
(in %)



Source: National Bank of the Republic of Macedonia.

The wider monetary aggregates M2 and M4 at the end of 2008 registered annual growth of 6.9% and 11.2%, respectively (compared to the growth of 28.3% and 29.5%, respectively in December 2007). Despite the fact that the effect of the global financial crisis on the domestic banking system did not have direct influence, changes in the economic agents' behavior were evidenced since the beginning of the year. Thus the confrontation with the high inflation pressures in the first half of the year and the deepening of the world crisis in the second half, directed the private sector tendencies towards larger foreign exchange saving. Consequently, the foreign exchange component has constantly strengthening its contribution to the rise in the wider monetary aggregates M2 and M1 during the entire year and in December it supported 96.2%, i.e. 78.5% of the additionally created money supply M2, i.e. M4, annually. This is a turning point in the continuous growth trend of the contribution of the Denar part (which in December 2007 explained 81.8% and 79.7% of the annual increase in the money supply M2 and M4). The monetary aggregate M2 - Denar part, went up by moderate 0.4% (compared to the high increase of 41.9% in December 2007), while the monetary aggregate M4 - Denar part of 4% (42.6% in December the preceding year). Additional characteristic from the aspect of the supply of money in 2008 is the constant growth in the long-term time deposits, which registered high two-digit rate of contribution to the increase in the money supply M4 at the end of the year (42%, compared to 8.9% in December 2007).

Figure 88
Average annual growth rates of the money supply M2 and M4
(in %)

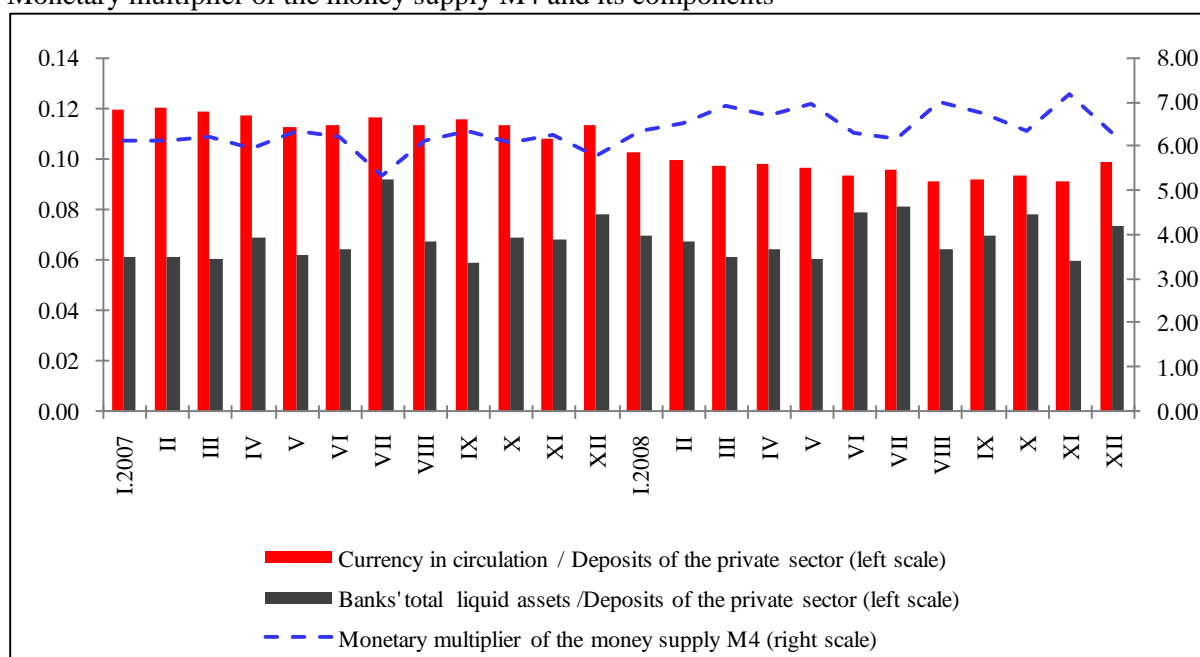


Source: National Bank of the Republic of Macedonia.

The strengthening of the entities' awareness for the opportunity costs for saving cash, compared to investment in other yield-bearing forms of financial property, contributes to lower growth in the demand of cash, and decrease in its share in the money supply. This resulted in further strengthening of the contribution of the banks in the process of monetary multiplication, in conditions of stable correlation between the preference to keep liquid assets of the banks with the NBRM and the increase in the deposit potential. Thus the monetary multipliers of the monetary supply M2 and M4 equaled 6.14 and 6.63, on average, in 2008 (comparing to 5.75 and 6.08, respectively in 2007).

Figure 89

Monetary multiplier of the money supply M4 and its components



Source: National Bank of the Republic of Macedonia.

The monetary growth slowed down in large number of economies in 2008. This pertains also to the fast growing economies and economies in transition, the financial system of which were not directly affected by the global crisis, but in which the problems in the real sector acted fast on the savings growth rate dynamics. Namely, these economies showed resistance to the world financial tremors in initial stage, as a result of insufficient integration into the global financial markets, the absence of financial innovations in the supply of the domestic banks and financing of the activities mainly through domestic sources. However, in conditions when the decrease in the global demand and general uncertainty were transferred in form of slowing down of the economic activity, the transitional effects on the monetary growth were inevitable. From the aspect of the monetization degree, it is characteristic that in Euro area and in some other economies, the share of the money supply in the GDP went up in 2008, which can be interpreted as a redistribution of the assets from more risky towards less risky forms of investment.

Figure 90
Annual growth rates of the money supply M4*
(in %)

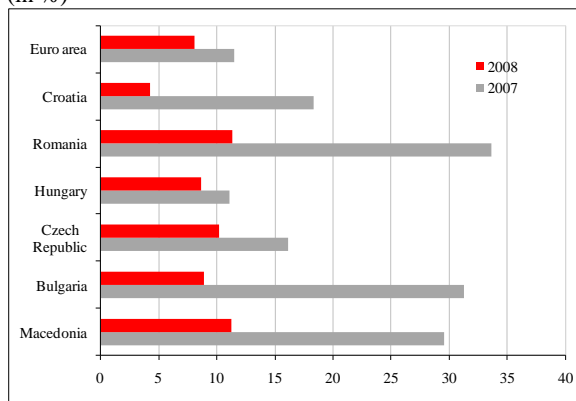
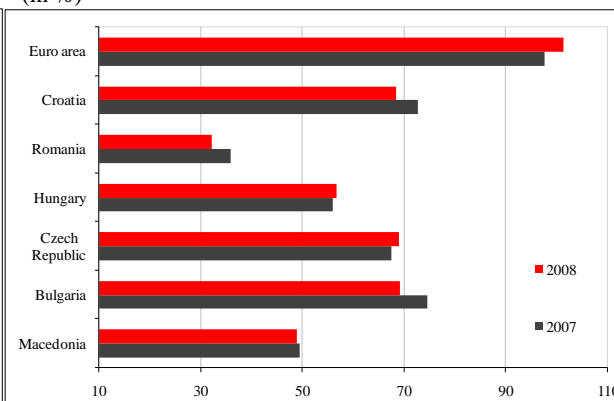


Figure 91
Share of the broadest money supply M4 in GDP*
(in %)

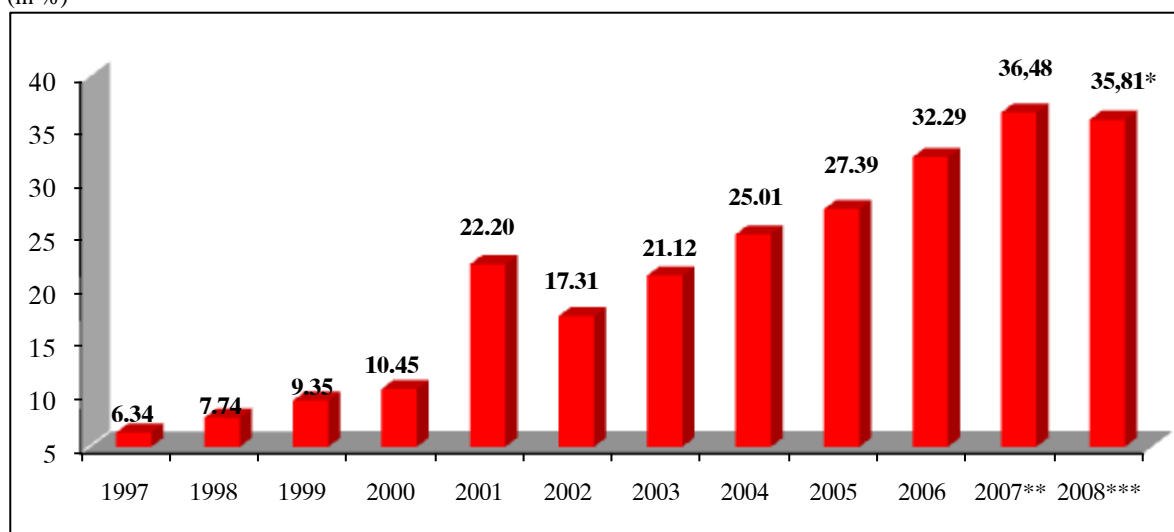


Source: The EBRD Transition Report in 2008, EBRD; web sites of the central banks; Eurostat; NBRM *The data on the money supply M4 are taken on annual basis, at the end of the year. The datum on the money supply M4 in 2008 pertaining to Czech Republic and Romani pertains to November. The datum on the GDP in 2008 for Macedonia is estimated, while projected for other countries.

3.3.1. Total deposits

In conditions of larger uncertainty, caused by the world crisis, in 2008 the high growth rates of the saving of the private sector registered until then decelerated. The failure of the global financial mechanisms to localize the problem of the US mortgage markets, resulted in turning of this financial problem into a threat to the economic growth of almost all countries in the world. The Macedonian economy, as a small-size and open economy, failed to remain immune to these developments. With a certain delay, this effect was felt in the economic agents' behavior when making financial decisions. The intensified growth in the foreign exchange saving since the beginning of the year represented an early signal for change in the economic agents' expectations, while the further deepening of the crisis reduced the annual increase in the savings to the lowest level since 2003. However, even in such circumstances, the saving in the Macedonian banking sector remained on satisfactory level also in 2008, participating with 35.8% in the gross domestic product of the country.

Figure 92
Share of the private sector's deposits with the banks in GDP
(in %)



* The data on the total deposits are as of the end of the year.

** Preliminary datum on the GDP.

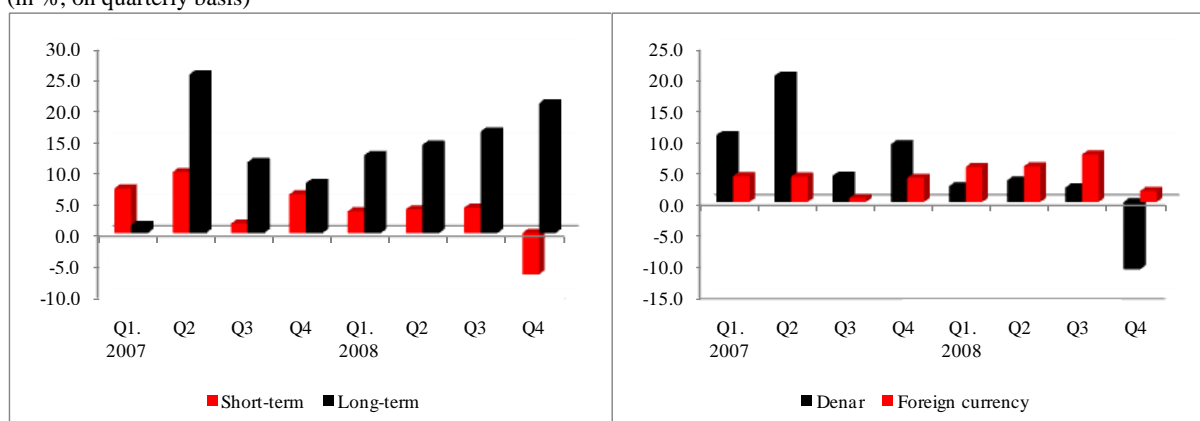
*** Estimated datum on the GDP.

Source: National Bank of the Republic of Macedonia.

At the end of 2008, the total deposits (without demand deposits) in the banking sector surged by 10.4%, compared to the previous year, which is the lowest deposit growth in the last several years. Although the deceleration of the growth was present during the entire year, its intensity, still, was the largest in the last quarter of the year, in conditions of large payment of dividend to a foreign shareholder, slow down of the total economic growth and capital inflows in the domestic economy, as well as more apparent psychological pressures with the depositors. **However, the main feature of the changes in the saving during the year observed from the aspect of the currency structure, was the significantly reduced interest in Denar saving, compared to the constant growth in the saving in foreign currency.** This is a turning point in the "Denarization" trend of the domestic economy, which commenced in the second half of 2006 and continued during the entire 2007. Since the beginning of 2008, the growth rates of the saving in Denars registered a continuous downward trend, thus contributing to a cessation of the trend of reorientation to Denar saving, and loss of the dominant position of the Denar saving contribution in the total deposit starting from August to the end of the year. Thus in December 2008, the Denar deposits registered sharp annual drop of 3.2%, while the foreign currency deposits registered high annual growth rate of 22.4%. This is the first fall in the Denar deposits on annual basis since the Euro conversion period, and it clearly indicates changes in the entities' expectations due to the problems in the global economy.

Figure 93

Changes with the components of the total deposits according to maturity and currency
(in %, on quarterly basis)



Source: National Bank of the Republic of Macedonia.

From the aspect of the maturity structure, since the beginning of the year, and especially in the last quarter, significant growth in the long-term time deposits was registered, which augmented by 81%, annually at the end of the year. Simultaneously, the short-term deposits grew with continuous slower dynamics and in December they registered one-digit growth rate (of 4.4%), which deviates from the trend of high growth rate characteristic for the last several years. Thus, the contribution of the long-term deposits in the newly created deposit base reached 61.2% in December, compared to 12.2% and 7.3%, as it equaled at the end of 2007 and 2006, respectively. The interest to invest funds in the banking sector on long-term basis can be explained with the stimulating interest rate policy the banks offer in order to attract more stable deposit core, as well as wider range of products created for satisfying different propensities of numerous clients. On the other hand, the saving on longer terms can be related also to the expectations of the domestic private sector for stabilization and the temporary character of the effect of the constant global imbalances, as well as the confidence in the stability of the Macedonian banking sector. In direction of longer-term investment, the possible effect in the deferred consumption of durable consumer products and redirecting of the planned assets on this basis in form of deposits with longer term should also be emphasized.

Table 22
Total deposits of the banking sector*
(in millions of denars)

	2007				2008			
	stock as of 31.12.2007	annual change %	contribution to the growth of total deposits	share	stock as of 31.12.2008	annual change %	contribution to the growth of total deposits	share
Total deposits to the non- government sector	129,272	28.8	100%	100%	142,737	10.4	100%	100%
- in Denars	60,727	52.0	71.9	47.0	58,808	-3.2	-14.3	41.2
- in foreign currency	68,546	13.4	28.1	53.0	83,929	22.4	114.2	58.8
Short-term deposits	119,099	27.0	87.8	92.1	124,331	4.4	38.9	87.1
- in Denars	55,057	51.6	64.9	42.6	49,359	-10.3	-42.3	34.6
- in foreign currency	64,042	11.5	22.9	49.5	74,972	17.1	81.2	52.5
Long-term deposits	10,174	53.3	12.2	7.9	18,406	80.9	61.1	12.9
- in Denars	5,670	56.2	7.1	4.4	9,449	66.6	28.1	6.6
- in foreign currency	4,504	49.7	5.2	3.5	8,957	98.9	33.1	6.3

Source: National Bank of the Republic of Macedonia.

From the aspect of individual sectors, slower rise in the deposits in both households and enterprises was registered, although on average, the slowing down was more apparent with the enterprises. Thus in 2008, the corporate deposits augmented by 18.7%, on average, compared to 37.2% in the previous year, while this difference in the growth rates with the households equaled 7.8 percentage points. The changes in the growth dynamics of the **households' deposits** were influenced by several factors, which had divergent effects. The inflationary pressures and the increased uncertainty, the lower inflows based on private transfers and the unfavorable trend on the financial markets (i.e. the stock exchange), caused oscillations in the households' available income, and thus decline in the propensity for saving. On the other hand, the nominal increase in the wages in the first three quarters acted towards rise in the households' deposit potential. Since October 2008, when the effects of the world crisis were felt more strongly in the domestic economy, the households' deposits recorded a remarkable deceleration in the annual growth (and a drop on a quarterly basis), with the annual growth rate reducing to 11.4% in December, compared to 30.8% in the same month of 2007.

The changes in the expectations reflected in the households' **currency preferences**. Thus the annual increase in the households' foreign currency deposits reached 25.4% in December (12.6% in the preceding year). On the other hand, the growth rate of the Denar deposits was constantly decreasing, and at the end of the year their stock reduced by 6.8% compared to the end of 2007. From maturity aspect, the amount of the long-term deposits at the end of the year was larger almost by twice compared to 2007, which enabled the contribution of these deposits to the annual growth in the total deposits to reach 59.5% in December (12.4% in the previous year).

Table 23
Total deposits of households and enterprises
(in millions of denars)

	Households				Enterprises			
	31.12.2007	annual change (in %)	contribution to the growth of total deposits	share in total deposits	31.12.2007	annual change (in %)	contribution to the growth of total deposits	share in total deposits
Total	98,388	11.7	76.4	68.9	39,654	5.9	16.5	27.8
- short-term	85,804	5.1	30.9	60.1	37,376	4.3	11.3	26.2
- long-term	12,584	94.6	45.4	8.8	2,278	43.5	5.1	1.6
- in Denars	35,012	-6.8	-18.9	24.5	19,770	-1.2	-1.7	13.9
- in foreign currency	63,376	25.4	95.3	44.4	19,884	14.1	18.2	13.9

Source: National Bank of the Republic of Macedonia.

Regarding the enterprises, the movement of the deposits was conditioned, to great extent, by the different needs of funds during the business cycle. Consequently, the intensity of their growth is more variable compared to the "households" sector. However, since the beginning of the year, downwards trend of the annual growth rate is registered, exception to the August - October period,

when due to the preparation for payment of dividend by one company to foreign investor, the deposit accounts of the enterprises registered high growth. After October, when the global recession spilled over on the economic activity in the country and when larger amount of dividend was paid outside the country, the increase in the corporate deposits drastically reduced. The lower foreign and domestic demand conditioned a fall in the inflows based on the enterprises' regular operating, which in environment of increased expenses, resulted in a slight increase of 5.9% in December, which is the lowest annual growth rate in the last two years. The movements with the **currency structure** are similar to those with the households, i.e. at the end of the year the foreign currency deposits plunged by 1.2% compared to the previous year, while the growth rate of the foreign currency deposits maintained on the level registered in 2007 (14.1% and 14.2% in December 2008 and 2007, respectively). From the aspect of the maturity structure, compared to the similar growth dynamics of the short-term and long-term deposits of the corporate sector in 2007 (21.8% and 18.9%, respectively), in 2008 the long-term deposits grew significantly faster than the short-term deposits (43.5% and 4.3%, respectively). Such changes in the trend can be explained with high inflows from the enterprises' short-term deposits in November, due to the payment of high amount of dividend to one larger foreign investor.

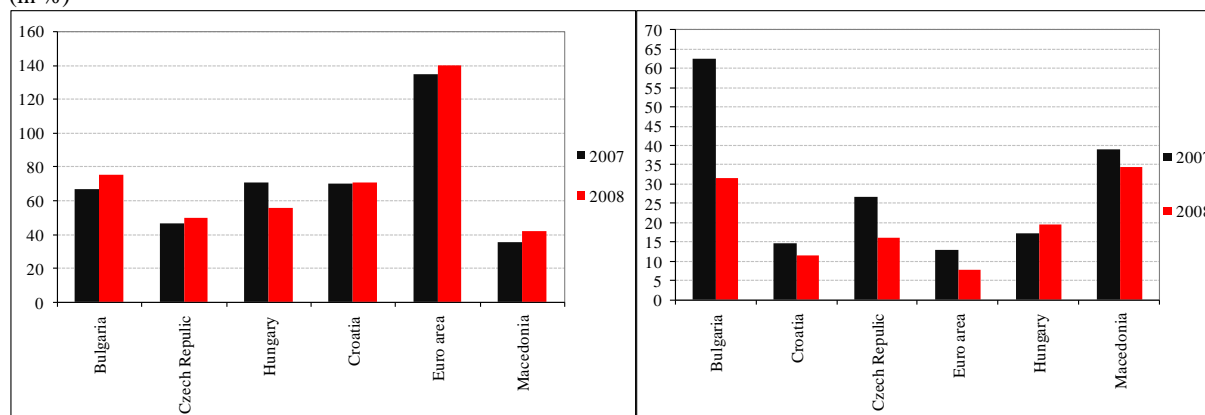
3.4. Bank placements

In 2008, the credit growth in the Macedonian economy significantly decelerated, which can be considered as a combined effect of the undertaken monetary measures and the consequences arising from the global crisis. One of the most significant characteristics of the crisis in 2008 is the large uncertainty it creates and the globalism with which it encompasses almost all countries in the world. The preference for aggressive undertaking of financial risks, in conditions of their underestimate and improper management, has laid down the "asymmetric information" in the credit relations in the crises base. Also the delayed transfer effect can be added as additional characteristic of the crisis, especially with the financial systems of the fast growing economies and the economies in transition. Although the credit growth in the Macedonian economy began to decelerate in May 2008, however, this trend significantly intensified in the last several months of the year, when the global crisis escalated. Thus in December, the annual credit growth equaled 34.4% (compared to 39.1% in December 2007), which is larger deviation from the average for the year (that equals 40.4%). Similar movements were recorded also on the credit markets of other countries, and besides the impeded credit activity compared to 2007, the deepening of the financial intermediation continued.

Figure 94

Share of the banks' total placements in the GDP and the annual growth rate of the credits in 2008 by countries*

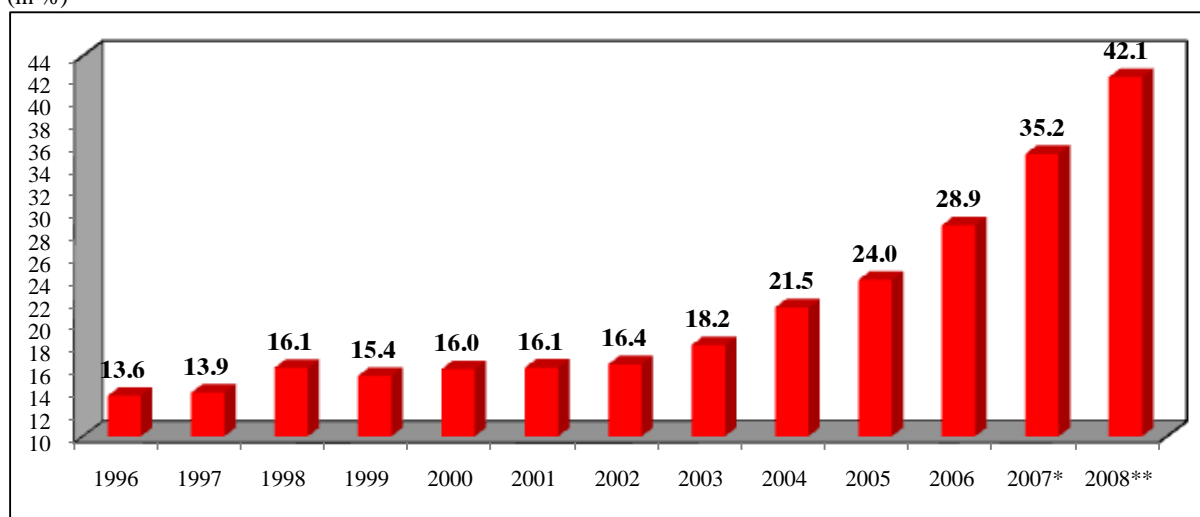
(in %)



*Source: Eurostat, web sites of individual banks, NBRM. The datum pertaining to GDP in 2008 by countries is projected. The datum on the GDP in 2007 for Macedonia is preliminary, while for 2008 it is estimated.

In the Macedonian economy, the activity on the credit market retained the growth dynamics in the largest part of 2008, showing further deepening of the financial intermediation. In global terms, significant impediment of the credit growth was evidenced, in conditions of reevaluation of the risk degree, liquidity reduction, closure of part of the sources of financing, tightening of the crediting conditions and credit rationalizing. In 2008, the functioning of the Macedonian financial system remained stable and out of such tremors. This, to large extent, is due to the fact that the domestic financial system is characteristic with simple structure, which is in initial stage of diversification. The insufficient integration into the global financial flows, as well as the relatively small diversification of the bank supply (especially the non-representation of the structural products) represented additional safeguard against the crisis in 2008. Simultaneously, the Macedonian banks register constant improvement in the profitability and efficiency in the operating, which contributed to preserve safe and sound Macedonian banking system, as well as good solvency position of the banks. Consequently, the banking support in the Macedonian private sector financing grew also in 2008, increasing the share in the total credits in the GDP by 6.9 percentage points, compared to the preceding year.

Figure 95
Share of the credits in GDP
(in %)



The data on the total credits are as of the end of the year. If the share of the credits is calculated as geometrical average of the total credits in the GDP, the participation of the total credits in the GDP equals 37.5%.

* Preliminary data on GDP value.

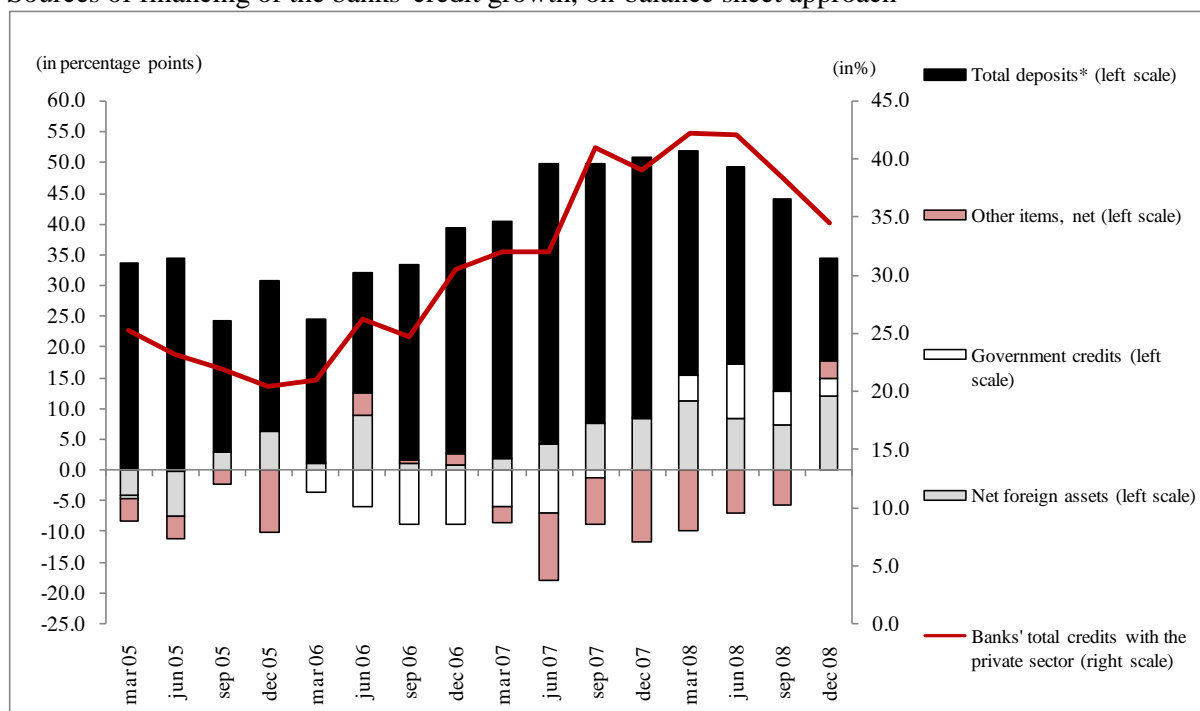
**Estimated GDP value.

Source: National Bank of the Republic of Macedonia.

Main sources for financing the banks' credit activity in 2008 were the deposit potential, as a primary source, and the management with the net foreign currency position, as well as the inflow of additional capital in the banking system. The reliance on domestic sources of financing enabled the Macedonian banking sector not to feel the direct negative effects of the lower liquidity on global level. The uncertainty regarding the extent of the losses the world financial institutions are exposed to caused mutual non-confidence and non-readiness to lend to each other, and on the other hand, the concern for the own adequacy of the liquidity position with each financial institution resulted in increased demand for borrowings. Thus, the narrowing of the liquidity was inevitable. The Macedonian banks felt the transfer effects of these changes through more restrictive conditions and relatively lower availability for external financing. Thus starting from March 2008, the **foreign assets** of the banks registered two-digit rates of decrease for the first time since June 2006. On the side of the **liabilities**, the external indebtedness reduced to an annual growth of 3% in December (given larger outflows based on debt repayment and relatively small new debiting), compared to 37% at the end of 2007. However, at the end of the year, the net foreign assets went down by 98%, compared to 2007 and it equaled Denar 284 million. In such conditions, the domestic banks faced with larger

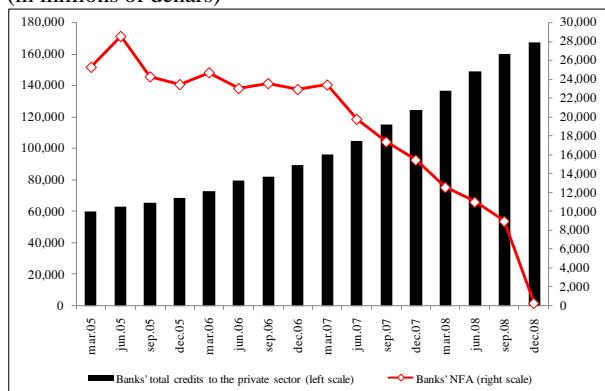
competitiveness for providing the required scope of sources of financing through the domestic deposit market.

Figure 96
Sources of financing of the banks' credit growth, on-balance sheet approach



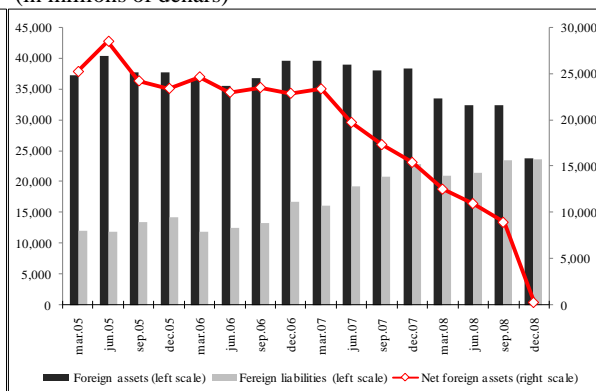
Source: National Bank of the Republic of Macedonia.

Figure 97
Total credits and net foreign assets
(in millions of denars)



Source: National Bank of the Republic of Macedonia.

Figure 98
Foreign assets and foreign currency deposits
(in millions of denars)



Besides the tightening of the monetary policy, the trend of continuous strengthening of the credit activity lasted until April 2008, when the credit growth reached its peak of 44.1%, annually. This process was enduring parallel to the increase in the inflation pressures and deterioration in the situation in the external sector. In such conditions, in June NBRM undertook additional measure (it adopted the Decision on a compulsory deposit), the aim of which was to slow down the credit growth rate and to enable safeguard against potential future risks. In the future period, the rise in the total credits slowed down continuously.

Table 24
Domestic credits of deposit banks*
(in millions of denars)

	stock 31.12.2008	annual change		contribution to the growth of total placements (in %)	share
		in mil. Denars	in %		
Total placements of the banks with the private sector	167,887	43,012	34.4	100%	100%
Denar placements**	129,808	35,312	37.4	82.1	77.3
Foreign currency placements	38,079	7,700	25.3	17.9	22.7
Short-term placements	65,289	17,479	36.6	40.6	38.9
Long-term placements	102,598	25,533	33.1	59.4	61.1
Placements to enterprises	101,055	24,765	32.5	57.6	60.2
Placements to households	66,430	18,158	37.6	42.2	39.6

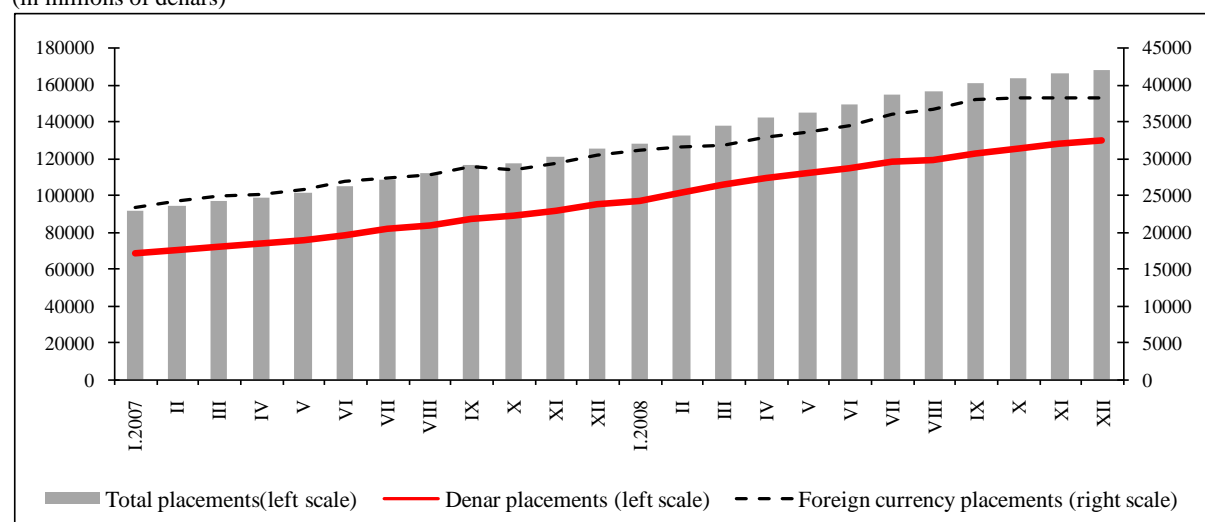
* The foreign exchange categories are estimated at a current exchange rate.

**Denar credits include also the Denar credits with FX clause.

Source: National Bank of the Republic of Macedonia.

From the aspect of the currency structure of the crediting, the long term-credits had larger role in the credit expansion also in 2008, with their share in the annual increase in the total credits in December being equal to 59.4%. However, in comparison with the preceding two years, the contribution of these credits registered a decline (67.7% and 73.6% in 2007 and 2006, respectively), thus reflecting the slower dynamics of the growth rate (from 44.5% in December 2007 to 33.1% at the end of 2008), given intensified increase in the short-term credits. From the **currency aspect**, during the year the Denar⁶⁸ credits grew on average with intensified dynamics compared to the preceding year (43.9% compared to 36%, on average in 2007), while the average rate of the foreign currency credits was lower by 1.1 percentage point compared to 2007 and it equaled 30.2%.

Figure 99
Banks' placements according to currency structure
(in millions of denars)



Source: National Bank of the Republic of Macedonia.

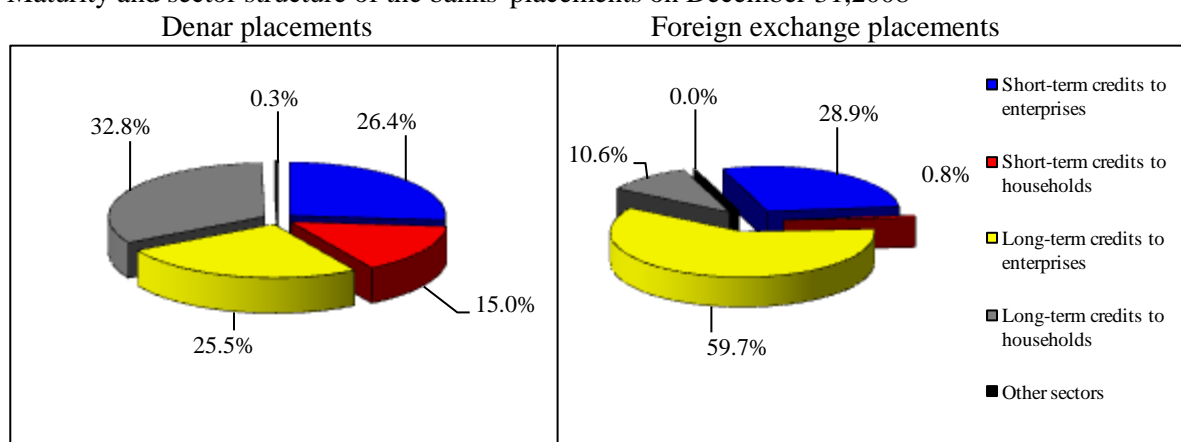
The contribution of the credits extended to both households and corporate sector to the rise in the total credits in 2008 was almost balanced. However, larger portion of the funds were distributed with the corporate sector, the average contribution of which in the increase in the total credits equaled 53.4%. The dynamics analysis shows a trend of decline in the contribution of the households' credits during the year. This trend was especially apparent at the end of the year, when the banks' perceptions of risk significantly went up, transferring relatively fast to the segment of

⁶⁸ It includes also the Denar credits with currency clause.

the households' crediting. Consequently, the contribution of the corporate sector augmented, while the growth rate of lending to enterprises was relatively stable.

Figure 100

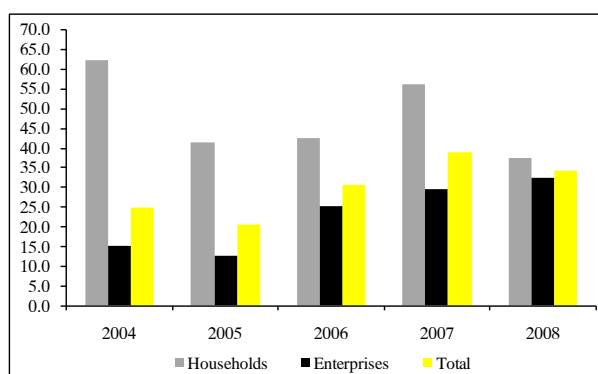
Maturity and sector structure of the banks' placements on December 31, 2008



Source: National Bank of the Republic of Macedonia.

Figure 101

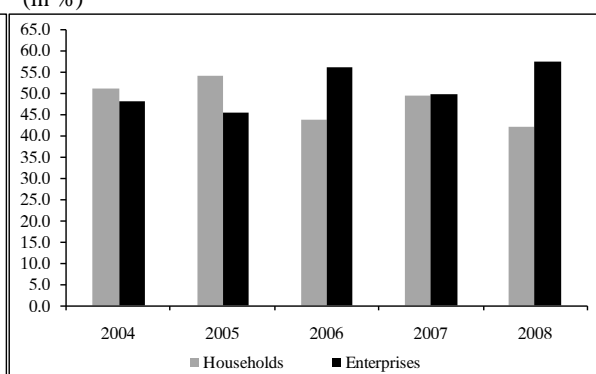
Annual changes
(in %)



Source: National Bank of the Republic of Macedonia.

Figure 102

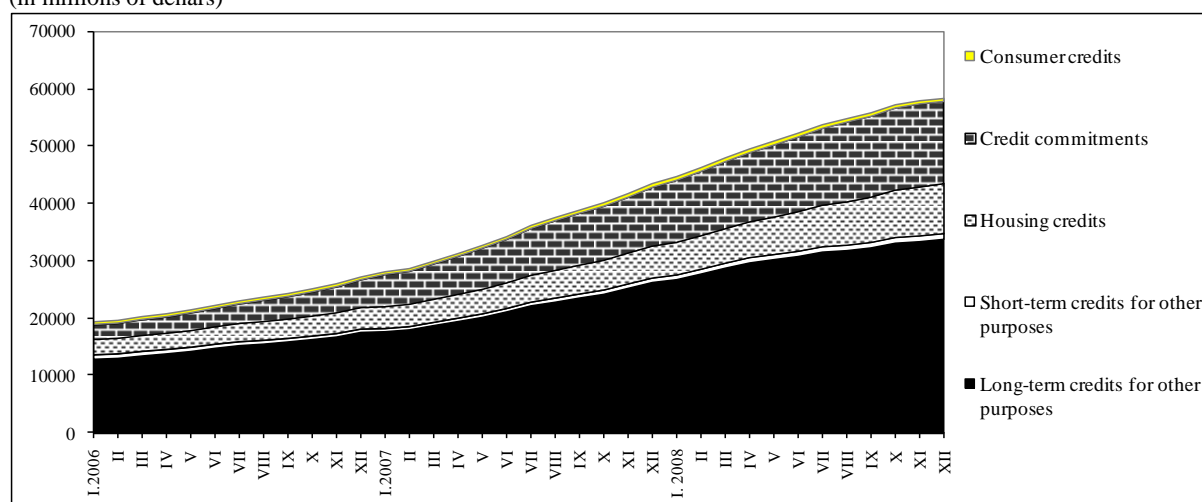
Contribution in the annual growth of the total credits
(in %)



At the end of 2008, the credits placed with the sector "households" surged by 37.6%, which is significant deceleration of the high growth registered at the end of 2007 (of 56.4%), in environment of tightening of credit conditions and more rational rise in the financial liabilities in conditions of high uncertainty. In the first quarter of the year, the credit growth accelerated parallel to the increase in the inflation and the constant "erosion" of the balance on the current account, thus producing additional pressures on the internal and external equilibrium of the economy. Since the second quarter, the trend of slowing down of the annual growth rate commenced, as a combined effect of the undertaken monetary measures, the narrowing of the sources of financing of the banks and the growing perceptions of the risk not only by the banks, but by the households, as well. In such conditions, in 2008 the average growth rate of the total households' credits equaled 51.4%, which is almost on the same level as in the preceding year (51.1%). From the aspect of the maturity and currency structure of the total households' credits, in 2008 no significant changes were registered. Thus also in 2008 the Denar credits (including also the Denar credits with FX clause) had dominant contribution to the increase in the total households' credits of 89.1%, while from the aspect of the maturity structure, the contribution of the long-term credits was once more of higher significance (68.7%).

From the aspect of type of credits, the main component of the increase in the households' credits were the long-term credits for other purposes⁶⁹, which participated in the rise of the households' Denar credits with about 52.6%, on average, in the first half of 2008. In March 2008, this type of credits registered constant growth rates deceleration, which resulted in appropriate decrease in their contribution in the total increase. In such conditions, the total credits continually slowed the growth dynamics down and at the end of the year their rise reduced to the lowest level in the last two years. Additional characteristic from the aspect of the individual types of households' credits is the negative dynamics of the **consumer credits** in the last quarter of the year. Stable, even intensified growth trend compared to the preceding year was registered only with the **housing credits**. This is related to the prices of real estate, which were augmenting during the entire year and have elevated the collateral value, thus increasing the possibilities for debiting through this type of credit. However, the strong redirecting of the banking activities from the consumer to housing segment, in conditions of worsen expectations, does not mean better hedging. Namely, in conditions of expected delay in the economic growth, there is a probability for a decrease in the collateral value (i.e. the price of real estate), thus reducing the effect of the additional hedging with this type of crediting.

Figure 103
Distribution of households' Denar credits by types of credits
(in millions of denars)



Source: National Bank of the Republic of Macedonia.

Having in mind that the **long-term credits for other purposes** represent heterogeneous category, containing different types of credits, the stated credit classification gives no clear picture of the movements by individual types of credits with this sector. In order to obtain better picture for the annual dynamics of individual types of credit products, the analysis includes the total amount of individual types of credits extended to households⁷⁰, with last available data pertaining to September 2008, as an indicator of the annual dynamics. However, larger change in the annual growth with the consumer credits is registered, the annual growth of which equals 25.8% (compared to 15.5% in the previous classification). Regarding the housing credits, despite the fact that no changes of larger significance in both cases were registered (51.9% and 55.7%), the larger scope of the housing credits influenced towards higher contribution to the increase in the total households' credits. Regarding the remaining types of households' credits, the total amount of the framework credits according to the second classification is higher by 60.8%, on annual basis (compared to 56.2%).

Opposite to the slowing down of the households' credit growth, the crediting to the households, the crediting of the enterprises had relatively more stable movement (in December the annual growth rate equaled 32.7%, compared to 29% at the end of 2007). Thus in 2008, the

⁶⁹ The credits for other purposes include: consumer credits, housing credits, automobile credits, education credits and credits for other purposes.

⁷⁰ Source of data: Credit Registry.

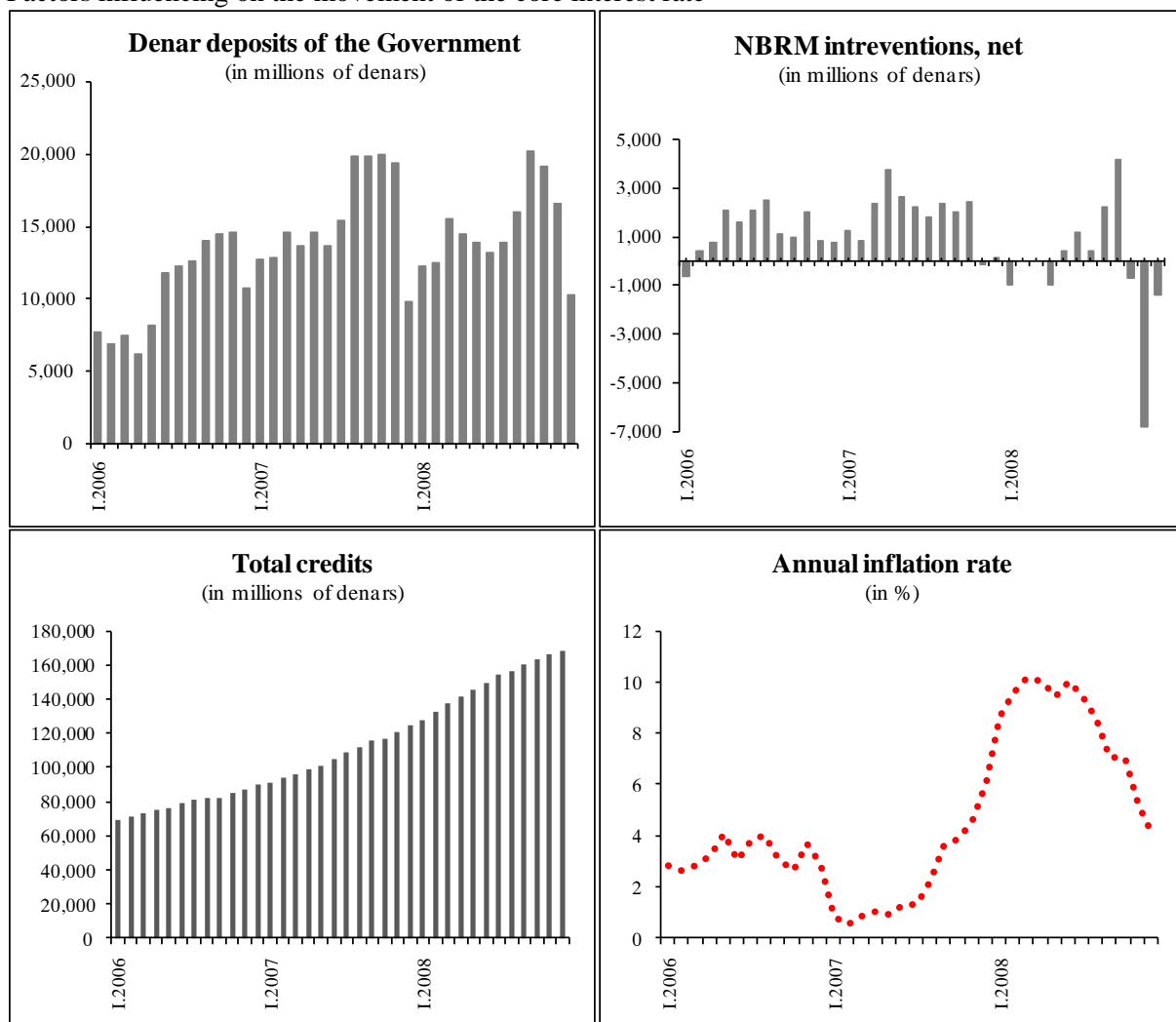
credits the banks had distributed to the enterprises were more by 34.1%, on average, than in 2007, when the credit growth equaled on average 26.7%. From maturity aspect, the long-term credits remained to be the main carrier of the increase in the total credits. However, in conditions of enhanced annual growth in the short-term credits compared to the previous year, the dominant contribution of the long-term credits began to reduce (from 71.9% in December 2007 to 52.8% in December 2008). The currency structure points to reverse trends with growth rates of the Denar and foreign currency credits. Thus the increase in the Denar credits as intensified compared to 207 (given the rise in the Denar credits with FX clause), while the foreign currency credits registered constant downwards trend (and their growth reduced to 20.4% in December, compared to 29.4% in 2007). In the first half of 2008, the banks' credit expansion towards enterprises was in conformity with the intensified economic activity, especially investments in construction and processing industry, as well as retail and wholesale trade. Consequently, dominant share in the increase in the total credit exposure of the banks towards enterprises accounts to the banks' credit exposure to these activities. However, the necessity for financing the investments in fixed assets and working capital for conducting regular operations of the enterprises were the main factors for stimulating the enterprises' credit demand in the largest part of 2008. The future trends with the corporate credits will probably be conditioned by the intensity of the global crisis effects on the Macedonian real sector, which began to feel since October. The slower economic activity of the countries which are our trade partners caused lower interest for the domestic export products, while on the domestic market, the increased uncertainty caused cautious saving, which will probably act on the supply of and demand for credits. However, the deteriorated economic climate the enterprises function in caused pessimistic estimates for the future placement of the production, especially in the manufacturing industry and construction⁷¹. Also, from the aspect of the financial security of the enterprises, in conditions of global liquid problems, the external financing and the decrease in the inter-company indebtedness are registered. All of this makes the domestic debiting through banking credits a crucial element in the maintenance of the capacity for partial dealing with the external shocks.

3.5. Interest rates

In 2008, the interest rates of the NBRM were market by the monetary policy tightening, while the interest rate policy of the banks was mainly focused towards savings stimulation. Namely, in conditions of uncertain economic environment, increased inflation pressures, growing deficit on the current account, strong credit growth in the first several months of the year, as well as expectations for more relaxed fiscal policy (which were realized to great extent in the last quarter of the year), the NBRM carried out gradual increase in the reference interest rate in the first half of 2008. On the other hand, the banks' lending interest rates registered no significant annual change, and in conditions of slower rise in the deposits given high credit activity, in 2008 the banks tended to attract additional sources of funds through constant increase in the deposit interest rate.

⁷¹ Surveys on the business tendencies in the manufacturing industry and construction. Source: SSO.

Figure 104
Factors influencing on the movement of the core interest rate

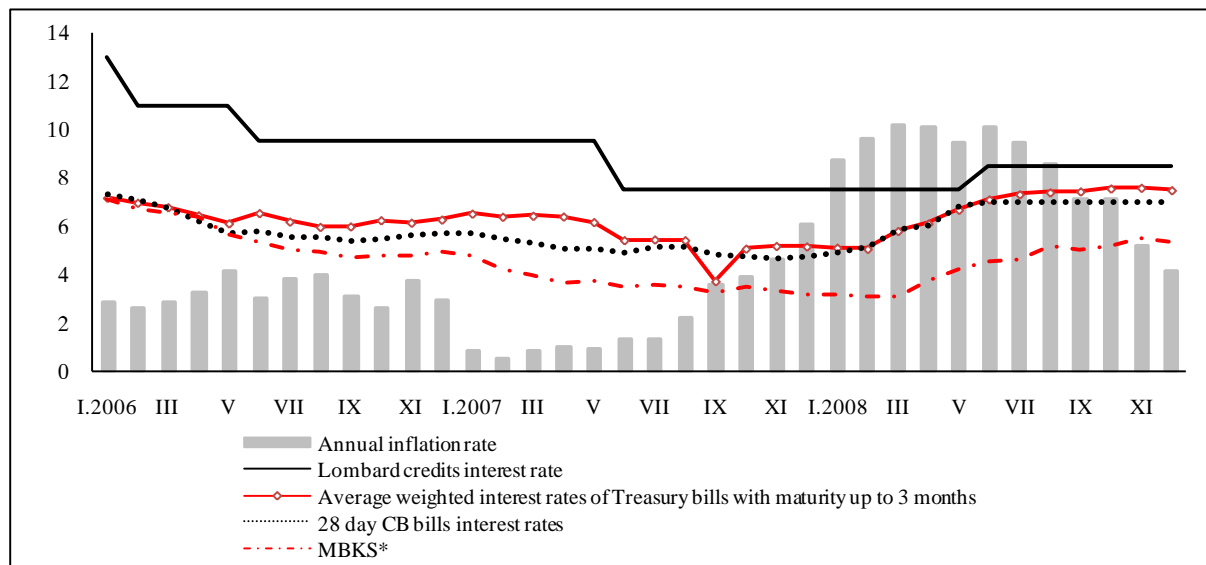


Source: National Bank of the Republic of Macedonia.

In the first half of 2008, the NBRM changed the monetary instruments layout and increased the reference interest rate, in order to stabilize the inflationary expectations, maintain the price stability and to reduce the external misbalance. Namely, the beginning of the year was marked by the strengthened inflation pressures, mainly because of the movement of the prices of food and oil on the international markets, given simultaneous intensification of the domestic demand and deepening of the external misbalance. Regarding the fact that such movements were continuation, to great extent, of the last several months of 2007, the interest rate on the CB bills since 2007 commences to grow gradually, compared to the downward trend registered until then. For the purpose of better indication of the monetary policy direction, in February the "interest rate tender" applied on the CB bill auctions was replaced with "volume tender" and fixed interest rate. Also, in the first half of the year, when applying this type of tender, the NBRM increased the interest rate on CB bills three times, and with the last change in May it was set at the level of 7% (compared to 4.77% in December 2007 and the historically lowest level of 4.66% in November 2007). In line with the increment in the reference interest rate, in June 2008, the NBRM adopted a decision on increasing the interest rate on Lombard credits by 1 percentage point, and it equaled 8.5%.

Figure 105

Short-term interest rates of NBRM, interest rates on the Money Market, the market of Government securities and annual inflation rate



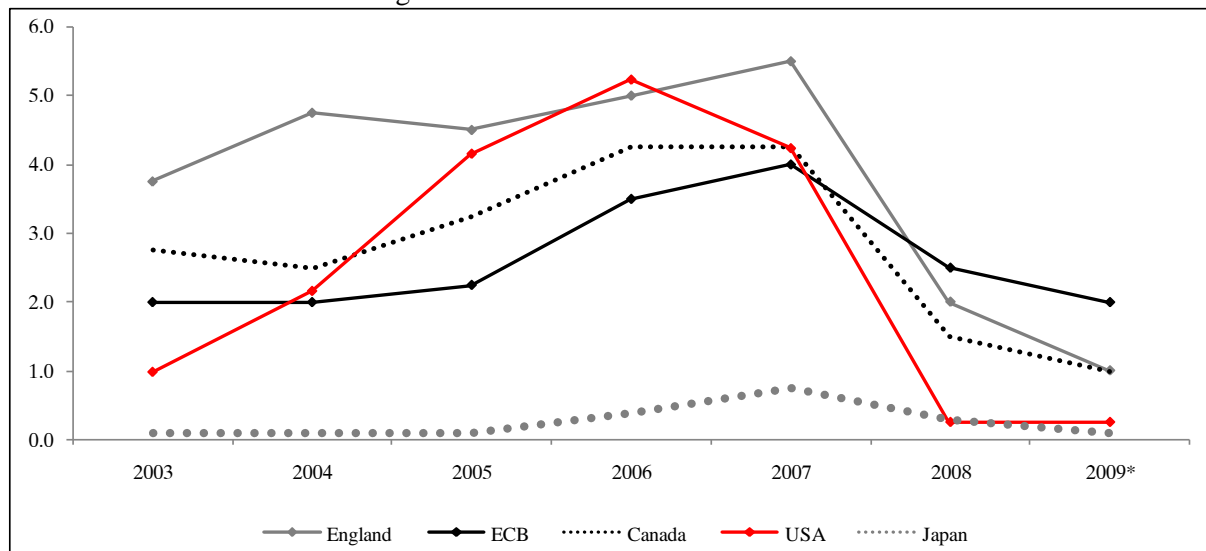
*MBKS-interbank interest rate.

Source: NBRM and the Ministry of Finance.

The deepening of the global economic crisis forced the central banks to undertake frequent corrections of the reference interest rates. Thus the central banks in the developing countries facing with lack of liquidity on the financial markets reduced the reference interest rates for several times. Also, as a result of the constant decrease in the growth rates of the production and worsening in the employment data, at the end of the year, some of the largest central banks (USA, Switzerland and Japan) began to implement the policy of zero reference interest rates.

Figure 106

Reference interest rates of the larger central banks



*last change for 2009 (January-February).

Source: Web sites of the central banks.

The countries in the region, the priority task of which was slowing down of the credit expansion, the trend of inflation pressures and the high trade deficit, were directed towards tightening of the monetary policy. In the group of analyzed countries, increase in the reference interest rates was registered since the beginning of 2008, with exception to Albania, where the reference rate remained unchanged, in conditions of lower inflation pressures. With the gradual

stabilization of the inflation at the end of the year and on other hand, the poorer realization in the real sector, the central banks of the more developed economies in transition in the last two months of the year, faced with the requirement for decreasing the reference interest rates (Croatia, the Czech Republic, Slovakia and Poland).

Table 25
Reference interest rate of the central banks by countries
(in %)

	2003	2004	2005	2006	2007	2008
Albania	6.50	5.25	5.00	5.50	6.25	6.25
Serbia	10.63	16.30	19.16	15.35	9.57	17.75
Croatia	/	/	3.50	3.50	4.06	6.00
Bulgaria	2.83	2.37	2.05	3.26	4.58	5.77
Romania	20.40	17.96	7.50	8.75	7.50	10.25
Czech Republic	2.00	2.50	2.00	2.50	3.50	2.25
Hungary	12.50	9.50	6.00	8.00	7.50	10.00
Slovakia	6.00	4.00	3.00	4.75	4.25	2.50
Poland	5.25	6.50	4.50	4.00	5.00	5.00
Macedonia	6.15	10.00	8.52	5.74	4.77	7.00

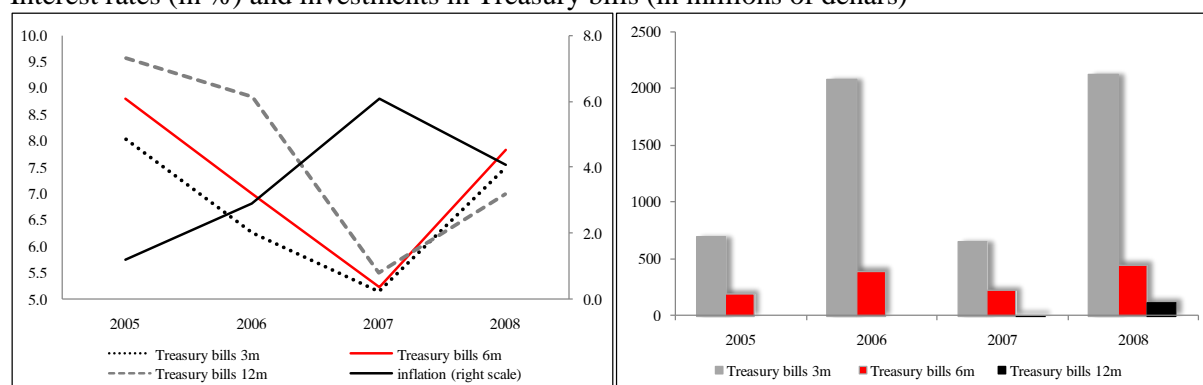
Source: Web sites of the central banks.

Source: European Bank for Reconstruction and Development.

The rise in the reference interest rate had transfer effect also on the interest rates on both securities market and Money Market, which reached the highest levels in the last two years. In conditions of higher average supply than demand for **government securities**, the interest rates on the three-month, six-month and twelve-month Treasury bills in December equaled 7.48%, 7.84% and 7%, respectively (compared to 5.15%, 5.4% and 5.5%, respectively in December 2007). The increase in the interest rates was registered also with the government bonds, specifically with the two-year government bonds, from 6.5% in November 2007, to 8.25% in October 2008 and with the three-year government bonds from 7.99% in March 2007, to 8.4% in September 2008. In mid-March, the Ministry of Finance replaced the "interest rate tender" on the Treasury bills auctions with "volume tender" and fixed interest rate. The constant increase in the interest rate on the Treasury bills, registered certain deceleration at the end of the year and in December the interest rates on the three-month and the twelve-month Treasury bills declined. In conditions of higher turnover on the Money Market during 2008 (twice larger than in the preceding year) rise in the **interbank interest rate** from 3.14% in December 2007 to 5.31 in December 2008 was registered.

Figure 107

Interest rates (in %) and investments in Treasury bills (in millions of denars)



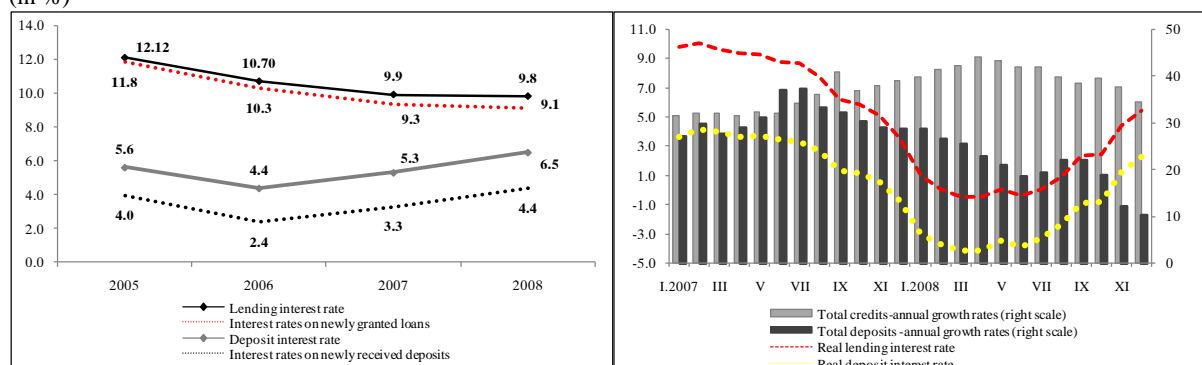
Source: NBRM

In 2008, the banks' interest rate policy was directed towards stabilization of the several year downward trend of the lending interest rates which contributed to a credit expansion and increase in the deposit interest rates in order to maintain the constant and to attract new sources of financing, which resulted in further decrease in the interest rate spreads. Thus, in 2008 the deposit

interest rate surged by 1.2 percentage points and in December 2008 it equaled 6.5%, which corresponds to the need for maintaining and increasing the deposit base in conditions of global uncertainty. In environment of higher competence, the saving was additionally stimulated also through promotion of new banking saving products with attractive interest rates. **The average lending interest rate** decreased slightly by 0.1 percentage point annually (December 2008 / December 2007), and remained on the level of 9.8%. According to the dynamics, the trend of the average lending interest rate in the first half of the year is still downwards, mainly as a reflection of the strengthened competitive pressures. In the second part of the year, influenced by the monetary policy measures, the deepening of the global crisis and its effects on the domestic economy, the decelerated deposit growth, as well as the constant decrease in the interest rate spread, this trend discontinued and the lending interest rates registered slight increase. **The interest rates on the newly extended credits and the newly accepted deposits** registered similar movements (decline of 0.2 percentage points and increase of 1.1 percentage point, respectively), and they equaled 9.1% and 4.4% in December 2008. In 2008, constant narrowing in the interest rate spread was registered, especially evident between the Denar lending and deposit interest rate (from 4.5 percentage points in December 2007 to 3.2 percentage points in December 2008), which is mainly conditioned from rise in the deposit interest rate.

Figure 108

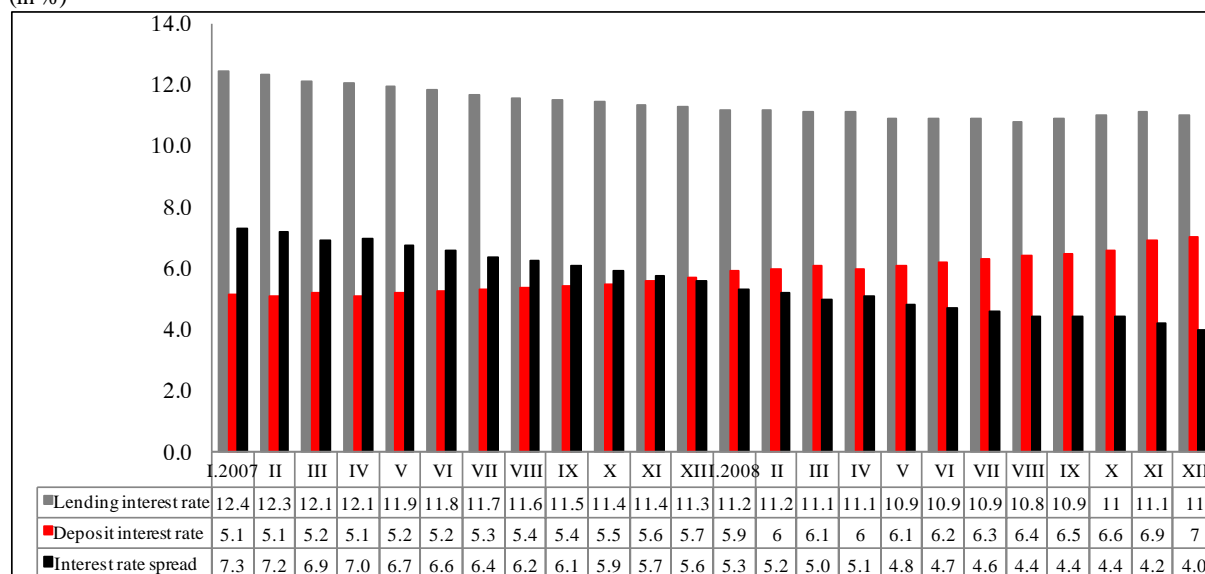
Denar lending and deposit interest rates and annual growth rates of the total credits and deposits (in %)



Source: National Bank of the Republic of Macedonia.

Within the "households" sector, in 2008, annual decrease in the lending interest rate of the banks is registered, given more significant increase in the deposit interest rate. Namely, the lending interest rate for households declined by 0.2 percentage points in 2008, while the deposit interest rate augmented by 1.3 percentage points. However, at the end of the year, the lending interest rates on the consumer credits and the overdrafts on the transaction accounts incremented, as a reaction of the NBRM measures related to the credit expansion, and partially due to the compensation for the higher costs with the deposit interest rates. The detailed analysis of the lending Denar interest rates with the households showed moderate increase with all categories, with exception to the long-term credits with FX clause, which plunged. On the side of the deposit interest rate for households, the largest annual increase was registered with the time deposits without FX clause with maturity from 3 to 6 months and from 6 to 12 months (of 0.9 percentage points), as well as with the interest rate on deposits with FX clause with maturity exceeding one year (of 1.9 percentage points).

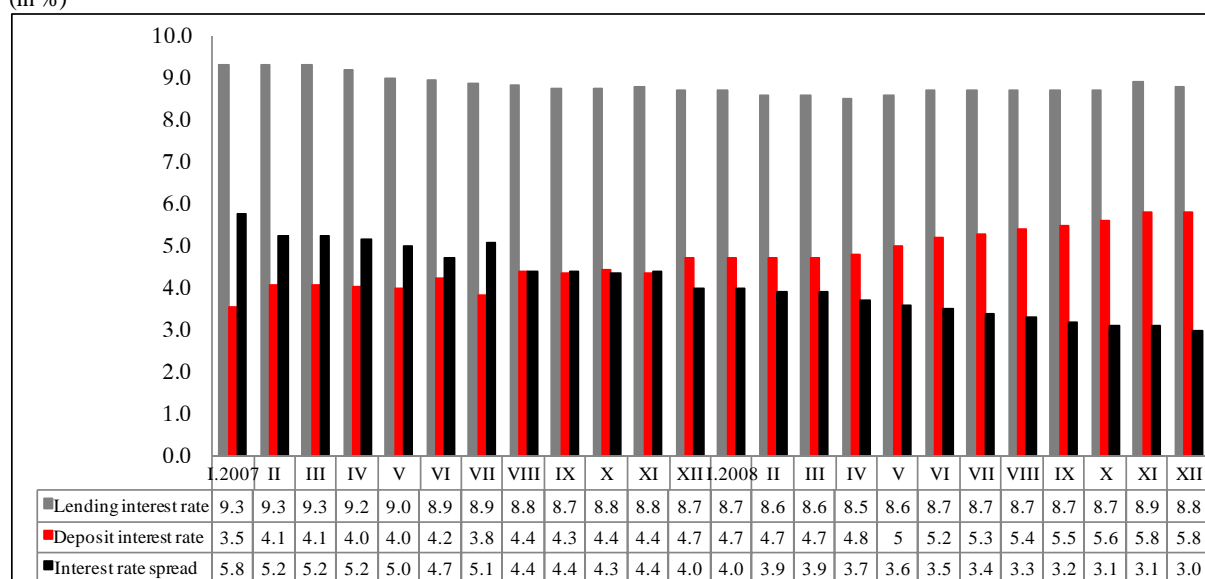
Figure 109
Weighted denar lending and deposit interest rate for households
(in %)



Source: National Bank of the Republic of Macedonia.

With the corporate sector, annual rise in the bank lending and deposit interest rate on Denar credits and deposits was registered. The detailed analysis of the lending interest rates showed that increase in the interest rates without FX clause was registered, especially with the short-term and the long-term credits of 0.4 percentage points, respectively, while the decrease of 0.3 percentage points was registered only with the long-term interest rates with FX clause, which is significant from the aspect of the support of the investments in the economy. With respect to the deposit interest rates, the interest rates with all time deposits without FX clause augmented by approximately 1 percentage point, with the same trend being registered with the interest rates on the time deposits with FX clause, i.e. increase of 1.7 percentage points with the interest rate on the deposits with maturity from 3 to 6 months.

Figure 110
Weighted Denar lending and deposit interest rate for enterprises
(in %)

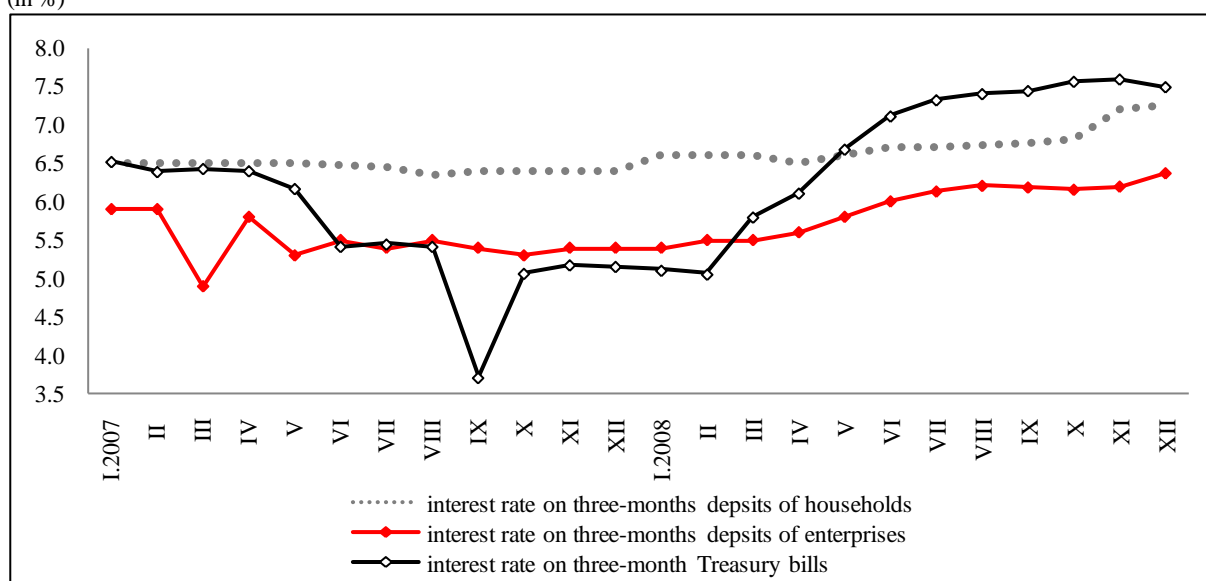


Source: National Bank of the Republic of Macedonia.

The enterprises and households interest to invest in three-month Treasury bills, instead to deposit their unrestricted savings in the banks, enhanced since the beginning of 2008. The trend of increase in the Denar time deposits up to three months, that commenced last year, ceased in the third quarter of 2008, when they began to fall on annual basis, which corresponded to the slower annual increase in the total deposits in the banking system. However, in the last months of 2008, higher investment in the three-month Treasury bills was registered. In this period, the supply of three-month Treasury bills was bigger, as well as their higher realization, in conditions of increase in the interest rates. In December, the interest rate on the three Treasury bills was higher than the interest rates on the households and enterprises' time deposits, with both registering an upward trend.

Figure 111

Interest rate on three-month Treasury bills and three-month time Denar deposits
(in %)

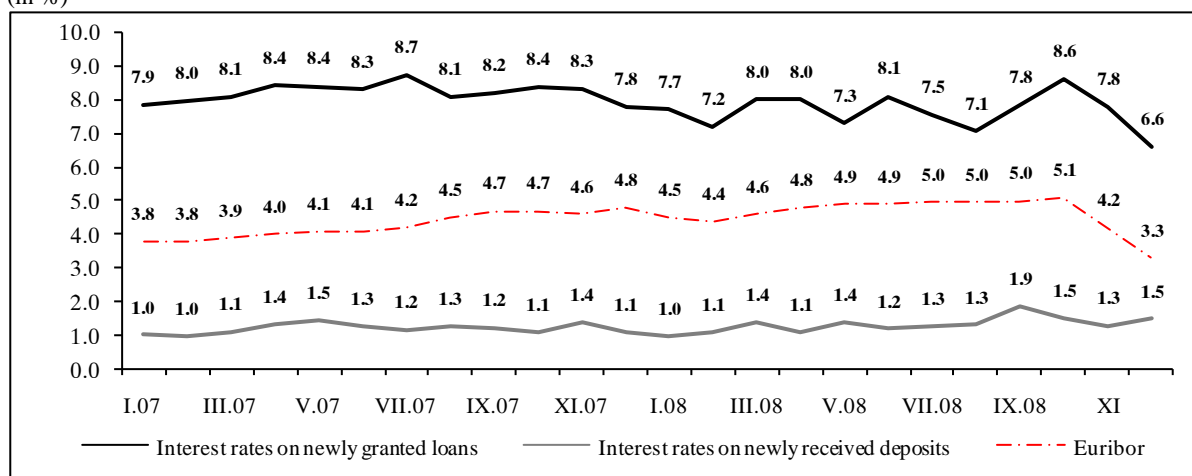


Source: National Bank of the Republic of Macedonia.

In 2008, the interest rate on foreign currency credits followed the movement of the international interest rates, while the interest rates on the foreign currency deposits were influenced by the banks' interest rate policy for saving stimulation. Thus the interest rate on the foreign currency credits fell by 1.3 percentage points, and in December it equaled 7.2%. The interest rate on the foreign currency deposits went up, and they reached 3% in December, compared to 2% in December 2007. This trend of movement was registered also with the interest rates on the newly extended foreign currency credits and the newly accepted foreign currency deposits, which equaled 6.6% and 1.5%, respectively in December (drop of 1.2 percentage points and increase of 0.4 percentage points, respectively, compared to the respective month in 2007).

Figure 112

Foreign exchange lending and deposit interest rate and three month interbank interest rate Euribor (in %)

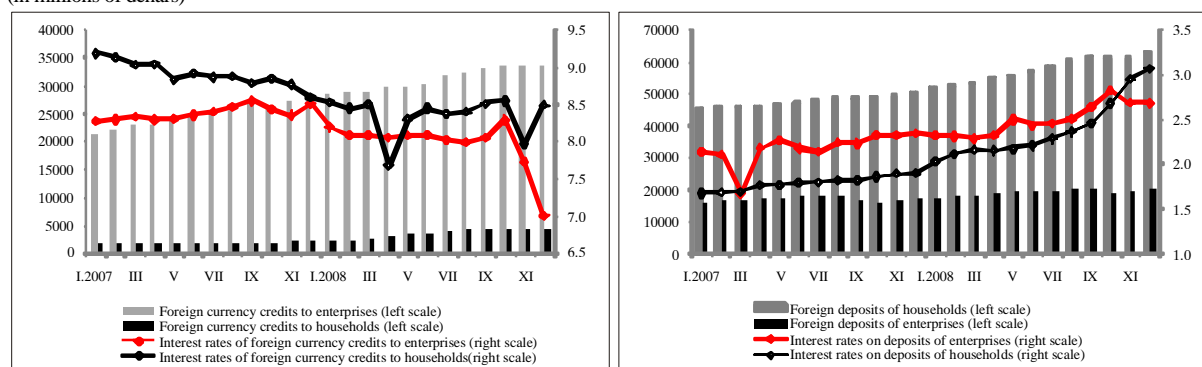


Source: National Bank of the Republic of Macedonia.

In the sector analysis of the foreign exchange interest rates, slight decrease in the lending interest rate with the **households** sector was registered, and it equaled 8.5% in December (compared to 8.6% at the end of 2007), as well as annual growth in the deposit interest rate of 1.2 percentage points, thus equaling 3.1%. The foreign currency credits, especially those denominated in US Dollars, registered the most evident change, i.e. annual decline of 1.7 percentage points. The deposit interest rates with the deposits in Euro currency went up, while the price of the deposit in US Dollars went down. With the **enterprises** sector, decrease in the lending interest rate of 1.5 percentage points was registered, so it equaled 7% in December, while the deposit interest rate surged by 0.4 percentage points and equaled 2.7%. With respect to the foreign currency credits, severe decrease with all interest rate categories was evidenced, with the most significant one being recorded with the foreign currency short-term and long-term credits in US Dollars (annual decrease of 3.7 and 3.4 percentage points, respectively). The detailed analysis with the deposit interest rates shows increase in the time deposits in Euro with maturity of 3 and 6 months of 0.9 percentage points and decrease with the time deposits in US Dollars with maturity of 1 and 3 three months of 1.8 percentage points.

Figure 113

Monthly dynamics of the foreign exchange credits and deposits of the private sector of both lending and deposit foreign exchange interest rate (in millions of denars)

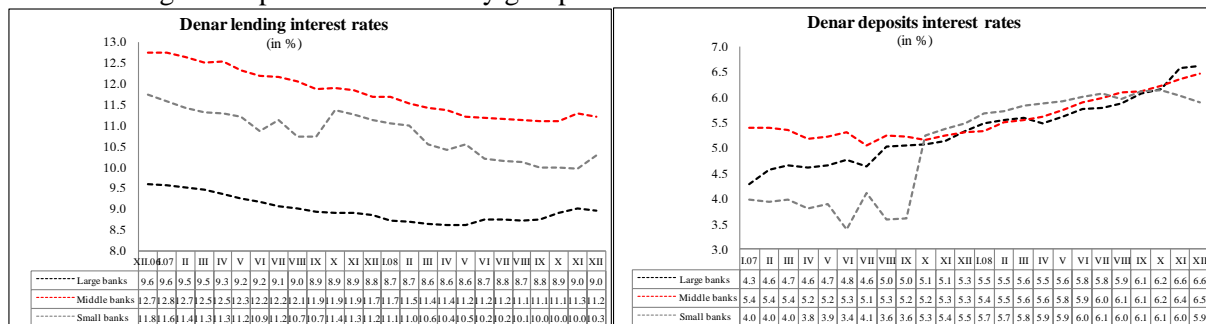


Source: National Bank of the Republic of Macedonia.

Within the interest rate analysis by groups of banks, in 2008 the lending interest rate with the medium and small-size banks registered annual drop, while the large banks registered an increase, with the deposit interest rate being incremented with all group of banks. Regarding the lending interest rates, the most obvious changes were registered with the short-term credits intended to households by all groups of banks. Regarding the deposit interest rates, the largest changes

were made by the large and the medium-size banks, having in mind that they are mainly financed by deposits of the non-financial entities, compared to the small-size banks which lean on their capital and reserves⁷². Also, the credit expansion in the last several years and the slower deposit growth in 2008 imposed the need to stimulate and attract new savings.

Figure 114
Denar lending and deposit interest rate by groups of banks



Source: National Bank of the Republic of Macedonia.

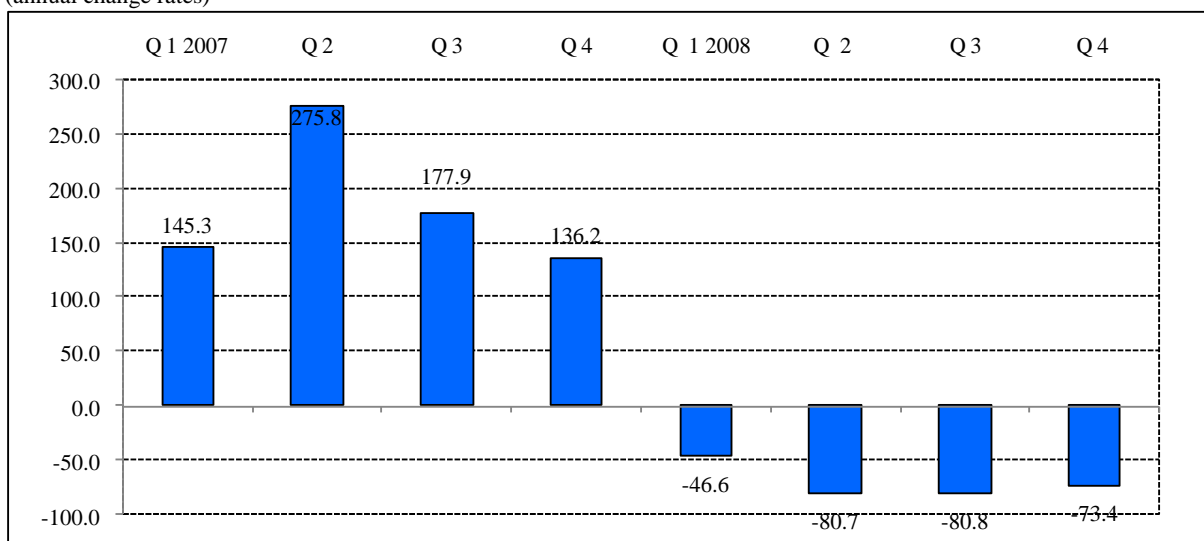
⁷² Banking Supervision Report in the third quarter of 2008, NBRM.

IV. Capital market

2008 characterized with continuous downward trend in the activity on the Macedonian stock exchange. Such deviations in the capital market were characteristics of large number of other markets in global frames, which represented logical consequence of the escalation of the credit crises in USA into global financial and economic crises. For the regional capital markets, which functioned until recently relatively isolated from external developments, the larger deepening in the global turbulences represented a start of their higher exposure of the global trends. Subsequently, the "bear" mood, which dominated on the world financial stock exchanges, "contaminated" the local and foreign investments of the stock exchanges in SEE as well.

In accordance with the drop in the turnover of the stock exchange, the Macedonian stock exchange index drastically decreased as well. Such dynamics of the index, after the exquisitely high growth in the largest part of 2007 may be explained with the worsened perceptions for risk of the domestic and foreign investors, the further strengthening in the inflation pressures in the Macedonian economy (in the first half) and the speculations about possible change in the exchange rate, the deepening in the crises on the international financial markets caused by the problems with the subprime mortgage loans in USA, as well as from the increased danger from falling into recession of some of the leading world economies.

Figure 115
Stock exchange turnover realized with classical trading
(annual change rates)



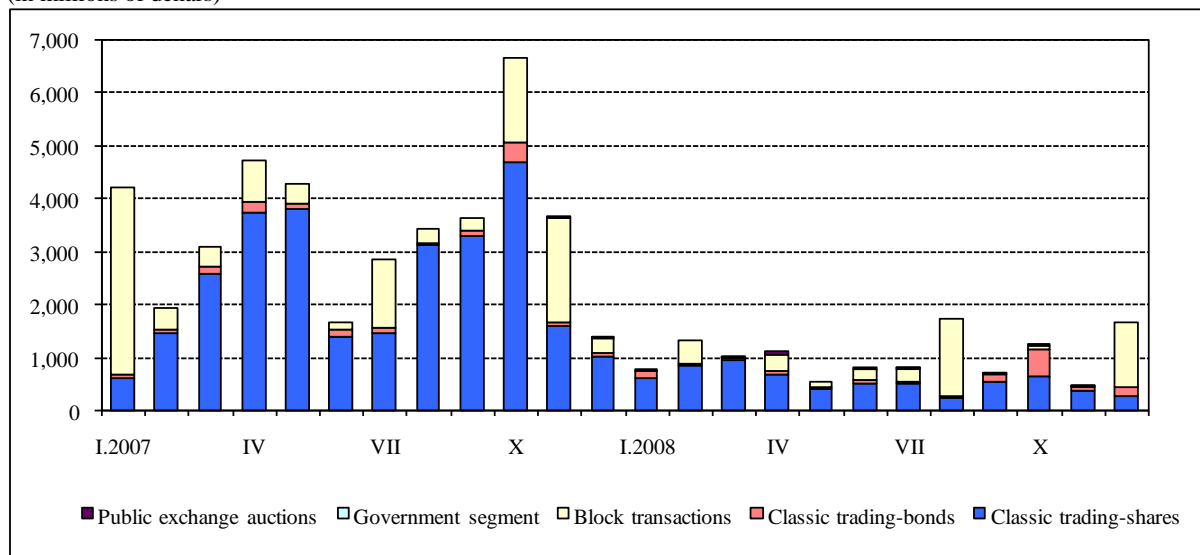
Source: "Macedonian Stock Exchange" AD Skopje.

The stock exchange turnover and the MBI-10 index⁷³ during the year characterized with relatively high changeability, which additionally strengthened the investors' aversion to risk. The total turnover realized on the Macedonian stock exchange from long term securities in 2008 equaled Denar 12.4 billion, which represented fall of 70.3%, relative to the turnover in 2007. Fall in the trade was registered in all stock exchange segments. However, the turnover realized with classical trading realized largest downward correction (drop of 73.3%), and the average daily turnover realized with the same type of trading registered identical change as well. The trading with shares of companies from the banking sector, the pharmaceutical industry, the trade with oil derivatives and construction mostly

⁷³ Price index, weighted with the market capitalization, comprised of common shares of ten, at most, listed companies on the official market. During the regular index reviews (twice a year), the composite elements of the MBI-10 are set having in mind the market capitalization, the average daily turnover and the number of transactions in the previous six months, the number of trade days and the relative liquidity of the shares of the companies listed on the official market.

participated in the classical trading with shares. The stock exchange turnover realized through the block transactions registered annual decrease of 62.9%.

Figure 116
Structure of the stock exchange turnover
(in millions of denars)



Source: "Macedonian Stock Exchange" AD Skopje.

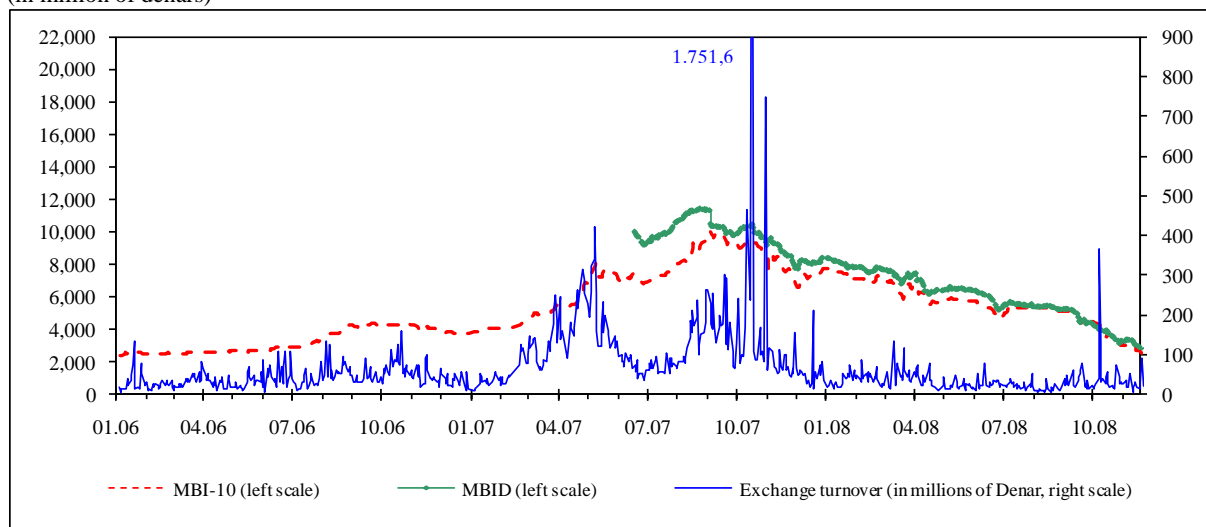
The two digit fall in the indices was characteristic for most of the capital markets world wide. On the European and USA markets, the main reasons which resulted in such trends, mostly resulted from the financial sector, where the crises actually begun. The collapse of some of the financial institutions, the Government interventions in part of the financial sector, the mistrust among the banks, the creation of the global mistrust in the financial sector and the spillover of the financial crises into the real sector, created fast transfer effects on the capital market in these economies as well. Different from them, the countries from South-East Europe generally did not suffer large financial stroke, so the negative tendencies on the stock exchanges in this region can be explained with the global aversion to risk by the investors, the lower liquidity and the fears of slowing down in the domestic economies, under the influence of the global crises.

The regional stock exchange indices registered considerable decline in 2008. Thus, the Sofia SOFIKS together with the Belgrade BELEKS-15 and the Macedonian MBI-10 suffered the highest losses of the value in the group of analyzed indices from the region, with downward corrections of 79.7%, 75.6% and 72.9%, respectively. The sector "financial services" in the Macedonian stock exchange index had weight slightly higher than one third, whereas in the Belgrade and in the Sofia index this sector created more than 53%. The fall in MBI-10 was mostly due to the withdrawal of the investors from the market as a result of the global drop in the liquidity and the growth in the aversion to risk. MBI-10 ended the year with value of 2.096,16 index points.

At the end of 2008, the value of the index of publicly owned companies - MBID⁷⁴ amounted to 2.213,9, which represented drop of 72.9%, relative to December 31, 2007. The development in the MBID fully followed the development of MBI-10.

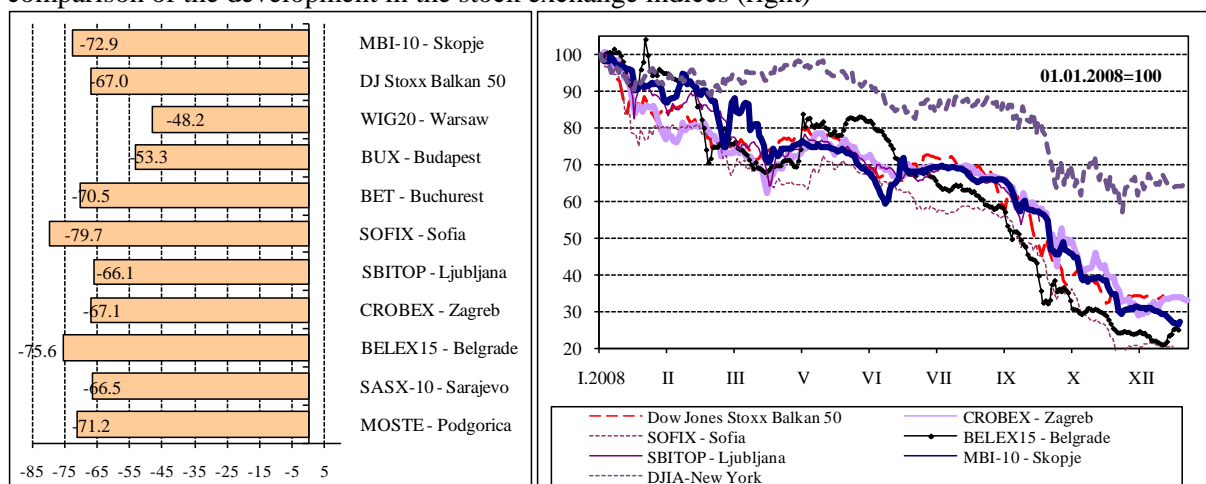
⁷⁴ Price non-weighted index, which includes common shares listed on the Publicly Owned Companies Market. During the regular quarterly reviews of the index, the composite elements of the MBID are determined having in mind the registered turnover and the number of trade days in the previous quarter.

Figure 117
 MBI-10, MBID and stock exchange turnover realized with classical trading⁷⁵
 (in million of denars)



Source: "Macedonian Stock Exchange" AD Skopje.

Figure 118
 Annual growth rates of the national and composite regional stock exchange indices⁷⁶ (left) and
 comparison of the development in the stock exchange indices (right)



Source: Bloomberg (Bloomberg), "Macedonian Stock Exchange" AD Skopje, national stock exchanges.

Considering the global economic slowing down and the skepticism related with it concerning the investments on the capital market, the positive financial reports of the companies listed on the Macedonian stock exchange failed to be stimulus enough for higher inflow of foreign investments. In 2008, the foreign natural entities withdraw from investing in securities, whereas the image for the foreign legal entities in 2008 remained relatively positive mostly as a result of several strategic takeovers in the financial sector⁷⁷, as well as the capitalizations in "Beton" and "Makstil". When the domestic investors are in question, it is obvious that the aversion to risk reached

⁷⁵ The Figure shows the daily turnover through classical trading, which encompasses only the classical trading with shares and bonds, whereas it excludes the other types of transactions. For better presentation of the data, the Figure does not show fully the classical trading on October 16, which equaled Denar 1.751,6 million (as a result of the taking over of one domestic company by foreign investor).

⁷⁶ "Dow Jones Stoxx Balkan 50" includes the shares of the 50 largest and most liquid companies from eight Balkan stock exchanges. „Morgan Stanley Capital International - Emerging Markets Eastern Europe“ (MSCI EM EE), is an index weighted according to the market capitalization and it includes shares from four Central and Eastern European stock exchanges.

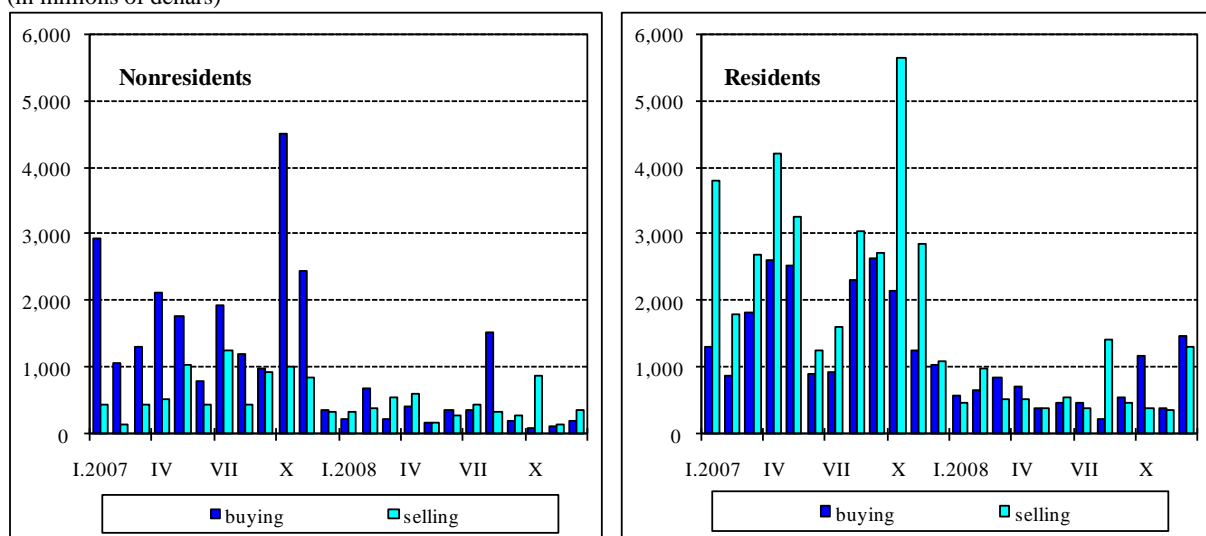
⁷⁷ The transactions executed through the stock exchange includes the entry of the Dutch "DEMIR-HALK Bank" in the "IK Banka" AD Skopje and the taking over of "Makosped Osiguruvanje" by the Bulgarian "Euroins". While the entry of the Austrian "Steiermarkische Bank und Sparkassen" as strategic investor in "Invest Banka" AD Skopje and the sale of the "Sileks Banka" to the Bulgarian "Centralna Kooperativna Banka" were performed through public invitation, i.e. without the transactions being carried out through the stock exchange.

to large extent, causing low stock exchange turnover. Thus, the domestic natural entities in 2008 invested Denar 48.1 million on net basis, whereas the domestic legal entities realized net sale of securities in amount of Denar 7.8 million. In 2008, the net investments of the foreign legal entities in securities on the Macedonian stock exchange, reached up to Denar 159 million. In 2008, the foreign natural persons realized net sale of securities in amount of Denar 199.3 million on net basis.

At the end of 2008, the foreign investors participated with 33.26% in the total principal of the listed companies and 4.77% in the total nominal value of the listed bonds (30.85% and 8.40%, respectively, at the end of 2007). The growth in the foreign investors in the structure of the listed shares was mostly due to the entry of the Austrian "Steiermarkische Bank und Sparkassen" in "Invest Banka" AD Skopje, on the second emission of shares of "Beton": in type of monetary deposit through private offer, as well as to the entry of a foreign investor in "Makstil" AD Skopje.

Figure 119

Turnover on the stock exchange in 2008, by investors and direction of transactions
(in millions of denars)



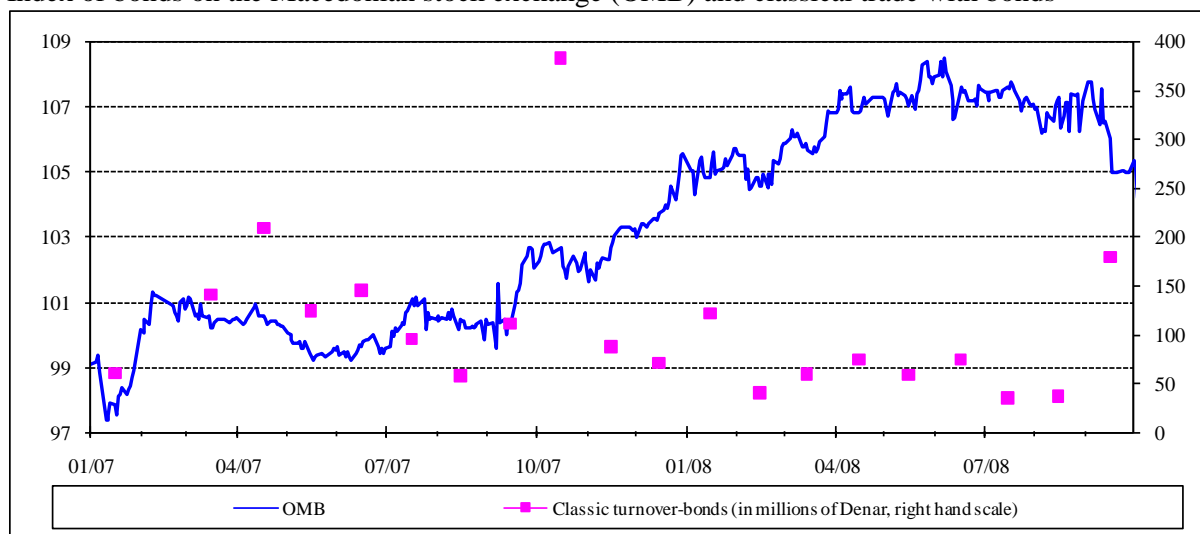
Source: "Macedonian Stock Exchange" AD Skopje and NBRM calculations.

The realized turnover with bonds on the official market on the stock exchange in 2008 amounted to Denar 1.454,5 million and it was lower by 6.8%, relative to the same period of 2007. However the developments of the segment where the bonds are traded indicated to partial redirection of the demand of shares to demand of bonds, as more secure financial instrument. The bonds for old saving and denationalization bonds from the seventh emission were mostly traded (21.2% and 16.4% of the total turnover realized with bonds, respectively). During the year, the prices of the government bonds were ranging in relatively wide range - from 79.3% (The denationalization bond from the seventh emission) to 101.2% (The corporate bond of "Prokredit Banka" AD Skopje) of the nominal value. The index of bonds on the Macedonian stock exchange⁷⁸ (OMB) till the beginning of June, with short stagnation and dropping periods, registered upward trend, in the summer months it mainly stagnated, and since the beginning of the first week of September and almost till the end of October, OMB rapidly dropped (it even reduced under the level of 2007). However, till the end of the year this index returned the loss of value. Consequently, at the end of 2008, OMB positioned at the level of 107.6 index points, which represented growth of 1.9%, relative to the end of the previous year.

⁷⁸ The OMB index is composed of bonds for old foreign exchange savings and denationalization bonds of the 1st, 2nd, 3rd, 4th, 5th and 6th issue. The OMB is a price index weighted by the turnover, with a restriction according to which the share of none of the bonds within the index structure is not allowed to exceed 30%.

Figure 120

Index of bonds on the Macedonian stock exchange (OMB) and classical trade with bonds



Source: "Macedonian Stock Exchange".

In 2008, the total realized turnover with long-term securities on the over the counter market amounted to Denar 400 million, relative to Denar 696.3 million in 2007. The turnover with securities with original and residual maturity up to two years created 75%, and the rest of it pertains to Treasury bonds with original and residual maturity up to three years.

V. Other activities of NBRM

5.1. Payment system in the Republic of Macedonia

In 2008, the payment system in the Republic of Macedonia continued enabling smooth performance of the payment transactions, and in the same time further development and harmonization with the Basel principles were registered. The NBRM, as the owner and manager of the Macedonian Interbank Payment System (MIPS), through which real time gross settlement is performed, successfully implemented its operational function in the payment system. Also, the other components of the payment system, such as: the Clearing House "KIBS" AD Skopje, "Kasis" AD Skopje and the internal bank systems, through their functioning, contributed to stable, smooth and efficient performance of the payment transactions in the Republic of Macedonia.

In 2008, the National Payment Systems Council of the Republic of Macedonia was focused on the implementation of the Payment System Development Strategy of the Republic of Macedonia 2007-2011. For such purpose, in 2008, NBRM within the technical cooperation with the Dutch Central Bank a seminar with the topic "First Conference of the Macedonian Financial Sector on the Payment Systems and Security Settlement Systems" thus realizes successful transfer of knowledge and information to the main carriers of the payment system in the Republic of Macedonia. The cooperation with the Central Bank of Nederland in the process of implementation of the payment system development strategy of the Republic of Macedonia 2007-2011, recommended by the National Payment Systems Council continued also in July 2009 with specific topics from the payment system area related with the implementation of the Strategy.

Through the National Council of Payment Systems of the Republic of Macedonia, complete cooperation and coordination with the institutions, which are indirectly and directly related with the payment system and in charge of implementation of strategic instructions, was performed.

5.1.1. NBRM role in the payment operations

In order to ensure efficient and safe payment system in the Republic of Macedonia, NBRM realized its role through the following functions:

- a) operational function;
- b) regulatory function and
- v) oversight function.

a) Operational function

In the performance of its operative function, NBRM manages the settlement system - MIPS. In 2008, MIPS operated in a real time with accessibility of 99.93% of the envisaged working time during the entire year. Furthermore, the system processed 19.394 transactions a day on average, whereas the maximal number of transactions processed a day amounted to 95.250.

Participants in MIPS are the banks (including the NBRM), the clearing institutions, brokerage houses and Ministry of Finance. At the end of 2008, the total number of participants in MIPS equaled 24.

Apart from the above, while performing the operational function, in 2008 the NBRM received and processed 3.715 execution orders and decisions on forced collection, out of which 2.368 were fully executed, whereas the others were partially or fully unexecuted, as a result of lack of funds with the debtors, delayed by the body that adopted them, or they were not complete and as a result to that they were either returned to the courts, or to the authorized executors to be finalized.

In 2008, the National Bank of Republic of Macedonia performed a complete change in the total hardware and software infrastructure of MIPS. The introducing of the latest technical and technological solutions in the infrastructure of MIPS resulted in decrease in the queues emerging from technical reasons.

b) Regulatory function

In 2008, pursuant to the new Payment Operations Law, within its regulatory function, the NBRM in the area of the payment system adopted the following acts:

- Amendments to the Instructions for submission of data on performed activities in the payment operations, which resulted from the Instructions on amending the Instructions on the form and contents of the payment instruments for performing the payment operations in the country, which introduced the new payment instrument - Payment order for wage contributions (PP 53 form).

- Amendments to the Decision on the manner and procedure for opening and closing a transactional account, as a result of the need of single procedure by the payment operation careers during opening bankruptcy accounts for the participants subject to bankruptcy or liquidation procedure. Namely, the blocking system of the account of ERTS participants does not enable unblocking of the account in case of bankruptcy or liquidation procedure with the participant, if the blockage was initiated by a payment operations career who lost that status (as a result of bankruptcy or liquidation). With the amendments the existing problems shall be overcome and the efficiency of the bankruptcy procedures shall increase.

- Instruction on assessment of the consolidation of the payment systems with the core principles, adopted on the basis of the Decision on the manner and methodology of oversight on the payment systems. With these Instructions, the methodology on assessment of the consolidation of the payments systems with the core principles shall be developed (operating standards of the payment systems), which is in accordance with the Methodology applied in the European Central Bank and in the central banks of the EU member states.

c) Oversight function

In 2008, NBRM, within its competence for payment systems oversight, conducted off-site oversight on the internal payment systems of banks and the payment system of the clearing house. The off-site oversight is performed through information obtained on the basis of the Instructions on submitting data on performed activities in the payment operations, according to which the data on the payment operations of banks shall be submitted electronically, on a daily basis.

With processing the obtained data, the following types of reports were generated:

1. Reports on the Denar payment operations in the Republic of Macedonia;
2. Reports on the number of accounts;
3. Reports on the use of payment instruments;
4. Report on the use of the payment cards and ATMs and POS terminals in the country.

The reports represent quantitative indicators on the situation in the payment systems in the Republic of Macedonia, thus enabling monitoring of large number of indicators: the number of transactional accounts, the number and the value of the performed bank and interbank transactions, the number of the blocked accounts and the depositors. All stated parameters are being monitored in the process of oversight on the payment systems and they are published on monthly basis on the NBRM official webpage.

According to the Payment Operations Law and the bylaws adopted by NBRM, the Decision on the manner and methodology of payment systems oversight and the Decision on the criteria and

standards on the operations of the payment systems, the Instructions on assessment of the consolidation of the payment systems with the core principles was adopted, which completed the legal framework for successful implementation of the payment systems oversight function, as function of NBRM, according to the best practices of the central banks of the EU member states. Such approach resulted from the technical cooperation with the expert of the Central Bank of Nederland. This cooperation continued in 2009 as well, in order for this function to be practically implemented in the part of assessment of the consolidation of the payment systems with the core principles.

In 2008, NBRM was included in the educational project of the Customs Administration of the Republic of Macedonia, through professional presentations pertaining to the payment systems, for the purpose of education of the customs officers.

5.1.2. Indicators for the operations of the payment system in the Republic of Macedonia

a) Opened accounts

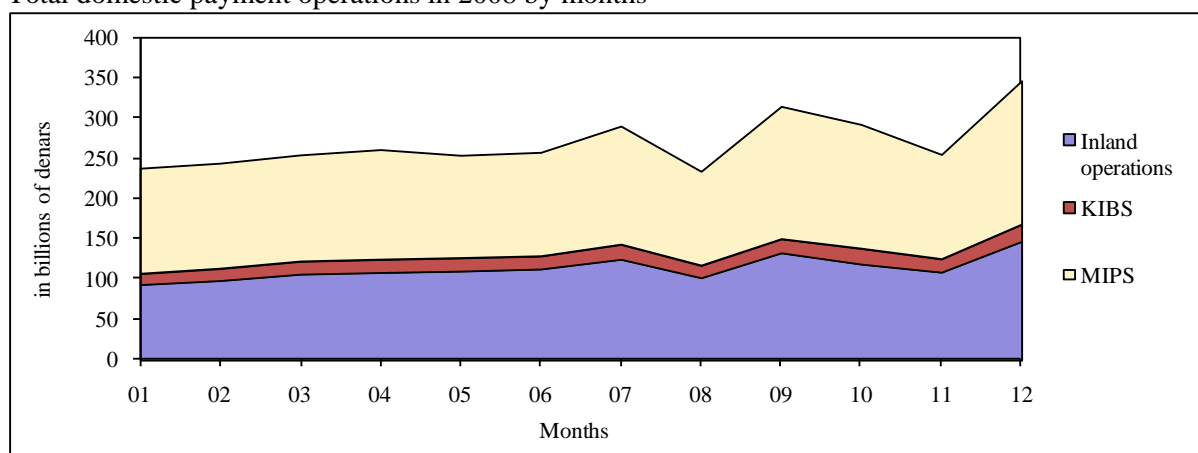
In 2008, total 851.040 new account of natural persons and legal entities were reported in the Single Accountholders Registry with the careers of the payment operations in the Republic of Macedonia (banks and NBRM), and 19.476 accounts were closed, with the total number of opened accounts in the Single Accountholders Registry reaching 2.959.390 at the end of the year. Holders of these accounts were 1.286.534 different entities (natural persons and legal entities), where 48.57% of them holding only one account, with the average number of opened accounts equaling approximately 2.30 accounts per entity.

From the launching of the new payment system (July 30, 2001) to the end of 2008, the total number of registered blocked accounts amounted to 26.269. In 2008, 25.023 blockings were instigated, whereas 14.424 were closed (unblocked), which represented 57.64% of the total number of initiated blockings.

b) Total payment operations in the Republic of Macedonia

In 2008, the executed payment operations totaled Denar 3.236,79 billion. The internal payment operations of banks (among accounts in a same bank) amounted to 42.2% of the total amount, interbank payment operations realized through MIPS equaled 51.6% and 6.2% are interbank payment operations realized through KIBS.

Figure 121
Total domestic payment operations in 2008 by months



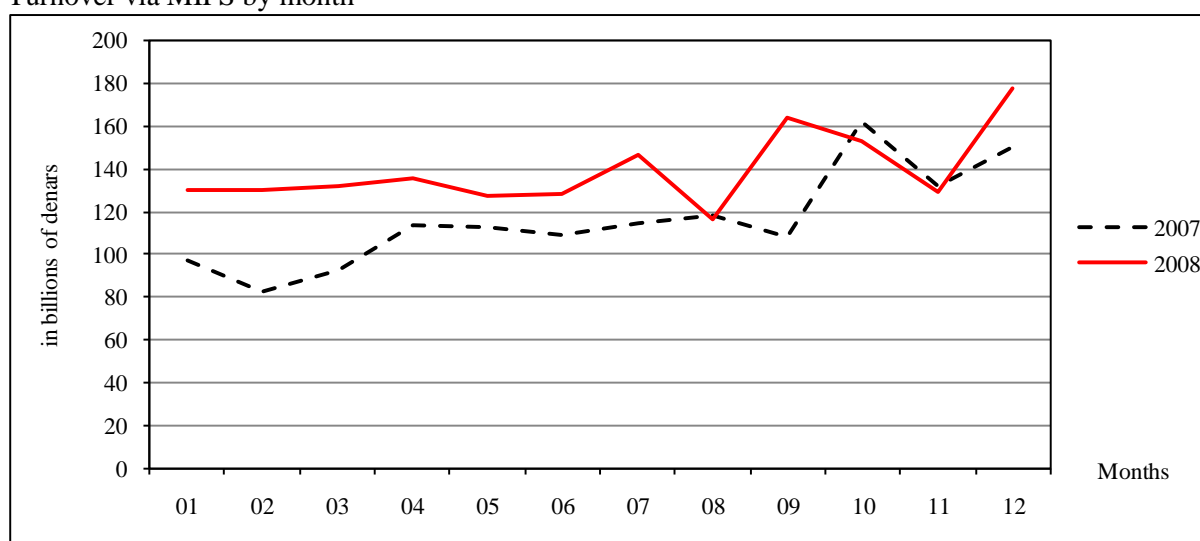
Source: National Bank of the Republic of Macedonia.

In 2008 the total number of realized transactions in the domestic payment operations amounted to 45.305.584, out of which 10.8% were performed through MIPS, 33.0% through KIBS, and 56.2% were transactions performed through the internal clearing in the banks.

c) Turnover and number of transactions executed via MIPS in 2008

In 2008, total turnover of Denar 1.669,55 billion was conducted via NBRM's MIPS in a total number of 4.906.672 executed transactions, including also the transactions of settlement of the net balances of the clearing house "KIBS". In 2008, the turnover made through MIPS went up by 14.9%, relative to the previous year. Of the total turnover through MIPS, 56.1% represented interbank turnover realized by other payment operations careers (banks, clearing and brokerage houses), whereas 43.9% represented turnover realized by an order given by the government institutions (NBRM, Treasury system etc.).

Figure 122
Turnover via MIPS by month



Source: National Bank of the Republic of Macedonia.

In 2008 the number of executed transactions realized growth of 73.3% relative to the previous year. Of the total number of transactions through MIPS, 42.4% represented interbank transactions realized by other payment operations careers, while 57.6% represented transactions realized by an order given by the Government institutions (NBRM, Treasury system etc.).

g) Internal banking payment operations in 2008

The analysis of the executed payment operations in 2008 through the transactional accounts of the banks' clients opened with the same bank - payment operations career, showed rise in the value of the internal banking payment operations of 38.8%, relative to the previous year. The realized turnover amounted to Denar 1.367,4 billion, and the number of performed transactions equaled 25.457.090, which is by 111.1% more relative to the previous year.

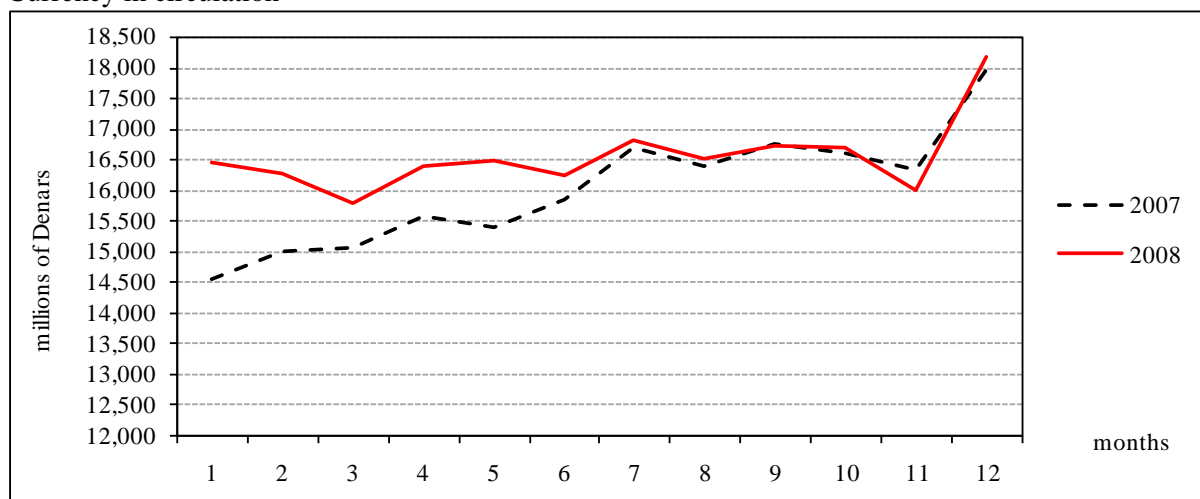
5.2. Cash management operations

5.2.1. Currency in circulation

At the end of 2008 the currency in circulation went up by Denar 194 million on annual basis, so during year they followed the usual seasonal trend. With respect to the structure, on December 31 2008, the banknotes participated with 98.4% in the stock of the currency in circulation, while the coins participated with 1.6%. The structure of the currency in circulation, expressed through number of

pieces, showed that the banknotes participated with 28.5% and the coins with of 71.5%. The value structure of the currency in circulation remained relatively unchanged relative to 2007, whereas the structure expressed through number of pieces decreased in the banknotes and increased in the coins in circulation in 2008.

Figure 123
Currency in circulation



Source: National Bank of the Republic of Macedonia.

At the end of 2008, the number of banknotes in circulations amounted to 55.6 million, which was by 1.2% less relative to 2007, while their value (of Denar 17.9 billion) remained unchanged. In 2008, the coins by number of pieces amounted to 139.1 million showing rise of 11.4%, relative to 2007, whereas their value (of Denar 295 million) registered annual growth of 13.5%.

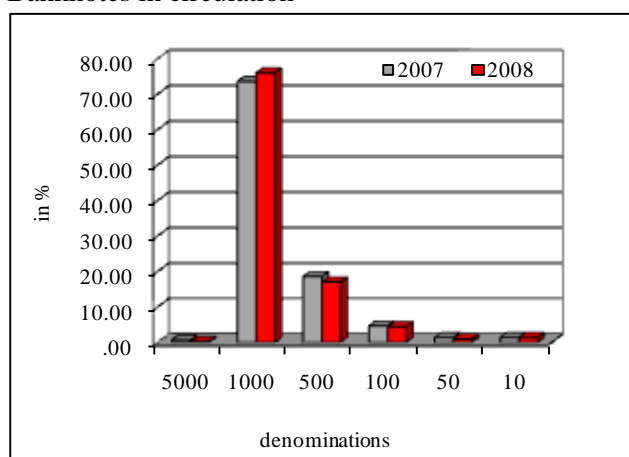
Table 26
Currency in circulation

	Banknotes		Coins		Total cash in circulation in millions of Denars
	value in millions of Denars	quantity in millions	value in millions of Denars	quantity in millions	
1999	8,052	30.6	116.1	60.2	8,168
2000	9,424	36.0	135.2	68.7	9,559
2001	14,141	44.9	145.9	74.2	14,287
2002	13,945	44.4	160.9	80.9	14,106
2003	14,004	45.4	175.2	87.8	14,179
2004	14,049	46.9	192.6	96.2	14,241
2005	14,401	49.6	211.2	104.1	14,612
2006	16,109	53.0	233.0	113.4	16,341
2007	17,708	56.3	260.0	124.9	17,968
2008	17,867	55.6	295.0	139.1	18,162

Source: National Bank of the Republic of Macedonia.

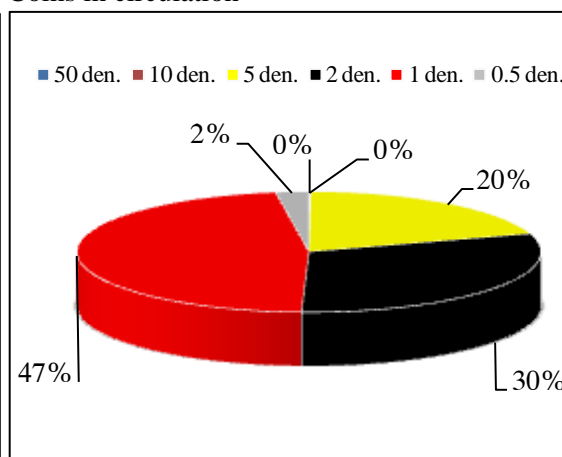
Analyzing the value, the denominations of Denar 1000 and Denar 500 registered the largest participation in the banknotes in circulation. The denomination of Denar 1000 participated with 76.0% (73.6% at the end of 2007), and the denomination of Denar 500 participated with 17.0% in the value of the banknotes in circulation (18.5% at the end of 2007). The other denominations of banknotes participated with 7% of the total value of banknotes in circulation, which was by 0.9 percentage points less than their participation at the end of 2007. The largest share of the coins in circulation accounts for the denomination of Denar 1 (47%).

Figure 124
Banknotes in circulation



Source: National Bank of the Republic of Macedonia.

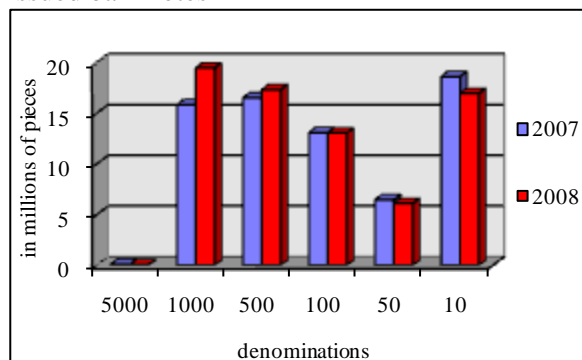
Figure 125
Coins in circulation



5.2.2. Supplying banks with cash

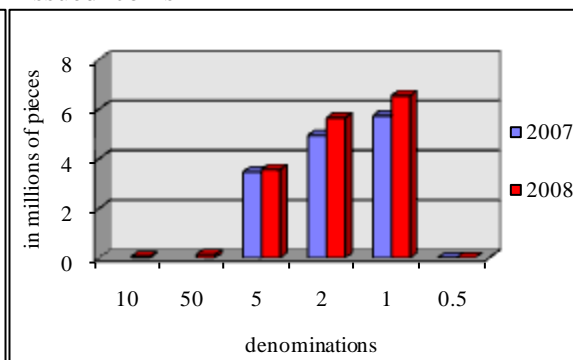
In 2008, the central vault of the National Bank and the subunits for handling cash in the Republic of Macedonia, issued Denar 30.2 billion in cash to banks, or total 3.363 realized transactions (72.9 millions of banknotes and 16.0 millions of coins issued), which was by 14.2% more relative to 2007. Simultaneously, cash in the amount of Denar 29.3 billions was received from the banks, through 4.500 transactions. In 2008, 70.1 million of banknotes and 1.8 millions of coins were received. In 2008 growth in the received banknotes was registered by 7.5%, and in the coins - decrease by 36.6%, relative to 2007. Regarding the denomination structure of the banknotes and the coins, both, in the process of issuing and receiving, the denomination of Denar 1000 registered the highest participation (26.0%).

Figure 126
Issued banknotes



Source: National Bank of the Republic of Macedonia.

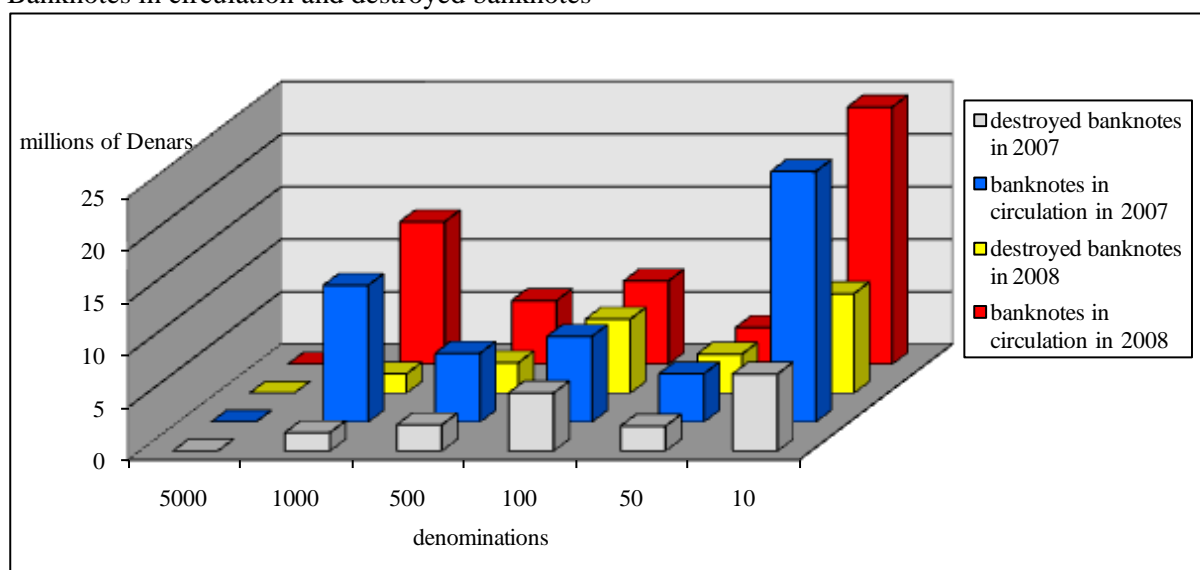
Figure 127
Issued coins



5.2.3. Banknote processing and destroying

In 2008, in the process of inspection of the quality of banknotes in circulation, in the central vault total 54.6 millions of banknotes were processed, relative to 35.2 millions of banknotes in the previous year. Of the total processed 54.6 millions of banknotes, as a result of wear out and damage, 25 million banknotes were destroyed (relative to 19.5 millions of banknotes in 2007). The denominations of Denar 10, 50 and 100 mostly participated in the destroyed banknotes (81%), while the other (19%) were destroyed banknotes with higher denomination structure (Denar 500, 1000 and 5000), which was due to the higher participation of the banknotes with lower value in the cash transactions.

Figure 128
Banknotes in circulation and destroyed banknotes



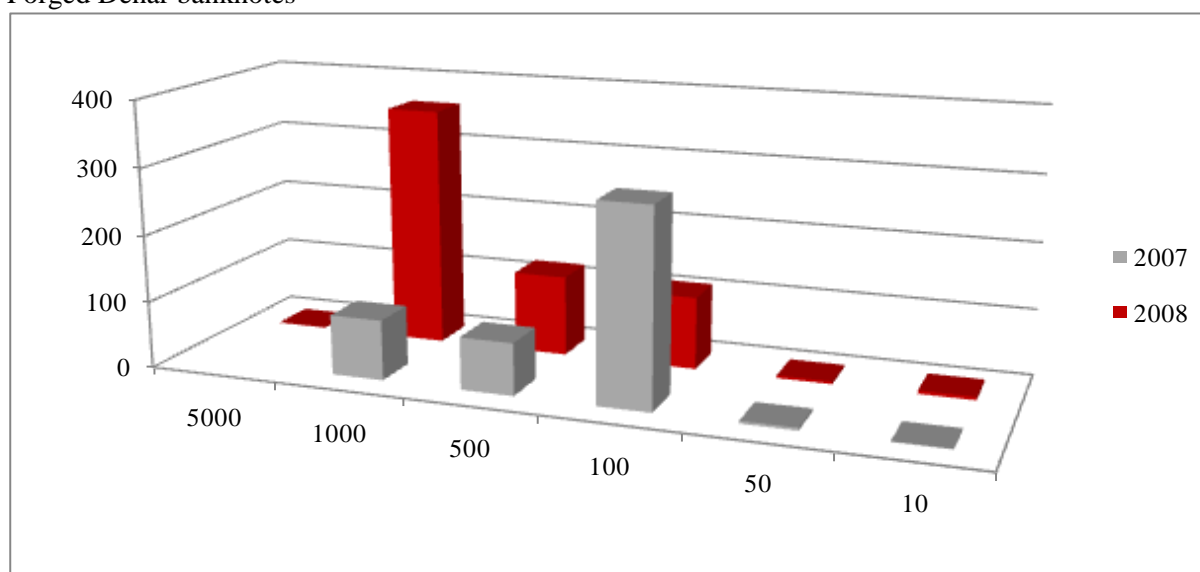
Source: National Bank of the Republic of Macedonia.

5.2.4. Expertise on suspicious / forged banknotes

In 2008, the expertise showed total of 600 forged Denar banknotes discovered by the commercial banks and confiscated in Republic of Macedonia by the Ministry of Interior (MOI), which was by 28.8% more relative to the forgeries discovered in 2007 (466 banknotes). Of the total number of discovered forged banknotes, in 2008 there was a change in the denomination structure relative to the previous year, i.e. in this year the denomination of Denar 1000 was most frequent (total 360 peaces, or 60.0% of the total number of forgeries), different from 2007 when the denomination of Denar 100 was most frequent, with total 293 peaces or 62.8% of the total number of discovered forgeries. The total value of the forged Denar banknotes amounted to Denar 436.650 participating insignificantly relative to the total value of the currency in circulation.

The general assessment was that the forged banknotes were with bad quality, which enabled their easier detection. During the expertise of the technique of manufacturing of the forged banknotes, it was determined that they were primarily made by computer (scanning and printing). Also, a photocopier machine was used able to produce color copies using regular paper, without protection elements. In 2008, the National Bank sent also 5 banknotes of suspected forged Euros (in denomination of 50, 100 and 200), to MOI for an expertise, reported and submitted to the National Bank by companies and natural entities. The experts in MOI, after performing the expertise, discovered that all sent banknotes were forgeries.

Figure 129
Forged Denar banknotes



Source: National Bank of the Republic of Macedonia.

5.2.5. Printing of banknotes and other value papers

In 2008, in order to supplement the reserves of banknotes, total 25 millions of banknotes were printed, i.e. 10 millions of banknotes in denomination of Denar 100 and 15 millions of banknotes in denomination of Denar 50. Since November 15, 2008, new denominations of minted coins of Denar 10 and 50 were put in circulation, in accordance with the Decision on putting minted coins in denomination of Denar 10 and 50 into circulation published in the "Official Gazette of RM" No. 54/07. In the process of minting, in 2008 total 12.7 millions of coins were minted, i.e. 5.3 millions of pieces in denomination of Denar 1, 2 and 5 and 7.4 millions of pieces of the new denominations of Denar 10 and 50.

5.2.6. Other cash management operations

For the account of the Ministry of Finance, total 17.9 millions pieces of administrative and court government stamps and 200 thousand pieces of bill of exchange forms were issued. Simultaneously, for the account of the Ministry of Finance, administrative and court government stamps in total amount of 12.9 millions of pieces (12.7 millions in 2007) and bill of exchange forms in all denominations in total amount of 250.100 pieces were sold (268.400 pieces in 2007).

In 2008, for the account of the Ministry of Finance and the Public Revenues Office, alcohol and cigarettes banderoles were stored and issued in the vault. There were total of 190 transactions of issuing cigarettes banderoles, which was by 2.2% more, relative to 2007. Also, there were total of 432 transactions of issuing alcohol banderoles, or 14.3% less relative to 2007.

Total of 88 transactions on the basis of depositing foreign assets and Denar assets temporary confiscated by the competent bodies in the National Bank's vault were executed in 2008 (111 transactions in 2007). Total of 55 payments of temporarily confiscated foreign currencies were executed on the basis of court decisions (22 in 2007). Simultaneously, 10 sureties (Denar and foreign currency) were deposited in the National Bank's by the competent courts in the Republic of Macedonia, with 9 transactions for returning of the sureties being carried out.

As a result of the regular foreign currency vault operation for the Government bodies, there were 2.993 payments of cash foreign currency from the vault, which was by 9.2% more relative to

2007. In the same time, 361 payments of cash foreign currency were preformed, which was by 20.8% less relative to 2007.

The sold numismatics of jubilee coins made of gold and silver equaled 175 pieces, i.e. 105 gold and 70 silver coins in 2008.

5.3. Internal audit

With the implementation of the Internal Audit Program in 2008, the Internal Audit Department fulfilled its ultimate task to improve the performance of NBRM activities, through systematic and regular assessments and improvement of the risk management, the internal control system and the management processes. The process of achieving this goal was performed through giving an assurance to the managing bodies of NBRM that the risk management, the internal control systems and the managing processes, created and implemented by the management, are adequate and that they function on a manner that enables to achieve the following goals: credibility and integrity of the financial and other information, compliance of the operations with the laws and bylaws, the internal policies and the operating procedures, safeguarding of assets, and rational and efficient resource employment.

The largest part of the regular activities pertained to the performance of regular audits, the performance of which was planned, not only with respect to the level of inherent, business risks, but also to the importance of the functions performed, the interval from the last audit performed, as well as the changes made in the operating processes. The audit reports provided an opinion on the adequacy of the established internal audit system, on which the NBRM management was regularly informed. Recommendations were given for overcoming the identified weaknesses, if any, presented in the audit reports together with the accomplishment of the given recommendations.

In 2008, 14 regular and 2 extraordinary audits were conducted, with the implementation of the recommendations given in the audit reports, which were to be completed by 2008, being closely monitored on a regular quarterly basis. The monitoring mainly showed that the recommendations were observed and implemented within the given periods. The audits of 33 work processes in NBRM in 2008, resulted in 53 recommendations for improvement of the internal control system.

Despite the regular activities, the internal audit also undertook some other activities aimed at improving its own operation quality and efficiency through commenced activities for implementation of the international internal audit standards. These activities were performed in cooperation with the Central Bank of the Netherlands, which shall result in more quality and more efficient internal audit and strengthening of the internal audit system in order to decrease the risks present in the NBRM operating to an acceptable level. With respect to this, in 2008 the following was developed: developing the Internal and External Program on assessment of the operating quality in the internal audit, developing methodology on risk assessment, as a starting point for the annual planning of the regular revisions, creating a new form of Audit Report and introducing procedure for ranging the given recommendations with respect to their level of risk.

5.4. Improving of the NBRM institutional capacity

- In 2008, the National Bank continued with the activities on building the institutional capacity through developing the human resource management, focusing mostly on the professional upgrade of the employees and improvement of the employee qualification structure. In order to enable development in the planned activities in the area of human resource management for the following period, software for human resource management was obtained. In 2008 certain preparations for launching the software and for starting with the planned processes in the area of human resource management were made.

In 2008 growth, there was growth in the number of the seminars attended by the NBRM employees, which points to the constant efforts for upgrade and professional improvement of the personnel. The number of seminars attended abroad increased, while the number of seminars attended in the country insignificantly dropped.

Table 27

Number of seminars attended and number of employees attending seminars in 2007 and 2008

	2007	2008	annual changes
Number of attended seminars	119	130	9.2%
In the country	20	18	
Abroad	99	112	
Number of employees who attended seminars	89	89	/

Source: National Bank of the Republic of Macedonia.

From the aspect of the area the seminars cover, 37% of the attended seminars are from the monetary policy and central banking operations area, 11% pertain to the supervision area, 8.5% from the statistics, 7.7% from the financial stability and financial markets, the Euro integration processes, payment systems and internal audit accounts for 4.7% each, 3% for the legislation area and 3% for the human resource management area, 2 % pertains to the accounting area, while the remaining 14% accounts for the seminars covering the cash management, the IT area etc.

It is significant to emphasize that the large number of the professional improvements is realized on the basis of the annual training programs of the European central banks and other significant international institutions, the largest share of which, regarding the costs, is covered by the organizers themselves. Namely, from the aspect of the organizers, the largest portion of the attended seminars in 2008 (12.3%) was organized by International Monetary Fund, the Bank of England (12.3%), followed by the seminars organized by the Central Bank of Nederland (8%) and the German Central Bank (7%), the Financial Stability Institute - FSI (5%), and smaller share, but not insignificant share of the total professional improvement for the employees pertains to the seminars organized by the central bank of Austria, Czech Republic, Poland, Italy, Turkey, as well as ECB - The European Central Bank, and the International Settlement Bank - ISB, and other organizations.

- In 2008, the qualification structure of the NBRM registered improvement, through increase in the number of high qualified stuff for the account of drop in the number of employees with lower level of qualifications which is presented as follows.

Table 28

Qualification structure of the NBRM employees

Qualifications structure	31.12.2007	31.12.2008	annual changes
Total number of employees	418	433	3.6%
(university degree, total with MSc and MA, and PhDs)	212	233	9.9%
1. MSc and MA	30	30	
2. PhDs	3	5	66.7%
Two years of university degree	19	18	-5.3%
High school	168	164	-2.4%
High school with fifth degree	4	4	
Elementary school	15	14	-6.7%

Source: National Bank of the Republic of Macedonia.

- In 2008, NBRM continued performing the planned activities pertaining to the improvement and finalization of the inflation projection model. The first final version of the model was presented in October 2008. The final version reflects the main transmission canals of the monetary policy and since October 2008 it is used for preparation of so called inflation projections for internal needs of NBRM. Parallel with the launching of the model, the implementation of the changes in the form and the contents of the reports generated by it commenced. The inflation projection is expected to develop in an operative and efficient mean for conducting the monetary policy and communication with the public which will approximate NBRM additionally to the practices of the modern central banks. The project was realized together with an expert from the Czech central bank, through technical assistance financed by IMF.

- The Credit Registry of the National Bank represents a database and information base on the credit risk exposure of banks and saving houses in the Republic of Macedonia to legal entities and natural persons.

In the second half 2008, the National Bank rounded the planned activities for improvement of the Credit Registry, which pertained to creating an appropriate and improved legal framework and software application. The basic goal of the improving activities of the Credit Registry of NBRM was achieving higher efficiency in the process of determining the size of the credit risk the banks are exposed to, as well as in the performance of the audit function by the National Bank.

The improvement of the Credit Registry consisted of considerable broadening of the types and the scope of data and information on the credit risk exposure, it contains, as the following: date of granting a credit, amount of the credit at the day of granting, amount and type of the interest rate, data on the due claims, days of delay in the payment of liabilities, method of payment of the credit (single or annuity payment), credit status (restructured, prolonged), compliance of the foreign currency position of the client, type and value of the collateral. The most significant change regarding the type and the scope of the data pertains to the reporting by credit, relative to the reporting by client performed so far. The threshold of reporting per single credit decreased, equalling Denar 300 thousand for legal entities (for the banks), i.e. Denar 50 thousands (for saving houses) and Denar 5 thousands for natural persons (for banks and saving houses). The shortening of the terms for submitting and processing of data, as well as the transfer to monthly reporting and improvement of the reporting forms in the Registry represented especially significant innovation.

- In 2008 NBRM was performing activities on significant improvement in its IT infrastructure. Over 300 PCs (desktops and laptops) were replaced, so the average use of utilization of the PCs of the National Bank's employees considerably improved. On the new servers with the new robust disc capacity, installed at the end of 2007, the IT services and applications were gradually tested and put into production, and additional 6 new servers were introduced. The following IT infrastructure services were introduced: Active directory, Dynamic Host Configuration Protocol (DHCP), file share on two locations with double discs, Windows Server Update Services (WSUS) and other Microsoft products, ePolicy Orchestrator, System Center Configuration Manager, e-mail system, backup system and others. At the end of 2008, the implementation of the Event Lock Management System, Public Certificate Authority System for Digital Signing, within the National Bank IT Service desk, commenced. Besides that, in 2008 migration of over 90% of the 200 users applications developed in the National Bank was performed to the new environment, and all those applications were maintained and upgraded depending on the final users' requirements. Besides the migration and the maintenance of the existing applications, several new were developed.

Also, in 2008 the training of the employees and documenting the procedure for implementation of the IS Safety Policy of NBRM commenced, which is expected to be finalized at the end of 2009.

- In direction of improvement in the monitoring of the financial position of the National Bank and improving the financial reporting to the National Bank according to the International standards for

financial reporting, and in accordance with the needs of the central banks, in 2008 the Accounting Rules for the specific transactions of the National Bank were adopted (transactions with currency in circulation and other valuables, etc.), which encompass the method of recording, the documents and the manner of presenting in the financial reports.

The new accounting plan for banks which started being applied in 2009 pertains to the National Bank as well, so in 2008 several preparation activities for its implementation in the National Bank's accounting applications were performed.

In order to introduce an Integrated accounting system in the National Bank, which shall improve the operating significantly, and make it more efficient, more productive and better organized, with easy approach to the related documents, enable higher automation in the process of recording the transactions and enable easy usage of various types of information for all kinds of requirements, in 2008, in cooperation with external consultant, the Technical documentation on integrated accounting system was prepared. The documentations contains: functional requirements for the accounting system, technological features of the system, description of the necessary relations and transfer of data electronically for system integration and description of the requirements for system support. Also, descriptions of the financial and accounting processes were prepared, as well as general and detailed drafts of the used applications and a description of the documents for creating the Document Management System.

In 2008, the cooperation between NBRM and the Dutch Central Bank continued in the area of financial and accounting operations of the central banks, so 4 meetings were organized between representatives of the financial and accounting operations departments of both central banks. The discussions and the exchange of experience considerably contributed to improvement in the organization of performing the operating tasks of the financial and accounting operations department and in the preparation of the technical documentation for integrated accounting system.

The optimization of the applicative solution for preparing of the Financial Plan and Investment Plan and the monitoring of the implementation of plans continued in 2008 as well. In 2008 successful consolidation of the data from the single plans of the organizational units and monitoring of the implementation of plans was achieved.

- Since the beginning of 2008, radical reforms in function of improvement in the operating of the NBRM library were initiated. At the end of 2008 the recording of books in the electronic application of the library intensified, so since April 2008 the process of borrowing and giving back to the library is performed only electronically, through internal electronic application. In 2008, activities for improvement of the electronic application and its enriching with new elements were undertaken. Based on this application, intranet-application for the books in the library was created, available for use by the NBRM employees. Besides that, in 2008 the fund of professional literature was enriched on regular basis, in accordance with the requirements of certain departments.
- In 2008 the cooperation between the National Bank of Republic of Macedonia and the Dutch Central Bank in the area of technical assistance continued. The Project on technical assistance for NBRM by the Dutch Central Bank, initiated in 2000, continued to be successfully carried out in 2008 as well. The project encompassed almost all main functions and activities of the National Bank of the Republic of Macedonia. Also, in 2008, the National Bank cooperated actively in the area of the technical assistance also with the International Monetary Fund.
- In 2008, in the NBRM premises the following trainings, seminars and workshops were held:
 - On April 24, 2008, the National Bank of Republic of Macedonia organized a workshop on the topics: *Prices of food and inflation*. The main objective of the workshop was to give review on the influence of the prices of food, and especially on the prices of agricultural products, the reasons for their price growth and the potential effect on the economy, as well as to aspects related with

satisfying the consumption of agriculture products. Regarding to this, within the workshop a review was given on the factual condition in the agricultural sector in the Republic of Macedonia, the strategies and the measures of the Government in this area and the potential measures for overcoming of the problem and suppressing the price growth. Representatives from the relevant institutions in the Government, as well as from the enterprises which have common ground with the stated issue participated on the workshop. The workshop gave useful perceptions, relevant for potential mitigation of the influence of the prices of food on the inflation;

- On May 30, 2008 the National Bank of Republic of Macedonia organized international conference on the topics: *Competitiveness of the South-East Europe countries and challenges on the road to EU*. Works related with the competitiveness of the new and potential member-states in the process of EU integrations, the real and the nominal convergence, the challenges for the monetary policy, and other similar topics were presented on the Conference. Representatives from the central bank and institutions which are very familiar with the economies of the transition countries and their integration in the European Union and the European Monetary Union, as well as representatives from the scholarly-educational institutions, Government institutions, banks and enterprises in Macedonia participated on the Conference. The presented experience of the new EU and EMU member-states will be of great use for Macedonia, which shall be facing intensively with these processes and challenges in the following period;
- In 2008, in cooperation with the Dutch Central Bank and the Central Bank of England, in the NBRM premises were organized successfully two workshops:
 - The first workshop on the topics: *Governance in the central banks and financial sector*, held in the period September 29, 2008 - October 1, 2008, was with international character and together with the participants from the National Bank of the Republic of Macedonia, representatives from the central banks from the region participated;
 - The second workshop on the topics: *Integrity supervision in the theory and practice*, held on October 2, 2008 was intended for the National Bank employees, as well as for the representatives from the commercial banks in the Republic of Macedonia.
- In 2008, the NBRM second time in a row, awarded an Annual award for best work in the macroeconomic area for junior analyst, in order to stimulate the scholar and analytical work in the country and to initiate the young staff potentials to investigate deeply the macroeconomic issues concerning the economy.
- Internal acts of higher importance adopted in 2008 are as follows:
 - Code of conduct of the National Bank;
 - Regulations for preparation of general legal act;
 - Regulations on the manner and procedure for fulfilling the need of manpower by an announcement;
 - Regulations for public procurement which enabled the required compliance with the Public Procurement Law;
 - Regulation for information classification in The National Bank.
- In 2008, the National Bank participated with its representatives in the activities of the work group for the Draft of the Law on amending the Law on Obligations. In 2008, the National Bank actively participated through membership and giving opinions within the work group on the Law on Financial Collateral. In 2008, the National Bank developed explanations, legal opinions concerning the Draft of the amendments on the Criminal Code and the Law on Administrative Disputes.