National Bank of the Republic of Macedonia

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Dear Sir/Madam,

Macroeconomic performances of the Macedonian economy in 2004 can be assessed as relatively satisfactory, especially from the viewpoint of the Central Bank, having in mind the trend of preserving price and financial stability, the favorable developments in the banking system and the development of financial markets. Yet, the accomplishments in the real sector of the economy and the international economic relations, as well as the still high unemployment rate, emphasize the need of making deep structural reforms in the economy, which will create capacity for generating faster and sustainable growth on a long run. Hence, the accomplished positive results in certain segments of the economy seem to be less favorable, having in mind that there are still problems with generating economic growth, which should at the same time be the basic points of interest, addressed and treated with the highest priority in the Government's macroeconomic policy.

In 2004, the real GDP growth equaled 2.9%, which represents an insignificant acceleration of the growth relative to the previous year (2.8%). Such performances are to a large extent a result of the high concentration of the domestic output, i.e. the reduced activity in industry, which is the dominant component of the GDP. Contemporaneously, the current account deficit reached 7.7% of GDP, mainly as a consequence of the broadening of the trade deficit. Hence, the revitalization of the economy imposes a need for restructuring of the real sector, diversification of the production and stimulation of the exports. These reforms are aimed at creating competitive, export-oriented corporate sector, which would contribute to the reduction of the trade deficit and intensification of the economic growth. At the same time, the high structural unemployment (in 2004 the unemployment rate equaled 37.2%) represents a signal of the necessity for conducting high-quality reforms on a microeconomic level, incurring the investment activity and attracting foreign direct investments.

In addition, during 2004, the monetary policy was directed toward creating favorable environment for economic activity through further maintaining of the price stability, as the main monetary policy objective. The monetary strategy of a de facto targeting of the nominal exchange rate of the denar against the euro was maintained. Consequently, the exchange rate remains to be a nominal anchor, which contributes to stable inflation expectations and maintaining of a low and stable inflation. In 2004, the average change in the rate of inflation was negative and equaled 0.4%, which was primarily due to non-monetary factors, i.e. lower costs of food due to the reduction of the customs duties on imports in line with the Stabilization and Association Agreement with the EU and the membership in the World Trade Organization (WTO). With this, the extremely high increase in the price of crude oil on the international markets in 2004 was completely offset and there was no transmission effect on the domestic inflation.

The pressures on the foreign exchange market (caused by the broadening of the current account deficit, unrealized inflows from abroad and speculations), as well as the uncertain distribution of the budget spending during the year, represented the main factors of the changes in the monetary policy stance in 2004. In the course of 2004, the National Bank of the Republic of Macedonia (NBRM) increased the interest rates on CB bills on several occasions (so that the interest rate on CB bills with maturity of twenty-eight days reached 10% p.a.), which was made in order to stabilize the movements on the foreign exchange market and preserve the exchange rate stability. Simultaneously, in December, NBRM adopted a decision on increasing the compulsory reserve requirement from 7.5% to 10% (effective since January 2005). The higher reserve requirement on denar deposits should contribute to the reduction of the structural excess liquidity in the banking system and creation of an additional supply on the foreign exchange market. On the other hand, the higher rate of reserve requirement in foreign exchange is of a prudential character, given the intensive lending in foreign currency, after the *liberalization of the lending in foreign currency in July 2003. Such changes in the monetary instruments resulted in an insignificant amount of net-sale of foreign currency on the foreign exchange market by the NBRM in 2004. Gross foreign exchange reserves in 2004 registered an annual increase of US Dollar 82.3 million (which is mainly due to foreign exchange gains), with their level providing coverage of 3.6 months of import of goods and services from the current year.*

From a viewpoint of the fiscal policy, in 2004 the central budget registered surplus of 0.1% of GDP, while the general government budget was almost balanced. The accomplished budget balance for 2004, however, deviated from the projection (projected deficit in the central and in the general government budget of 0.8% of GDP and 1.9% of GDP, respectively), where the budget spending during the year signaled uncertainty, which implied adequate precautionary measures of the monetary policy. In 2004, the fiscal sector significantly contributed to the development of the financial market by issuing the first short-term government securities (three-month and six-month Treasury bills), with which the sources of budget financing expanded. At the same time, the diversification of the securities portfolio is aimed at further promotion of the monetary set of instruments, i.e. it is a basis for conducting open market operations. To the end of supporting the development of the domestic financial market and integrating the Macedonian economy into the global financial flows, the Republic of Macedonia was given the first international credit rating, made by the international rating agency "Standard & Poor's", which granted the Republic of Macedonia rating BB/B for the debt in foreign currency and BB+/B for the debt in domestic currency, with positive expectations for the future.

In 2004, current account deficit deteriorated (7.7% of GDP, compared to 3.3% of GDP in 2003), primarily generated from the significant broadening of the trade deficit, which reflects certain special circumstances in 2004 (restarting of one of the major metallurgic plants, increase in the price of oil on the world markets, intensified import of vehicles before the reintroduction of excises on motor vehicles), but is also an effect of the gradual trade liberalization in line with the Stabilization and Association Agreement with the EU and the membership of the Republic of Macedonia in the WTO. Current transfers still represent the dominant source of the trade deficit financing. The degree of coverage of the current account deficit with inflows from foreign direct investments and portfolio investments in 2004 equaled 36.2%, but further keeping of the foreign direct investments at the level of 2% of GDP points to the need of incurring this long-term and stable source of financing, which should also enable an increase in the productivity, faster economic growth and higher employment rate. In 2004, the total external debt registered an annual increase of US Dollar 203.6 million, with almost half of the realized growth being due to the realized foreign exchange gains. The Republic of Macedonia, however, is still in the group of less, i.e. moderately indebted countries, and all indicators of the degree of indebtedness in 2004 registered improvements relative to the previous year.

The positive tendencies in the banking system continued during 2004. Thus, further broadening of the banks' deposit base, i.e. annual increase of the total deposits of 23.9% was registered, which indicates further strengthening of the confidence in the banking system and increased propensity of the economic entities to save. The increased economic activity, the expectations of economic agents for stable environment, the high inflows on the basis of private transfers, as well as the revenues from the payment of the government liabilities on the basis of the bonds for the old foreign exchange savings, which were in a large part kept in the banking system, acted toward an increase in the saving in the banking system. With respect to the currency of denomination, significant increase was registered in both denar and foreign currency deposits (25.1% and 23.3%, respectively), which points to the emphasized preferences to save in both domestic and in foreign currency. The increase in the deposits in the banking system also resulted in high rates of monetary growth, with the annual growth rates of the money supply M2-denar part and M4 equaling 12.1% and 16.2%, respectively, in 2004.

In 2004, bank credits represented again a significant source of additional financing of households and enterprises, where the annual growth rate of the bank's total placements equaled 23.7%. The accelerated lending activity of banks resulted in an annual increase in the share of the banks' placements in GDP of 3.1 percentage points (the share reached 19.4%) and hence a significantly stronger financial intermediation. The accelerated lending activity of banks is due to the increase in the deposits, as the basis of the lending activity, the expanded supply of the types of credits and the terms for their extending, as well as to the more active use of the available foreign exchange deposit potential by the banks. The qualitative changes in the banks lending activity are confirmed by the annual increase in the share of the long-term credits in the total credits of 7.7 percentage points. At the same time, a reduction in the share of the credit exposure classified in the three most risky categories from 15.1% in 2003 to 13.2% in 2004 was registered, which points to the more adequate assessment of the credit risk by the banks and the higher level of financial discipline of the borrowers. Improved performances of the banking system are also evident from the CAMELS composite rating of banks for 2004, i.e. from the increase in the number of banks with the highest composite rating "1" from one bank in 2003 to two banks in 2004.

Despite the increase in the interest rates on the CB bills and the short-term Treasury bills, the downward trend in the lending and deposit interest rates of banks continued also in 2004. Thus, the average weighted lending interest rate (on short-term denar credits) registered an average annual decline of 3.5 percentage points and equaled 12.5%, while the decline in the average weighted deposit interest rate on the three-month denar deposits equaled 1.4 percentage points, thus being reduced to 6.5%. The decline in the banks' interest rates reflects the increased deposit potential of banks, the higher quality of the credit portfolio, the improved efficiency and reduction of the costs of the banks, the higher level of competition in the banking system, as well as the need for maintaining good business relations with creditworthy clients. The higher efficiency of the banking system and the higher level of competition are confirmed also with the decline in the costs of financial intermediation, expressed through the narrowing of the interest rate spread by 2.1 percentage points. Yet, despite the downward trend, the interest rates of banks in the Republic of Macedonia are higher relative to those in the advanced countries in transition, which points to the need for further improvement of the banking operations.

In 2004, the Republic of Macedonia confirmed its firm determination to get closer to the European Union and actively integrate in the international trade and financial flows. In March 2004, the Republic of Macedonia formally filed the application for membership in the EU, while in April 2004 the Stabilization and Association Agreement with the EU became effective, after it had been ratified by all countries-members of the EU. With this, the Republic of Macedonia gained the status of a country with associative membership, and successfully continued the process of gradual convergence to the EU, as its strategic objective.

The key challenge for the Macedonian economy is to supplement the consistent macroeconomic framework with structural reforms, to strengthen the corporate governance and the institutional framework and to create favorable investment climate. The need for structural reforms is also stressed in the new arrangement with the IMF agreed in May 2005, which at the same time confirms the delayed implementation of the structural reforms in the economy, reflecting unfavorably on the growth dynamics, compared with the other countries in transition. Simultaneously, the acceleration of the economic growth rate and the reduced unemployment are necessary for providing real convergence to the EU and for increasing the level of the standard of living. With this, the positive trends in the Macedonian banking system and the conduct of a prudential and consistent macroeconomic policy will be supported by a more dynamic economic growth of higher quality. NBRM will continue to be focused on preserving the price stability, as the main monetary objective, so that the monetary policy will contribute in the most adequate manner to the creation of an environment for initiating and maintaining faster economic growth. Thus, NBRM successfully converges towards the position of the central *banks in the developed economies and gives its contribution for faster integration of the Republic of Macedonia in the EU.*

Skopje, May 2005

Petar Goshev, MSc.
Governor and President of the
National Bank of the Republic
of Macedonia Council

I. Economic developments in the world[1]

The gradual mitigation of the negative effects on a global level, caused by the war in Iraq and the "sars" epidemics, contributed to the considerable recovery of the world economy. Thus, the global economic growth in 2004 is expected to reach 5%, which is above the historical trend of 4% and is by 1.1 percentage points more relative to 2003. The expectations for a faster economic growth are in line with the growth in the industrial output, intensification of global trade flows, increased personal consumption, improved conditions on the labor market and the increase in investments.

Table 1
Selected indicators for the world economy

	2000	2001	2002	2003	2004
			(in %)		
Real GDP growth rate	*4.7*	*2.4*	*3.0*	*3.9*	*5.0*
Developed countries	3.9	1.2	1.6	2.1	3.6
USA	3.7	0.8	1.9	3.0	4.3
Euro-zone	3.5	1.6	0.8	0.5	2.2
Central and Eastern Europe	4.9	0.2	4.4	4.5	5.5
CIS*	9.1	6.4	5.4	7.8	8.0
Growth in the world trade	*12.5*	*0.2*	*3.3*	*5.1*	*8.8*
Inflation rate					
Developed countries	2.1	2.1	1.5	1.8	2.1
USA	3.4	2.8	1.6	2.3	3.0
Euro-zone	2.0	2.4	2.3	2.1	2.1
Central and Eastern Europe	23.0	19.6	14.8	9.2	6.9
CIS*	24.5	20.3	13.8	12.0	9.9
Average growth of prices					
Oil	57.0	-13.8	2.5	15.8	28.9
Primary products	4.4	-4.1	0.6	7.1	16.8
Industrial products	-5.6	-2.8	2.4	13.2	7.5
			(% of GDP)		
Saving rate	*23.8*	*23.2*	*23.1*	*23.9*	*24.5*
Investments	*23.5*	*23.0*	*22.8*	*23.5*	*24.2*
			(USD per unit of national currency)		
EUR	*0.924*	*0.896*	*0.944*	*1.131*	*1.217***

Source IMF World Economic Outlook, September 2004.
* Includes Mongolia, although it is not a member of CIS (Commonwealth of Independent States).
** Estimation

The unfavorable developments on the world oil markets in 2004, however, reduced the positive influence of these factors. The world price of crude oil in 2004 registered an average increase of 28.9%, with the price of oil during the year reaching levels that have not been registered since the beginning of the 1980s. The faster economic growth in 2004 caused an increase in the global demand for crude oil that exceeded the expectations, and hence an increase in its price. Reduced production of oil in certain countries - exporters (Iraq, Venezuela, Russia), the announcements for reduction of the production quotas by the member-countries of OPEC (excluding Iraq), as well as the speculative activities given the increased geopolitical insecurity, acted in the same

[1] The analysis is based on the IMF World Economic Outlook, September 2004 and the EBRD Transition Report 2004.

direction. Here, the problem of lower supply of oil on the world market and the low level of world stock of crude oil, is becoming growingly evident. In 2004, besides in the prices of oil, an increase was registered also in the prices of primary products (16.8%) and in the prices of industrial products (7.5%).

1.1. Developed countries in 2004

In 2004, the group of developed countries registered an economic growth of 3.6%. In that framework, significant generator of the growth, besides Japan, is USA (growth rate of 4.3%), where the effects of the fiscal deficit and the increase in the interest rates were offset with an increase in productivity. In 2004, USA again faced with the problem of further deterioration of the balance of payments position, as a consequence of the significant growth of the import and broadening of the current account deficit to the level of 5.4% of GDP (4.8% in 2003). In 2004, the countries of the euro-zone register a slower growth (2.2%) due to their slower adjustment to shocks, so far. Given the low domestic demand, the growth in the euro-zone in 2004 is mainly determined by the external demand.

The inflation in developed countries was relatively low (2.1%) in 2004, and it was slightly above that achieved in the previous year (1.8%). The reduction in the rate of unemployment in the developed countries of 0.3 percentage points (6.3%) in 2004, signals a globally improved condition on the labor market (which is not the case with the euro-zone, where the rate of unemployment in 2004 reached 9%). Further appreciation of the euro relative to the US dollar, continued in 2004, so that the average value of the euro reached US dollar 1.217 per one euro (appreciation of 7.6% relative to 2003).

Table 2
Selected economic indicators for the developed countries

	GDP (real growth in %)			Inflation (in %)			Unemployment (in %)			Current Account Balance in the Balance of Payments (in billions of US dollars)			Current Account Balance in the Balance of Payments (% of GDP)		
	2002	2003	2004	2002	2003	2004	2002	2003	2004	2002	2003	2004	2002	2003	2004
Developed coutries	1.6	2.1	3.6	1.5	1.8	2.1	6.4	6.6	6.3	-216.4	-246.5	-266.1	-0.8	-0.8	-0.8
Euro-zone	0.8	0.5	2.2	2.3	2.1	2.1	8.5	8.9	9.0	52.8	25.5	72.2	0.8	0.3	0.8
Germany	0.1	-0.1	2.0	1.3	1.0	1.8	8.7	9.6	9.7	43.1	52.9	118.5	2.2	2.2	4.4
France	1.1	0.5	2.6	1.9	2.2	2.4	8.9	9.4	9.4	14.5	5.5	-12.8	1.0	0.3	-0.6
Italy	0.4	0.3	1.4	2.6	2.8	2.1	9.0	8.7	8.3	-6.7	-21.9	-18.1	-0.6	-1.5	-1.1
Grece	3.9	4.3	3.9	3.9	3.4	3.3	10.0	9.0	8.9	-8.1	-9.8	-11.9	-6.0	-5.7	-6.0
USA	1.9	3.0	4.3	1.6	2.3	3.0	5.8	6.0	5.5	-473.9	-530.7	-631.3	-4.5	-4.8	-5.4
Japan	-0.3	2.5	4.4	-0.9	-0.2	-0.2	5.4	5.3	4.7	112.6	136.2	159.4	2.8	3.2	3.4

Source IMF World Economic Outlook, September 2004.

Among the euro-zone countries, which represent the most significant trading partners of the Republic of Macedonia, the fastest economic growth in 2004 was registered by Greece (3.9%), followed by Germany (2%) and Italy (1.4%). The inflation rates in Germany and Italy were in line with the average for the euro-zone, while Greece significantly exceeds the average with an inflation rate of 3.3%. The rates of unemployment in Germany and in Greece are almost unchanged relative to 2003, while in Italy, unemployment reduced by 0.4 percentage points. Germany is singled out with a significant surplus in the balance of payments current account (4.4% of GDP).

1.2. Countries in transition in 2004[2]

The economic growth in the countries in transition in 2004 equaled 6.1% (5.6% in 2003), and it was accompanied by a rapid growth in the domestic lending, which contributes to an increased financial intermediation and encourages investment and spending. The main driving force behind the high growth rates of the countries in transition is still the domestic demand.

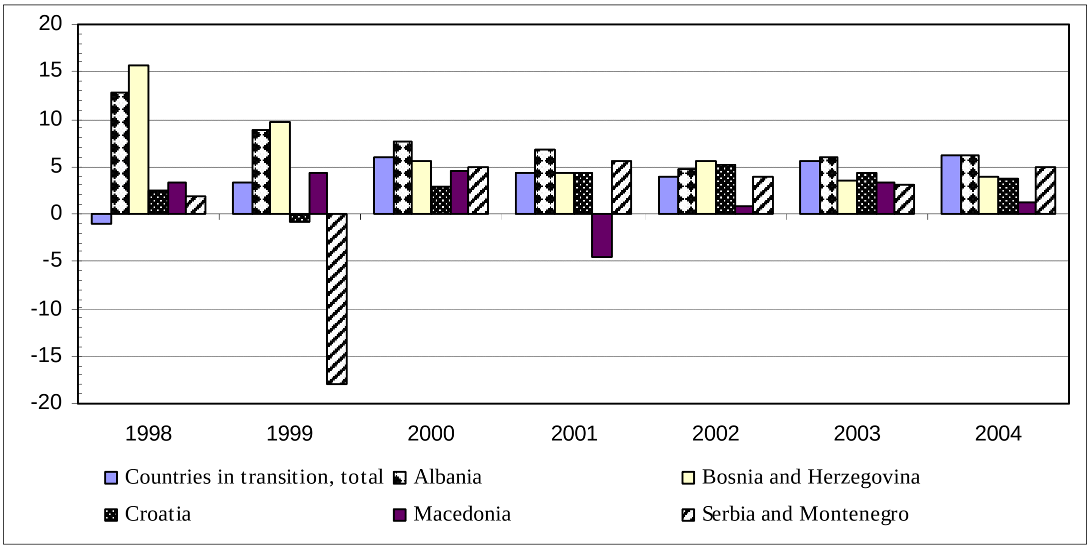
Table 3
Selected economic indicators for the countries in transition

	GDP (real growth rate in %)			Inflation (growth in %)			Current Account of the Balance of Payments (in % of GDP)			Foreign direct investments (in millions of US dollars)		
	2002	2003	2004	2002	2003	2004	2002	2003	2004	2002	2003	2004
Countries in transition	**4.0**	**5.6**	**6.1**	**8.3**	**6.6**	**6.9**	**-4.2**	**-4.8**	**-5.1**	**30,345**	**19,004**	**30,094**
Central and Eastern Europe	*2.4*	*3.8*	*4.9*	*3.1*	*2.9*	*4.5*	*-5.5*	*-5.8*	*-5.8*	*21,764*	*8,707*	*14,708*
Southeastern Europe	*4.7*	*4.4*	*5.0*	*9.9*	*5.7*	*5.9*	*-8.8*	*-8.8*	*-8.5*	*3,552*	*6,613*	*6,747*
Albania	4.7	6.0	6.2	5.2	2.4	3.4	-9.0	-7.6	-7.3	135	178	377
Bosnia and Herzegovina*	5.5	3.5	4.0	0.3	0.2	0.9	-18.4	-17.4	-14.8	230	320	420
Bulgaria	4.8	4.3	5.5	5.9	2.3	6.0	-4.4	-8.4	-8.0	876	1,398	2,000
Macedonia**	0.9	2.8	2.9	1.8	1.2	-0.4	-9.5	-3.3	-7.7	77	94	150
Romania	4.9	4.9	5.8	22.5	15.4	11.9	-3.4	-5.8	-5.6	1,080	1,528	2,100
Serbia and Montenegro	4.0	3.0	5.0	21.4	11.3	8.5	-8.8	-10.2	-11.3	562	1,395	600
Croatia	5.2	4.3	3.7	2.2	1.8	2.5	-8.4	-6.1	-5.8	591	1,700	1,100
Commonwealth of Independent states	*5.2*	*7.6*	*7.4*	*11.0*	*9.5*	*8.9*	*-0.7*	*-1.8*	*-2.8*	*5,030*	*3,684*	*8,639*

Source: EBRD Transition Report 2004.
* The date on the inflation is taken from the IMF World Economic Outlook, September 2004.
** Source of the data for the Republic of Macedonia are the relevant official institutions.

The average growth of the GDP of the countries of SEE in 2004 is 5%. Among the countries from the Western Balkans, the highest growth rate is registered in Albania, generated from the increase in the private investments, strengthening of the export and the expansion of services, construction and transport.

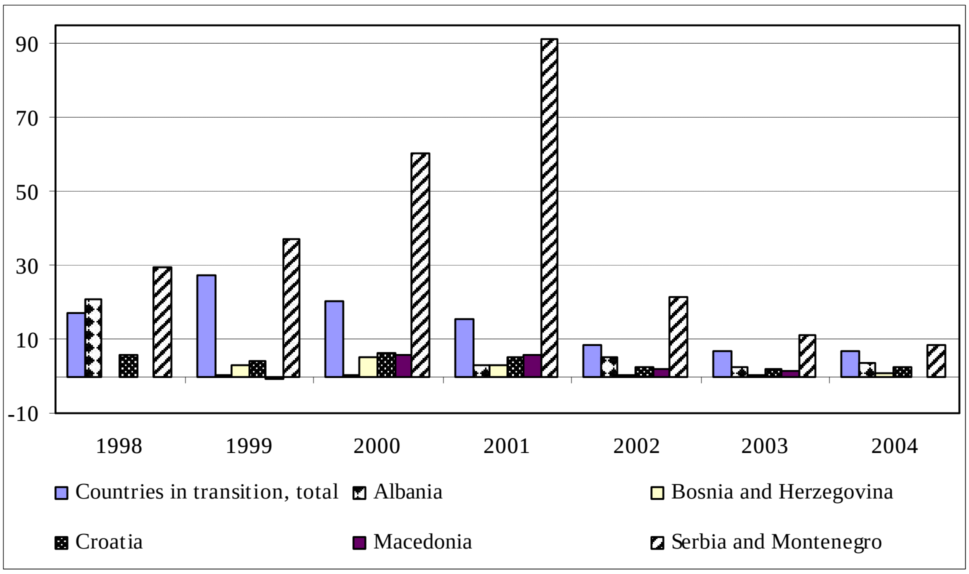
Figure 1
Gross domestic product
(annual growth rates, in %)



[2] Pertains to the countries of Central Eastern Europe and the Baltic States (CEB) - including the countries which have become members of the EU, Southeastern Europe (SEE) and the Commonwealth of Independent States (CIS).

The inflation rates in the countries of the Western Balkans, in 2004, were below the total average of the countries in transition, as well as below the average of SEE, except for Serbia and Montenegro. The inflation in this country is still larger than the inflation in the other countries in the group. Still, having in mind that in 2004 this country succeeded in achieving a single-digit rate of inflation after a longer period of time, the rate of 8.5% in 2004 simultaneously represents a significant progress.

Figure 2
Inflation
(average rate, in %)



In 2004, foreign direct investments (FDI) in the economies in transition return to the level from 2002, where one may notice partial reallocation of foreign capital from the countries of CEB to the countries of SEE, which is attributed to the lower taxes and unit labor costs in the countries of SEE. In addition, a significant part of the FDI in the countries of SEE is generated from the inflows from the privatization of the large enterprises. Among the countries from the Western Balkans, Croatia is the most attractive country for the foreign investors, with highest inflows of FDI in 2004.

The realization of reforms in the countries in transition in 2004 registers a significant progress. Most of the reforms are related to the financial sector, infrastructure and privatization of large enterprises. Such a condition shows exit from the initial and shift to the second, so-called advanced stage of reforms.[3]

The CEB countries are characterized by intensive reforms in the period prior to the formal accession to the EU (May 2004). Despite the fact that in 2004 these countries registered progress in the area of regulating the capital markets, lending to the private sector and strengthening of prudential supervision, still there is significant room for improvement of the institutional reforms.

[3] The initial stage of reforms encompasses liberalization, stabilization and privatization of small enterprises. The second, advanced stage of reforms pertains to improvement of the competitiveness, restructuring of enterprises, development of financial institutions and infrastructural reforms.

Table 4
Transition indicators for 2004*

	Enterprises			Markets and trade			Financial institutions		Infrastructure
	Large-scale privatisation	Small-scale privatisation	Governance & enterprise restructuring	Price liberalisation	Trade & foreign exchange system	Competition policy	Banking reform & interest rate liberalisation	Securities markets & non-banking financial institutions	Infrastructure reform [1]
Albania	2+	4	2	4+	4+	2	3-	2-	2
Bosnia and Herzegovina	2+	3	2	4	4-	1	3-	2-	2+
Macedonia	3+	4	2+	4	4+	2	3-	2	2
Serbia and	2+	3+	2	4	3+	1	2+	2	2
Croatia	3+	4+	3	4	4+	2+	4	3-	3

Source: EBRD Transition Report 2004.

* Transition indicators vary from 1 to 4+, where 1 represents minor change or no change in the position from a rigid centrally planned economy, while 4+ represents meeting of standards of an industrialized market economy.

1/ Infrastructural reforms pertain to the following areas: electricity, railroad traffic, roads, telecommunications, water and waste waters.

The transition process in SEE continued to grow stronger, so that the countries from this region increasingly approach the CEB countries. The aspirations for EU membership, which previously had a positive influence on the transition process in the CEB region, have an increasingly stimulating effect on the progress of the reforms in the SEE countries, primarily in the candidate-countries for accession to the EU (Bulgaria, Croatia and Romania). The efforts for meeting the EU standards resulted in strengthening the rule of law in some of these countries, as well as in activities for reducing corruption, by passing various anti-corruption programs and laws.

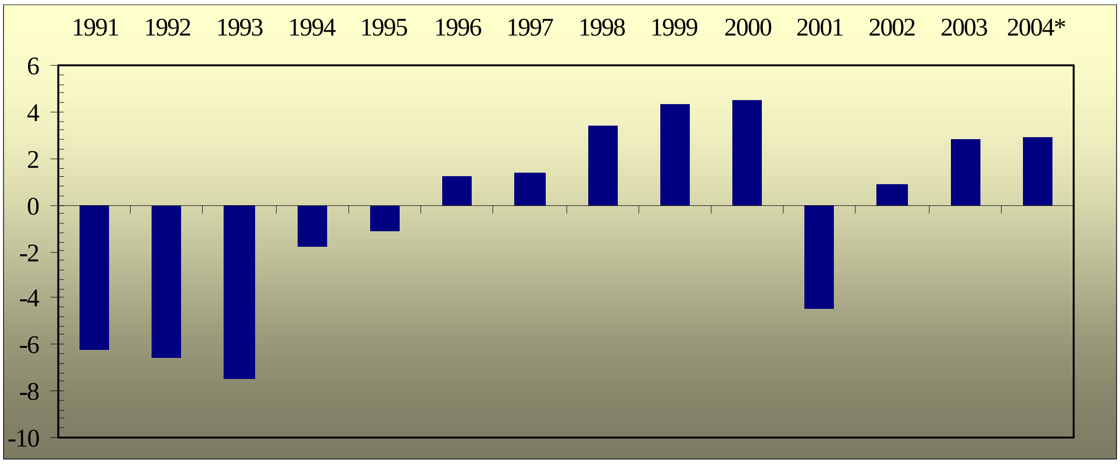
The reform process in the CIS countries does not register a significant progress, primarily due to the turbulent year of political transition. Yet, certain improvement is registered in the public sector and in the implementation of the infrastructural reforms.

II. Economic developments in the Republic of Macedonia

2.1. Gross domestic product[4]

Preserving the price stability and the lower average price of the banks' credits relative to the previous year, created favorable environment for growth of the economic activity in 2004. Thus, the real growth rate of GDP in 2004 equals 2.9%[5], which, however, is an insignificant change (2.8%[6] in 2003) relative to the previous year.

Figure 3
Gross domestic product of the Republic of Macedonia
(real growth rates, in %)



*Estimation

Such economic performances, to a large extent are due to the reduced activity in industry, which has the largest single share in GDP of 23.3%. The inactivity of one of the larger metallurgic plants and of a significant number of mines contributed to the decline in the industrial output. Having in mind the high level of concentration of the domestic output, the weaker performances of several large plants inevitably reflected on the production activity of the industry in 2004. Value added in all other activities registered an increase, with a faster increase being registered in the trade and construction, which represent important leading indicators of the overall economic activity and at the same time significantly contribute to the GDP. Such developments in the other activities offset the effect from the reduction in the value added in industry.

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[4] Source: State Statistical Office of the Republic of Macedonia. Quarterly calculations of GDP are expressed at constant prices, in denars from 1997. The structure is in line with the National Classification of Activities (NCA).
[5] Estimated data of the State Statistical Office.
[6] Preliminary revised data of the State Statistical Office.

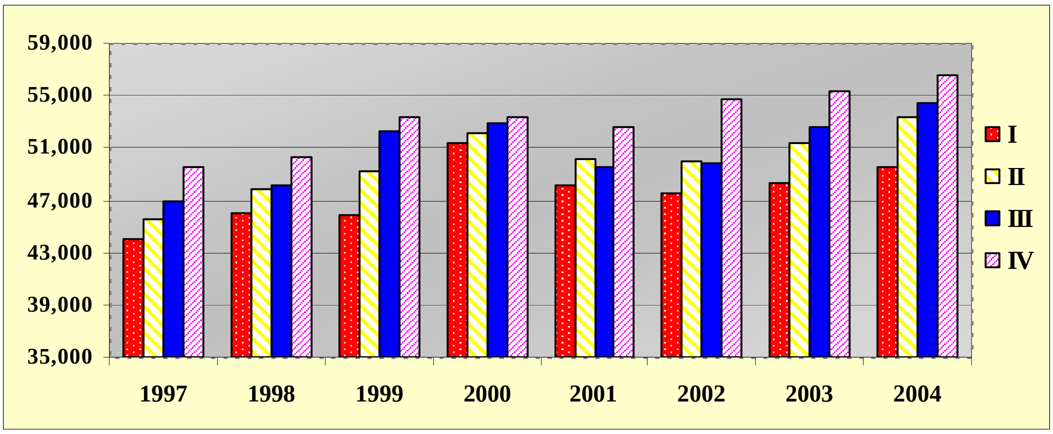
Table 5
Gross domestic product - production side

	2004				2004/2003	2003	2004
	Q1 2004 / Q1 2003	Q2 2004 / Q2 2003	Q3 2004 / Q3 2003	Q4 2004 / Q4 2003	(growth rates, in %)	(share, in %)	
	(growth rates, in %)						
Gross domestic product	***2.4***	***3.7***	***3.4***	***2.1***	***2.9***		
Agriculture	3.7	4.9	4.6	4.4	4.4	9.5	9.6
Agriculture, hunting and forestry							
Fishing							
Industry	-0.6	-0.7	-0.1	-6.3	-2.1	24.5	23.3
Mining and quarrying							
Manufacturing							
Electricity, gas and water supply							
Construction	4.0	11.4	7.9	10.0	8.7	5.7	6.0
Wholesale and retail trade, repair of vehicles, motorcycles and items for personal use and for households	5.1	6.7	8.2	9.2	7.4	11.6	12.1
Hotels and restaurants	5.4	8.7	1.8	4.4	4.9	2.0	2.0
Transport, storage and communication	2.0	5.0	5.3	8.1	5.2	8.0	8.1
Financial intermediation; Real estate, renting and business activities	2.2	3.0	2.6	2.0	2.5	12.4	12.4
Public administration and defence, Compulsory social security; Education, Health and Social work and Extraterritorial organizations and bodies	2.4	2.1	1.1	1.6	1.8	14.6	14.4

Source: State Statistical Office

From the viewpoint of the year-on-year quarterly dynamics, positive rates of real growth were registered in all quarters. The economic growth was faster in the second and in the third quarters (real growth of 3.7% and 3.4%, respectively), while in the first and in the last quarters more moderate growth rates of 2.4% and 2.1%, respectively, were registered. With regard to individual activities, value added in all activities, excluding industry, registered continuous quarterly growth. Larger positive quarterly changes were registered in construction (fastest growth in the second quarter of 11.4%), which represents a positive signal, having in mind the multiplication effect of this activity on the other segments of the economy. At the same time, high rates of quarterly growth in 2004, were also registered in trade (highest growth in the last quarter of 9.2%). On the other hand, industry, which is the dominant component of GDP, during the year, registered negative year-on-year quarterly growth rates, which were most intensive in the last quarter (6.3%).

Figure 4
Quarterly distribution of the gross domestic product*
(in millions of denars, at constant prices in denars from 1997)



The analysis of the expenditure aggregates of GDP[7] in 2004 points to a nominal growth of all components. Regarding the more dynamic growth of the import of goods and services, the net export has a negative contribution, i.e. it acts toward reduction of the aggregate value of the GDP. On the other hand, investments in machines and equipment and the public consumption registered a nominal increase of 4.9% and 1.8%, respectively.

2.2. Prices[8]

In 2004, in the Macedonian economy prevailed an environment of stable inflationary expectations and dominant influence of the factors, which determined low inflation rate. Hence, the price stability, as a key element of the overall macroeconomic stability and main monetary objective, was maintained also during 2004. Here, NBRM acted toward preserving the price stability, through further maintaining of a stable nominal exchange rate of the denar relative to the euro, as an important factor for changes in the inflation.

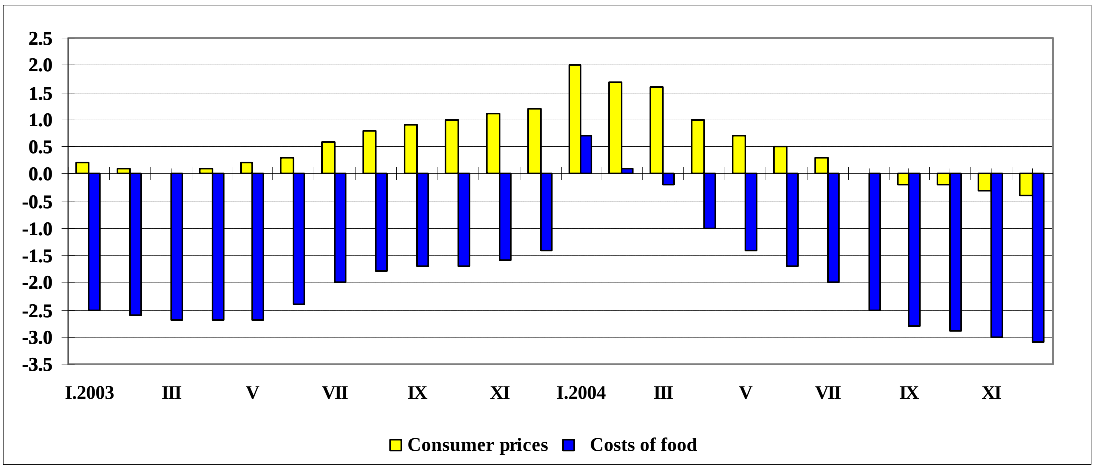
The changes in the consumer prices (measure of the inflation rate) in 2004, were primarily under the influence of factors on the supply side, i.e. of non-monetary factors. The following factors are the main determinants of the changes in the prices in 2004:

1. The extremely high growth in the price of the crude oil on the world markets, caused by the high demand for oil, with a simultaneously reduced supply of oil due to the problems in Iraq. The increase in the price of oil is an external shock for the Macedonian economy, which adequately reflected on the domestic prices of oil and hence on the costs of certain goods and services for final consumption;
2. The changes in the VAT structure in April 2003 (reduction in the VAT rate from 19% to 18% and transfer of a part of the products and services which were until then taxed at a rate of 5% to the group of products and services which are taxed at a rate of 18%), which meant lower comparison basis in the first three months of 2003;
3. The influence of the first two factors (which acted toward an increase in the consumer prices), was completely offset by the decline in the costs of food (as the dominant component of the consumer price index). This is mainly generated from the reduction of the average customs encumbrance for imported products (reduction from 12.16% in 2003 to 11.09% in 2004), in accordance with the membership of the Republic of

[7] In the announcements released by the State Statistical Office on the quarterly changes of GDP, on the expenditure side only public consumption, investments in machines and equipment, import and export of goods and services (all at current prices) are calculated. The State Statistical Office works on the development of a methodology for calculation also of the personal consumption, investments in construction buildings and changes in stocks.
[8] Source: State Statistical Office.

Macedonia in the World Trade Organization (WTO) and the provisions of the Stabilization and Association Agreement with the EU (SAA). These changes had a double effect: direct effect through the reduction of the final prices of imported products and indirect effect through the reduction of the prices of domestic producers, under the pressure of the competition in the import.

Figure 5
Average change in the total consumer prices and costs of food
(in %)

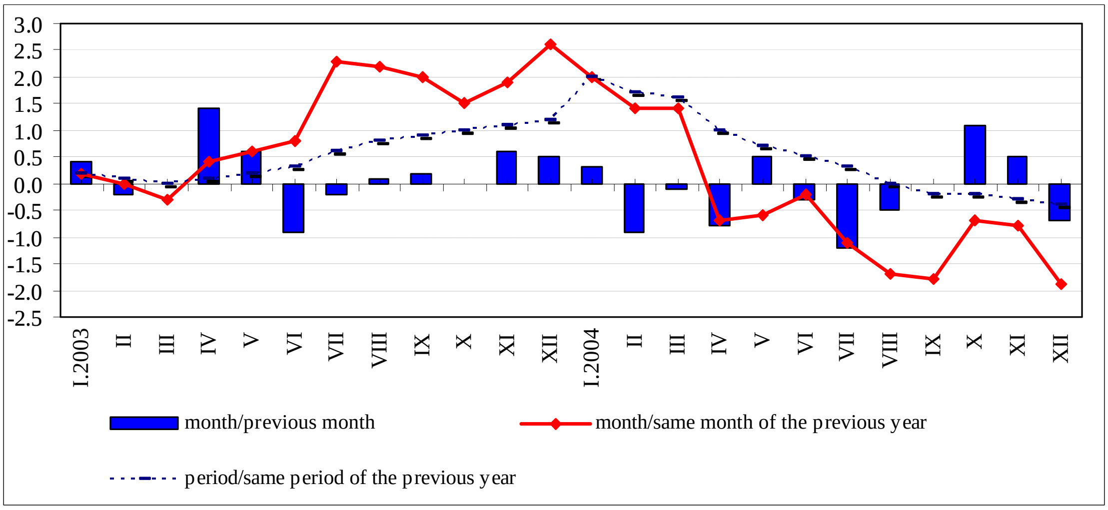


The significant average decline in the costs of food (of 3.1%) resulted in a negative average change in the consumer prices in 2004 of 0.4%[9]. On the other hand, all other categories of costs register an increase, on average. Thus, the increase in the costs of housing of 2.2%, is mainly a reflection of the higher costs of electricity, gas and other fuels for households (by 3.1%). Simultaneously, an increase of 4% was registered in the costs of transport equipment and services, primarily as a result of the increase in the prices of fuels and lubricants for personal transport equipment (of 6.2%). Compared on annual level (December 2004 / December 2003), consumer prices registered a negative change of 1.9%.

From the viewpoint of the dynamics, by June 2004, changes in the consumer prices moved in the zone of moderate inflation, in August they were unchanged, while the negative average changes in the consumer prices started in September 2004.

[9] In 2004, the core inflation rate, which excludes the influence of food and energy, is positive and equals 1.19%, on average. The calculation of the core inflation rate is made in the NBRM's Research Department, according to own methodology.

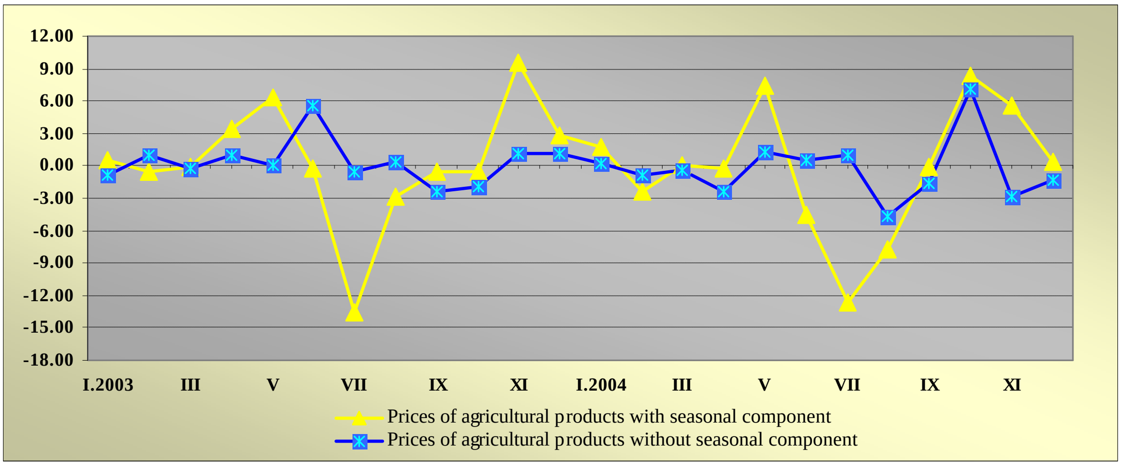
Figure 6
Consumer prices
(changes in %)



The analysis of the monthly dynamics of the consumer prices shows common seasonal fluctuations, caused primarily by the seasonal changes in the agricultural products, and it simultaneously reflects the changes in the prices of oil derivatives. The highest monthly inflation rate is registered in October (1.1%), which is due to the higher costs of food (by 2%), given the increased costs of fruit and vegetables, as well as the higher costs of transport equipment and services (by 1.5%), while the highest negative monthly change in the consumer prices (of 1.2%) was registered in July (under the influence of the seasonal decline in the prices of agricultural products).

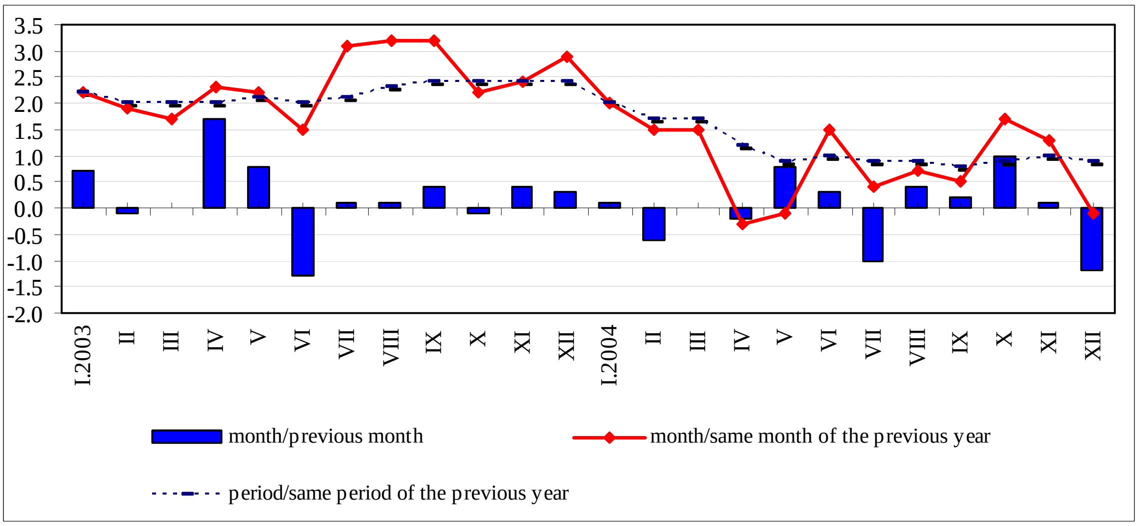
From a viewpoint of the structure, the average drop in the consumer prices is caused by the decline in the costs of goods (of 1.1%). Such movements correspond with the reduced costs of food, as a category with the largest share in the total consumer price index. This offset the increase in the costs of services (of 3.3%), which is a result of the increase in the costs of telephone services (5.9%), the increase in the services in passenger transport by road (5.7%), as well as the increase in the costs of the services of heating for households (2.1%).

Figure 7
Prices of agricultural products with and without seasonal component
(monthly changes in %)



In 2004, *retail prices* registered an annual increase of 0.9%, primarily caused by the increase in the retail prices of non-food industrial products of 2.1%, which did not react to the reduced customs duties. The average customs duty on the import of industrial products reduced from 9.26% in 2003 to 8.49% in 2004. From a viewpoint of the structure, the prices of services registered an average increase of 2.5%, given the unchanged prices of goods. On annual basis (December 2004 / December 2003), retail prices are almost unchanged (a decline of 0.1%).

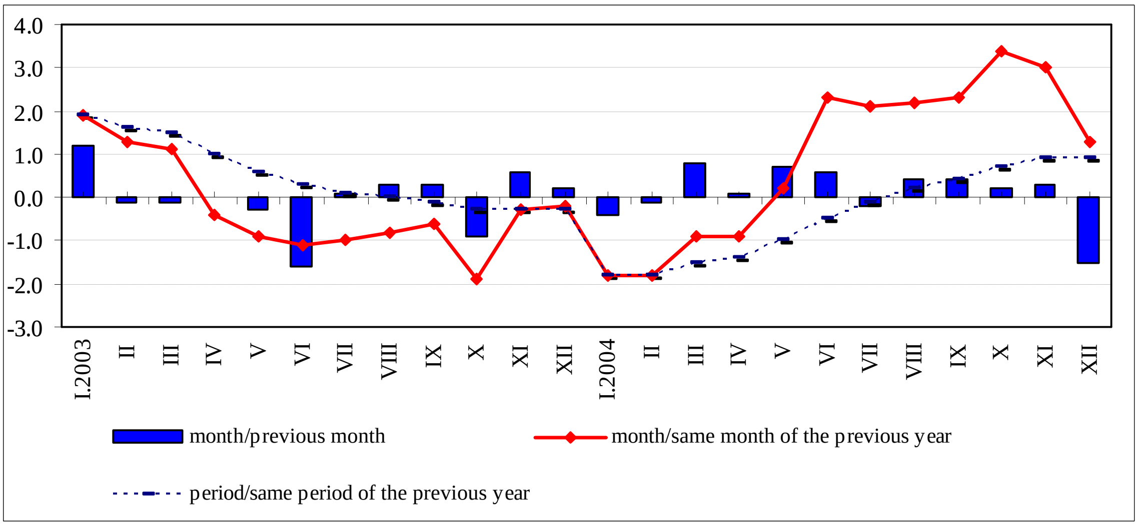
Figure 8
Retail prices
(change in %)



The value of the *consumers' basket for food and beverages*[10], in 2004, amounted to Denar 9,953, on average, which relative to the previous year, is a decline of 2.7%. Lower average value is registered in all categories of products, except milk and dairy products (increase of 0.3%). The lower average value of the consumers' basket is mainly as result of the lower costs of food, as well as the reduction in the prices of agricultural products. Thus, the average value of the most important categories, "wheat and cereals" and "fresh and processed meat" (whose structural share equals 42.3%) reduced by 5.3% and by 1.9%, respectively. On annual basis (December 2004 / December 2003), the value of the consumers' basket was lower by 5.1%, with registered lower value in all categories of products.

[10] All products of the category "food and beverages" that compose the basket are considered to be average monthly needs of a four-member non-agricultural household. The structure of the products is constant (same products – same quantities) within a year.

Figure 9
Prices of the producers of industrial products
(change in %)



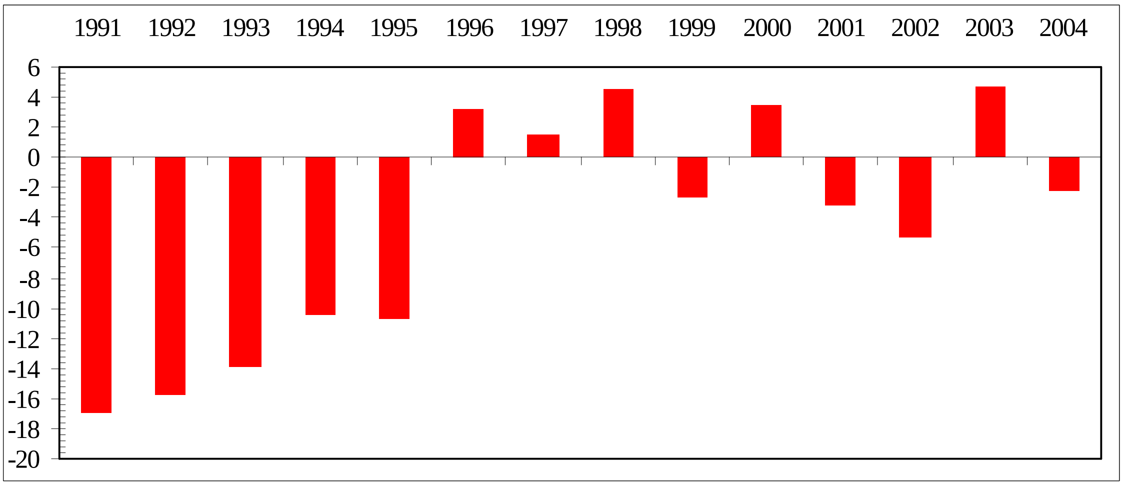
In 2004, *the prices of the producers of industrial products* registered an average increase of 0.9%, primarily as a result of the increase in the prices of the producers of energy (of 1.3%) and intermediary products, except energy (of 4.6%). An increase in the production prices was registered in 6 out of 22 industrial branches, while in 10 of the analyzed branches the prices remained unchanged. The increase in the price of crude oil on the world markets reflected in the prices of the domestic producers of industrial products through two channels: directly, on the prices of the producers of oil and oil derivatives, and indirectly, on the prices of other producers, which use oil as an input in their production. Thus, in 2004, the prices of the producers of oil and oil derivatives increased by 3.5%, on average. The increase in the prices of intermediary products, except energy is mainly caused by the increase in the prices of the producers of basic metals of 1.4%, as well as by the increase in the prices of the producers of electrical machinery and apparatus of 18.8%. On the other hand, the prices of the producers of non-durable goods for joint consumption are lower by 3.3%, on average, mainly as a result of the drop in the prices of the producers of food products and beverages (of 3.9%) and the decline in the prices of the producers of textiles (of 1.1%). The movement in the prices of these products may be partially explained by the need of adjustment of the prices of the domestic producers to those of the international competitors, given the lower customs encumbrance. The prices of the producers of capital products were lower by 0.5%, primarily due to the reduction in the prices of the producers of fabricated metal products, except machinery and equipment (of 1.1%). On annual level, the prices of the producers of industrial products are by 1.3% higher.

2.3. Domestic output[11]

The *volume of the industrial output* in 2004 is by 2.2% lower, on average. Despite the fact that in 2004 several industrial plants were not operating, the restarting of one of the major industrial plants (in mid-2004) positively influenced the movement of the industrial output by the end of the year.

[11] Source: State Statistical Office

Figure 10
Industrial output
(average change in %)



From the viewpoint of the more important industrial groups of products (those with more significant share in the total industrial output), a decline was registered in the production of non-durable goods for joint consumption (of 3.4%), mainly as a result of the reduced production of food products and beverages and tobacco products. The production in the category "energy" is lower by 1.8%, on average, reflecting the decline in the production and distribution of electricity, gas, steam and hot water and mining of coal and lignite and extraction of peat. On the other hand, in 2004, the production in the category of intermediary products, except energy is by 0.9% higher, which is primarily a result of the increased volume of production of basic metals (in the context of the aforementioned restarting of one of the industrial plants), as well as of the increase in the production of other non-metal minerals and chemicals and chemical products.

The analysis from a viewpoint of the industrial sectors points to a reduced activity in all three sectors. Thus, the reduction in the production in the category "mining and quarrying" equals 5%, in the processing industry it is 2.1%, while in the sector "electricity, gas and water supply" the decline equals 2.6%. The reduced production in the processing industry, as a dominant industrial branch (79.4% of the industrial output), is mainly a result of the decline in the activity of the producers of food products and beverages and tobacco products, not operating of part of the metal processing plants, as well as the reduced production of electrical machinery and apparatus, and textiles.

On the basis of the results obtained from the Survey on the business tendencies in the manufacturing[12], since December 2004, the main restrictive factor for the intensification of the production activity are the financial problems of the production enterprises. Yet, the influence of this factor relative to December 2003 is significantly smaller. Simultaneously, the situation in the domestic and foreign demand, although improved, still represents a significant restrictive factor in the production. On the other hand, during 2004, factors that increasingly restrict the production are: lack of raw materials and ambiguous laws. The competition from the imports is considered as a less restrictive factor, relative to December 2003, but it is still considered important.

[12] The State Statistical Office started to conduct the Survey on the business tendencies in April 2001 on a monthly basis, in order to obtain prompt data on the current condition and expected movements in the enterprises.

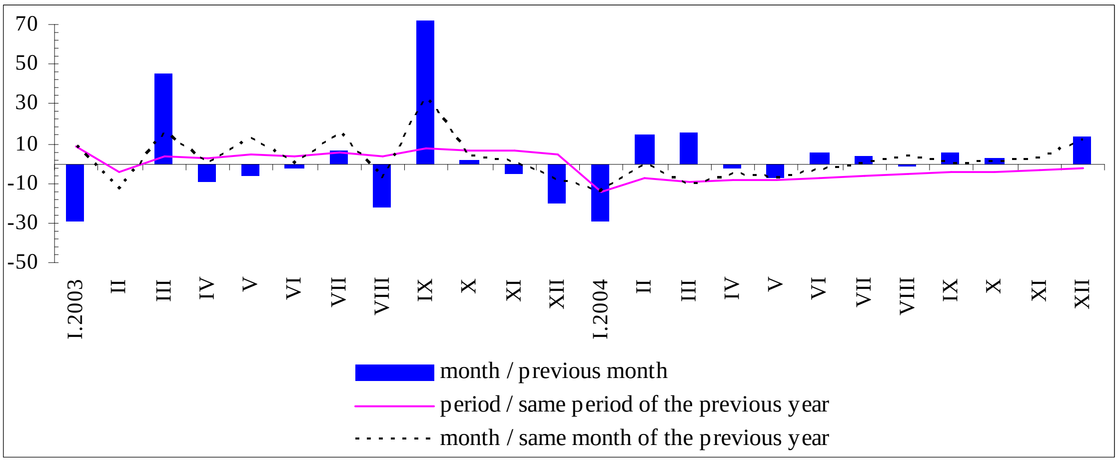
Table 6
Industrial output

	structure in %	XII.2004 / XII.2003	I-XII.2004 / I-XII.2003
		in %	
Total	**100.0**	**11.3**	**-2.2**
Energy	***21.8***	-0.5	-1.8
Intermediate products, except energy	***33.8***	32.0	0.9
Capital goods	***4.8***	-36.3	-20.1
Durable consumer goods	***1.4***	2,4 times	9.1
Non-durable consumer goods	***38.1***	7.9	-3.4
Mining and quarrying	***1.8***	***-3.1***	***-5.0***
Manufacturing	***79.4***	***13.7***	***-2.1***
Manufacture of food products and beverages	20.0	9.2	-3.9
Manufacture of tobacco products	3.9	-21.3	-17.7
Manufacture of textiles	2.5	-0.4	-11.4
Manufacture of wearing apparel; dressing and dyeing of fur	8.6	16.1	1.2
Publishing, printing and reproduction of recorded media	3.9	7.5	3.8
Manufacture of coke, refined petroleum products and nuclear fuel	3.0	-18.7	3.0
Manufacture of chemicals and chemical products	5.9	30.0	0.2
Manufacture of rubber and plastic products	2.6	-5.6	-0.7
Manufacture of other non-metalic mineral products	8.1	14.7	3.0
Manufacture of basic metals	6.0	95.6	14.0
Manufacture of fabricated metal products, except machinery and equipment	3.8	-10.3	-25.7
Manuafacture of electrical machinery and apparatus	3.2	79.2	-17.3
Electricity, gas and water supply	***18.8***	***3.3***	***-2.6***

Source: State Statistical Office

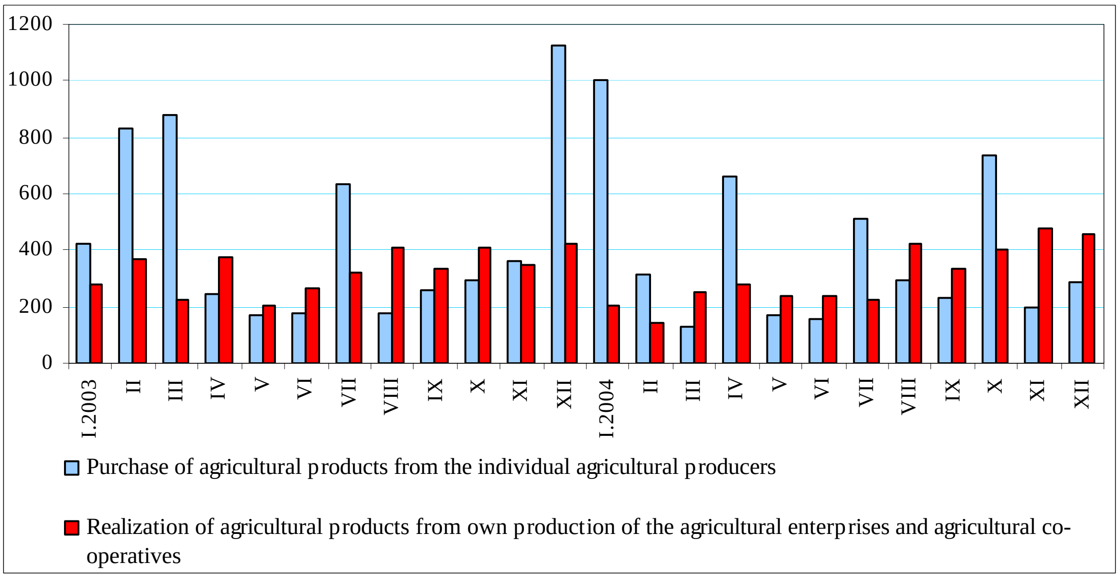
Analyzed from the viewpoint of the monthly dynamics, faster monthly decline in the industrial output was registered in January (29.2%) and in May (6.9%). The decline in the production in January has a seasonal character (smaller number of working days). Reduced production in May corresponds with the common monthly dynamics of the industrial output, which, in May, came as a result of the reduced production of energy (by 32.1%), i.e. the considerable decline in the production of oil derivatives. On the other hand, more significant monthly rates of growth of the industrial output were registered in February (increase of 14.4%, due to the commonly low comparison basis from the previous month), in March (increase of 15.1%, in line with the high growth of the production activity in all industrial sectors), and in December (increase of 13%, having an increased production in almost all more important industrial branches).

Figure 11
Dynamics of the industrial output
(change in %)



In 2004, the total *agricultural production* of the Republic of Macedonia registered an annual increase of 4.8%[13]. The fastest increase was registered in “fruit growing”, primarily as a result of the favorable weather conditions for growing of these fruits, and the low comparison basis from the previous year. Fruit growing registered an annual increase of 70%, with a simultaneous increase in the production in farming and viticulture (of 13.3% and 1.9%, respectively). On the other hand, the annual production in cattle breeding plunged by 1.9%.

Figure 12
Sale of agricultural products
(in millions of denars)



The total value of the sold agricultural products from agricultural enterprises’ and co-operatives’ own production amounted to Denar 3,672 million, in 2004, which is an annual decline of 1%. Faster fall in the sale was registered in the categories “fruit and grapes”, “livestock” and “poultry and eggs” (of 6.5%, 41.3% and 9.6%, respectively). Increase in the sale was registered in grains, industrial plants, garden plants and alcoholic beverages.

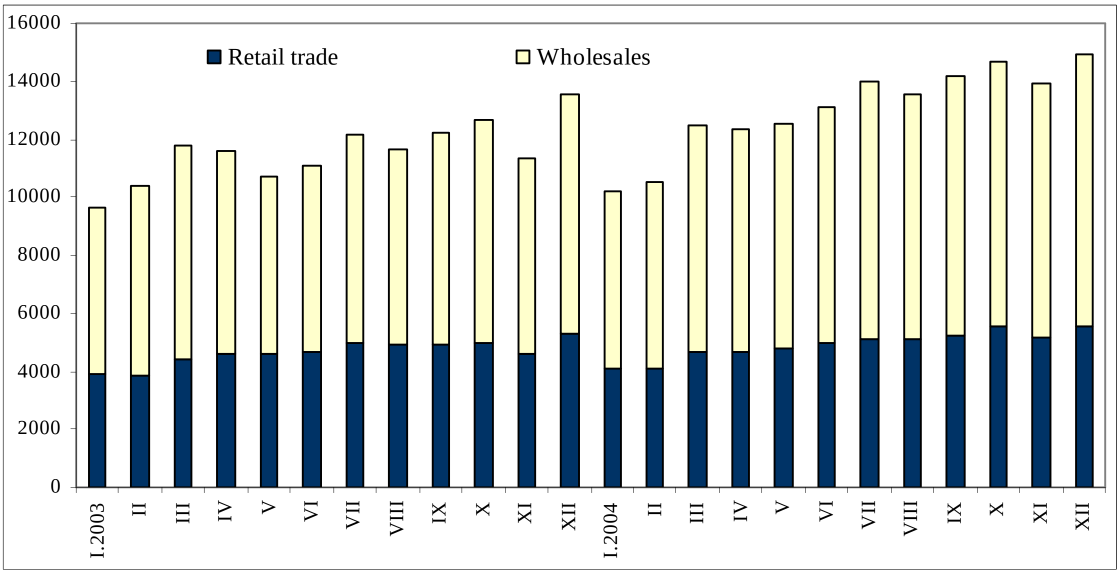
[13] Estimated data of the State Statistical Office.

The total value of agricultural products purchased from the individual agricultural producers in 2004 was by 16.1% lower relative to the previous year, and amounted to Denar 4,688 million, reflecting the decline in the purchase with the most significant categories of products in the group of the agricultural products. In 2004, significant decline in the purchase was registered in the industrial plants, fruit and grapes, as well as milk and dairy products (of 15.5%, 43% and 7.1%, respectively), whose share in the structure of the total purchase of agricultural products is 80.2%.

2.4. Turnover in trade and construction[14]

In 2004, the total trade turnover amounted to Denar 156,420 million, which is an annual increase of 12.7%. The high growth rate of the total trade turnover is a result of the accomplished increase in the turnover in all four quarters of the year and corresponds with the growth in the average net paid wage, as well as with the higher amount of credits to households and to the corporate sector. Thus, in the first quarter, moderate increase in the value of the total turnover was registered (of 4.3%, relative to the same period of the previous year), while in the other quarters the growth dynamics was faster (15.3%, 15.8% and 15.8%, respectively). Analyzed by months, the highest growth rate was realized in March (19%), while the highest value of the trade was registered in December (Denar 14,947 million) with the accomplished monthly growth rate being 13.9%.

Figure 13
Total trade turnover
(in millions of denars)



The turnover in the *retail trade* amounted to Denar 58,967 million, in 2004, i.e. growth rate of 5.9% was achieved, with a simultaneous increase in *wholesales* of 17.3% (which in 2003 amounted to Denar 97,453 million). The highest growth rate in retail trade was registered in the fourth quarter (9.6%), while the growth rate in the wholesales was highest in the third quarter and equaled 23.6%.

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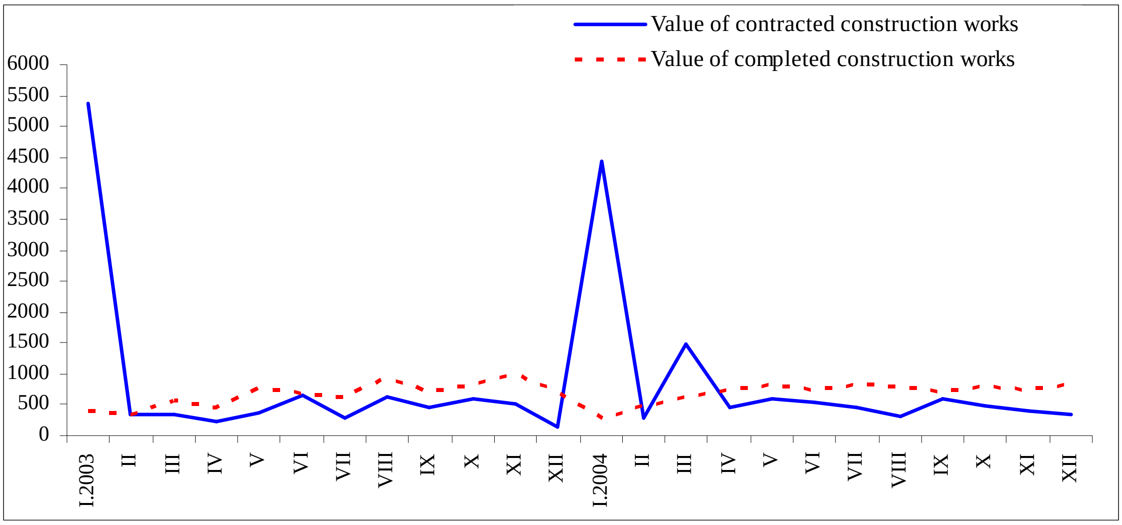
[14] Source: State Statistical Office

Figure 14
Value of contracted and completed construction works
(in millions of Denars)



In 2004, *construction activity* is characterized by an increased intensity, with simultaneous increase in the value of both the contracted and the completed construction works. During 2004, several contracts for conducting construction works abroad (Ukraina, Russia, Croatia) were signed, which results in a higher value of the contracted construction works (by 4.8%). Thus, the total value of the contracted construction works in 2004, reached Denar 10,377 million, while the total value of the completed construction works were by 4.3% (Denar 8,359 million) higher on annual level. From a viewpoint of the quarterly dynamics, the most intensive construction activity is registered in the second quarter. Thus, the total value of contracted and completed construction works in the second quarter, relative to the same period of the previous year was higher by 27.4% and 19.5%, respectively. Moderate intensity was registered in the first and in the third quarter, while in the last three months of the year a decline in the construction activity (of 1.9% in the contracted and 6.8% in the completed construction works) was registered.

2.5. Labor market[15]

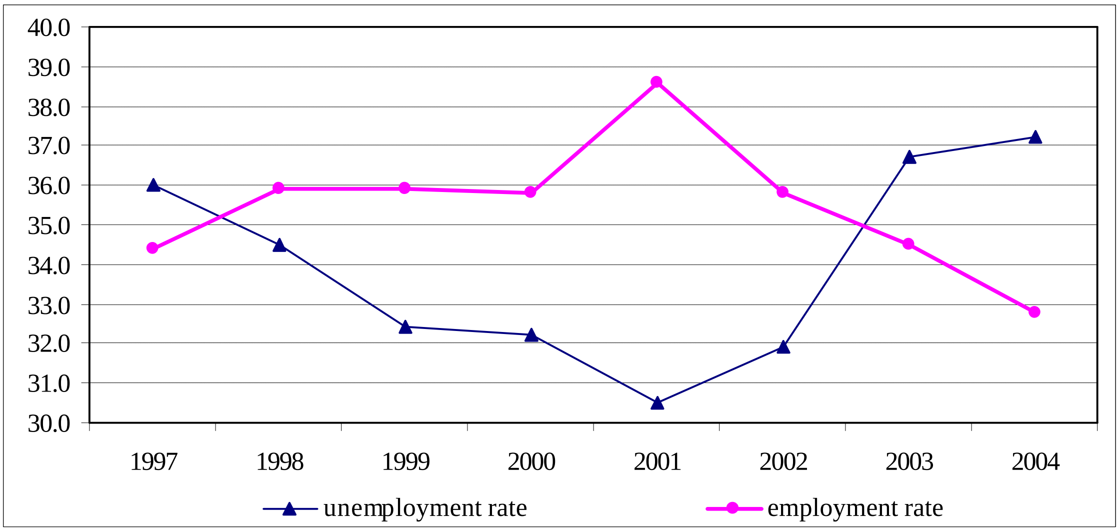
The trend of continuous growth of the rate of unemployment, which started in 2001, continued in 2004 with more moderate intensity. Thus, the rate of unemployment for 2004 equaled 37.2%[16], which represents an increase of 0.5 percentage points, relative to 2003. The total number of unemployed persons in 2004 equaled 309,286. The total active population (total labor force) in 2004 amounted to 832,281 persons (annual decline of 3.3%), with the total number of employed persons (share of employed persons in the total population aged 15 and

[15] According to the data of the Labor Force Survey for 2004. The survey was conducted by the State Statistical Office of the Republic of Macedonia on the basis of a sample of 10,000 households on the whole territory of the country and it is in accordance with the methodological recommendations of the International Labor Organization (ILO) and the recommendations of the European Statistical Bureau (EUROSTAT). Starting from 2004, it is being conducted as a continuous survey throughout the year, while data are processed quarterly.

[16] In line with the ILO standards, the persons who fulfill the following three conditions are considered *unemployed*: had no job during the reported week (according to set criteria); were actively seeking for a job, i.e. undertook concrete activities to find one; were ready to accept a job in the reported week or in the following week. The rate of unemployment is the share of the number of unemployed persons in the total labor force.

over) registering an annual drop of 4.1%, thus equaling 522,995 persons[17]. The high structural unemployment is partially due to the intensified structural reforms in the economy. At the same time, it points to the need of undertaking complex measures in the area of incurring domestic investments and attracting foreign capital, which will create a capacity for absorption of part of the unemployed persons, intensification of the reform processes and restructuring in the corporate sector, as well increase in the flexibility of the labor market.

Figure 15
Rates of employment and unemployment
(in %)



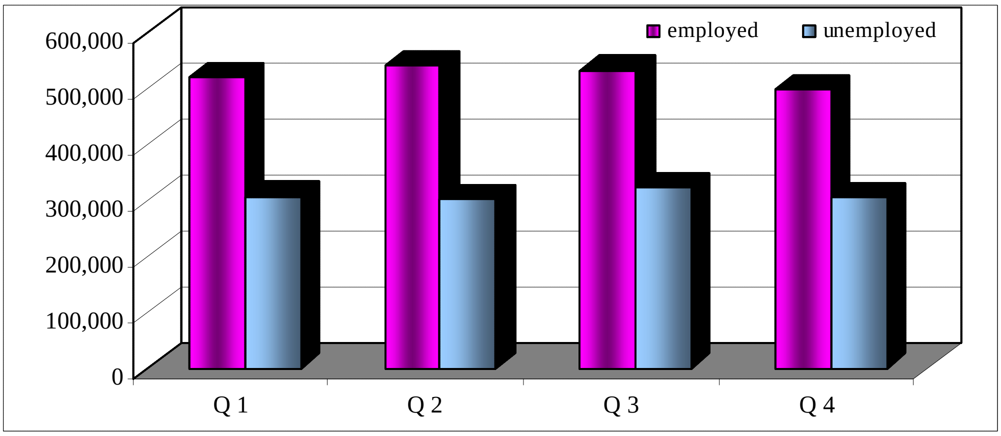
Source: State Statistical Office

From the viewpoint of the gender structure, 320,640 persons or 61.3% of the total number of employed persons are males, i.e. the employment rate with the male population is 40.2%. On the other hand, the number of employed female persons in 2004 equaled 202,355, which resulted in a lower employment rate with the female population (25.4%). The rates of unemployment with the male and the female population were 36.7% and 37.8%, respectively.

With respect to the age, highest employment rates are registered with the population aged between 35 and 39 (51.2%), between 40 and 44 (56%) and between 45 and 49 (55.6%), while the young population still registers the highest rates of unemployment. Thus, the rates of unemployment with the population aged between 15 and 19, between 20 and 24 and between 25 and 29, equals 72.8%, 62.5% and 49.4%, respectively.

[17] Given the reduced number of employed persons and the simultaneous increase in the GDP, in 2004, labor productivity (GDP/number of employed persons) increased by 9.7% (increase of 6.2% in the preceding year). Contemporaneously, in line with the increased total salaries, unit labor costs (total salaries / number of employed persons) increased by 1.5% in 2004 (in the previous year they registered an increase of 5.8%).

Figure 16
Number of employed and unemployed persons in 2004



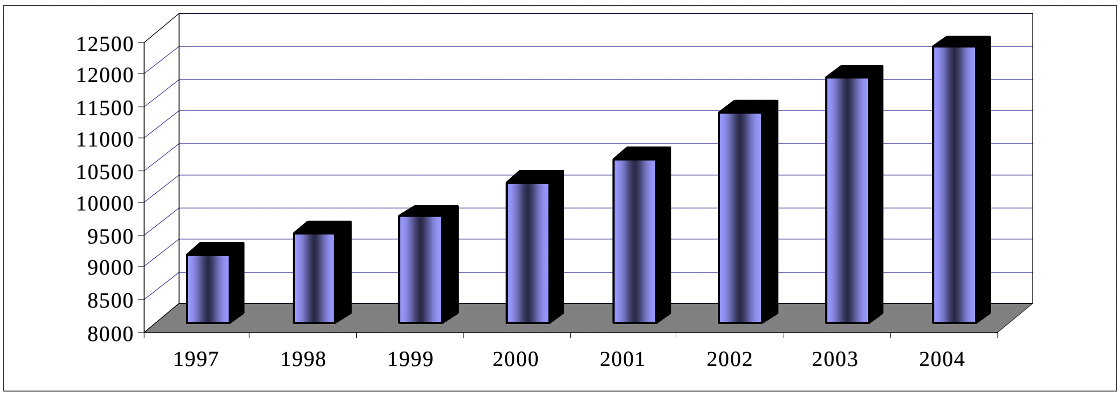
Source: State Statistical Office

Analyzed by quarters, the number of unemployed persons and the rate of unemployment were the lowest in the second quarter, when a total number of 301,508 persons was registered, while the rate of unemployment equaled 35.8%. During 2004, the highest unemployment was registered in the last three months of the year (rate of unemployment of 38%), with the number of unemployed persons equaling 306,131.

2.6. Wages

The trend of continuous annual increase in the wages, which started in 1996, continued also in 2004. The increase in the nominal wage is mainly due to the increasingly larger share of the wages paid in the private sector in the total wage structure. The Law on Wages, which restricts the increase of wages in government institutions and in all legal entities the degree of privatization of which is below 51%, was applied also in 2004, but its effect is gradually reducing (as a result of the increase in the degree of privatization of the legal entities). Wages in the private sector are set in line with the market movements and the business policy of enterprises. As for the wage policy, 2004 is characterized with the one-time decompression of the wages of civil servants, in order to increase the efficiency and improve the quality of operations of the public administration.

Figure 17
Nominal average net paid wage per worker
(in denars)



In 2004, the nominal average net paid wage per worker in the Republic of Macedonia amounted to Denar 12,293, thus registering a nominal annual increase of 4%. Analyzed by structure, a nominal increase was registered in the wages in all branches, except for the category “agriculture, hunting and forestry”, and “activities related to real estate, renting and business activities”. The average net paid wage in the processing industry, education and in the category “health and social work” (the total share of which in the total employment equals 54.7%) was higher by 4.6%, 0.5% and 1.5%, respectively. The highest net-wage (Denar 25,209, which is twice higher than the average wage) was paid in the “financial intermediation”, while the lowest average net paid wage per worker amounted to Denar 9,353 and it was paid in the construction.

Table 7
Paid net wage per worker in the Republic of Macedonia

	Amont in denars	Nominal growth 2004/2003	Real growth 2004/2003
	2004	(in %)	
Average monthly wage, total	**12,293**	**4.0**	**4.4**
Selected activities:			
Mining and quarrying	13,826	4.4	4.8
Manufacturing	10,486	4.6	5.0
Transport, storage and communication	15,116	2.9	3.3
Financial intermediation	25,209	7.2	7.6
Public administration and defense, Compulsory social security	13,636	5.6	6.0
Education	11,606	0.5	0.9
Health and social work	12,042	1.5	1.9
Other community, social and personal service activities	12,204	1.5	1.9
December wage, total	12,534	4.8	6.8

*Real rates represent nominal rates corrected by the inflation rate.

In 2004, the average net wage registered faster growth in real rather than in nominal terms (by 0.4 percentage points) which equaled 4.4%, due to the negative average change in the consumer prices in 2004 of 0.4%.

On annual basis (December 2004 / December 2003), the average net paid wage per worker was by 4.8% higher, in nominal terms. The growth in the average net wage per worker in real terms equaled 6.8%, reflecting the reduction in the consumer prices.

2.7. Government budget[18]

The stable environment in 2004 was supported also by the manner of conducting the fiscal policy. Thus, *the consolidated budget in 2004 was balanced*. From the viewpoint of the distribution of public consumption, during the year public revenues were permanently under the projected level, which increased the probability of concentration of budget spending at the end of the year. Under such circumstances, in October, a supplementary budget was adopted and the budget deficit (central government budget) for 2004 was appropriately reduced.

[18] Source of data: Ministry of Finance of the Republic of Macedonia

Table 8
Consolidated government budget
(in millions of denars)

	Q1.2004	Q2.2004	Q3.2004	Q4.2004	Total 2004	
					amount	structural share in %
Total revenues	**21,210**	**21,649**	**21,826**	**23,491**	**88,176**	**100.0**
Tax revenues and contributions	**19,126**	**20,072**	**20,191**	**21,870**	**81,259**	**92.2**
Tax revenues:	*12,707*	*13,139*	*13,152*	*14,189*	*53,188*	*60.3*
- personal income tax	1,738	1,923	1,930	2,116	7,707	8.7
- profit tax	958	506	522	375	2,361	2.7
- VAT	6,103	6,479	6,025	7,150	25,757	29.2
- excises	2,501	2,618	3,161	2,716	10,996	12.5
- customs duties	1,228	1,496	1,397	1,694	5,815	6.6
-other taxes*	178	113	116	143	552	0.6
Contributions	*6,419*	*6,933*	*7,039*	*7,681*	*28,072*	*31.8*
Non-tax revenues:	**1,909**	**1,418**	**1,509**	**1,481**	**6,306**	**7.2**
-profit from public and financial institutions	794	302	356	164	1,616	1.8
- administrative taxes and remunerations	358	375	337	393	1,463	1.7
- revenues from participation	154	142	120	146	562	0.6
- other administrative taxes	64	69	59	65	257	0.3
- other non-tax revenues	200	70	179	287	737	0.8
- compensation for use of a motorway	340	460	446	426	1,672	1.9
Capital revenues	**175**	**158**	**127**	**140**	**600**	**0.7**
Revenues from collected loans	**0**	**0**	**11**	**0**	**11**	**0.0**
Total expenditures	**20,554**	**22,284**	**21,173**	**24,159**	**88,169**	**100.0**
Current expenditures	**19,758**	**20,894**	**19,570**	**21,914**	**82,136**	**93.2**
- wages and salaries	5,237	5,476	5,236	5,492	21,440	24.3
- goods and services	2,177	1,994	1,640	2,390	8,200	9.3
- transfers	11,779	12,828	12,080	13,439	50,125	56.9
- interest	539	596	584	594	2,312	2.6
Capital costs	**796**	**1,390**	**1,603**	**2,244**	**6,033**	**6.8**
Budget balance	***655***	***-635***	***654***	***-667***	***7***	
Financing	**-655**	**635**	**-654**	**667**	**-7**	
Eksternal financing, net	*672*	*-103*	*-553*	*1,305*	*1,318*	
*Financing from domestic sources, net***	*-1,415*	*738*	*-180*	*-927*	*-1,785*	
Revenues from privatization	*88*	*0*	*81*	*290*	*459*	

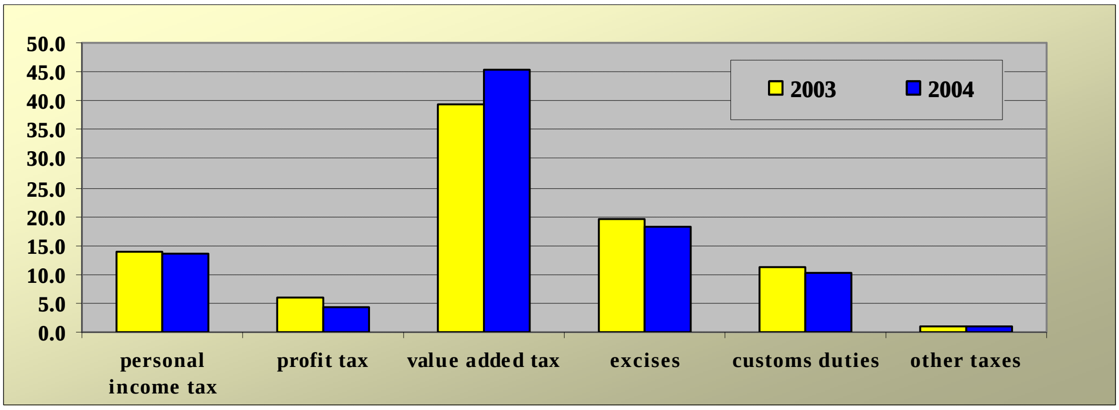
Source: Ministry of Finance of the Republic of Macedonia
* Includes the utility taxes.
** Includes the use of funds from the Government's account with the NBRM.

Despite the projected deficit, the consolidated budget for 2004 registered negligible surplus (Denar 7 million), with the total public revenues and expenditures amounting to Denar 88,176 million and Denar 88,169 million, respectively. The most important component of the public revenues are taxes and contributions (92.2% of the total revenues), which in 2004 amounted to Denar 81,259 million and were by 4.7% higher relative to 2003. Dominant element in the public expenditures are the current expenditures, which registered an increase of 2.7% relative to the previous year, while capital expenditures registered an annual drop of 5%.

The higher level of total budget revenues, relative to the total budget expenditures, resulted in a *surplus in the central government budget of Denar 371 million (0.1% of GDP[19])*. The total revenues of the central government budget in 2004 amounted to Denar 56,982 million (by 0.5% lower than the initial projection) and relative to 2003 they were by 5.8% higher. Within the budget revenues, tax revenues (dominant revenue category) registered an annual increase of 6.8% and amounted to Denar 52,526 million. The main cause for the increased tax revenues were the revenues from the value added tax (which represent 45% of the total revenue structure). Thus, in 2004 the revenues from the collection of the value added tax stood at Denar 25,757 million (they exceeded the projected amount by 7.4%), which represents a significant increase (of 21.6%) relative to 2003, primarily due to the improved collection of the revenues during the year. Higher amount of revenues was realized also from the personal income tax and from the other taxes (by 2.7% and 15%, respectively), while the revenues from the profit tax, excises and customs duties registered a decline (of 27.8%, 2.2% and 5.3%, respectively).

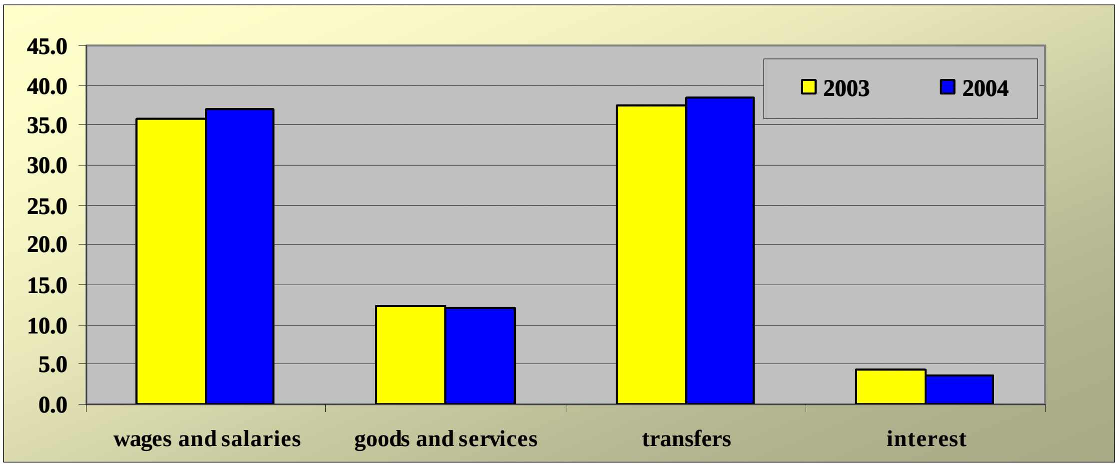
[19] Estimated data for GDP for 2004.

Figure 18
Structural share of the individual tax categories in the total revenues of the central government budget
(in %)



In 2004, non-tax revenues stood at Denar 3,844 million, which is a decline of 4.9% relative to the previous year. The decline in the non-tax revenues is a result of the registered decline in the revenues from profits of public and financial institutions, as well as the revenues from other administrative taxes (of 11.7% and 30.5%, respectively).

Figure 19
Share of the individual categories of current expenditures in the total expenditures of the central government budget
(in %)



The total expenditures of the central government budget were by insignificant 0.3% higher on annual basis and amounted to Denar 56.611 million, which represents 94.8% of the initially planned expenditures. Current expenditures stood at Denar 51,726 million (96.7% of the planned expenditures) and registered an annual increase of 1.5%, mainly reflecting the higher expenditures for payment of wages and transfers (by 3.5%, each). On the other hand, in 2004 the expenditures for payment of interests were significantly lower (by 16%). Contrary to current expenditures, capital expenditures registered an annual drop of 3% and amounted to Denar 4,886 million.

In 2004, funds' total revenues (together with the transfers from the central government budget) stood at Denar 54,624 million, while funds' total expenditures amounted to Denar 55,067 million, which is an increase of 3.5% and 5.3%, respectively, relative to the previous year. The total revenues of social funds (Pension Fund, Health Fund and Employment Fund) were by

4.5% higher and amounted to Denar 51,325 million, while their expenditures stood at Denar 51,178 million (by 5.2% more relative to the previous year). The total revenues of the Road Fund registered an annual fall of 10.1%, while the expenditures increased by 6.2%.

Box 1
Issuance of short-term government securities on the Macedonian financial market

Treasury bills are short-term securities issued by the Government for the purpose of financing the current deficit in the budget (i.e. bridging of the temporary lack of liquid funds due to the time discrepancy between the public revenues and expenditures).

In January 2004, the first Treasury bills in the Republic of Macedonia were issued. The realization of this project derives from the need of expanding the sources for budget financing, incurring the development of the financial markets in the Republic of Macedonia, as well as diversification of the securities portfolio. Issuer of the Treasury bills is the Government (Ministry of Finance), while the NBRM plays the role of Government agent.

Treasury bills are issued in domestic currency, in a dematerialized form, i.e. in the form of electronic bills with a three-month maturity. Their issuance and payment are at par, while they are sold at a discounted value. Treasury bills auctions are conducted according to the principle of interest rate tender, with a pre-set rule for elimination of speculative bids.

In line with the specified Calendar for issuing Treasury bills, during 2004, there were twenty-three auctions of Treasury bills with maturity of three months (auctions are conducted twice a month), where Treasury bills in the amount of Denar 6,860 million were offered, the total demand amounted to Denar 7,228.5 million, while the total realization stood at Denar 6,184.4 million. The smaller subscription was a result of the application of the rule which enables exclusion of the transactions considered to be of a speculative character.

In 2004, the demand for three-month Treasury bills amounted to Denar 314.3 million per auction, on average, exceeding the supply by Denar 16 million, with the realized average weighted interest rate equaling 8.6%. Except for the first quarter, the higher demand relative to the supply characterized the whole year. Thus, in the first three months of the year, the supply stood at Denar 170 million and exceeded the demand by 12%, with the average weighted interest rate equaling 8%. The interest in investing in short-term government securities in the following months of the year was continuously increasing. In the second quarter, the average demand exceeded the average supply by 2.5%, which corresponds with the segmentation of the securities market. Thus, non-banking entities were deprived of the possibility to invest in CB bills and they were redirected toward the Treasury bills market. The demand for Treasury bills reached its peak in April 2004 (Denar 903 million).

During the third quarter, the average supply amounted to Denar 350 million, while the demand was slightly higher (by 1.2%). The permanent increase of the demand was most evident in the last months of the year, so that in the last quarter the demand exceeded the supply by 19.9% and amounted to Denar 385.8 million. In line with the change in the reference interest rate of the NBRM in the second half of the year, the interest rate on the three-month Treasury bills registered an increase and equaled 8.4% and 9.1% in the third and in the fourth quarter, respectively. The highest average weighted interest rate in 2004 (9.2%) was achieved in December.

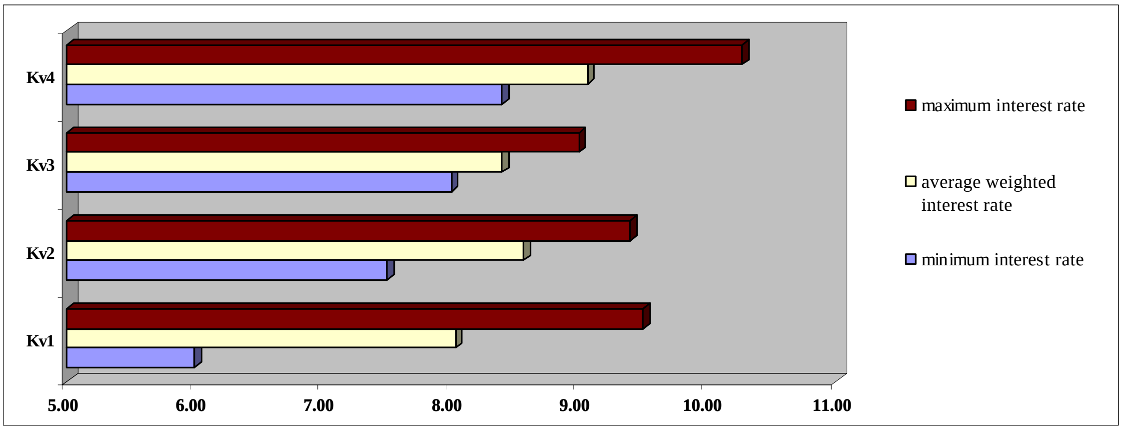
Table 9
Supply, demand and interest rate on Treasury bills
(in millions of denars)

	average supply	average demand	average turnover	average weighted interest rate in %
Q1	170.0	151.8	106.9	8.0
Q2	330.0	338.3	299.9	8.6
Q3	350.0	354.2	329.8	8.4
Q4	321.7	385.8	312.0	9.1
2004	298.3	314.3	268.9	8.6

Source: Ministry of Finance of the Republic of Macedonia

In November 2004, Treasury bills with maturity of six months were introduced (auctions of six-month Treasury bills are conducted once a month), in order to further diversify the securities portfolio, as well as to increase the interest in investing in longer-term securities. At the first auction (November 2, 2004), Treasury bills in the amount of Denar 58.1 million were subscribed, with an average interest rate of 9.5%. The supply of six-month Treasury bills amounted to Denar 70 million and exceeded the demand by 8.9%. The second auction was conducted on December 7, 2004, when out of the total supply (Denar 50 million), Treasury bills in the amount of Denar 25.8 million were subscribed. The higher supply, when conducting an interest rate tender, resulted in a monthly increase in the average weighted interest rate of 0.87 percentage points, thus equaling 10.4%.

Figure 20
Interest rate at the auctions of three-month Treasury bills
(in %)

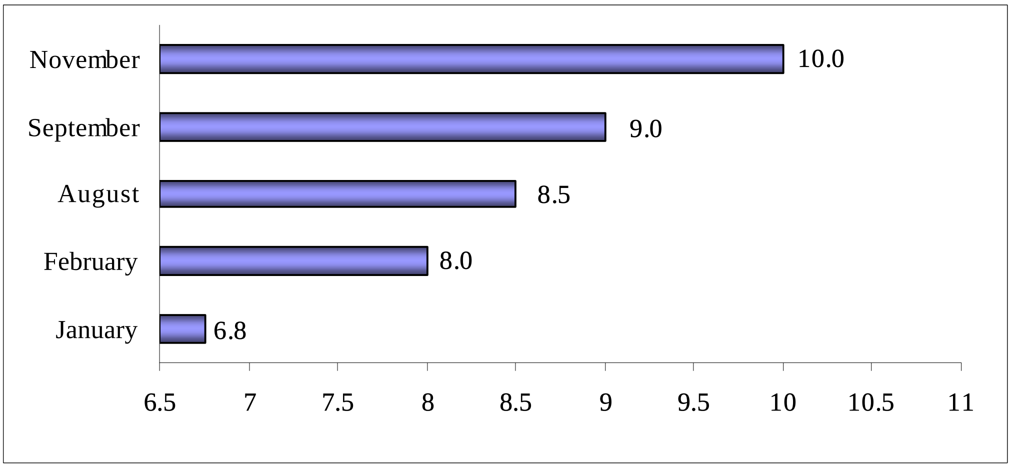


III. Monetary policy

3.1. Monetary policy in 2004

In 2004, the monetary policy was conducted in circumstances when there was a high deficit in the balance of payments current account and prudential fiscal policy. In line with such circumstances, during the year, several changes in the monetary policy were made, directed toward *maintaining the price stability, as a legally determined main monetary objective.* Having in mind the role of the exchange rate as the key determinant of the inflation, the NBRM continued to implement the *strategy of a de facto targeting the nominal exchange rate of the Denar relative to the Euro*, also during 2004. Thus, *the nominal exchange rate of the Denar relative to the Euro* continued to represent *an intermediary target of the monetary policy*. Accordingly, also in 2004 the change in the interest rates of the NBRM and its active participation in the foreign exchange market were directed towards stabilization of the movements on the foreign exchange market and preserving the exchange rate stability.

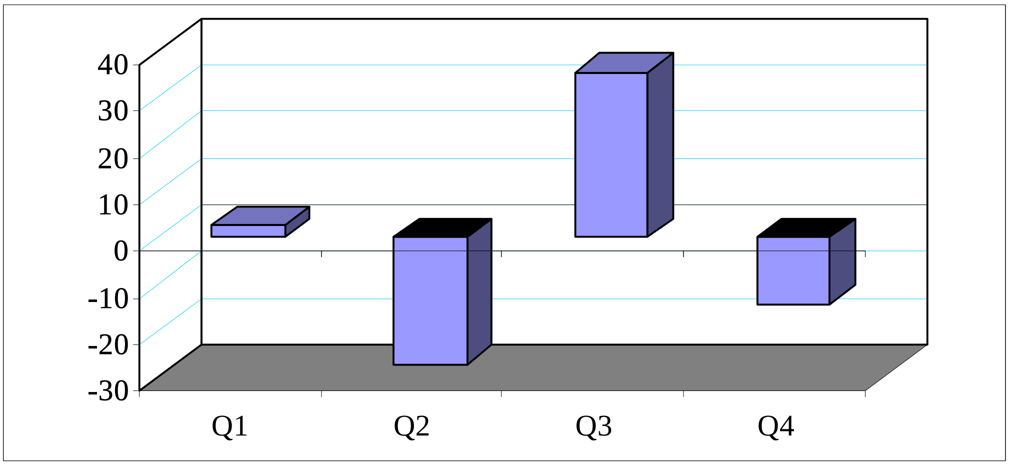
Figure 21
Movement of the interest rate on twenty-eight-day CB bills in 2004
(in %)



From an operational aspect, in 2004, in the set of monetary instruments, changes were made that were directed towards the creation of preconditions for the banks to manage their liquidity more efficiently (increment in the permitted use of the reserve requirement from 60% to 80%), active monetary - fiscal coordination (exclusion of the non-banking entities from the CB bills market, in order to redirect them to the short-term government securities market) and more efficient planning of certain components of the banks' liquidity by the central bank (fixing the amount of vault cash eligible for fulfillment of the reserve requirement). Given the structural excess of denar liquidity in the banking system, also in 2004 the main monetary policy instrument were the short-term securities issued by the NBRM (CB bills). In line with the existing monetary strategy and the need for maintaining an adequate level of foreign exchange reserves (as an indicator of the capacity of the central bank for maintaining the exchange rate stability), during 2004 several changes in the interest rate on CB bills were made. The changes in the monetary policy stance were a reaction to the anticipated developments on the foreign exchange market (in line with the movements in the balance of payments) and the expectations for the fiscal policy stance.

Thus, after the significant outflow of foreign exchange on the basis of the NBRM interventions on the foreign exchange market in the first month of the year and the expectations for a more expansive fiscal policy in the second quarter, in February, NBRM made a shift toward conducting CB bills auctions according to the "volume tender" principle and fixed interest rates of 5% and 8% for the CB bills with seven-day maturity (newly introduced) and twenty-eight-day maturity, respectively. Changes in the monetary policy contributed to the stabilization of the foreign exchange market by the end of the first quarter, which resulted in an insignificant quarterly net-purchase of foreign exchange by the NBRM. The repatriation of a larger amount of dividends to a part of the foreign investors, led to pressures on the side of the demand for foreign currency in April, which was satisfied by interventions of the NBRM. By the end of the second quarter, the foreign exchange market did not register any major turbulences.

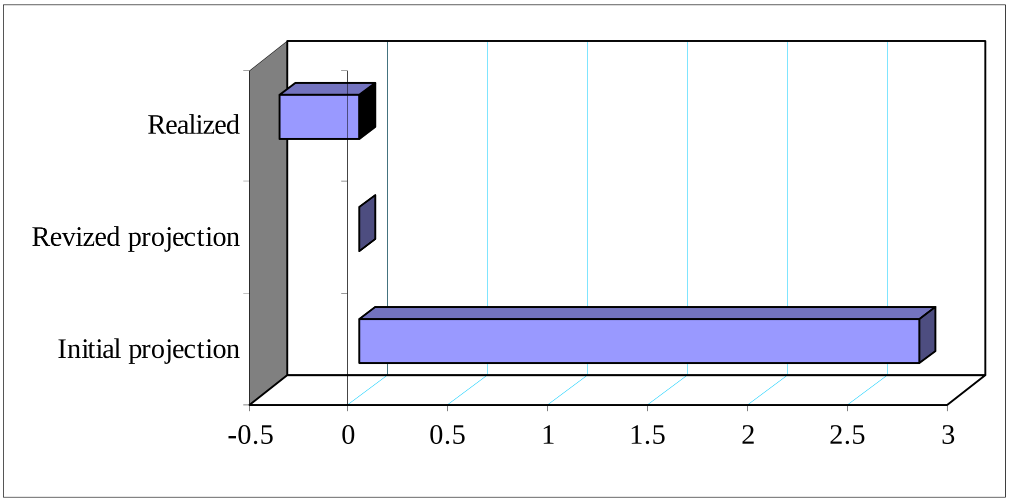
Figure 22
NBRM interventions on the foreign exchange market in 2004
(in millions of US dollars)



During the third quarter, NBRM increased the interest rates on CB bills by 0.5 percentage points on a couple of occasions (in August and in September), with the interest rates on CB bills with maturity of seven days and of twenty-eight days reaching 6% and 9%, respectively. Despite the seasonal growth in the foreign exchange inflows on the basis of private transfers and the increased supply of foreign exchange from a part of the banks due to the need of higher denar liquidity, the net-purchase of foreign exchange in the third quarter was lower relative to the same quarter of the previous year, while simultaneously, part of the expected inflows from abroad were delayed. Consequently, a need was imposed for changing the monetary policy, as a result of the influence of the following factors: 1) lower amount of realized inflows on the foreign exchange market; 2) non-execution of a major part of the planned budget spending and the possibility for concentration of the budget spending in a short period of time and certain pressures on the foreign exchange market; 3) appearance of pressures on the foreign exchange market as a result of certain speculations for possible depreciation of the denar; 4) expectations for a significant increase in the demand for foreign currency in the last quarter, in line with the common increase in the import in this period. Despite the changes in the interest rate, the increase in the import in October and November resulted in NBRM interventions with a significant amount of net-sale of foreign exchange and need of another change in the monetary policy in mid-November (increase in the interest rate on the CB bills by 1 percentage point). NBRM successfully resisted these pressures and maintained the nominal exchange rate of the denar relative to the euro at the targeted level. In December 2004, the situation on the foreign exchange market significantly changed towards reduction of the demand and simultaneous increment of the supply, with the NBRM registering net-purchase of foreign exchange. The following acted toward a decline in the demand for foreign exchange: 1) increase in the interest rate on CB bills; 2) unusually low demand for foreign exchange on the foreign exchange market by the enterprises in this period, which is partially due to the meeting of the need for foreign exchange of the corporate sector through indebtedness in the form of foreign currency credits from the banking system; 3) further maintaining of the course of restrained budget spending (partial realization of the expected concentration of budget expenditures in the last month of the year). The following acted toward an increase in the supply of foreign exchange on the foreign exchange market in the last month of the year: 1) increase in the rate of reserve requirement of banks in mid-December from 7.5% to 10% (which became effective on January 11, 2005), which led toward increasing the needs of banks for denar liquidity; 2) sale of foreign exchange for the purpose of harmonization of some banks with the limits of the open foreign currency position.

Changes in the monetary policy and the NBRM interventions on the foreign exchange market contributed to maintaining the stability of the nominal exchange rate of the denar against the euro and the price stability. Thus, the NBRM contributed to the creation of stable expectations and stable economic environment, as important preconditions for initiation and acceleration of the overall economic activity.

Figure 23
Average rate of inflation in 2004
(in %)



In line with the expectations for acceleration of the economic growth, the initial projection of the average inflation for 2004 equaled 2.8%. The further increase in the prices of oil, as well as the changes in the VAT structure from April 2003 (with which the first three months of 2003 represent lower comparison basis), were also expected to act toward increasing the inflation. Although a part of these assumptions effectuated, the inflation achieved in the first eight months of the year was significantly lower than the projection, which imposed the need of revision of the initial projection of the inflation to 0%. The deviation of the achieved from the projected rate of inflation is mainly a result of the reduced import prices due to the lower customs duties on a larger number of food products (in line with the Stabilization and Association Agreement with the EU and the admission of the Republic of Macedonia to the WTO), which creates pressures for reducing the prices of the domestic producers. The dominant influence of this factor resulted in a negative average change in the consumer prices in 2004 of 0.4%, *which is primarily due to factors on the side of the supply, i.e. non-monetary factors.*

From a viewpoint of the banking system, the increase in the interest rates of the NBRM did not cause a reaction in the interest rate policy of banks. Thus, in 2004, further decline in the price of credits was registered, which is partially due to: the sufficiently wide interest rate spread in the previous period, the increasing level of competition in this sector, the banks' orientation toward establishing good long-term business relations with creditworthy clients, the efforts to reduce the costs of banks even at the price of an opportunity cost from retaining the interest rates at the existing level, where the interest rate on CB bills went up.

In 2004, as a result of the further increase of the preferences to save within the banking system, the banks' total deposit potential registered an annual increase of 23.9%. The broadening of the banks' deposit base enabled more intensive monetary growth in 2004, so that the annual growth rate of the money supply M2-denar part and M4 equaled 12.1% and 16.2%, respectively, which exceeds the initial expectations (the initial projection of growth of the money supply M2-denar part and M4 equaled 11.7% and 12.6%).

The reduction of the banks' lending interest rates, the higher deposit potential, the more active use of foreign exchange funds by the banks, the expansion of the portfolio of credit products, as well as the diversification of the terms for extending credits resulted in a significant annual increase in the total credits extended to the non-government sector of 23.7% (contrary to the initial expectations for an increase in credits of 9%). Given the significant annual increase in credits, their share in the GDP[20] in 2004 reached 19.4%, and it is by 3.1 percentage points higher relative to the previous year, which points to a significantly higher level of financial intermediation.

[20] Estimated data for GDP for 2004.

IV. Monetary developments in the Republic of Macedonia

4.1 Liquidity of banks

Liquidity management in the banking sector in 2004 was characterized with more efficient liquidity management of banks and adequate adjustment of the monetary instruments of the NBRM. In 2004, the changes in the design of the monetary policy and the banks' liquidity management policy successfully offset the effects from the influence of the autonomous factors (foreign exchange transactions, government deposits with the NBRM and currency in circulation).

At the end of 2004, banks' liquidity amounted to Denar 3,583 million, which was a decline of Denar 492 million, or 12.1%, relative to the previous year. The lower liquidity is a result of the drop in the net foreign assets of NBRM and the higher interest of banks in investing in CB bills, which, on cumulative basis, represent main flows of withdrawing liquidity in 2004. Despite the accumulation of funds on the government's denar account with the NBRM, which was directed toward liquidity withdrawal, net domestic assets represented a flow of creation of liquidity in the banking system, together with the moderate influence of the currency in circulation in this direction.

Table 10
Flows of liquidity creation and withdrawal*
(in millions of denars)

	Balance as of 31.12.2003	Changes by quarters Q1	Q2	Q3	Q4	Total	Balance as of 31.12.2004
Banks' liquidity	4,075	-1,594	-1,217	-96	673	-492	3,583
Liquidity creation						**358**	
1. Net domestic assets	-19,870	-1,448	829	-1,048	2,010	343	-19,527
of which:							
Net position of the Government	-7,050	-3,082	1,533	-805	1,329	-1,025	-8,075
2. Currency in circulation	14,177	1,224	-371	12	-850	15	14,162
Liquidity withdrawal						**-850**	
1. Net foreign assets	42,501	2	-1,675	1,828	-832	-677	41,824
2. NBRM bills	4,379	-1,372	1,742	-888	345	-173	4,552

* (+) liquidity creation; (-) liquidity withdrawal

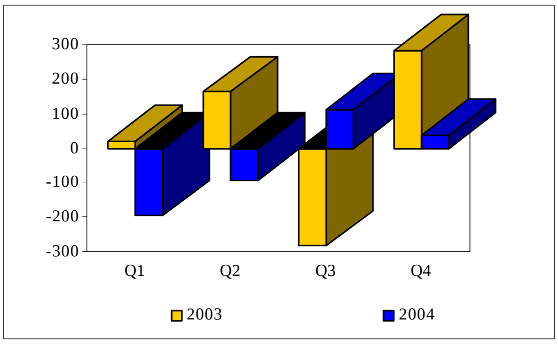
In 2004, the average daily balance of liquid funds of banks[21] amounted to Denar 3,619.5 million, which is a decline of 1.4% relative to the previous year. Analyzed according to the dynamics, after the initial high liquidity created at the end of 2003 (concentration of government spending in the last quarter of December and commonly higher level of liquidity at the end of the year), in the first and in the second quarter of the year the average daily liquidity of banks registered a decline, while in the third and in the fourth quarter banks' liquidity registered an upward trend. The negative quarterly dynamics of the average daily liquidity in the first quarter of 2004 (a decline of Denar 194.9 million relative to the last quarter of 2003) reflected the effect from the foreign exchange transactions and, on average, the higher demand for cash. Easter holidays and the beginning of the holiday season which generated an insignificantly higher demand for cash, as well as the withdrawal of liquidity through the higher level of CB bills and higher amount of government deposits, caused lower average daily liquidity of banks (quarterly decline of Denar 92.3 million) in the second quarter. In the third quarter, the higher inflows of foreign exchange, which are due to seasonal factors (mainly from the currency exchange market) and the need of higher daily liquidity of banks resulted in a positive quarterly dynamics of the average daily liquidity (increase of Denar 113.9 million). The highest average level of

[21] Includes the banks' account with the NBRM and the vault cash.

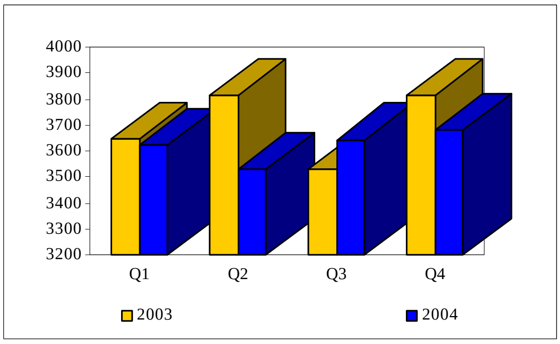
liquidity (Denar 3,682.6 million) was accomplished in the last quarter of the year, as a result of: 1) the higher budget spending in the last month of the year; 2) the higher seasonal liquidity needs (prior to the end of the year, due to the sizeable outflows of cash); 3) the preparations of banks for fulfillment of the higher reserve requirement (from 7.5% to 10%).

Figure 24

Quarterly change of the average liquidity
(in millions of denars)



Average daily balance of banks' liquid funds
(in millions of denars)



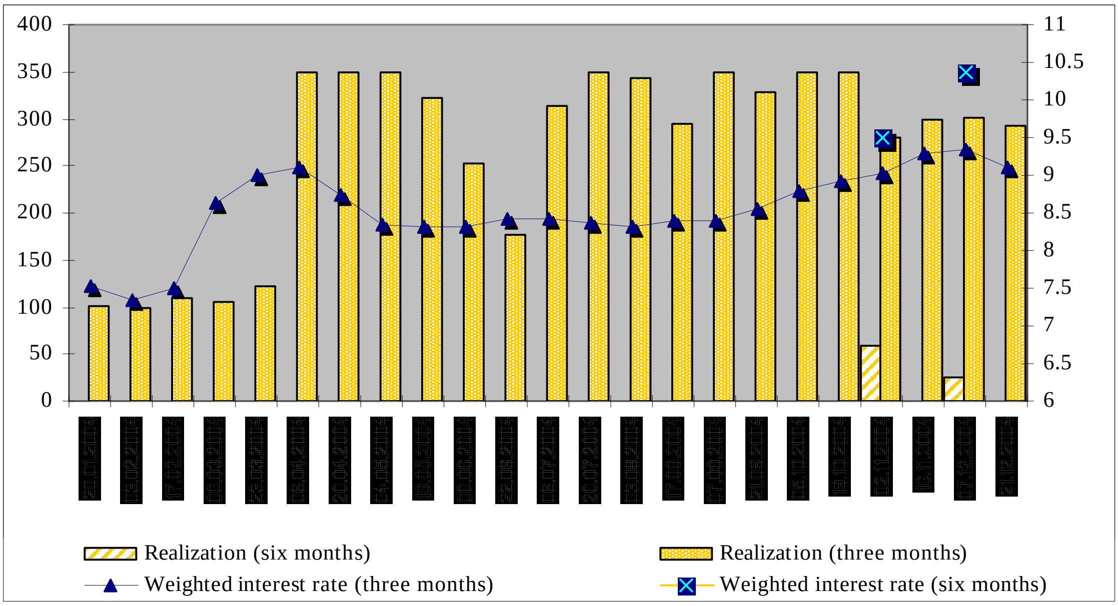
The flexible setup of the monetary policy instruments and the more efficient liquidity management by individual banks, resulted in a decline in the average excess of funds over the prescribed reserve requirement (15% in 2004, as opposed to 28% in 2003). Thus, during 2004, NBRM made several changes to the reserve requirement instrument, so that in July, the percentage of permitted daily use of the reserve requirement was increased from 60% to 80%, while in September NBRM fixed and simultaneously reduced the share of vault cash (from 60% to 30%) as an eligible asset for fulfillment of the reserve requirement[22]. At the same time, changes were made in the interest rate on Lombard credits, with which the difference between this interest rate and the interest rate on CB bills decreased. These changes were aimed at more active liquidity management and reduction of the unused excess liquidity on banks' accounts. The qualitative changes in the banks' liquidity management in 2004, are also confirmed with the decomposition of the excess allocated funds by components (accounts and vault cash). Thus, in the first three quarters the excess allocated funds are entirely due to the vault cash, which points to more efficient management of funds on the banks' account.

From a viewpoint of the flows of creating and withdrawing liquidity, in 2004, the *foreign exchange transactions of the NBRM* represented a flow of liquidity withdrawal. In line with the accepted monetary strategy of a de facto targeting of the nominal exchange rate of the denar relative to the euro, the NBRM actively participated in the foreign exchange market. Analyzing the dynamics, in the first quarter of the year, the NBRM intervened with an insignificant amount of a net-purchase of foreign exchange, thus acting toward liquidity creation, partially as a result of the change in the monetary policy stance in February 2004. Such changes resulted in a net-purchase of foreign exchange in the second half of February and in March, thus offsetting the pressures for depreciation of the domestic currency on the foreign exchange market from January 2004 (caused by the created excess liquidity at the end of 2003 due to the government spending and higher seasonal foreign exchange outflows in the beginning of the year). The one-time effect from the import of Slovenia (before the admission to the EU), as well as the repatriation of the dividends of foreign investors, generated higher demand for foreign exchange funds and, accordingly, net-sale of foreign exchange by the NBRM in the second quarter of the year. In the third quarter, the seasonal movements in the balance of payments (inflows of

[22] Before adopting the decision, 70% of the daily amount of vault cash during the period of fulfillment were incorporated in the reserve requirement (with the amount of the vault cash, as an asset eligible for fulfillment of the reserve requirement, not being known in advance). With the changes, in the beginning of the period of fulfillment, the amount of vault cash is determined in advance and it equals 70% of the average daily stock of vault cash in the previous period of fulfillment (where this amount must not exceed 30% of the reserve requirement).

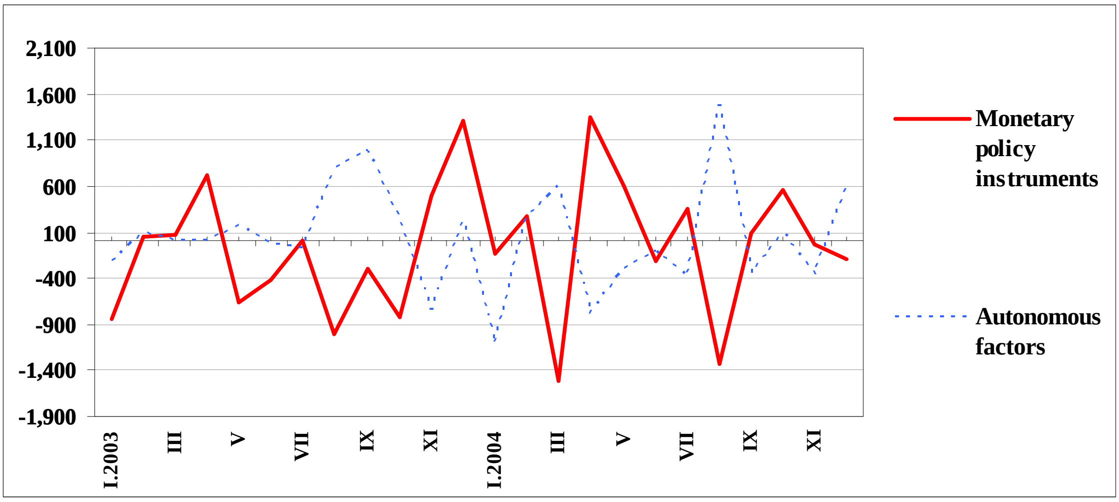
foreign exchange funds on the currency exchange market), the need for denar liquidity of individual banks, as well as the higher interest on CB bills, resulted in a net-purchase of foreign exchange from the foreign exchange market and, accordingly, creation of liquidity in the banking system. In the fourth quarter, foreign exchange transactions of the NBRM acted in line with the common seasonal dynamics, i.e. they represented a flow of liquidity withdrawal. The net-sale of foreign exchange on the foreign exchange market by the NBRM (realized in October and November) was partially offset with the net-purchase of foreign exchange by the NBRM realized in December (which deviates from the common seasonal movements on the foreign exchange market in the last month of the year).

Figure 25
Realization of three-month and six-month government securities and average weighted interest rate
(in millions of denars, in %, respectively)



At the end of 2004, *government's denar deposits with the NBRM* increased by two times relative to the end of the previous year and in December 2004 they amounted to Denar 4,696 million. Thus, they represented a flow of withdrawal of liquidity from the banking system. From a viewpoint of the quarterly dynamics, during the year government deposits oscillated in line with the common seasonal dynamics. Thus, prior to the payment of the regular installment of the government bonds for the old foreign exchange saving (in April and in October), in the first and in the third quarter of the year, continuous accumulation of funds on the government denar account with the NBRM was registered. In the second and in the fourth quarter of 2004, this autonomous factor acted toward liquidity creation (quarterly decline in the denar deposits, mainly caused by the bond payment). The drop in the fourth quarter (despite the conducted transfer of the accounts of the public funds from the banking sector to the NBRM) was additionally intensified in line with the higher budget spending, especially in December 2004. During the year, the government obtained additional funds through the issuance of short-term government securities with maturity of three and six months. In line with the determined framework for issuing government securities, in 2004, twenty-three auctions were conducted, with total realization of Denar 6,268 million. At the auctions of three-month Treasury bills the demand exceeded the supply by 5.4%, with the average weighted interest rate equaling 8.6%, unlike the auctions of six-month Treasury bills (first introduced on November 02, 2004), where the supply exceeded the demand by 1.3 times and an average weighted interest rate of 9.8% was realized.

Figure 26
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

CB bills auctions, as the basic monetary policy instrument, during 2004 partially offset the effects from the influence of the autonomous factors (currency in circulation, public consumption and NBRM interventions on the foreign exchange market) thus acting in line with their defined function for liquidity withdrawal. Thus, at the end of December 2004, CB bills amounted to Denar 4,552 million, which relative to the end of the previous year, represents an additionally withdrawn liquidity in the amount of Denar 173 million. From the aspect of the quarterly dynamics, in the first quarter of the year, the level of CB bills registered an increase of Denar 1,372 million, so that at the end of the quarter CB bills registered their peak level in 2004 and amounted to Denar 5,751 million. Such achievement is to a large extent a result of the high interest in CB bills in March 2004, as a combined effect from the seasonal reduction in the level of currency in circulation (the lowest level during the year was registered in March 2004) and the changed setup of the CB bills auctions[23] which generated higher interest in investing in this instrument. In the second quarter of 2004, immediately after the change in the tender setup (introducing a tender with restricted amounts) and the abolishment of the possibility for investment by other entities except banks[24], the level of subscribed CB bills gradually reduced, contrary to the higher realization of Treasury bills (trend which started in the second half of April), when a quarterly decline in the CB bills in the amount of Denar 1,742 million was registered. The higher supply, relative to the demand for foreign exchange on the foreign exchange market in the third quarter of the year resulted in interventions of the NBRM with net-purchase of foreign exchange and creation of additional denar liquidity in the banking system. Such movements were offset through the higher amount of CB bills (increase of Denar 888 million relative to the previous quarter). In line with the common accumulation of liquidity at the end of the year (due to the expected cash outflows prior to the holidays), as well as the preparation of the banks for fulfillment of the higher reserve requirement (increase in the reserve requirement from 7.5% to 10%), reduced interest of banks in investing in CB bills was registered at the end of the fourth quarter. Thus, in the last quarter of the year, the amount of CB bills registered a decline of Denar 345 million.

The relatively satisfactory level of liquidity in the banking system reflected on the interbank (institutionalized and non-institutionalized) money market. Thus, in 2004 the total supply of

[23] In February 2004, NBRM shifted toward CB bills auctions according to the "volume tender" principle and fixed interest rate of 5% and 8%, for the CB bills with maturity of seven days (newly introduced), and twenty-eight days, respectively.
[24] As of April 14, 2004 (immediately prior to the abolishment of the possibility for investing), the level of CB bills of other entities stood at Denar 1,354 million.

liquid funds exceeded the cumulative demand on the institutionalized money market, which led to a decline in the annual average weighted interest rate from 9.8% in 2003 to 6.8% in 2004. Simultaneously, a decline in the average interest rate on the non-institutionalized money market was registered, from 9.7% in 2003 to 6.9% in 2004. During 2004, in line with the high level of liquidity, only four Lombard credits[25] to two banks were extended (in April and in October).

Table 11
Reserve money
(in millions of denars)

	Balance as of	Changes by quarters					Balace as of
	31.12.2003	Q1	Q2	Q3	Q4	Total	31.12.2004
Reserve money	18,252	-2,818	896	-108	1,523	-507	17,745
- currency in circulation	14,177	-1,224	371	-12	850	-15	14,162
- banks' liquidity*	4,075	-1,594	525	-96	673	-492	3,583

* Liquidity of banks includes the banks' account with the NBRM and the vault cash.

At the end of 2004, currency in circulation was almost identical with the level registered at the end of 2003 and amounted to Denar 14,162 million. During the year, the demand for currency in circulation oscillated in line with the common seasonal dynamics. Thus, with the normalization of the high seasonal demand from the end of 2003, in the first quarter of 2004, currency in circulation reduced by 8.6%, while in the second quarter it registered moderate increase (of 2.9%), mainly due to the payment of the government bonds for the old foreign exchange saving. In the third quarter, the demand for currency in circulation remained the same, whereas in the fourth quarter it went up by 6.4% due to seasonal factors.

In line with the movement of some components (almost unchanged level of currency in circulation and lower level of liquidity), the reserve money dropped by 2.8% annually, totaling Denar 17,745 million at the end of 2004.

Table 12
NBRM survey
(in millions of denars)

	As of	Changes by quarter					As of
	31.12.2003	I	II	III	IV	Total	31.12.2004
Reserve money	18,252	-2,818	896	-108	1,523	-507	17,745
Net foreign assets [1]	42,501	2	-1,675	1,828	-832	-677	41,824
Foreign assets	45,854	-27	-2,106	2,203	-1,238	-1,168	44,686
Foreign liabilities	3,353	-29	-431	375	-406	-491	2,862
Net domestic assets	-24,249	-2,820	2,571	-1,936	2,355	170	-24,079
1. Banks, net	-4,297	-1,376	1,736	-887	333	-194	-4,491
- credits	82	-4	-6	1	-12	-21	61
- instruments	-4,379	-1,372	1,742	-888	345	-173	-4,552
2. Net Government position with the NBRM	-7,050	-3,082	1,533	-805	1,329	-1,025	-8,075
- Claims on the Government	3,267	-79	-307	0	0	-386	2,881
- Government deposits [2]	-10,317	-3,003	1,840	-805	1,329	-639	-10,956
3. Other items, net	-12,902	1,638	-698	-244	693	1,389	-11,513

1/ The foreign currency categories are valued at a current exchange rate.
2/ Since here we discuss about the liabilities accounts recorded in the assets, the amounts on December 31, 2003 and December 31, 2004 are presented with a minus (-) sign. As for the changes by quarter, a change with a negative sign denotes increase in the deposits, and vice versa.

Analyzing the NBRM balance sheet, the lower level of reserve money is a result of the NBRM net foreign assets, which in 2004 was directed towards withdrawing liquidity from the banking system. Observing the dynamics, the NBRM net foreign assets remained unchanged in the first quarter. The external outflows based on servicing of the liabilities to foreign creditors (most of which registered in January) were offset with the external inflows (from the International Bank for Reconstruction and Development and the International Development Association), as well as

[25] Collateralized credit for bridging the temporary shortages of liquid funds.

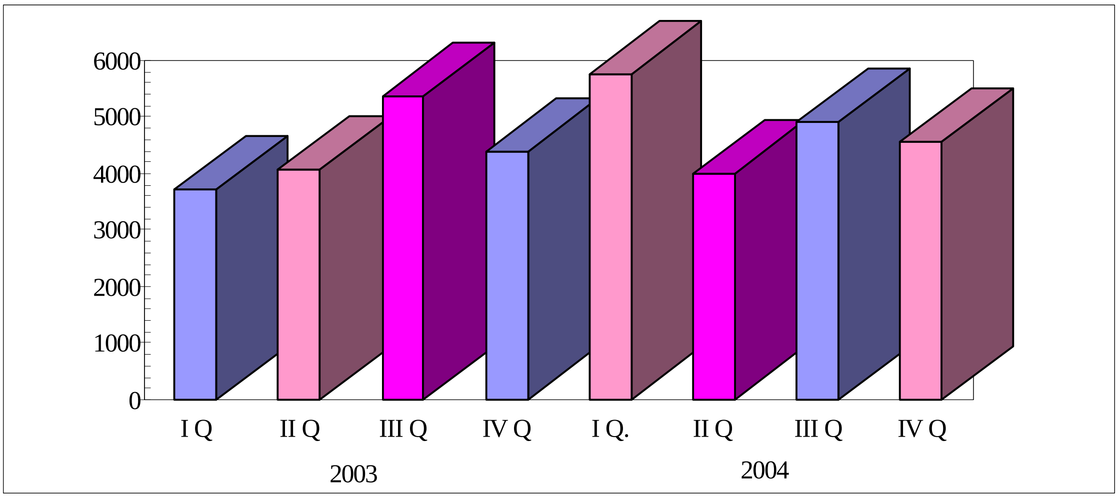
with the net purchase of foreign currency from the foreign exchange market. In the second quarter of the year, the net sale of foreign currency in the foreign exchange market reduced the NBRM foreign assets. As a result of the higher foreign currency inflows (from the exchange operations, as well as from the funds approved by the World Bank and the IMF based on the Stand By Arrangement) the NBRM foreign assets surged in the third quarter. Notwithstanding the considerable external inflows from donations and credits, the last quarter registered lower foreign assets, due to the net sale of foreign currency by the NBRM. The changes in the NBRM foreign liabilities in 2004 reflected the regular repayments of the liabilities to the IMF (a decrease of Denar 491 million compared to the end of 2003). In 2004, in spite of the accumulation of funds by the Government and the higher interest of the banks to invest in CB bills, the net domestic assets were directed towards creating reserve money, particularly due to the changes in the other assets.

4.1.1. Main monetary policy instruments

The flexible design of the monetary policy instruments in 2004 ensured successful adjustment to the changes in the macroeconomic environment. In 2004, the changes in the monetary policy design were a result of the movements in the balance of payments and the restrained budget spending. The CB bills (short-term securities issued by the NBRM) are the major NBRM monetary policy instrument, primarily intended for sterilizing the excess liquidity of the banking system. Having a Denar exchange rate targeting strategy in place, this instrument is aimed at redirecting the Denar liquidity from the foreign exchange market, thus reducing the pressures on the foreign exchange market. The CB bills were one of the most attractive financial instruments in 2004. Despite the issuance of the Treasury bills in January 2004, which resulted in larger diversification of the available securities portfolio and deepening of the financial market, yet, the CB bills remain a dominant financial instrument for investing the excess liquidity of the banking system, primarily owing to the shorter maturity.

With respect to the reserve requirement, the flexible design of the system (a system of average allocation with a possibility to use a part of the requirement) enables the banks to have more efficient liquidity management.

Figure 27
CB bills*
(in millions of denars)



*The chart shows the discounted amount of CB bills.

In 2004, the fluctuations of the autonomous factors (foreign exchange transactions and budget spending) and their effects on the liquidity imposed the need for proper adjustment of the monetary instruments. Thus "interest rate tender" auctions were conducted by mid-February. On

February 18, 2004, the type of tender changed, and the NBRM started conducting "volume tender" auctions and fixed interest rate. Afterwards, CB bills with maturity of 28 days and 8% fixed interest rate were offered. Also, 7-day CB bills were introduced having a 5% interest rate. The introduction of shorter maturity was aimed at increasing the interest of the banks in investing in CB bills, in line with the possibility for faster conversion into liquid funds, and consequently, stabilization of the foreign exchange market movements. In the second quarter of the year, the NBRM changed the auction design once again. In early-April 2004, restricted amounts for investing in CB bills were introduced, and in the middle of the month (April 13, 2004), the possibility for investing in CB bills by entities other than banks (which resulted in lower level of CB bills) was abolished. This switch corresponds with the Government securities market development strategy, i.e. it provided a redirection of the customers from the CB bills market to the Treasury bills market. On June 9, 2004, the auctions with unrestricted offer were reintroduced, with the interest rates (5% on 7-day CB bills and 8% on 28-day CB bills) remaining unchanged.

In the second half of the year, in line with the expected higher budget spending, the NBRM increased the interest rate on CB bills without changing the principle of conducting auctions. In conformity with the macroeconomic performances and the expectations for more expansive fiscal policy, in August and September 2004, the CB bills interest rate went up by 0.5 percentage points, respectively, and in November it increased once again by 1 percentage point. Hence, the interest rates on the 7-day and 28-day CB bills equaled 7% and 10%, respectively. Since December 13, 2004, the auctions of CB bills with maturity of 7 days have been conducted on a daily basis, with a view to offsetting the liquidity effects of the autonomous factors, primarily owing to the uncertain dynamics of the expected more considerable Government spending.

With respect to the reserve requirement, a change was made in July 2004, when the percentage of allowed daily usage of the banks' reserve requirement with the NBRM was increased from 60% to 80%. Such changes were directed towards: 1/ more efficient smoothening of the liquidity oscillations caused by the movement of the autonomous factors; 2/ more efficient liquidity management by the banks and lowering the excess liquidity over the specified reserve requirement; 3/ reducing the variability of the interest rates on the money market; 4/ reducing the NBRM presence on the money market through the CB bills auctions. Also, in September 2004, the amount of cash in the vault, which participates in the fulfillment of the reserve requirement, was fixed, while the percentage of the requirement that could be fulfilled with cash in the vault reduced from 60% to 30%. The need of such changes results from the relatively small effective exploitation of the cash in the vault as funds for fulfilling the reserve requirement by the banks, and the possibility for it to be used for fulfilling the reserve requirement, in accounting terms, creates a high excess allocated reserve requirement. Additionally, the fixing of the amount of cash in the vault, which could be used for fulfilling the reserve requirement, creates an opportunity for more efficient liquidity management by the banks, since the required amount is known in advance.

The need of maintaining an adequate capacity of the NBRM for preserving the exchange rate stability, as well as for reducing a portion of the structural excess liquidity in December 2004, resulted in a decision of the NBRM on increasing the reserve requirement rate (of both Denar and foreign currency deposits) from 7.5% to 10% (which became effective on January 11, 2005). Having a substantial growth in the foreign currency credits (a trend that commenced in mid-2003 when the foreign currency lending was liberalized), the higher reserve requirement rate of foreign currency deposits is also of a prudential nature. At the same time, on a short run, it will enhance the NBRM capacity to intervene on the foreign exchange market, ensuring an equilibration of the supply of and the demand for foreign currency and stable Denar exchange rate. Simultaneously, the NBRM abolished the remuneration of the allocated reserve requirement of the banks' foreign currency deposits (which previously equaled 2%). This change could contribute to reducing the foreign currency savings yield, thus increasing the attractiveness of the Denar deposits. With respect to the Denar reserve requirement, the increase was made for the purpose of sterilizing a portion of the structural excess liquidity in the banking sector, as well as creating additional supply of foreign currency on the foreign exchange market.

In 2004, the NBRM changed the interest rate on the Lombard credit, as an interest rate which is an indicator for the ceiling in the interest rate corridor. For the purpose of more active liquidity management by the banks and their direction towards investing the liquid funds in securities on a longer run, on July 13, 2004, the NBRM reduced the interest rate on the Lombard credit from 14% to 11% and made the Lombard credit more available for the banks with a view to overcoming the short-term excessive shortages of liquidity. Consequently, the reference interest rate[26] (of CB bills with maturity of 28 days) - to - Lombard credit interest rate ratio reduced. The increase in the CB bills interest rate in the second half of 2004 (cumulative increment of 2 percentage points) considerably reduced the interest rate spread between the CB bills and the Lombard credit. With a view to offsetting the potential discouraging of the interbank trade in liquid funds, on November 23, 2004, the NBRM increased the interest rate on the Lombard credits by 2 percentage points (to 13%), thus creating an adequate spread between these two interest rates.

Box 2
Chronology of the changes in the monetary instruments design in 2004

February 18, 2004

The NBRM changed the CB bills auctions design, switching towards "volume tender" auctions and fixed interest rate. Thus CB bills with maturity of 28 days and 8% fixed interest rate were offered, and 7-day CB bills were introduced having a 5% interest rate.

April 7, 2004

The NBRM introduced restricted amounts of investing in CB bills.

April 13, 2004

The NBRM excluded the opportunity for investing in CB bills by entities other than banks, which corresponds with the Government securities market development strategy, i.e. redirection of the non-banking entities to this market.

June 9, 2004

Auctions with unrestricted offered amount were reintroduced, with the CB bills interest rates remaining unchanged (5% on 7-day CB bills and 8% on 28-day CB bills).

July 13, 2004

The NBRM Council adopted a decision on reducing the interest rate on the Lombard credits from 14% to 11%, as well as on increasing the percentage of permitted daily use of the reserve requirement by the banks (from 60% to 80%). Both decisions are aimed at creating conditions for more effective liquidity management by the banks.

[26] According to the empirical analysis, the banks take the interest rate on 28-day CB bills as a reference interest rate.

August 16, 2004

The NBRM adopted a decision on increasing the CB bills interest rates by 0.5 percentage points. According to this change, the interest rate on CB bills with maturity of 7 and 28 days reached 5.5% and 8.5%, respectively.

September 9, 2004

The NBRM Council adopted a Decision on amending the Decision on banks' Denar reserve requirement. The changes were directed towards fixing the amount of cash in the vault which participates in the fulfillment of the reserve requirement (previously, 70% of the daily amount of cash in the vault were incorporated in the determination of the fulfillment of the reserve requirement, in the period of fulfillment, and the amount of cash in the vault that participates in the fulfillment of the requirement was not known in advance), and reducing the percentage of the requirement which might be fulfilled with cash in the vault from 60% to 30%.

September 28, 2004

The NBRM increased the interest rates on CB bills by 0.5 percentage points. Hence, the interest rates on CB bills with maturity of 28 days and 7 days reached 9% and 6%, respectively.

November 12, 2004

The NBRM increased the CB bills interest rate by 1 percentage point. Thus the interest rate on CB bills with maturity of 28 and 7 days equals 10% and 7%, respectively.

November 25, 2004

The NBRM Council adopted a decision on increasing the interest rate on the Lombard credits from 11% to 13%. Hence, compliance was made between the CB bills interest rates and the Lombard credits interest rate.

December 10, 2004

The NBRM Council passed a Decision on increasing the reserve requirement rate of the Denar and foreign currency deposits from 7.5% to 10%, which became effective on January 11, 2005. Also, the NBRM adopted a decision on daily conduct of 7-day CB bills auctions (unlike the previous frequency of twice a week), with a view of successful offsetting the effects of the autonomous factors in this period, primarily the effects of the expected expansive budget spending.

4.2. Monetary aggregates

In 2004, all monetary aggregates registered a positive annual change caused by the further increase in the total savings within the banking system. Such dynamics of the monetary growth was a result of the more intensive economic activity, the further propensity of the households to save in the banking system, the additional available income of the households generated from the payment of a part of Government bonds for the old foreign currency savings, as well as the stable expectations of the economic agents.

The monetary aggregate M1 (currency in circulation and demand deposits) registered a moderate annual increment of 1% and totaled Denar 27,550 million at the end of 2004. Having an almost unchanged demand for currency in circulation, the change in the money supply M1 was due to the higher level of demand deposits. The decline in the reserve money resulted in strengthening of the money multiplication, acting towards an increase in the money supply M1.

In December 2004, the money multiplier of the money supply M1 equaled 1.55, compared to 1.49 in December 2003. The average annual growth rate of the money supply M1 came to 7.9% in 2004.

Table 13
Monetary survey[1]
(in millions of denars)

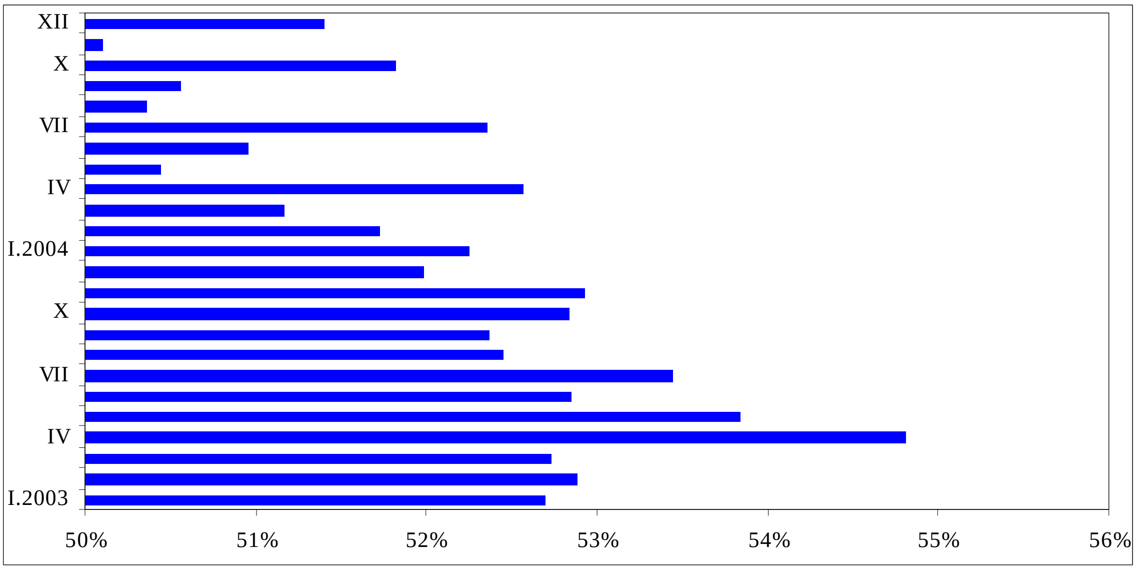
	As of	Changes by quarters					As of
	31.12.2003	I	II	III	IV	Total	31.12.2004
Money supply M4 (total)	82,468	-497	5,200	3,679	4,221	12,603	95,071
Money supply M4 (non-government sector)	80,813	-606	5,229	3,951	4,515	13,089	93,902
Net foreign assets of the monetary system*	65,792	-26	-187	2,894	392	3,073	68,865
Net domestic assets	16,676	-471	5,387	785	3,829	9,530	26,206
Domestic credits	50,616	-112	4,737	1,757	4,358	10,740	61,356
Credits extended by banks	57,666	2,970	3,204	2,562	3,029	11,765	69,431
of which:							
Credits to non-government sector	50,328	2,676	3,091	2,948	3,229	11,944	62,272
- in Denars	43,081	2,047	2,909	2,092	796	7,844	50,925
- in foreign currency*	7,247	629	182	856	2,433	4,100	11,347
Credits to government sector	7,338	294	113	-386	-200	-179	7,159
NBRM's claims on the Government, net	-7,050	-3,082	1,533	-805	1,329	-1,025	-8,075
Other items, net	-33,940	-359	650	-972	-529	-1,210	-35,150

1/ (+) Creation of money supply; (-) withdrawal of money supply.
* The foreign currency categories are valued at a current exchange rate.

Analyzing the dynamics, the quarterly dynamics of the monetary aggregate M1 corresponds with the common seasonal developments. Thus, in the first quarter, the money supply M1 dropped by 7.2%, which is a combined effect of the lower preferences of the economic agents to hold cash (after the excessive seasonal growth typical for the end of the year) and the stabilization of the demand deposits level (after the common accumulation of funds by the enterprises at the end of the year). In the second quarter of the year, the monetary aggregate M1 went up by 3.3%, with a simultaneous acceleration being registered in the demand for currency in circulation and higher level of demand deposits. In the last two quarters of the year, the money supply M1 registered an upward trend, surging by 0.7% and 4.6% in the third and the fourth quarter, respectively. The higher level of currency in circulation due to seasonal factors and the usual accumulation of funds on the transaction accounts of the enterprises were the rationale behind the faster growth in the monetary aggregate M1 in the last quarter of the year.

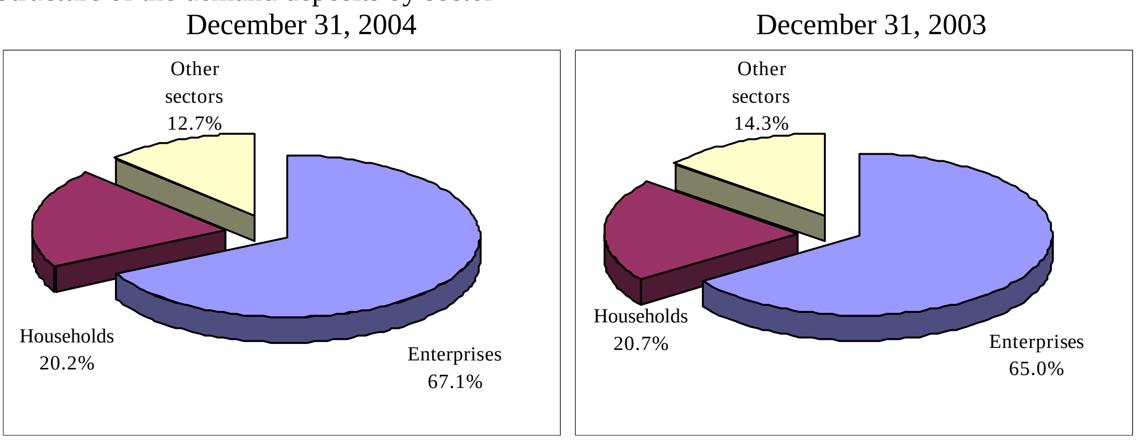
In line with the movements of each component, 2004 registered positive structural developments in the monetary aggregate M1. Thus, on December 31, 2004, the currency in circulation accounted for 51.4% of the money supply M1, which is an annual fall of 0.6 percentage points. The average monthly share also dropped and equaled 51.3% in 2004, thus being lower by 1.7 percentage points on annual basis.

Figure 28
Share of the currency in circulation in the money supply M1



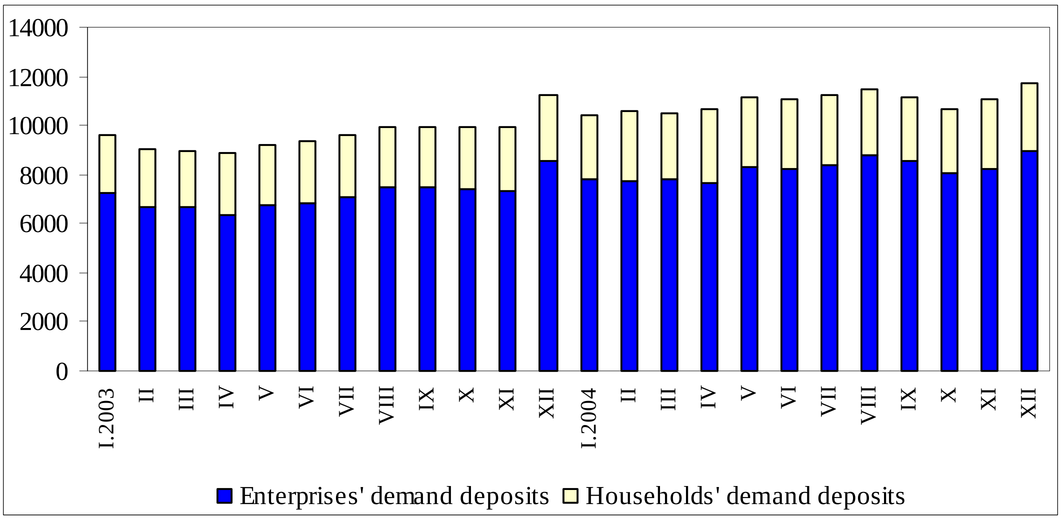
In 2004, the currency in circulation followed the usual seasonal trend. In the first quarter of the year, the currency in circulation dropped by 8.6%, reflecting the depletion of the seasonal effect after the New Year's and Christmas holidays. The change in the second quarter was more moderate (an increment of 2.9%), in line with the higher level of currency in circulation during the Easter and Labor Day holidays, the payment of the Government bonds for the old foreign currency savings (in April) and the beginning of the summer vacations. In the third quarter, the currency in circulation registered no considerable changes, while in the last quarter it registered an increase of 6.4% due to seasonal factors.

Figure 29
Structure of the demand deposits by sector



At the end of 2004, the total demand deposits were higher by 2.2% on annual basis, solely due to the higher amount of funds on the enterprises' transaction accounts, having an insignificant annual decline in the households' demand deposits. Such change caused a substantial slowdown of the annual growth in the demand deposits, compared to the preceding year, when the annual growth equaled 8.4%. At the end of December 2004, compared to the same month of the previous year, the enterprises' demand deposits went up by 5.7%. Analyzing by quarter, the enterprises' demand deposits registered a downturn (fall of 8.1%) only in the first quarter of the year, owing to the usual decrease in the enterprises' demand deposits in January. The steady acceleration of the economic activity initiates a permanent upward trend of the enterprises' demand deposits, which started in the second quarter, with nearly identical intensity of growth being registered in all three quarters. The average monthly level of enterprises' demand deposits was by 14.7% higher in 2004, compared to the previous year. Structurally observed, at the end of 2004, the enterprises' demand deposits made up 67.1% of the total demand deposits, which is a rise of 2.2 percentage points, on annual basis.

Figure 30
Demand deposits of the enterprises and the households
(in millions of denars)



In spite of the almost unchanged level on annual basis, the households' demand deposits registered constant fluctuations over the year. The fastest decline in the households' transaction accounts was registered in December, which corresponds with the higher seasonal demand for currency in circulation at the end of the year. Higher accumulation of liquid funds was registered in April and October, partially a result of the regular payment of a portion of the Government bonds for the old foreign currency savings. In 2004, the share of the households' demand deposits in the total demand deposits was lower by 0.5 percentage points annually, equaling 20.2% at the end of the year.

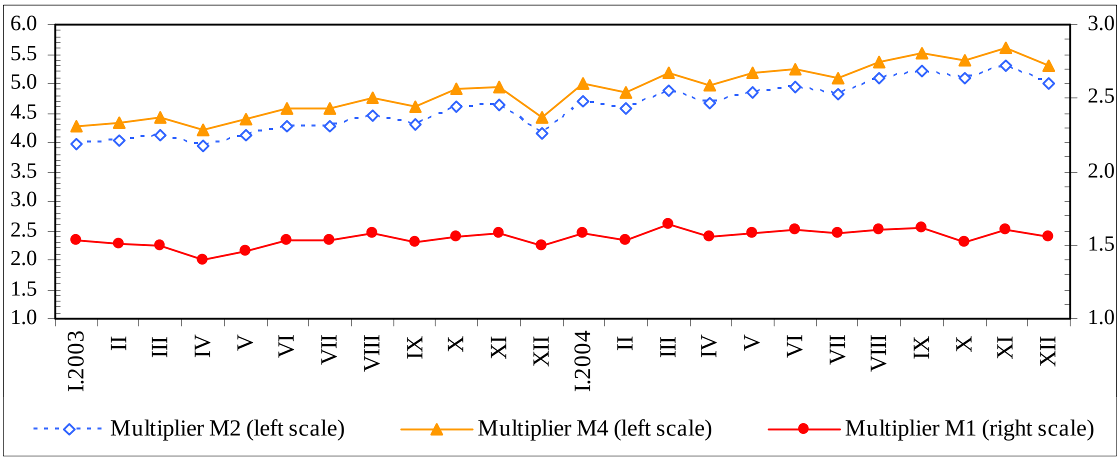
Table 14
Components of monetary aggregates*
(in millions of denars)

	As of					Changes by quarters				
	31.12.2003	31.03.2004	30.06.2004	30.09.2004	31.12.2004	I	II	III	IV	Total
Currency in circulation	14,177	12,953	13,324	13,312	14,162	-1,224	371	-12	850	-15
Demand deposits	13,096	12,360	12,826	13,015	13,388	-736	466	189	373	292
Money supply M1	27,273	25,313	26,150	26,327	27,550	-1,960	837	177	1,223	277
Quasi Denar deposits	15,568	15,173	17,954	19,456	20,483	-395	2,781	1,502	1,027	4,915
Quasi foreign currency deposits	33,187	34,655	36,802	38,998	40,808	1,468	2,147	2,196	1,810	7,621
Money supply M2	76,028	75,141	80,906	84,781	88,841	-887	5,765	3,875	4,060	12,813
Non-monetary Denar deposits	3,497	3,507	3,009	3,137	3,360	10	-498	128	223	-137
Non-monetary foreign currency deposits	1,288	1,559	1,521	1,469	1,701	271	-38	-52	232	413
Money supply M4	80,813	80,207	85,436	89,387	93,902	-606	5,229	3,951	4,515	13,089

* The foreign currency categories are valued at a current exchange rate.

In 2004, given the widening of the banks' deposit base, the broader monetary aggregates registered an intensive positive annual change. Thus, the money supply M2 (money supply M1, sight deposits and deposits with maturity of up to one year) totaled Denar 88,814 million at the end of 2004, which is an annual rise of Denar 12,813 million, or 16.9%. The monetary aggregate M2 - Denar component was by 12.1% higher on annual basis (largely a result of the higher level of short-term deposits in domestic currency with maturity from 6 months to one year). In December 2004, the money multiplier of the money supply M2 equaled 5.01, and in December 2003 it equaled 4.17.

Figure 31
Money multipliers

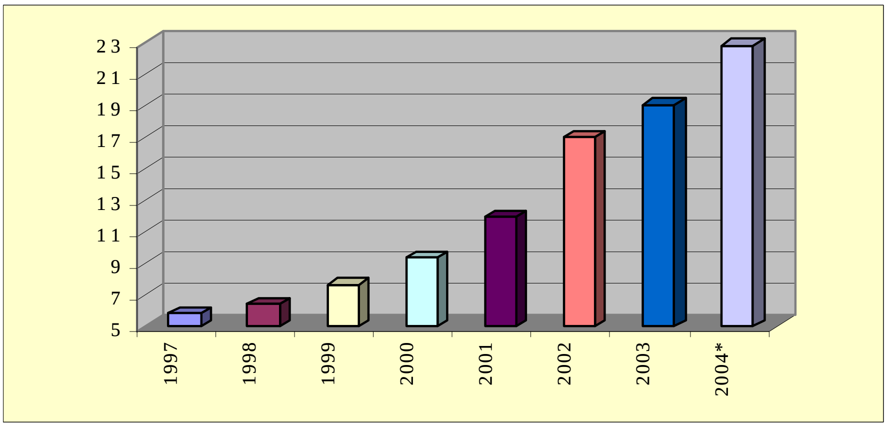


The broadest monetary aggregate M4 (money supply M2, restricted deposits and long-term time deposits) went up by Denar 13,089 million or by 16.2% annually, reaching Denar 93,902 million at the end of the year. Given the simultaneous decline in the reserve money, it resulted in strengthened money multiplication. The money multiplier of the money supply M4 equaled 5.29, and in December 2003, it equaled 4.43.

4.2.1. Total deposits

The upward trend of the banks' total deposit potential went on in 2004. The increase in the deposits is an indicator of a constant strengthening of the confidence of the economic agents in the banking system, and also, an essential precondition for accelerating the credit support of the economy by the banks. From monetary aspect, the increase in the deposits resulted in higher money supply, and consequently, strengthening of the money multiplication process.

Figure 32
Share of the deposits in the GDP
(in %)



*Estimated value of GDP.

At the end of 2004, the total deposits in the banking system reached Denar 66,352 million, which is an annual increase of Denar 12,812 million, or 23.9%. The intensive annual increment in the banks' deposit potential shows higher propensity to save and larger importance of the interest as an additional income source. Thus, a part of the additional deposit potential was created through the payment of the bonds for the old foreign currency savings and the higher level of private transfers, which were kept in the official banking channels. The analysis of the currency of denomination and the maturity structure of the total deposits indicates a dominant contribution of the foreign currency and the short-term deposits to the annual increase in the total banks' deposit potential in 2004. Thus the total foreign currency deposits went up by 23.3% annually, and their contribution to the increase in the total deposits equals 62.7%. An exceptionally high annual increment was also registered in the banks' short-term deposit potential (25.7%), which makes up 98% of the annual change in the total deposits.

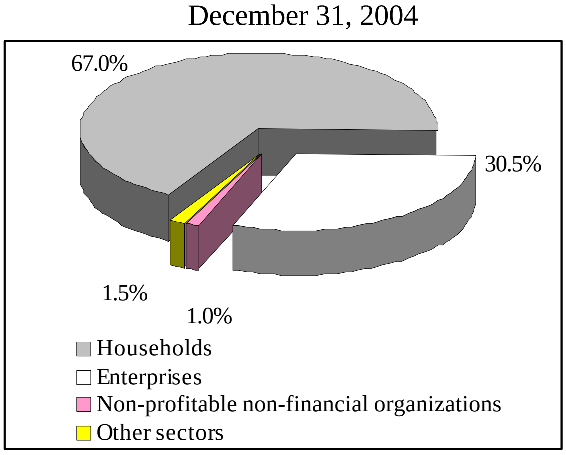
Table 15
Total deposits*
(in millions of denars)

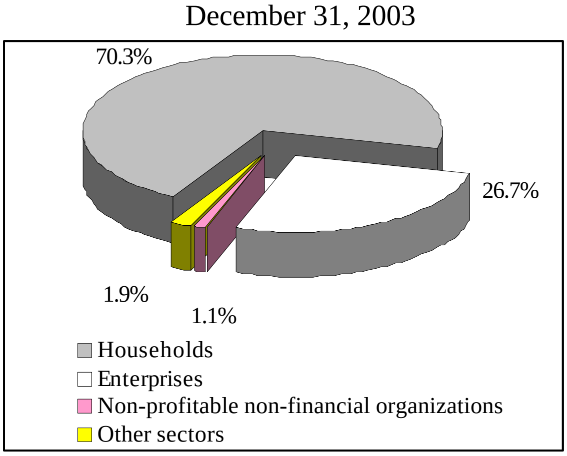
	As of					Changes by quarters					Structure of total deposit	
	31.12.2003	31.03.2004	30.06.2004	30.09.2004	31.12.2004	I	II	III	IV	Total	31.12.2003	31.12.2004
											(in %)	
Total deposits of non-government sector	53,540	54,894	59,286	63,060	66,352	1,354	4,392	3,774	3,292	12,812	100.0	100.0
- Denar	19,065	18,680	20,963	22,593	23,843	-385	2,283	1,630	1,250	4,778	35.6	35.9
- foreign currency	34,475	36,214	38,323	40,467	42,509	1,739	2,109	2,144	2,042	8,034	64.4	64.1
I. Short-term deposits[/1]	48,755	49,828	54,756	58,454	61,291	1,073	4,928	3,698	2,837	12,536	91.1	92.4
- Denar	15,568	15,173	17,954	19,456	20,483	-395	2,781	1,502	1,027	4,915		
- foreign currency	33,187	34,655	36,802	38,998	40,808	1,468	2,147	2,196	1,810	7,621		
II. Long-term deposits[/2]	4,785	5,066	4,530	4,606	5,061	281	-536	76	455	276	8.9	7.6
- Denar	3,497	3,507	3,009	3,137	3,360	10	-498	128	223	-137		
- foreign currency	1,288	1,559	1,521	1,469	1,701	271	-38	-52	232	413		

1/ The short-term deposits include sight deposits and time deposits with maturity of up to one year.
2/ The long-term deposits include time deposits with maturity of over one year and restricted deposits.
* The foreign currency categories are valued at a current exchange rate.

With respect to the quarterly dynamics, the banks' total deposit potential increased in all four quarters of 2004. Thus, in the first quarter, the total deposits went up by 2.5% in the banking system, with an increase being registered in all types of deposits (other than in the Denar short-term deposits). Fastest positive quarterly change was registered in the short-term foreign currency deposits. Having a permanent monthly increment in the second quarter, in June 2004, the total deposit potential of the banking system was by 8% higher quarterly, which is also the steepest quarterly increase in the year. The increment is largely due to the payment of the fifth installment of the bond for the old foreign currency savings in April, which resulted in accumulation of funds on the households' accounts, as well as to the higher short-term deposit potential of the enterprises. In the third quarter, the total deposits rose by 6.4%, as a result of the faster growth in the short-term deposits (with a simultaneous increase being registered in the both Denar and foreign currency deposits). The divergent movements in the currency of denomination structure of the long-term deposits (fall in the long-term Denar deposits) resulted in a less significant increase in the long-term deposit potential of the banks. The payment of the regular installment of the Government bonds for the old foreign currency savings in October, as well as the higher amounts of restricted deposits of the enterprises (with the fastest growth being registered in the committed Denar deposits) resulted in 5.2% increase in the level of the total deposits in the fourth quarter.

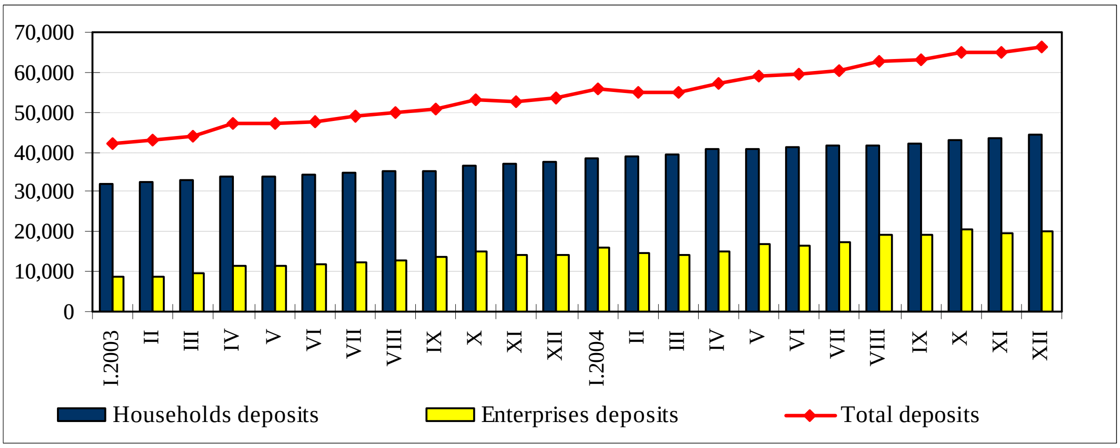
Figure 33
Deposit structure by sector





In 2004, the total deposits of the households sector were higher by Denar 6,792 million, or by substantial 18% on annual basis, totaling Denar 44,437 million at the end of December. Almost half of the annual change in the households' deposits was generated from the additional inflows on the households' accounts from the payment of the government liabilities based on the bonds for the old foreign currency savings. The retention of this income in the banking system is an indicator for the further strengthening of the confidence in the banking system, as an essential prerequisite for higher degree of financial intermediation. Also, the annual growth in the households deposits corresponds with the increase in the GDP and the higher amount of private transfers (remittances, pensions, rents, in particular, generating higher available income for the households). The increase in the households' deposits could be partially explained with the further redirecting of the savings of the households outside the banking channels to the banking system. Analyzing the quarterly dynamics, the total households' deposits were in constant growth in all four quarters of the year. Thus, in the first quarter of 2004, the increase in the households' deposits equaled 4%, primarily due to the higher short-term deposits in foreign currency. In late-June, compared to the end of the preceding quarter, the households' deposits went up by 5.7%, partially a result of the regular payment of the bonds for the old foreign currency savings in April, and consequently, of the more substantial growth in the Denar deposits (of 11.1%, while the foreign currency deposits were by 3.7% higher). The quarterly fall in the Denar deposits leads to slower growth in the total households' deposits in the third quarter (their quarterly increase equaled 1.8%). The payment of a part of the Government bonds for the old foreign currency savings in October and the higher propensity to save on a long run (particularly in foreign currency) resulted in a quarterly increase in the households' deposits of 5.5% in the last quarter of 2004.

Figure 34
Deposits by sector
(in millions of denars)



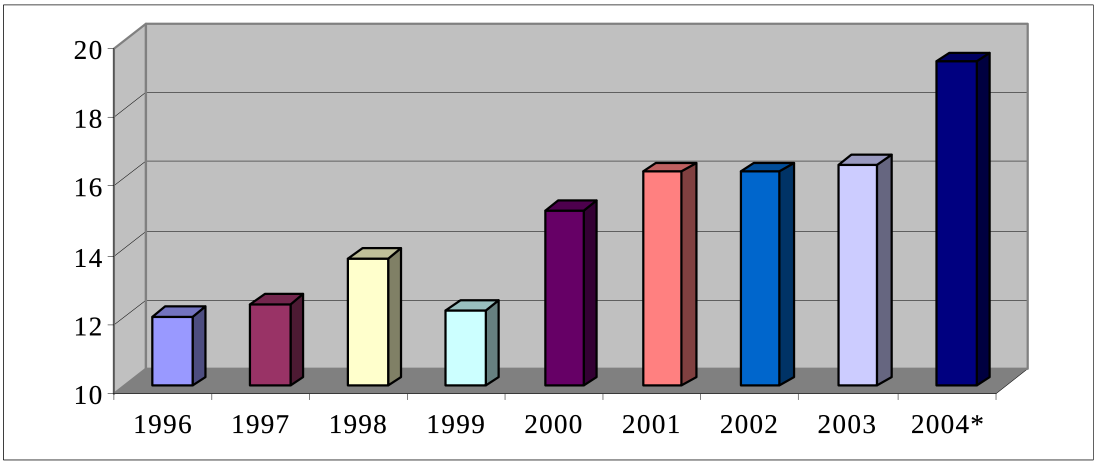
The preference of the corporate sector for short-term time domestic and foreign currency deposits was more evident in 2004. Hence, the deposits remain one of the essential investment alternatives of the enterprises. However, the introduction of the Treasury bills at the beginning of this year, as a new financial instrument, resulted in redirecting of a portion of the funds of the enterprises to this market. In late-December, the total deposits of the corporate sector reached Denar 20,206 million, which is an annual increment of Denar 5,929 million, or considerable 41.5%. Both the Denar and the foreign currency deposits contributed to such fast growth. The upward trend of the total deposits of the enterprises remained over the year (reflecting the preferences to cumulate funds on the Denar and foreign currency accounts in the banks), except in the first quarter when the total enterprises' deposits were by 0.9% lower, relative to the end of the previous year. Having an increase in the foreign currency deposit potential, the fall in the total enterprises' deposits in the first quarter is solely due to the lower level of Denar deposits (by 9.4%, quarterly). In the second quarter, the enterprises' deposits registered a fast growth and were by 15.6% higher at the end of June, due to the higher short-term deposits. The enterprises' deposits kept growing with faster dynamics in the next quarter, with a quarterly increase (September 2004 / June 2004) of 18.3%. Such changes were generated from the short-term deposits, which were higher by 19.5% on quarterly basis, owing to the higher amount of Denar time deposits with maturity of up to and over three months and the foreign currency deposits with maturity of up to three months. The last quarter registered a slower increase in the total enterprises' deposits (quarterly growth of 4.5%). Simultaneous rise war registered in both short-term and long-term deposits, with the considerably faster increase being registered in the long-term deposit potential of the enterprises.

The analysis of the deposit structure by sector indicates higher share of the enterprises of 3.8 percentage points, reaching 30.5% on December 31, 2004. On the other hand, the share of the households' deposits equaled 67% at the end of the year, which is an annual decline of 3.3 percentage points.

4.3. Banks' placements

In 2004, the banks intensified their lending to the private sector, generating stimulating effects on the total economic activity in the country. The enhancement of the banks' deposit base (an increment in their lending potential), the higher attractiveness of the credits by diversifying the lending terms, the positive developments in the banks' interest rate policy (reduction of the lending interest rates) and the higher competitiveness in the banking sector resulted in a high annual growth rate of the total credits extended to the private sector. Thus, at the end of the year, the banks' total placements reached Denar 62,272 million, which is an increase of 23.7% on annual basis.

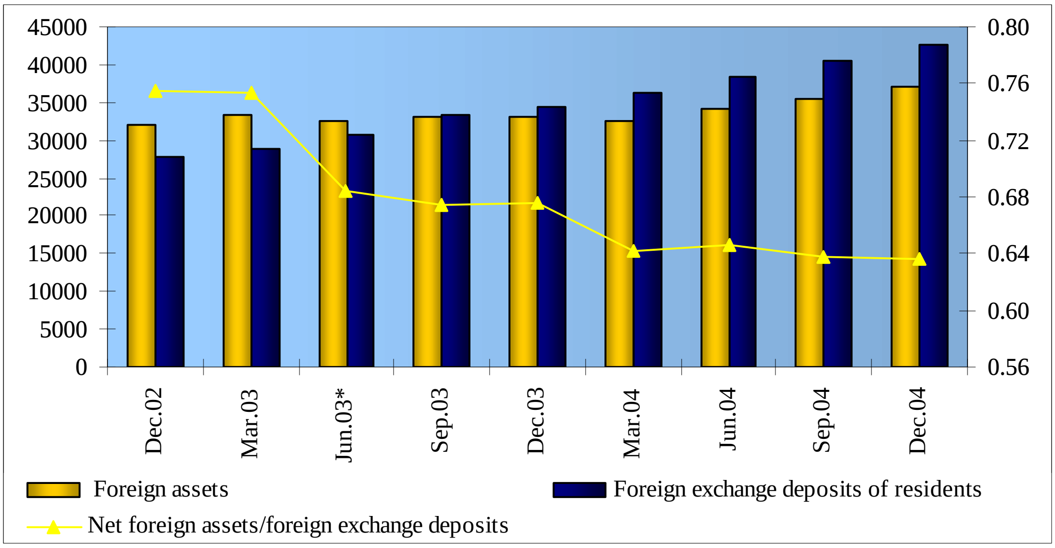
Figure 35
Share of the credits in the GDP[27]



* Estimated value of GDP.

The active usage of the banks' foreign assets additionally contributes to increasing the credits in 2004. In December 2004, the banks' net foreign assets - to - banking sector's total foreign currency deposits ratio equaled 0.64 (0.68 in December 2003), indicating a positive process of directing a portion of the enhanced foreign currency deposit base of the banks to higher lending to the households and the enterprises in the country. The net foreign assets of the banking system, in line with the higher foreign assets of the banks (by 12.2% on annual basis), having a relatively higher foreign liabilities of the banks (an increase of 2.8%, generated from the higher amount of funds on the non-residents' current accounts) was by 16.1% higher on annual basis, standing at Denar 27,041 million in December 2004.

Figure 36
Foreign assets and foreign currency deposits of residents in the banks
(in millions of denars)



*The reserve requirement for foreign currency deposits was introduced for the first time in June 2003, resulting in a decline in the banks' foreign assets, and consequently, lower foreign assets - to - total foreign currency deposits ratio in the banking system.

[27] The data on credits extended to the non-government sector does not include the accrued interest on credits. The annual growth rate of the credits to the non-government sector, excluding the accrued interest on credits, equals 25%.

The annual growth rate of the Denar credits[28] extended to the non-government sector equaled 18.2%, with a substantial decline being registered in their contribution to the increase in the total credits (65.7% in 2004, and 81% in the preceding year), reflecting the amendments to the Law on Foreign Exchange Operations (made in July 2003) that allowed foreign currency lending to all interested entities. With respect to the maturity structure of the Denar placements, typical for 2004 was the higher share of Denar credits extended on a long run, which equaled 39.9% in 2004, compared to 33% in 2003.

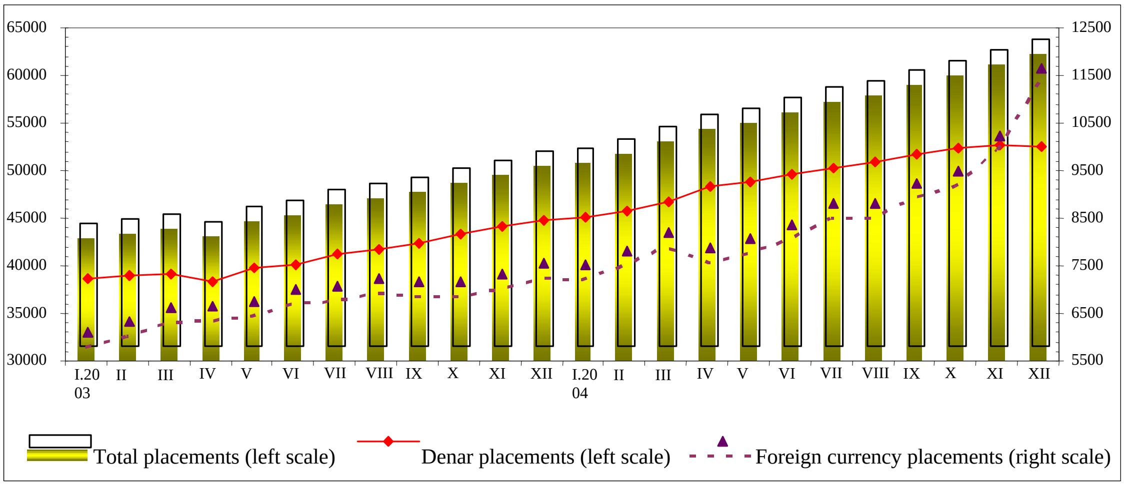
Table 16
Domestic credits of the deposit money banks*
(in millions of Denars)

	As of					Changes by quarters				
	31.12.2003	31.03.2004	30.06.2004	30.09.2004	31.12.2004	I	II	III	IV	Total
Total placements of banks to private sector	50,328	53,004	56,095	59,043	62,272	2,676	3,091	2,948	3,229	11,944
In Denars	43,081	45,128	48,037	50,129	50,925	2,047	2,909	2,092	796	7,844
In foreign currency	7,247	7,876	8,058	8,914	11,347	629	182	856	2,433	4,100

*The foreign currency categories are valued at a current exchange rate.

The credits extended in foreign currency increased considerably by 56.6% on annual basis, and within their structure, the share of the credits extended on a long rung was by 6.2 percentage points higher relative to the previous year. The fast growth in the banks' foreign currency lending is a result of the higher amount of foreign currency credits extended to the enterprises for domestic and international payments of liabilities and the higher long-term credits extended to the households for domestic payments.

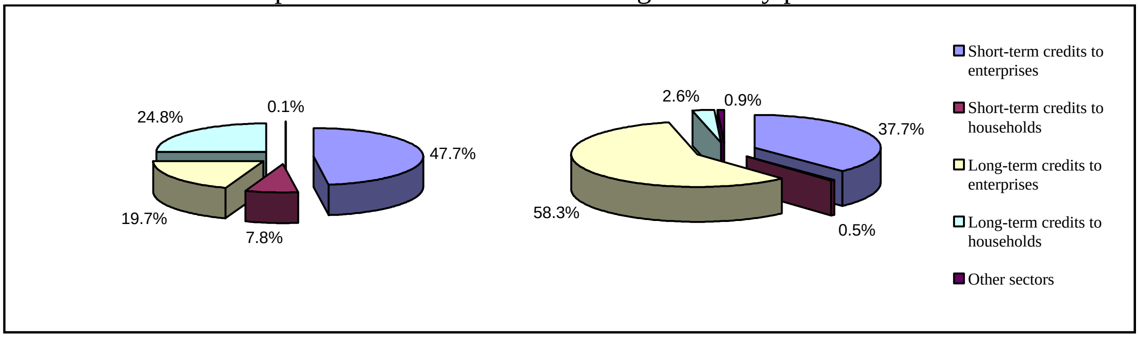
Figure 37
Banks' placements
(in millions of denars)



With respect to maturity, the preferences to lend on a long run were especially evident in 2004, resulting in an annual increase in the long-term credits of 50.2%. Such developments led to respective structural changes in the total placements (an increase in the share of long-term credits in the total credits from 36% in December 2003 to 43.7% in December 2004), unlike the deposit structure, which registered no changes. The short-term credits went up more moderately, and at the end of the year, relative to the end of 2003 they were by 8.3% higher.

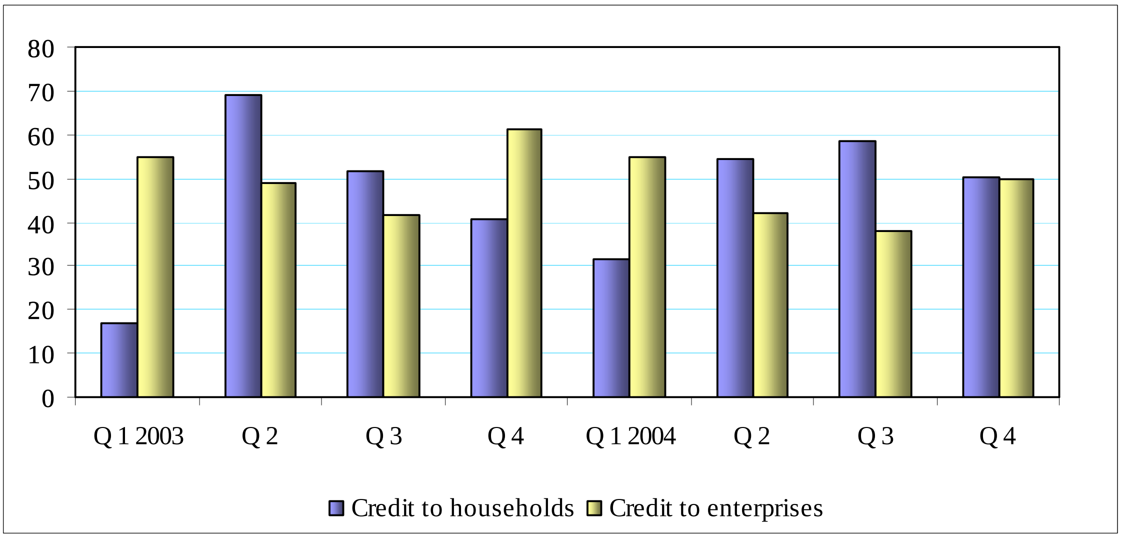
[28] Also, includes Denar indexed credits.

Figure 38
Maturity and sector structure of the banks' placements as of December 31, 2004
Denar placements Foreign currency placements



The credit analysis by sector shows that additional financial assets were allocated through the banks to both enterprises and households, indicating higher intermediation of the banking sector, thus stimulating the private consumption and the investments. In 2004 there was an intensive process of credit support to the households by extending consumer, housing and other credits, showing the banks' credit orientation to the households sector (as more diversified and less risky sector). On the other hand, both the short-term and the long-term credits to the enterprises rose annually, with the contribution of the credits to the households and the credits to the enterprises towards increasing the total credits being almost identical (49.2% and 46.1%, respectively).

Figure 39
Contribution of the credits to the enterprises and the households to the overall increase in the credits
(in %)

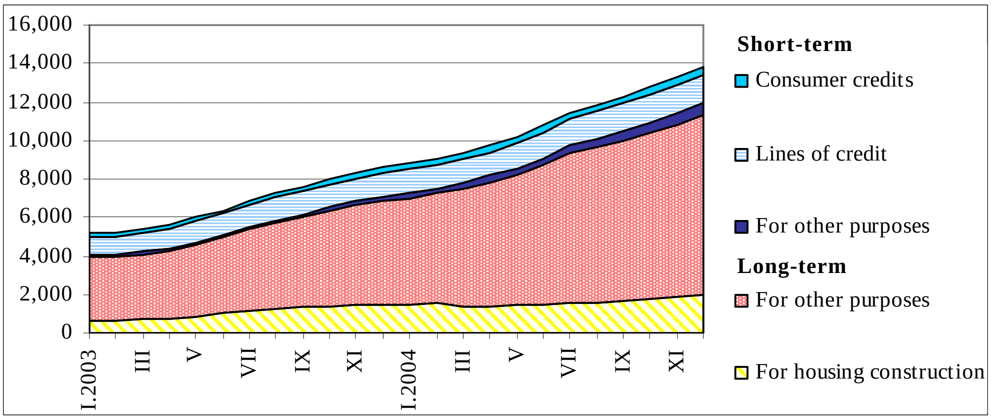


The banking system in 2004 played an important role in the supplementing of the financial potential of the households. Thus in late-December, relative to the same month of the preceding year, the total placements to the households were by considerable 62.4% higher. The Denar placements were major generator of the increment in the total placements to the households (making up 94.2% of the total growth). On the other hand, the amendments to the Law on Foreign Exchange Operations, as well as the more attractive interest rates on the foreign currency credits resulted in an annual growth in the placements to the households denominated in foreign currency of 17.1 times. This year registered faster increase in the credits extended to the households on a long run (of 69.5%), with their share in the total credits to the households increasing by 3.2 percentage points (from 73% at the end of 2003 to 76.2% at the end of 2004).

The short-term Denar credits to the households went up by 41.8% annually, as a result of the increase in the consumer loans (of 24.1%), the overdrafts (of 27.1%) and other credits (of 2.4 times). The overdrafts dominate the short-term Denar credits to the households (42.2% in December 2004), largely due to the simple administrative procedure for their extension.

The strengthened orientation of the banks towards lending to households was typical for all four quarters of the year, resulting in 5.8 percentage points higher share of the placements to the households in the total placements. Thus, in the first quarter, the total placements to the households rushed by 8.9%, particularly owing to the higher amount of long-term credits in domestic and foreign currency (of 8.9% and 5.3 times, respectively). Faster quarterly increment (of 16.4%) was registered in the second quarter of the year, with a simultaneous growth being registered in all types of credits (with respect to the maturity and the currency of denomination structure). Such trend went on more moderately in the next two quarters, with a quarterly increase being registered in the third and the fourth quarter of 14.4% and 11.9%, respectively.

Figure 40
Distribution of Denar credits to households by type of credit
(in millions of denars)



As of December 2004, the total credits extended to the corporate sector totaled Denar 41,681 million, which is by Denar 5,508 million or by 15.2% more compared to the preceding year. The banking loans are still mostly used for financing short-term liquidity needs of the enterprises (the share of the short-term credits in the total credits to the enterprises equaled 62.6% at the end of 2004). The maturity structure, however, registered positive movements, i.e. higher share of the long-term credits (of 6.3 percentage points), showing higher investment activity and development of the corporate sector. In 2004, there was a tendency of reorienting the enterprises to foreign currency credits, and the total foreign currency placements to the corporate sector were by considerably 54.6% higher on annual basis. Such annual dynamics of the foreign currency placements is a combined effect of the liberalization of the lending in foreign currency and the lower interest rate on such credits. The Denar credits increased in more moderate dynamics, and at the end of the year compared to the end of 2003, they were by 5.7% higher.

With respect to the dynamics, the banks kept supplementing the financial needs of the enterprises in all four quarters of the year, which was an additional stimulus for the process of accelerating the economic activity. In the first quarter, the foreign currency lending to enterprises on a long run was the most intensive in the first quarter (an increase of 12.7% quarterly), with the total credits to the enterprises being higher by 4.1% at the end of March 2004, compared to the preceding year. The second and the third quarter registered a quarterly growth in both Denar and foreign currency placements to the enterprises, resulting in a positive quarterly change in the total placements of 3.4% and 2.9%, respectively. Having a marginal quarterly fall in the short-term credits (of 0.3%), the quarterly growth in the total placements to the corporate sector in the fourth quarter is solely due to the higher level of long-term credits (quarterly increase of 12.1%).

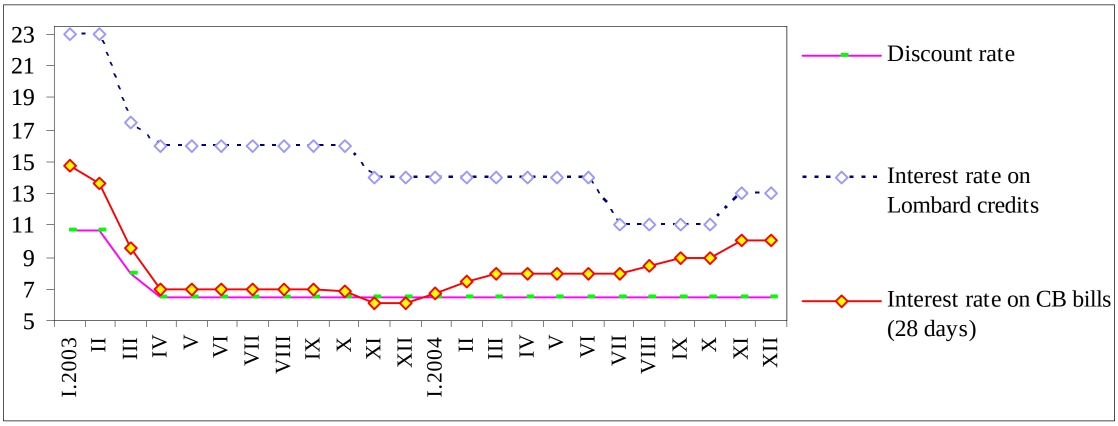
In 2004, the level of overdue claims and the suspicious and contested claims of the banks[29] went down, signalizing more suitable credit portfolio management by the banks, larger financial discipline and higher creditworthiness of the customers.

[29] The banks' overdue claims categorized in the three most risky categories constituted 13.2% of the total banks' credit exposure at the end of 2004, which is by 1.9 percentage points less compared to the previous year.

V. Interest rates

The changes in the NBRM reference interest rate (CB bills interest rate) in 2004, resulted in respective changes in the interest rates on the money market, as well as in the interest rates on the Treasury bills (issued for the first time in January 2004). On the other hand, in spite of the higher price of the short-term liquid finds and the higher yield on short-term securities, the changes in the interest rate policy of the bank in 2004 were aimed at lowering the lending and the deposit interest rates. Hence, the trends of decreasing the banks' interest rates and the gradual narrowing of the interest rate spreads kept on in 2004. The relatively low responsiveness of the banks' interest rate policy to the monetary signals in 2004 indicates that the monetary policy is not a dominant factor in the establishment of banks' interest rates. The downward trend of the banks' interest rates reflects the higher competitiveness in the banking system, the further enhancement of the banks' deposit base, the improvement of the banks' credit portfolio quality, as well as the higher efficiency in the banks' operations. The lower price of the credits extended by the banks in 2004 is one of the factors that further accelerated the banks' credit activity, thus creating additional sources of funding the overall economic activity.

Figure 41
NBRM interest rates
(in %, on annual basis)



In 2004, within the set of NBRM interest rates, only the interest rates on the CB bills and the interest rate on the Lombard credits were changed. On the other hand, *the discount rate*[30] was preserved at 6.5%. *The interest rate on the Lombard credits* (collateralized short-term credits for addressing the temporary liquidity problems of the banks, housed in the group of monetary instruments - standing facilities) was changed in July and in November. Thus, the interest rate on the Lombard credits (which is an indicator for the highest interest rate in the corridor of interest rates in the economy) was reduced from 14% to 11% in July. After the increase in the interest rate on the CB bills in the third and the fourth quarter, the interest rate on the Lombard credits was proportionately increased to 13%, with a view to creating adequate spread between these two interest rates, which will not discourage the interbank trading in liquidity.

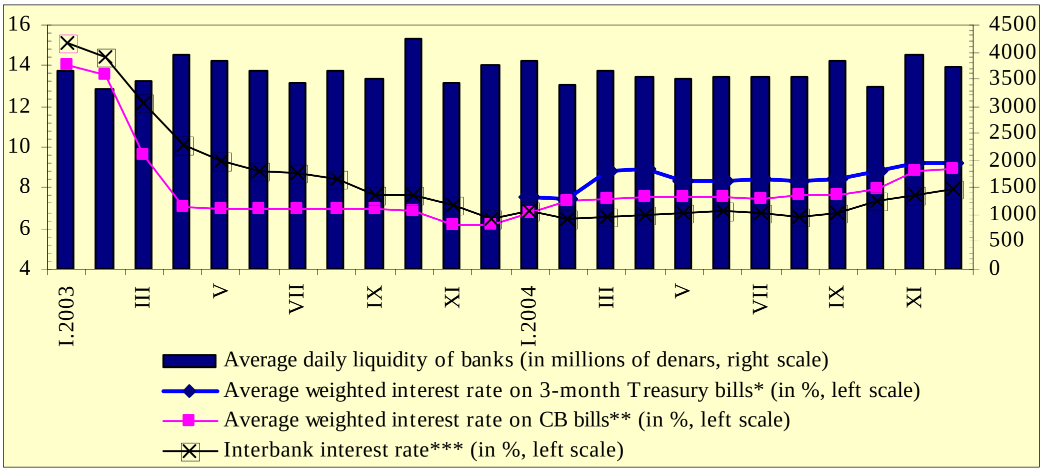
Having in mind the role of the CB bills, as a main monetary instrument, *the changes in the CB bills interest rate* represent indicators for the changes in the monetary policy design. In 2004, in line with the registered and the expected developments on the foreign exchange market, caused by the developments in the balance of payments and the changes in the expected distribution of the budget spending in the current year, the CB bills interest rates were subjected to several changes.

[30] The discount rate is only used as a basis for calculating the penalty interest rates and for payment of the interest on the basis of the Government bond for reconstruction of Stopanska Banka a.d. Skopje, issued in 1995.

At the beginning of the year, more precisely in January, the NBRM conducted "interest rate tender" auctions, and given the virtually equilibrated average demand and supply of CB bills, the average weighted interest rate on the CB bills stood at 6.75% and went up by 0.6 percentage points on monthly basis. On February 18, 2004, "volume tender" CB bills auctions were introduced, with the interest rates on 7-day (newly introduced) and 28-day CB bills being fixed at 5% and 8%, respectively. The 7-day CB bills were introduced for the purpose of creating an instrument for investing of the banks' short-term liquidity and its redirecting from the foreign exchange market. The CB bills auctions design was altered in April, i.e. a restricted amount for investing in these securities was temporarily introduced (to June 2004), and at the same time, the non-banking entities were removed from the CB bills market. The above changes were aimed at expanding the room for developing the new Treasury bills market, and were not accompanied by changes in the interest rates.

In the second half of the year, more precisely in August, September and November, the CB bills interest rates changed. Thus, on August 18, 2004 and September 29, 2004, the NBRM increased the interest rates on CB bills by 0.5 percentage points, respectively, so that the interest rates on 7-day and 28-day CB bills equaled 6% and 9%, respectively. These changes are response to the anticipated pressures on the side of the demand for foreign currency in the last quarter, in conformity with the seasonal dynamics of the foreign trade and the further postponement of the accomplishment of the planned budget spending. The same rationales stood behind the additional increase in the CB bills interest rates of 1 percentage point made by the NBRM on November 12, 2004, where the interest rates on 7-day and 28-day CB bills equaled 7% and 10%, respectively. Also, everyday auctions of 7-day CB bills were introduced in mid-December (until then, these auctions were conducted twice a week) as a liquidity "fine tuning" operation, for the purpose of offsetting the liquidity effects of the autonomous factors (the budget spending, in particular).

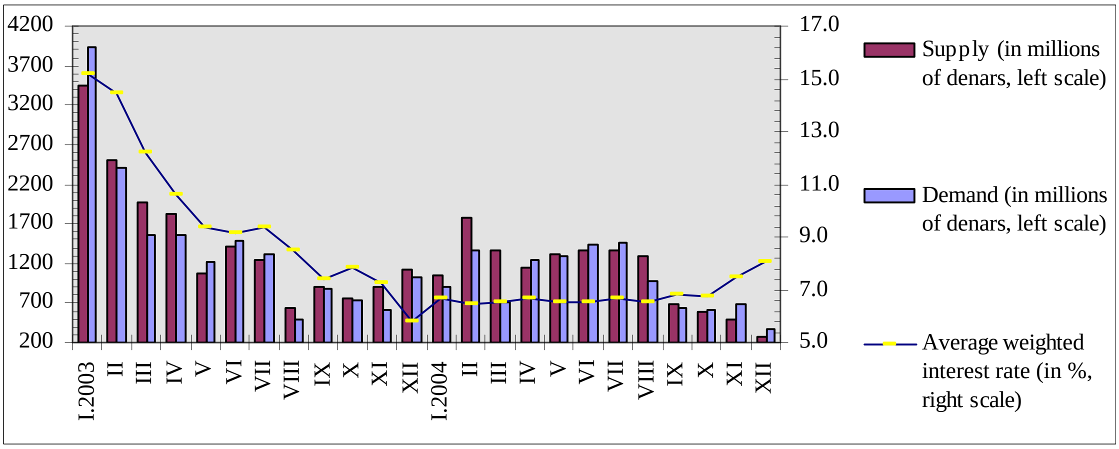
Figure 42
Short-term interest rates and average liquidity of the banks



*Issued for the first time in 2004.
**Average weighted interest rate on CB bills including all available maturity periods.
*** Average weighted interest rate on the interbank money market (institutionalized and non-institutionalized market).

The movement of the *interest rate on the institutionalized money market* in 2004 corresponds with the changes in the CB bills interest rate, indicating responsiveness to the changes in the monetary policy. Although the supply of short-term Denar liquid funds exceeded the demand, on average, the interest rate on the money market registered an upward trend in 2004, in line with the higher CB bills interest rate. However, in 2004, the average monthly weighted interest rate on the institutionalized money market equaled 6.8%, which is a major decline of 3 percentage points relative to the average in 2003.

Figure 43
Supply, demand and interest rates on the institutionalized money market

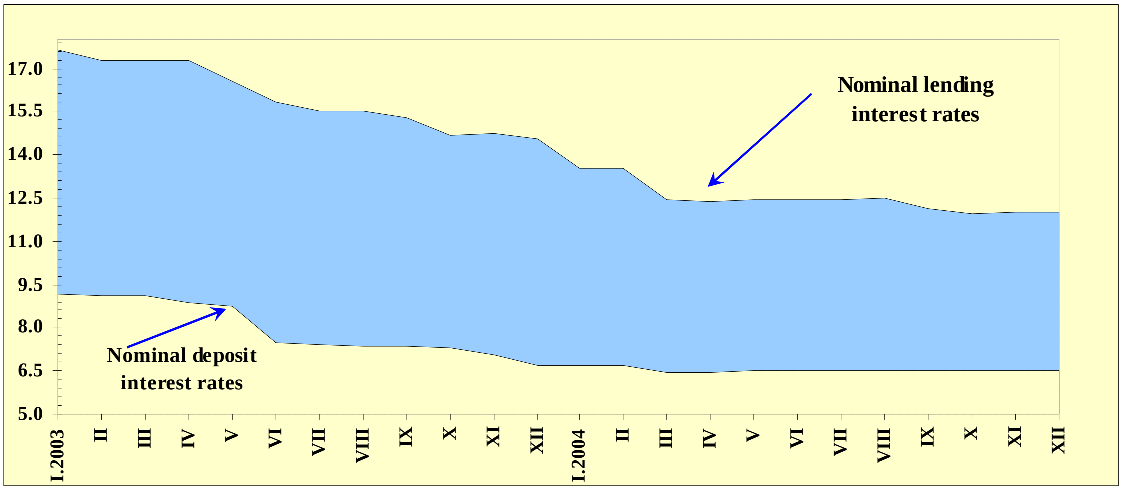


With respect to the quarterly dynamics, given the lower demand for currency in circulation and a net purchase of foreign currency by the NBRM (in March), the supply of liquid funds on the money market exceeded the demand, and the average interest rate equaled 6.56% (a decline relative to the preceding quarter of 0.4 percentage points). In the second quarter, the average interest rate remained almost unchanged relative to the previous quarter (6.58%). The liquidity created through the payment of the Government bonds for the old foreign currency savings was partially offset through the NBRM interventions on the foreign exchange market and the higher offered amount of Treasury bills, with the gap between the supply and the demand on the money market being substantially narrowed relative to the previous quarter. Although the supply of exceeded the demand for liquid funds in the third quarter, the changes in the monetary policy resulted in a minimum quarterly increase in the average interest rate on the money market of 0.1 percentage point. The response of the interest rates on the money market to the changes in the monetary policy were mostly evident in the last quarter of the year, when given the increase in the CB bills interest rate and the higher demand for relative to supply of liquid funds, the average interest rate went up by 0.7 percentage points quarterly, and reached 7.4%.

Although the CB bills interest rates went up and respectively reflected on the money and the short-term securities market, the downward trend of the *banks' interest rates* continued in 2004. The further decrease in the banks' interest rates is partially due to the following factors[31]: 1) the broad interest rate spreads of the banks, which led to reduction in the lending interest rates of the banks, in spite of the increase in the CB bills interest rate; 2) the opinion of the banks that the changes in the monetary policy design are provisional; 3) the offsetting of the effects of the lower interest income through proper rationalization of the expenses; 4) the growing competitiveness in the banking system; 5) the higher efficiency of the banking system; 6) the determination of the banks to keep the financially reliable customers with whom they have developed good business terms; 7) the further increase in the banks' deposit potential; and 8) improvement of the credit portfolio quality. The relatively low responsiveness of the banks' interest rates to the changes in the monetary policy is partially due to the structural excess liquidity in the banking system, where the NBRM interest rates are not an expense of the sources of financing for the banks, but an opportunity cost. Therefore, given the excess liquidity, the monetary transmission process is tough.

[31] Some of the reasons are identified through the interest rates survey, conducted in cooperation with the banks in January 2005.

Figure 44
Banks' nominal lending and deposit interest rates and interest rate spreads
(in %, on annual basis)

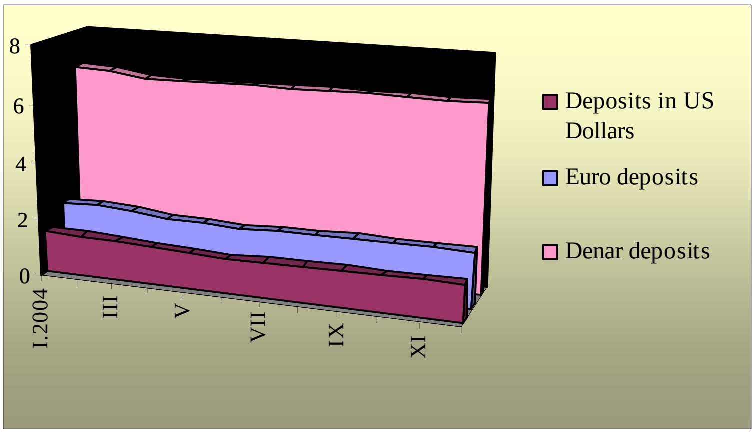


In 2004, the changes in the average weighted nominal lending and deposit interest rates of the banks registered varied intensity. Thus, considerably faster reduction was registered in the nominal weighted lending interest rate[32] of the banks, which equaled 12.5% on average, which compared to the previous year is a considerable decline of 3.5 percentage points. On the other hand, the average nominal weighted deposit interest rate[33] of the banks wend down moderately by 1.4 percentage points, in 2004, and equaled 6.5%. Such changes resulted in considerable narrowing of the average interest rate spread, which equaled 5.9 percentage points in 2004, and compared to 2003 it is by 2.1 percentage point lower. The narrowing of the interest rate spread indicates further lowering of the financial intermediation costs, given the higher competitiveness in the banking system and the higher efficiency in the banks' operations. Given the negative average change in the consumer prices in 2004, the real lending and deposit interest rates exceeded the nominal ones and equaled 12.9% and 6.9%, respectively.

The analysis of the dynamics shows permanent quarterly decline in the lending interest rates of the banks in 2004. Faster decline was registered in the first and in the second quarter (average quarterly reduction of 1.5 percentage points and 0.8 percentage points, respectively), whereas in the last two quarters, the reduction was more moderate (0.1 percentage point and 0.4 percentage points, respectively). The deposit interest rates of the banks were reduced in the first two quarters of the year (by 0.4 percentage points and by 0.1 percentage point, respectively), and no changes were registered in the second half of the year.

[32] Pertains to Denar short-term credits (with maturity of up to one year) including the Denar indexed credits.
[33] Pertains to three-month Denar deposit.

Figure 45
Average weighted interest rate on 3-month Denar and foreign currency deposits
(in %)



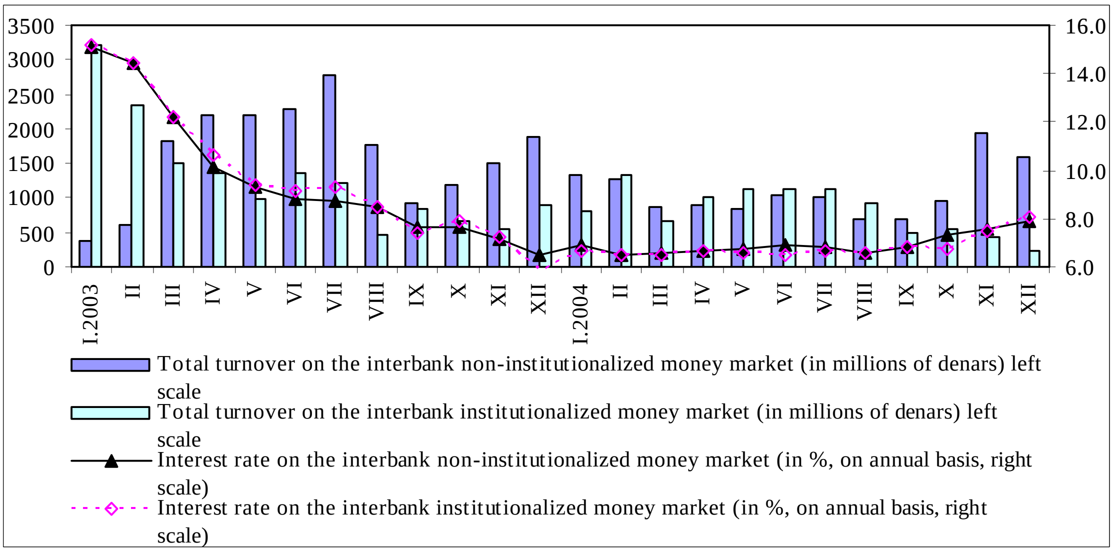
The average weighted interest rate on the short-term foreign currency credits equaled 7.7%, on average, in 2004, which is identical to the average in the previous year. The lower foreign currency credit price relative to the Denar credit price is partially due to the lower costs of the sources of funds. Thus the average weighted interest rate on the households' deposits with maturity of up to three months in Euro and in US Dollar equaled 1.95% and 1.29%, respectively, in 2004. The high spread between the yield on deposits in domestic and foreign currency should further encourage the Denar savings.

VI. Financial markets in the Republic of Macedonia

6.1. Money and short-term securities market

The downward trend of the activity on the institutionalized money and short-term securities market in Republic of Macedonia, which started in 2003, carried on in 2004. The total demand for and supply of liquid funds and the total turnover went down annually. At the same time, the total turnover of the direct (bilateral) trade of the banks in liquid funds also declined. The lower supply could partially account for the diversification of the short-term financial instruments portfolio, i.e. the introduction of CB bills with 7 days of maturity and short-term Treasury bills, some of the banks' liquid funds are target to. The sub-optimal liquidity management of some banks, manifested through a significant excess liquidity over the reserve requirement, illustrates the insufficient trade on the money market. From the aspect of the orientation of the banks to the different types of trading in liquid funds, despite the variability in the current year, in 2004 the banks preferred the direct trading. Such behavior of the banks is expected, taking into account the lower costs and the faster performance in the bilateral trade, compared to the trade with an intermediation of the institutionalized money market. The change in the CB bills interest rates triggered changes in the average weighted interest rate on the money market. In 2004, the interest rate on the money market registered no major fluctuations, except for the last quarter, when in line with the change in the monetary policy, the interest rates went up and considerably diverged from the annual average.

Figure 46
Total turnover and weighted interest rate on the institutionalized and the non-institutionalized money market



Source: Money and short-term securities market and NBRM.

The total turnover on the money market stood at Denar 9,838.8 million, in 2004, and compared to 2003 it is by Denar 5,541.3 million or by 36% lower. The decline in the turnover on the institutionalized money market is a result of the amounts of supplied and demanded liquid funds which were lower by 28.7% and 32.3%, respectively. Thus the total supply exceeded the demand by 8.8%, which left 22.4% of the total supplied funds unused, while 15.6% of the total demand remained unfulfilled (due to the limits set by the selling banks). The average daily turnover on the money market totaled Denar 38.7 million, which is a fall of 36%, relative to the preceding year. With respect to the maturity of transactions, 69.7% of the total number of executed transactions are one-day transactions, 11.2% are three-day transactions, and the transactions with maturity of 5 and 7 days make up 9.4% and 7.1%, respectively. The share of the transactions with maturity of up to one month is marginal, and constitutes 2.6%.

Table 17
Review of the trade on the money and short-term securities market

	Supply of liquid funds (in millions of Denars)		*Demand for liquid funds (in millions of Denars)*		*Turnover (in millions of Denars)*		*Average weighted interest rate (in %)*	
	2003	*2004*	*2003*	*2004*	*2003*	*2004*	*2003*	*2004*
I	3,460.0	1,038.6	3,994.8	901.6	3,225.0	822.6	15.2	6.7
II	2,505.2	1,774.1	2,401.7	1,357.6	2,330.7	1,336.6	14.4	6.5
III	1,979.7	1,356.5	1,559.3	712.0	1,494.0	674.0	12.2	6.5
IV	1,821.4	1,153.2	1,551.8	1,245.2	1,350.3	1,012.2	10.6	6.7
V	1,073.0	1,308.0	1,217.0	1,290.0	978.5	1,128.0	9.4	6.6
VI	1,421.5	1,369.5	1,474.0	1,431.0	1,371.5	1,131.0	9.2	6.5
VII	1,241.8	1,365.5	1,314.3	1,457.0	1,204.8	1,135.0	9.3	6.7
VIII	632.5	1,285.5	497.0	966.0	476.5	912.0	8.5	6.6
IX	895.4	673.5	889.7	624.5	837.4	489.5	7.4	6.8
X	757.0	589.0	726.5	617.0	658.5	547.0	7.9	6.7
XI	900.5	492.0	619.5	691.5	559.5	432.5	7.3	7.5
XII	1,111.5	278.4	1,023.0	368.6	893.0	218.4	5.8	8.0
Total	**17,799.5**	**12,683.8**	**17,268.6**	**11,662.0**	**15,379.7**	**9,838.8**	**9.8**	**6.8**

Observing the dynamics, February registered the highest turnover in 2004 (Denar 1,336.6 million). Also, in this month the banks were significantly more interest in trading in liquid funds through the institutionalized money market, relative to the bilateral trading. The highest concentration of the turnover was registered in the second quarter of the year, accounting for 33.2% of the total annual turnover. In the following quarters, the turnover on the money market considerably dropped. The above particularly pertains to the last quarter, with December registering the lowest turnover (Denar 218.2 million) since the beginning of the year. The decrease in this month is partially due to the lower supply, as a result of the needs of the banks for higher Denar liquidity due to seasonal factors, as well as of the high turnover on the non-institutionalized money market. Analyzing the relations between the supply and the demand, in the first quarter of 2004, the supply exceeded the demand by 1.4 times. In the next period (except for May, August and September), the demand for liquid funds exceeded the supply, with the discrepancy being the most evident in November (40.5%).

In 2004, an annual fall was registered in the interbank bilateral trading (non-institutionalized money market). Thus, the total turnover on this market stood at Denar 13,117.6 million, which is by Denar 6,379.7 million or 32.7% less, compared to the turnover in 2003. The share of the non-institutionalized money market in the total interbank turnover is virtually identical to the previous year and equals 57.6%.

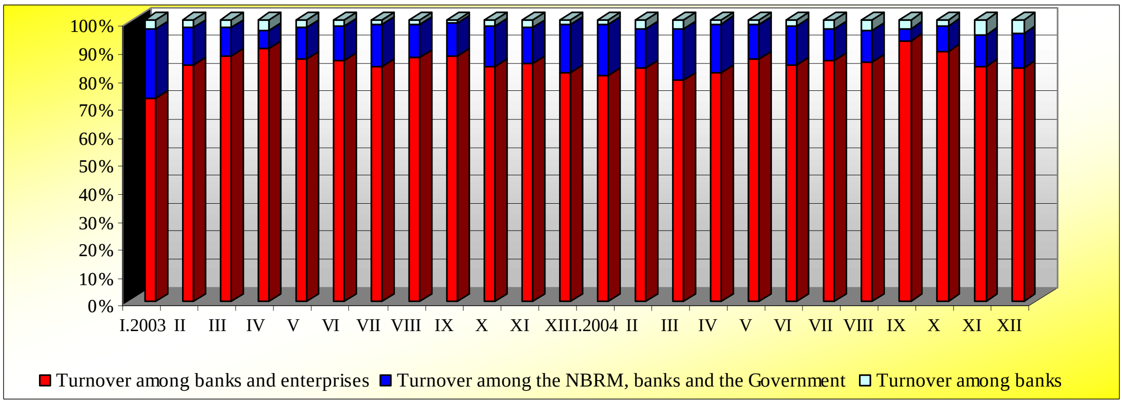
In 2004, the average weighted interest rate on the institutionalized money market equaled 6.8%, which is by 3 percentage points lower compared to the preceding year and corresponds with the relatively higher supply of than demand for liquid funds. In this year, the interest rate ranged from 6.5% to 8%, with no essential fluctuations being registered in the first three quarters of 2004. Considerable increase was registered in last quarter of the year, as a result of the rise in the CB bills interest rates.

6.2. Foreign exchange and currency exchange market

The developments on the foreign exchange market in the Republic of Macedonia in 2004 largely reflect the high deficit in the balance of payments current account, generated from the intensified foreign trade (given the faster increase in the imports relative to the exports), the changes in the banks' monetary and business policies. The NBRM interventions were directed towards narrowing the gap between the demand for and the supply of foreign currency, for the purpose of maintaining the stability of the nominal exchange rate of the Denar relative to the Euro.

In 2004, the total value of transactions executed on the foreign exchange market amounted to US Dollar 3,979.4 million, which is by US Dollar 1,013.6 million or 34.2% higher compared to the preceding year. The average monthly turnover stood at US Dollar 331.6 million in 2004, and US Dollar 247.1 million in 2003. Analyzing the segments, the transactions among the banks and the enterprises[34] constituted 87.3% of the total turnover (86.6% in 2003).

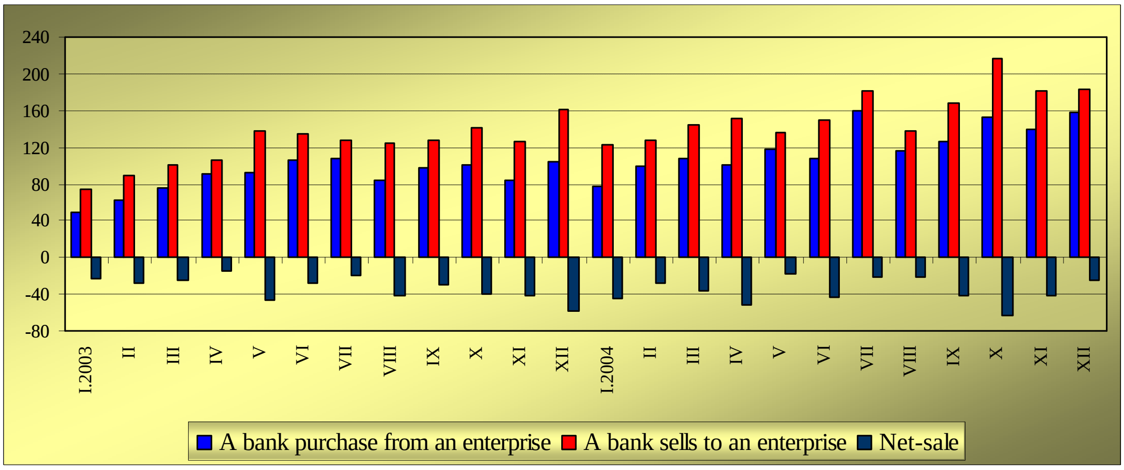
Figure 47
Share of each segment in the total turnover on the foreign exchange market



The analysis indicates a permanently higher demand relative to supply of foreign currency of the enterprises, in line with the evident preferences for accumulation of foreign assets on the enterprises' accounts, thus contributing to further broadening of the discrepancy between the demand for and the supply of foreign currency on the foreign exchange market. As for the first quarter, the discrepancy was the most obvious in January, which is a common seasonal movement and arises from the needs for paying the liabilities of the domestic importers, in conformity with the import which at the end of the preceding year was higher due to seasonal factors. In February, the NBRM started applying "volume tender" CB bills auctions and fixed interest rate (5% interest rate on the newly launched CB bills with maturity of 7 days, and 8% on the 28-day CB bills) which resulted in stabilization of the foreign exchange market developments and in a net purchase of foreign currency by the NBRM in February and March. In April, the intensified imports from Slovenia prior to its admission to the European Union (owing to the higher customs burden on the import of goods from this country after its admission to the EU) and the repatriation of the dividends of some foreign investors in the Republic of Macedonia, substantially broadened the gap between the supply of and the demand for foreign currency by the enterprises, triggering a net sale of foreign currency by the NBRM. After the higher net-sale of foreign currency by the NBRM in April, May and June, the foreign exchange market was relatively stable.

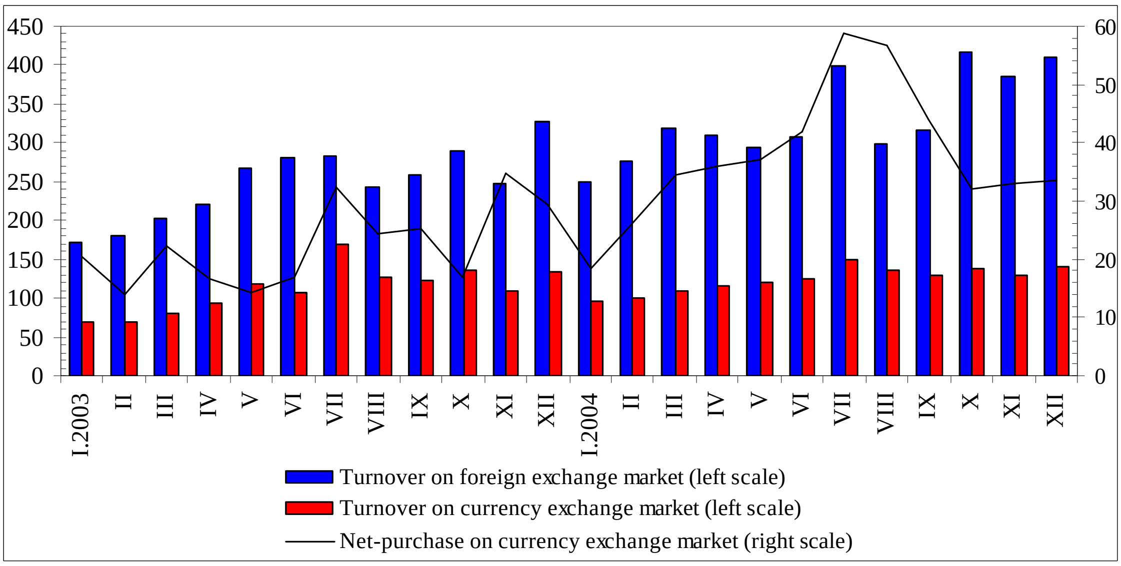
[34] It includes the purchase and sale of foreign assets from the exchange offices and the non-residents.

Figure 48
Transactions among the banks and the enterprises on the foreign exchange market
(in millions of US dollars)



In the third quarter, given the higher supply of foreign currency due to the higher seasonal inflows of foreign currency from private transfers, as well as to the higher need of Denar liquidity of some banks, the NBRM made a net purchase of foreign currency on the foreign exchange market. The deepening of the trade deficit typical for the last quarter of the year resulted in pressures on the side of the demand for foreign currency in October and November. The pressures on the foreign exchange market were offset through the NBRM interventions. Expecting further intensification of the demand for foreign currency in the last month of the year, in November, the NBRM increased the CB bills interest rates by 1 percentage point, and in December, it adopted a Decision on increasing the reserve requirement from 7.5% to 10%. Such change was aimed at sterilizing the expected expansive budget policy, i.e. preventing from foreign exchange market destabilization. As a result, in December, the foreign exchange market developments were exceptionally favorable (high net purchase of foreign currency), reflecting the switch of the monetary policy, the non-realization of a part of the budget spending, the adjustment of the open foreign currency position of some banks and the fulfillment of a part of the demand for foreign currency of the enterprises with foreign currency credits.

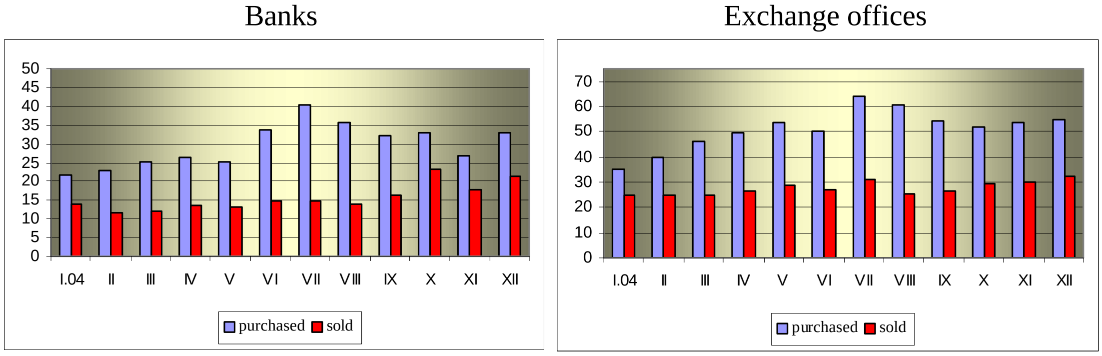
Figure 49
Turnover on the foreign exchange and currency exchange market
(in millions of US dollars)



In 2004, the turnover on the currency exchange market (exchange market of banks and private exchange offices) stood at US Dollar 1,487.2 million. Compared to the previous year, it was by 11.3% higher, having a higher supply of foreign currency (of 20.9%), and simultaneous decline in the demand (of 3%). Given the higher supply of relative to demand for foreign currency, the net-purchase of foreign currency on the currency exchange market totaled US Dollar 451.8 million (a net purchase of US Dollar 267.9 million in 2003). The monthly demand for foreign currency fluctuated from US Dollar 36.7 million in February to US Dollar 53.7 million in December. The quarterly analysis shows the most intensive demand for foreign currency in the last quarter, partially due to the demand created with the severance payment made to the employees in one larger company. At the same time, the supply of foreign currency on the currency exchange market registered the lowest level in January (US Dollar 56.8 million), and the highest in July (US Dollar 104.3 million). Analyzing the quarterly dynamics, the highest supply of foreign currency was registered in the third quarter, which corresponds with the seasonally high foreign currency inflows from private transfers in this period.

In 2004, 64% of the total demand for foreign currency by the individuals (residents and non-residents) was covered through the private exchange offices, and the remaining 36% through the commercial banks. The exchange offices and the banks account for 63.3% and 36.7%, respectively, of the supply of foreign currency.

Figure 50
Development of the turnover on the currency exchange market
(in millions of US dollars)



With respect to the currency of denomination structure of the demand for foreign cash in 2004, the share of the Euro and the US Dollar equals 78.7% and 10.8%, respectively. The analysis of the currency of denomination structure of the supply of foreign cash shows average share of the Euro, the Swiss Frank and the US Dollar of 53.1%, 32.8% and 8.9%, respectively, in the total amount of supplied foreign cash.

6.3. Stock Exchange

In 2004, the Macedonian Stock Exchange registered larger activity compared to the previous year. The intensified activity is manifested through the increase in the total Stock Exchange turnover, larger number of transactions executed in conventional trading, higher average daily turnover and higher value of the Stock Exchange Index (MBI).

Since the number of companies listed on the Stock Exchange dropped from 98 to 68, one of the factors for the higher Stock Exchange activity is the Decision on listing the third issue of denationalization bonds issued by the Republic of Macedonia (totaling Euro 47 million, the trade of which started on March 1, 2004) and the Decision on changing the manner of dealing in unlisted securities (since April 19, 2004, a trade was conducted three times a day, instead of once a day). Also, the procedure for block-transactions[35] was amended in the observed period, allowing larger transparency in the dealing in unlisted securities and higher efficiency in their market pricing. In 2004, the shareholder structure of the Macedonian Stock Exchange consisted of 20 shareholders (eight brokerage houses, eight banks, one insurance company and three individuals).

Table 18
Review of the trade on the Macedonian Stock Exchange

Stock Exchange indicators	2003	2004	2004 / 2003 (in %)
Total turnover in ordinary trade (in millions of denars)	**2,309.5**	**2,752.0**	**19.2**
Shares	777.4	1,277.0	**64.3**
Bonds	1,275.8	1,459.1	**14.4**
Other securities	256.3	16.0	**-93.8**
Volume (securities)			
Shares	2,049,128	3,894,124	**90.0**
Bonds (nominal value in Euro)	33,051,890	35,862,387	**8.5**
Other securities (nominal value in denars)	805,077,538	83,584,354	**-89.6**
Total number of transactions	**17,248**	**17,334**	**0.5**
Number of listed securities	**98**	**68**	**-30.6**
Number of trading days	**203**	**201**	**-1.0**
Average daily turnover (in millions of denars)	**11.4**	**13.7**	**20.3**
MBI	**1,178.7**	**1,351.6**	**14.7**
Block-transactions			
Value (in millions of denars)	3,768.5	5,168.5	**37.1**
Number of transactions	136	107	**-21.3**
Government segment			
Value (in millions of denars)	1,481.8	395.4	**-73.3**
Number of transactions	230	87	**-62.2**

Source: Macedonian Stock Exchange

In 2004, the total Stock Exchange turnover (excluding block-transactions and Government) went up by 19.2%, compared to the same period of the previous year, due to the higher value of executed transactions in shares and bonds on the official market segment by 53.9% and 14.4%, respectively. Also, the trade in shares on the unofficial market surged by 83.9%. In virtually identical number of trading days (201 in 2004 and 203 in 2003), the number of transactions executed through conventional trading went up by 0.5%. The average daily turnover reached Denar 13.7 million, which is by 20.3% more on annual basis.

With respect to the trade in Government bonds and other securities, the average price of the bonds issued by the Republic of Macedonia on the basis of the old foreign currency savings made up 72.4% of the nominal value, registering a turnover of Denar 363.9 million. Turnover of Denar 10.6 million was registered on the basis of the transactions in Government denationalization bonds (first issue), with the average price constituting 68.6% of the nominal value. At the same time, turnover of Denar 215.8 million and Denar 868.9 million, respectively, was registered on the basis of the transactions in Government denationalization bonds (second and third issue), with the average price accounting for 67.5% and 63.9%, respectively, of their nominal value. On the other hand, the average price in the trade in convertible certificates for claims on the collapsed savings houses[36] equaled 15.1% of the nominal value, with the turnover totaling Denar 13.7 million. The transactions in 3-month Treasury bills stood at Denar 2.3

[35] According to the adopted amendments dated June 30, 2004, the criteria on concluding and reporting a block transaction changed, i.e. the money criterion of Denar 5 million reduced to Denar 1 million, and the previous criterion (10% of the core principal) was abandoned, with a simultaneous introduction of a restriction of the maximum number of sellers/buyers in the block-transaction (max. 10). Furthermore, the price of the block transaction hooks up to the respective reference market price of the shares subject to the block transaction in the BEST system (the price may not diverge more than +/- 20%, i.e. 30% of the weighted average price of all Stock Exchange transactions in such shares over the last 30 calendar days as for the listed, i.e. unlisted shares), i.e. to their nominal value (in the case there is no prior trading in some shares, the price of the block-transaction may not be below 10% of their nominal value) and at the same time, a distinction is made in the treatment of the listed and the unlisted shares.
[36] These securities were for the first time launched on the Stock Exchange in July 2002.

million, making up 98.7% of the individual nominal value of each Treasury bill (Denar 10,000)[37].

Analyzing the market segments, most of the Stock Exchange turnover in conventional trading (81.5%) was realized on the official market segment, while the residue refers to the turnover on the unofficial market (18%) and the trade in convertible certificates and short-term Treasury bills (0.6%). Also, most of the transactions were executed through the conventional trading (17,334 of 17,528, in total).

Table 19
Structure of the Stock Exchange turnover by market segment

	2004		
Structure of turnover by market segment	Turnover (in millions of denars)	in %	Number of transactions
Official market	2,241.7	*81.5*	
Unofficial market	494.3	*18.0*	
Other securities	15.945	*0.6*	
Total	*2,752.0*	*100.0*	*17,334*
Block-transactions	5,168.5		107
Government segment	395.4		87
Total	**8,315.9**		**17,528**

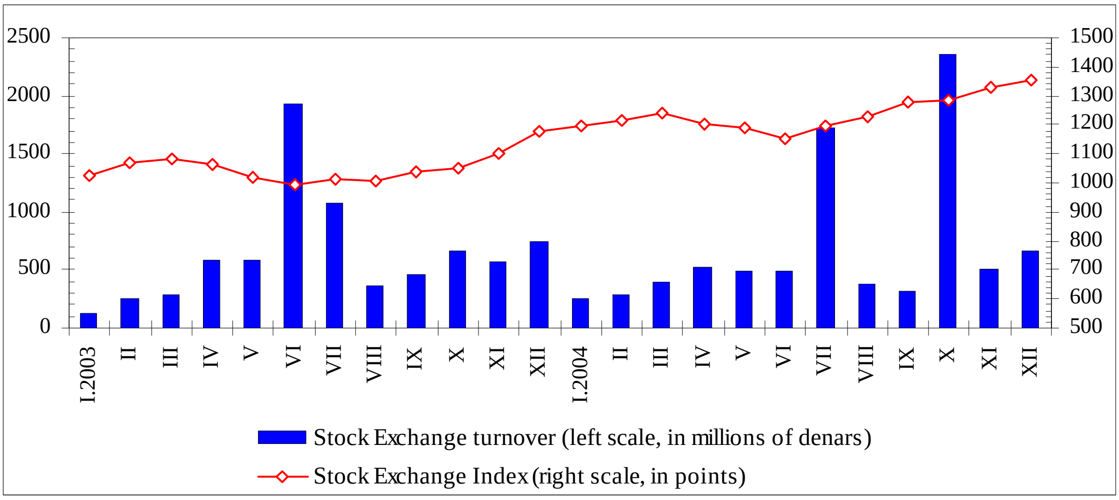
Source: Macedonian Stock Exchange

Notwithstanding the lower number of reported block-transactions (107 in 2004 and 136 in the previous year), the value of the turnover through block-transactions in 2004 was by 37.1% higher on annual basis. The turnover on the Government segment dropped by 73.3%, with a simultaneous decline being registered in the trade in shares and parts owned by the Government of 73.5% and 57.2%, respectively. In 2004, the shares and parts of the Privatization Agency in the amount of Denar 344.4 million were traded in, as well as those of the Pension and Disability Insurance Fund, the market price of which totaled Denar 51 million.

In 2004, the total Stock Exchange turnover (including block-transactions and transactions on the Government segment) stood at Denar 8,315.9 million, which is a 10% increase compared to the preceding year. The increase is particularly due to the higher value of the block-transactions, constituting 62.2% of the total Stock Exchange turnover.

[37] The amendments to the Securities Law dated December 31, 2003 ("Official Gazette of the Republic of Macedonia" no. 85/2003) allow trading in short-term securities through the Macedonian Stock Exchange. The Treasury bills were introduced in January 2004.

Figure 51
Total Stock Exchange turnover* and value of the Stock Exchange Index



*Also includes block-transactions and trade on the Government segment.
Source: Macedonian Stock Exchange.

In 2004, the indicator for the Stock Exchange developments - the Stock Exchange Index (MBI) was permanently maintained over its initial value (1,000 points), reaching 1,351.63 points in December, which is by 14.7% more compared to December 2003.

VII. External sector

7.1 Balance of payments

The liberalization of the foreign trade after the admission to the World Trade Organization (WTO) and in accordance with the Stabilization and Association Agreement (SAA) with the European Union, the rise in the world oil price and the restarting of one of the larger metallurgical plants in the Republic of Macedonia resulted in deepening of the *trade deficit* in 2004. The trade deficit, as well as the deficit in the trade in services and the net-outflows based on income, were partially covered through the high foreign currency inflows from current transfers. Such movements resulted in *current account deficit* of 7.7% of the gross domestic product, which is substantially more compared to the deficit in 2003 (3.3% of GDP)[38]. Simultaneously, the deficit in the balance of payments current account, excluding the official transfers in 2004, reached 9% of the GDP (5.6% of the GDP in 2003). In 2004, the commercial credits and the foreign direct investments were major components of the *funding of the balance of payments current account*.

7.1.1. Current account

After the considerable improvement of the international current transaction balance in 2003, the current account deficit deepened by US Dollar 262.4 million in 2004, primarily owing to the higher deficit in the foreign trade in goods (accounting for 93.1% of the balance of the categories that create the current account deficit).

Table 20
Balance of payments current account
(in millions of US dollars)

	1997	1998	1999	2000	2001	2002	2003	2004
Goods, net (fob)*	-386.1	-515.1	-495.8	-690.4	-526.4	-804.3	-851.5	-1,119.6
Services, net	-137.7	-59.8	42.0	48.7	-19.2	-22.1	-2.6	-43.3
Income, net	-54.9	-45.0	-42.3	-45.6	-40.7	-29.8	-32.3	-39.4
Transfers, net	292.6	350.2	463.8	615.0	342.6	498.4	734.1	787.7
Current account	**-286.1**	**-269.7**	**-32.4**	**-72.4**	**-243.6**	**-357.8**	**-152.3**	**-414.6**
Current account, % of GDP	**-7.7%**	**-7.5%**	**-0.9%**	**-2.0%**	**-7.1%**	**-9.5%**	**-3.3%**	**-7.7%**

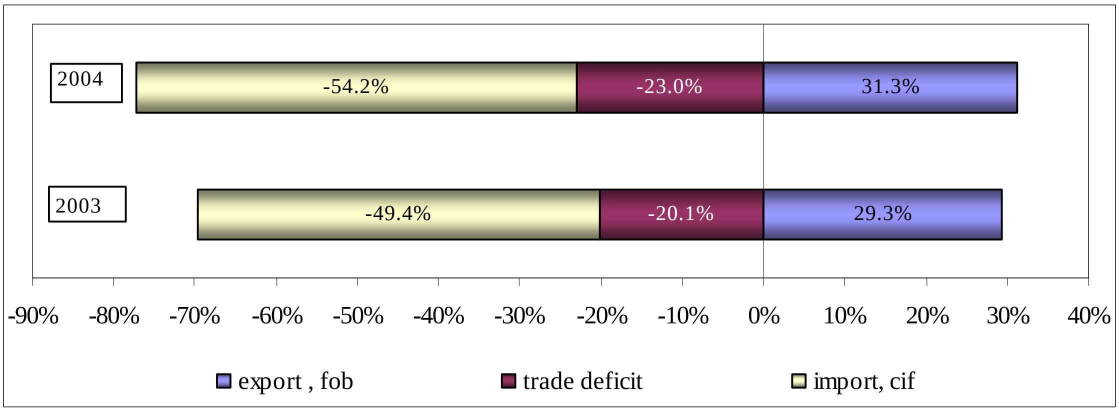
1) Preliminary data
*) The cif-fob factor in 2004 equals 3.8%.
Source: National Bank of the Republic of Macedonia

Given the strengthened export activity of the domestic economy and the simultaneous increase in the domestic demand for import goods, *the total foreign trade*[39] of the Republic of Macedonia went up by 24.6%, with a part of the growth owing to the depreciation of the US Dollar relative to the Euro[40] in 2004 (when 75% of the total foreign trade was made in Euro, and recorded in US Dollars).

[38] In October 2004, the time series of the balance of payments from January 2002 to June 2004 was revised. The following categories were subject to changes: private transfers, exchange operations (January 2003 - June 2004) due to the methodological reconciliation; currencies and deposits of commercial banks (March 2002 - June 2004), as a result of the introduction of a new source of data which enhanced the scope of the accounts the changes of which are computed on the basis of the changes in the amounts by original currency.
[39] Source: State Statistical Office. The exports and the imports differ from the amounts in the balance of payments of methodological reasons. The imports in the foreign trade, according to the data provided by the State Statistical Office, is presented on a cif basis.
[40] The average value of the US Dollar relative to the Euro depreciated by 9.6% on annual basis.

However, the more intensive increase in the import relative to the export of goods resulted in an annual increase in the foreign trade deficit of the Republic of Macedonia of 30.9% in 2004 and a decrease in the level of export - import coverage ratio of 1.6 percentage points (57.6%). The increase in the import and the export resulted in their higher share in the gross domestic product by 2 percentage points and 4.8 percentage points, respectively.

Figure 52
Export, import and trade deficit
(share in the GDP)



Source: State Statistical Office of the Republic of Macedonia; the calculations are made in the NBRM

The intensified production and export activity of the metal manufacturing industry, especially in the second half of the year, in the conditions of increase in the prices of nickel, steel and sheet steel on the stock exchanges initiated by the higher international demand, as well as continuously increased production and export activity of the textile industry, are the main factors that determined the *export of goods* to increase on annual basis by 22.4%. Analyzed by product categories classified by sectors of the Standard International Trade Classification (SITC), 50.4% of the increase in the export of goods from the Republic of Macedonia is due to the higher export of iron steel, while 25.3% accounts for the export of clothing and other textile products. Among other groups of products, a significant increase is registered in the export of fruit and vegetables, medical and pharmaceutical products, footwear, electrical machines and oil derivatives.

Table 21
Export of Goods by products according to the SITC

groups of products	**2003**	**2004**	**change in absolute amount**
		in millions of US Dollars	
Total export of goods	**1,367.0**	**1,673.5**	**306.5**
Products classified by materials	***398.1***	***546.3***	***148.2***
iron and steel	251.0	405.3	154.4
Other manufactured products	***471.8***	***568.7***	***96.9***
clothing	410.8	488.3	77.5
	share in the total export in %		**contribution to the total increase in %**
iron and steel	18.4	24.2	50.4
clothing	30.1	29.2	25.3
Total	***48.4***	***53.4***	***75.6***

Source: State Statistical Office of the Republic of Macedonia; the calculations are made in the NBRM

The large dependence of the Macedonian economy on the import and the lower customs burdening of the import (in accordance with the Agreement with the WTO and the SAA with the EU) are the main factors that acted towards stimulating the demand for imports. The *import* *of goods* reached US Dollar 2,903.4 million which is an annual increase of 25.9%. Observed by product categories, 37.3% of the increased in the imports in 2004 is due to the higher import of iron and steel, 13.2% to the higher import of textile and yarn. The reduced customs duties and the revoked excise in the import of vehicles, as well as the announcement of the Macedonian Government for re-introduction of excise from January 1, 2005, were the reasons for the significant increase in the import of vehicles, especially intensified in the last month of the year. Thus in 2004 the annual import of vehicles reached US Dollars 184.1 million and it was higher by US Dollar 82.1 million, which is represents 13.8% of the increase in the total import.

Table 22
Import of goods by group of products according to the SMTC[41]

groups of products	2003	2004	change in absolute amount
	in millions of US Dollars		
Total import of goods	**2,306.4**	**2,903.4**	**597.1**
Food products	***271.2***	***337.0***	***65.9***
Mineral fuels, lubricants, etc.	***323.1***	***377.3***	***54.3***
oil and oil products	259.0	295.9	36.9
electricity	22.6	38.9	16.3
Chemical products	***254.9***	***303.7***	***48.8***
Products classified by materials	***333.2***	***696.2***	***362.9***
textile, yarn, etc.	27.1	105.6	78.5
iron and steel	76.0	298.6	222.6
Machinery and transport equipment	***434.2***	***545.7***	***111.4***
road vehicles	101.9	184.1	82.1
Other manufactured products	***128.7***	***171.3***	***42.6***
	share in the total export in %		**contribution to the total increase in %**
oil and oil products	11.2	10.2	6.2
textile and yarn, etc.	1.2	3.6	13.2
iron and steel	3.3	10.3	37.3
road vehicles	4.4	6.3	13.8
Total	***20.1***	***30.5***	***70.4***

Source: State Statistical Office of the Republic of Macedonia; the calculations are made in the NBRM

The extremely high increase in the price of oil on the international stock exchanges, having in mind the dependence of the Macedonian economy on the import of oil, was a negative external shock determining higher outflow of foreign currency for the import of oil. The higher value of the import of oil in 2004 completely represents a price effect, while the imported quantities register a decrease. The augmented import of electricity in 2004 originates from the increased consumption, caused by the intensified economic activity of certain larger consumers. The higher import of industrial and other machines initiated from the higher needs of the economic agents, signalizes deferred positive effects and more intensive economic activity in the following period.

[41] In October 2004, the Law on Customs Tariff was amended, with the import of the further processed goods being included in the import of appropriate product categories. Hence, the annual change in the import of the appropriate products in 2004, also includes the amendment to the tariff methodology.

Table 23
Import of crude oil in the Republic of Macedonia

	2003	2004	change in absolute amount
crude oil (in millions of US dollars)	193.1	220.3	27.3
quantity (in tons)	880,062	781,798	-98,264
average price (price per 1 kg)	0.22	0.28	0.06

Source: National Bank of the Republic of Macedonia

Analyzed by the economic use of the products, the consumption goods and the reproduction materials dominate the import, with their share being equal to 49.3% and 48.8%, respectively. The dominant share of 64.7% in the total import accounts for the reproduction materials (mainly import of iron, steel and oil), while the consumption goods participate with 24.5%.

Box 3
Herfindahl - Hirschman export and import concentration index

Herfindahl - Hirschman Index, as a measure for the level of concentration of the export, i.e. the import, is a normalized index the values of which vary between 0 (minimal concentration) and 1 (maximum concentration), and it is calculated according to the following formula:

$$Hj = \frac{\sqrt{\sum(\frac{xi}{X})2-\sqrt{1/n}}}{1-\sqrt{1/n}}$$

Hj -Herfindahl-Hirschman Index of the country j;
xi -value of the export, i.e. the import of the product *i*
X - total export, i.e. import of the country j
n - number of products exported (imported) by the country classified according to the SITC, Revision 2 (Standard International Trade Classification). The maximal number of products according to the SITC equals 239, but when calculating this index for a particular country ***n,*** it includes only the products the share of which in the total export or import is larger than 0.3% (therefore it is called modified Herfindahl - Hirschman Index).

The value of the ratio of the concentration of the export of goods of the Republic of Macedonia measured according to the ***Herfindahl - Hirschman Index,*** resembles to the developing countries to a great extent and it is far from the export concentration characteristic for the advanced economies in transition, or for the developed countries. On the other hand, the value of the index points to a similar concentration of the import in the advanced economies in transition.

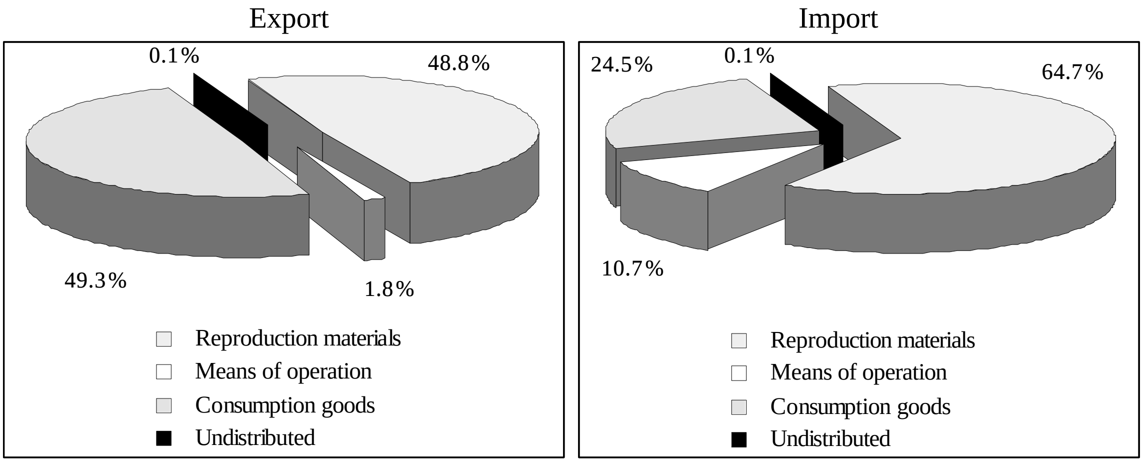
Thus ***Hj=0,271, n=35*** for the export of the Republic of Macedonia in 2004, (***Hj=0,261, n=31*** in 2003)*, while for the import ***Hj=0,089, n=54 (Hj=0,093, n=55*** in 2003) ****.**

The high export concentration ratio points to an absence of a diversified supply of the export sector, i.e. there are only several groups of products in the domestic export having more significant share over 4% in the export structure in 2004. Having in mind that the largest part of the export of these products are only goods for further processing aimed for export, then the share of the oil products is that dominating the export structure. Thus the export of oil products participates with 4.5% in the Macedonian export for 2004, tobacco and tobacco manufactures with 4.4%, fruit and vegetable with 3.8%, beverages with 3.3%, etc.

On the other hand, the low import concentration ratio points to a dispersion of the import, which is expected tendency taking into consideration the continuing trade liberalization. However, low level of import concentration is common also for the developed countries. The lower level of import than the export concentration is characteristic for almost all countries and it is a result of the tendency of the countries to focus their export on the sectors in which they have comparative advantages.

* The modified Herfindahl - Hirschman index of export concentration for certain countries in 2001 equaled: for the USA 0.081; Great Britain 0.101; Japan 0.135; Albania 0.265; Romania 0.119; Poland 0.081; Slovenia 0.103.
** The modified Herfindahl - Hirschman index of import concentration for certain countries in 2001 equaled: for the USA 0.099; Great Britain 0.085; Japan 0.102; Albania 0.077; Romania 0.066; Poland 0.066; Slovenia 0.061.
Source: UNCTAD Handbook of Statistics, 2003, Geneva, UN Conference on Trade and Development.

Figure 53
Structure of the foreign trade of the Republic of Macedonia by economic use of products in 2004



Source: State Statistical Office of the Republic of Macedonia

Analyzed by economic groups of countries, the European Union dominates in the total foreign trade (50.5%)[42] also in 2004, which represents an increase in comparison with the previous year of 2.7 percentage points. This group of countries traditionally has the highest share in the total export and import of the Republic of Macedonia, which in 2004 equals 56.4% and 47.2%, respectively. The share of the foreign trade with the countries of the former SFRY equals 18.6%, which is a decline of 3.5 percentage points compared to 2003 (due to the joining of Slovenia to the EU). The intensified import of iron and steel from Romania and Poland, and oil from Russia and Bulgaria caused a cumulative increase in the share of the trade with the Central and Eastern European countries of 1.2 percentage point, and in 2004 it equals 17.2%. The most intensive foreign trade of the enterprises in the Republic of Macedonia was realized with their partners from Germany, Serbia and Montenegro and Greece (total share of 38.9% in 2004, while the average share in the 1997 - 2004 period equaled 39.8%), thus pointing to the steadiness of the trade participants structure and the established cooperation on continuous basis. Within the ten most important trading partners, positive balance was registered only in the trade with three countries, i.e. Serbia and Montenegro (US Dollar 104.3 million), Croatia (US Dollar 14.9 million) and France (US Dollar 9.8 million), while the highest deficit is registered in the trade with Russia and Bulgaria (US Dollar 231.8 million and US Dollar 157.3 million, respectively).

[42] According to the data of the State Statistical Office of the Republic of Macedonia, the EU encompasses 15 member-states until April 30, 2004, while since May 01, 2004, it encompasses 25 countries.

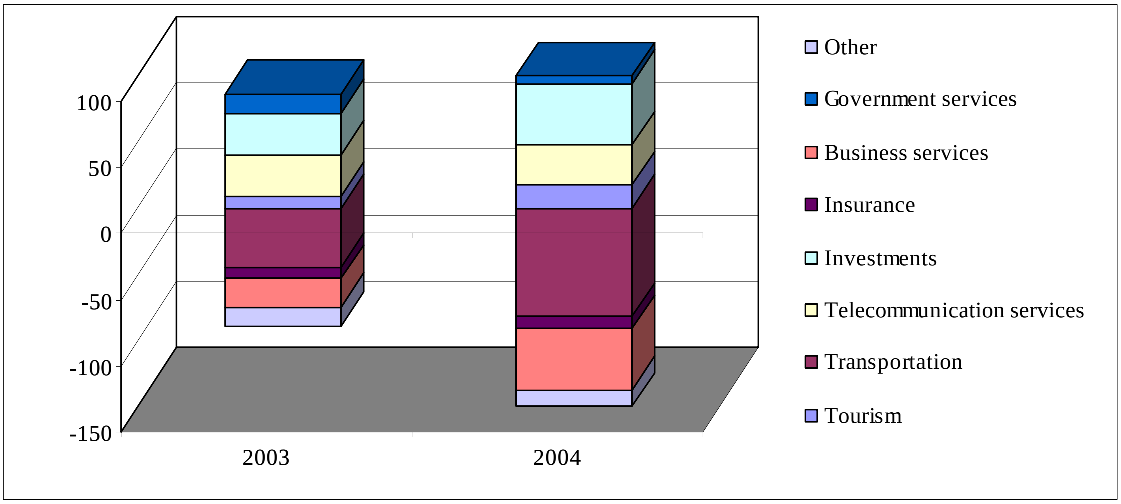
Table 24
Geographic distribution of the foreign trade of the Republic of Macedonia
(in millions of US Dollars)

	Export		Import		Total trade		Trade balance	
	2003	2004	2003	2004	2003	2004	2003	2004
European Union	**747.5**	**943.5**	**1,009.2**	**1,369.2**	**1,756.7**	**2,312.7**	**-261.7**	**-425.7**
Germany	279.4	315.6	304.8	365.6	584.2	681.2	-25.4	-50.1
Greece	180.4	228.6	300.6	280.6	481.0	509.2	-120.2	-51.9
Other	287.7	399.3	403.9	723.0	691.6	1,122.2	-116.2	-323.7
Central and Eastern European countries	**68.6**	**103.1**	**518.7**	**684.2**	**587.3**	**787.3**	**-450.1**	**-581.1**
Russia	13.7	19.7	179.0	251.5	192.7	271.2	-165.2	-231.8
Bulgaria	25.8	51.5	149.2	208.8	175.0	260.3	-123.4	-157.3
Romania	1.4	1.8	14.4	113.0	15.8	114.9	-13.0	-111.2
Poland	0.5	2.6	26.4	78.3	26.9	80.9	-25.9	-75.7
Other	27.2	27.5	149.7	32.5	176.9	60.0	-122.6	-5.1
Former countries of SFRY	**386.3**	**468.4**	**427.2**	**383.4**	**813.5**	**851.8**	**-40.9**	**85.0**
Serbia and Montenegro	275.0	347.5	212.8	243.2	487.8	590.7	62.2	104.3
Other	111.3	120.9	214.4	140.2	325.7	261.1	-103.1	-19.3
Other countries	**164.6**	**158.5**	**351.2**	**466.7**	**515.8**	**625.2**	**-186.7**	**-308.2**
TOTAL	**1,367.0**	**1,673.5**	**2,306.4**	**2,903.4**	**3,673.3**	**4,576.9**	**-939.4**	**-1,229.9**

Source: State Statistical Office of the Republic of Macedonia

In the trade of *services* in 2004, a deepening of the deficit by US Dollar 40.7 million on annual basis was registered, which is due to the higher foreign currency outflows for provided services (primarily due to the higher import of goods, as well as the realized transport of oil through oil pipeline) relative to the inflows on this basis. Thus, US Dollar 451 million on the basis of performed services to non-residents were paid in 2004, which is an increase of US Dollars 122.4 million on annual basis, and their share in the import of goods (fob) augmented by 1.3 percentage points (16.2%). From the aspect of separate services registering trade deficit, the transport services and business services are dominant (52.9% and 30.2%, respectively of the total balance of services registering deficit). On the other hand, foreign assets in the amount of US Dollar 407.7 million were received on the basis of performed services (annual increase of US Dollar 81.7 million), while their share in the export of goods retained the level registered in the previous year and it equals 24.4%. However, the highest share in the total services registering positive balance, accounts for the investments abroad and telecommunication services (42.1% and 27.3%, respectively). Also, positive balance was registered in the services based on tourism (US Dollar 17.3 million, or higher net inflow of US Dollar 8.6 million, annually).

Figure 54
Balance of certain categories of services
(in millions of US Dollars)

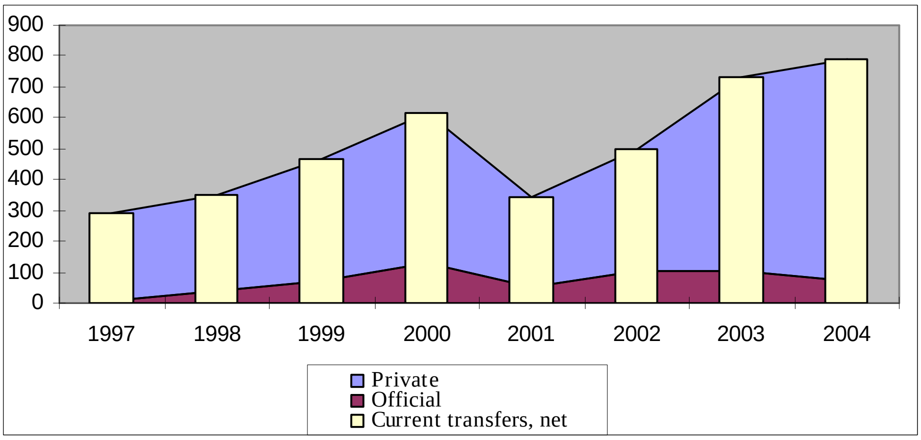


Source: National Bank of the Republic of Macedonia

Insignificant increase in the deficit of US Dollar 7.1 million was registered in the *income sub-balance* in 2004. The increase in the deficit is mainly due to the augmented foreign currency outflows on the basis of payment of dividends to non-residents. Namely, higher foreign currency inflows on the basis of employed persons - residents (of US Dollar 51.9 million) was registered in 2004, which neutralizes the profit repatriation effect with the foreign direct investors to a great extent (US Dollar 66.7 million). Net outflow of foreign assets based on interest was registered, as a result of the higher amount of paid interest to the foreign creditors for utilization of long-term and short-term credits compared to the registered inflows based on interest to the official foreign reserves and foreign currency deposits of the commercial banks abroad. Hence, the realized net outflow based on interest in 2004 amounts to US Dollar 26.2 million, i.e. lower net outflow by US Dollar 5.7 million were registered on this basis in comparison with the previous year.

The current transfers are the only category of the balance of payments' current account which is registering a positive balance. The high foreign currency inflows based on current transfers significantly neutralizes the high deficit in the trade of goods, services and income also in 2004.

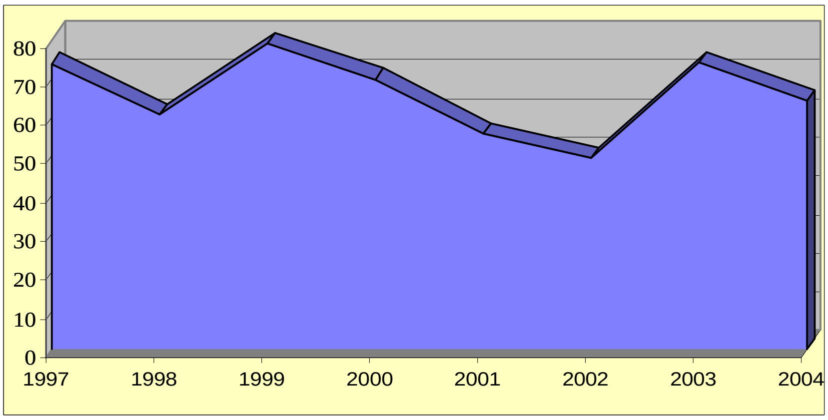
Figure 55
Current transfers, net
(in millions of US Dollars)



Source: National Bank of the Republic of Macedonia

In terms of reduced foreign currency inflows from official transfers, the higher foreign currency inflows based on current transfers (by US Dollar 53.6 million on annual basis) completely originate from the increased transfers of foreign assets from private entities. Inflows in the amount of US Dollar 75.9 million based on official transfers were registered in 2004, which is a decrease of US Dollars 31.5 million in comparison with the previous year, mainly as a result of the lower inflow of funds. The realized donations in funds in the amount of US Dollar 43.4 million (US Dollar 14 of which originate from the Netherlands and US Dollars 5.9 million from Germany) registered an annual decrease of 45%. Simultaneously, the assistance worth US Dollar 32.5 million that the official creditors provided in goods is higher by 19.9%. In 2004, the outflows based on official transfers equaled US Dollar 6 million. In 2004, net inflows of foreign assets in the amount of US Dollar 717.8 million on the basis of private transfers were registered, which is an annual increase of US Dollar 87 million, with the private transfers covering 64.1% of the trade deficit in 2004. The high trade deficit coverage ratio with private transfers points to a large importance of the private transfers for the level of deficit in the current account.

Figure 56
Coverage of the trade deficit with private transfers
(in %)



Source: National Bank of the Republic of Macedonia

The largest increase is registered in the foreign currency inflows through the currency exchange operations (US Dollar 42.4 million), while the increase in the other private transfers (mainly pensions, rents and disability support) and the remittances equals US Dollars 27.2 million and US Dollar 17.5 million, respectively. In 2004, the structure of private transfers is dominated by the share of the inflows through the currency exchange operations (61.4%), and the share of the remittances and the other private transfers equals 20.2% and 18.5%, respectively.

7.1.2. Capital and financial account

The capital and the financial transactions in 2004 resulted in an increase in the net financial foreign currency inflows (of US Dollars 206.3 million) mainly as a result of the significant increase in the trade credits and of the foreign direct and portfolio investments (an increase of US Dollar 87 million and US Dollar 74 million, respectively compared to 2003). The largest part of the deficit in the current account of the balance of payments (82.4%) was financed through these inflows.

Table 25
Capital and financial account of the balance of payments[1)]
(in millions of US Dollars)

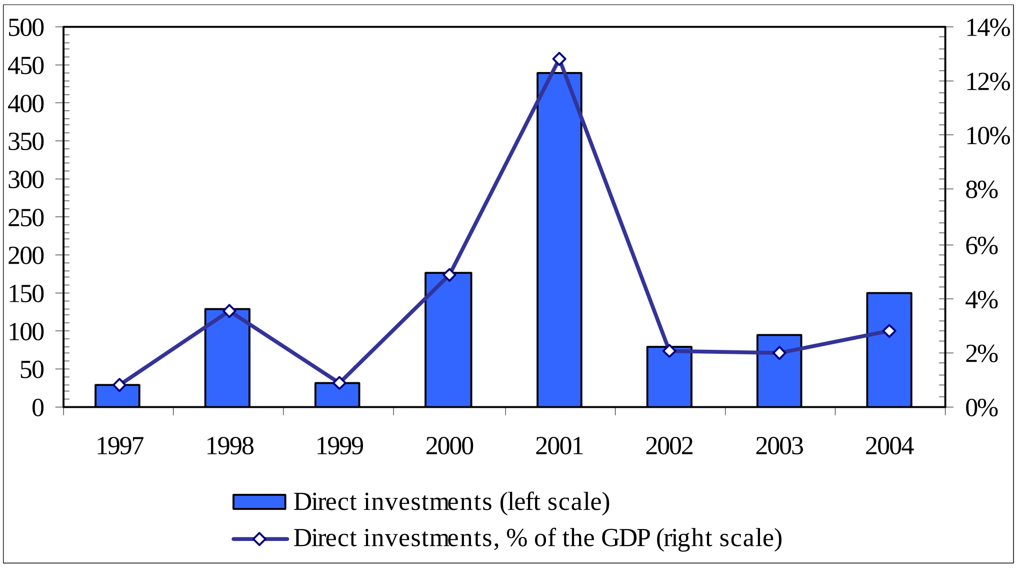
	1997	1998	1999	2000	2001	2002	2003	2004
Capital account	***0.0***	***-1.8***	***0.0***	***0.3***	***1.3***	***8.3***	***-6.7***	***-4.6***
Financial account	***345.3***	***340.2***	***16.0***	***274.7***	***316.9***	***238.0***	***227.6***	***431.8***
Direct investments, net	30.0	127.7	32.4	175.1	440.7	77.7	94.3	150.1
Portfolio investments, net	2.1	0.4	0.0	-0.1	0.4	0.3	3.4	21.5
Trade credits, net	267.4	46.5	8.2	147.4	-60.2	83.1	82.9	170.0
Loans, net	75.4	219.9	77.8	13.5	-107.2	8.2	23.5	59.8
Currencies and deposits, net	-37.8	-56.3	-120.5	-108.8	21.3	44.7	2.9	-3.8
Other, net*	8.1	2.0	18.1	47.5	22.0	24.0	20.7	34.2
Capital and financial account	**345.3**	**338.4**	**16.0**	**275.0**	**318.2**	**246.3**	**220.9**	**427.2**

1) Preliminary data
*Overdue claims
Source: National Bank of the Republic of Macedonia

The increase in *the trade credits* initiated by the intensified foreign trade activity in 2004 denoted increased crediting of the domestic importers and covered significant part of the deficit on the current account of the balance of payments (41%). Thus in 2004 the trade credits equaled US Dollar 170 million and covered even 15.2% of the trade deficit (9.7% in 2003).

The foreign direct and portfolio investments in the domestic economy in 2004 equal US Dollar 74 million. The increase was registered in both categories of non-debt financing. Thus the foreign direct investments (US Dollar 150.1 million) registered an annual increase of US Dollar 55.9 million with their share in the GDP being higher by 0.8 percentage points compared to 2003, and it equaled 2.8%. In 2004, the portfolio investments raised by US Dollar 18.1 million annually, and they equaled US Dollar 21.5 million. Almost half of the portfolio investments refers to the inflows from the European Bank for Reconstruction and Development related to the pre-privatization of the ESM. However, even if excluding this amount, there is a significant increase in the portfolio investments in 2004, which is in conformity with their gradual liberalization. The inflows from foreign direct and portfolio investments in 2004 financed 41.4% of the current account deficit.

Figure 57
Foreign direct investments in the Republic of Macedonia
(in millions of US Dollars)

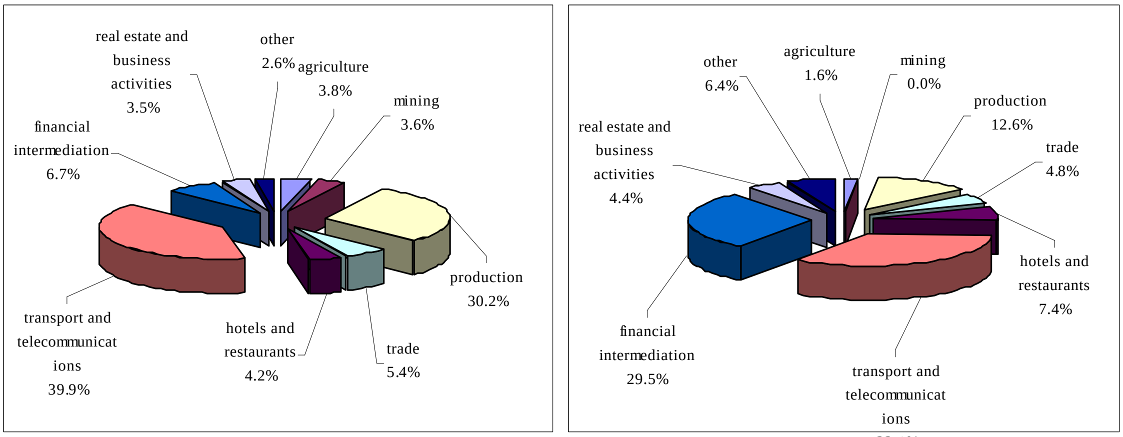


Source: National Bank of the Republic of Macedonia

The analysis of the allocation by activities points to the highest amount of foreign direct investments in the telecommunication services (US Dollar 61.9 million), i.e. 39.4% of the total foreign direct investments in the country in 2004. Total amount of US Dollar 47.5 million were invested in the output (US Dollar 30.2% of the total foreign direct investments), and within those frames, the larger investments refer to the refining of oil derivatives (US Dollar 20.9 million), production of metal products (US Dollar 12 million), production of chemicals and chemical products (US Dollar 6.1 million) and production of food products (US Dollar 2.4 million).

Figure 58
Foreign direct investments in the Republic of Macedonia by activities
(in %)

2004 2003



Source: National Bank of the Republic of Macedonia

Analyzed by countries, the largest investors are the Netherlands and Greece (42.1% and 19.2%, respectively), followed by Switzerland, Italy, Germany, Croatia, Bulgaria and Slovenia. The structure of the countries the foreign direct investments originate from corresponds to a large extent to the structure of the countries with which the Republic of Macedonia registers an intensive foreign trade.

In 2004, net inflow in the amount of US Dollar 59.8 million was registered on the basis of transactions pertaining to debt financing, which is due to the higher amount of used loans and credits, compared to the payments based on principal on the basis of withdrawn funds from foreign creditors. The net utilizations (higher by US Dollar 36.4 million on annual basis) financed 14.4% of the deficit in the current account.

An increase in the funds of US Dollar 3.8 million was registered in the category "currencies and deposits", which is due to the increase in the foreign assets with the commercial banks. Thus in 2004 inflow foreign assets with the commercial banks in the amount of US Dollar 105.1 million. On the other hand, the households' cash foreign assets registered a decrease (of US Dollars 74.8 million).

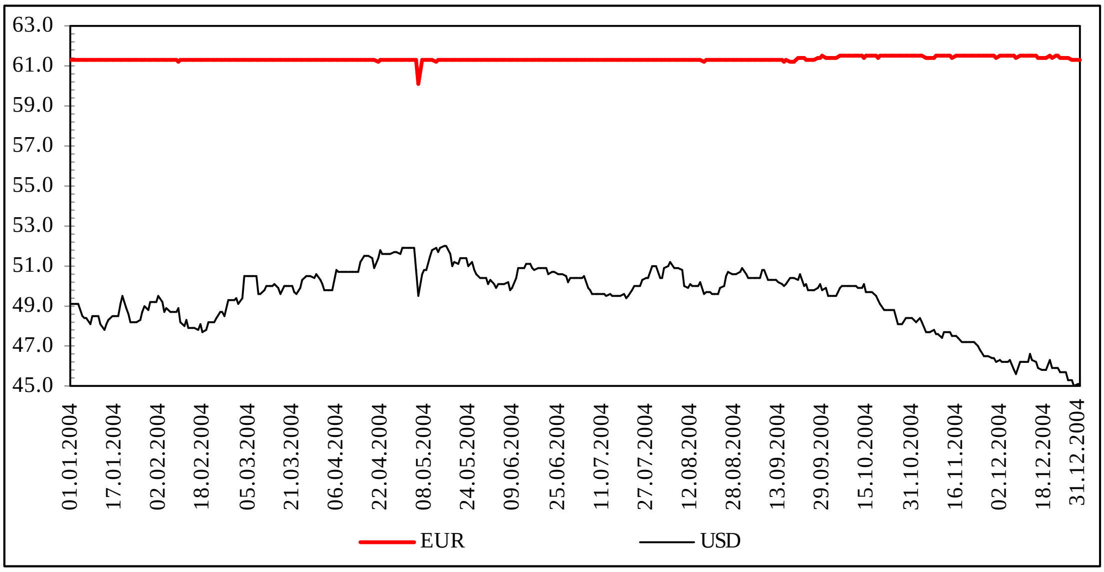
The deficit on the current account of the balance of payments was partially financed through "arrears" in the amount of US Dollar 34.2 million (they only pertain to the private sector) and through statistically non-identified inflows recorded as "errors and omissions" in the amount of US Dollar 6.9 million.

Such current and capital transactions and financial transactions in 2004 resulted in a decrease in the gross official reserves of the National Bank of the Republic of Macedonia[43] in the amount of US Dollar 19.5 million.

7.2. Denar exchange rate

In 2004, the nominal Denar exchange rate against the Euro on the foreign exchange market was stable. Thus as of December 31, 2004, Denar 61.31 per one Euro were traded, which is almost the same level compared to the end of 2003. In 2004, in accordance with the significant widening of the foreign trade deficit, as well as the outflows on the basis of repatriation of dividends, pressures for depreciation of the domestic currency were registered in certain periods, which were the most apparent in the first month of the year, as well as during April, October and November. Hence, the changes in the monetary policy (increase in the interest rates of the CB bills and the announced increase in the reserve requirement rate), as well as the NBRM interventions on the foreign exchange market completely neutralized such pressures. On the other hand, the higher supply of foreign currency (pressures for appreciation) was registered in March, in the third quarter (seasonal effect) and in December, which was also absorbed successfully through the NBRM interventions. Consequently, the monetary policy layout and the active participation of the NBRM on the foreign exchange market contributed to maintenance of stable nominal Denar - Euro exchange rate. The average value of the Denar exchange rate in 2004 equaled Denar 61.35 per one Euro.

Figure 59
Nominal Denar exchange rate against the Euro and the US Dollar on the foreign exchange market
(Denars per foreign currency unit)



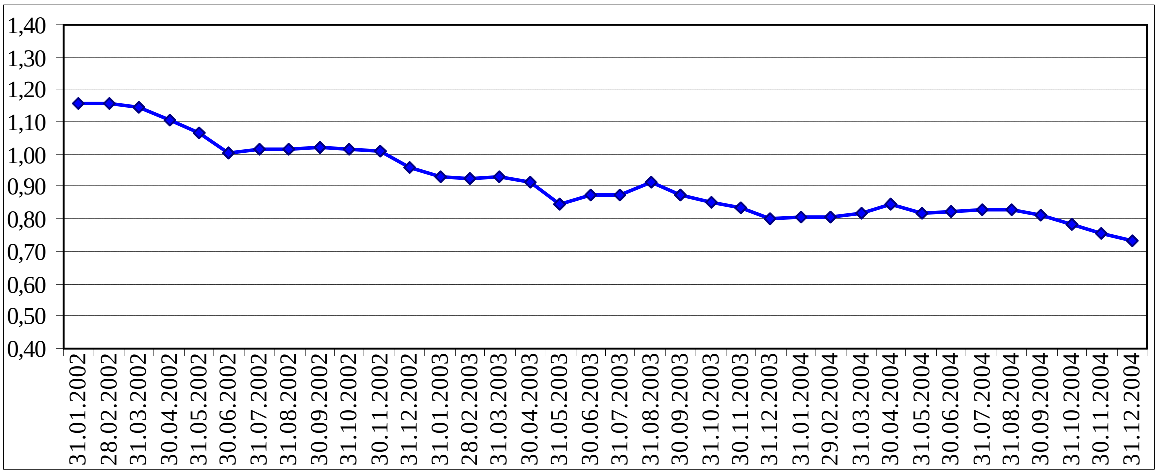
Source: National Bank of the Republic of Macedonia

During the whole year, the supply of foreign assets on the currency exchange market was higher than the demand, with the average supply exceeding the average demand for foreign assets by US Dollar 37.7 million. Besides such movements of the supply of and the demand for foreign assets on the currency exchange market, the average Denar exchange rate relative to the Euro retained almost the same level in 2004 as in 2003, with Denar 61.54 being traded per one Euro (Denar 61.55 per one Euro in 2003).

[43] The data on the gross official reserves given in the balance of payments differs from the data on the gross foreign reserves according to the official data because of which the cross currency differentials and the monetary gold are excluded from the balance of payments' statistics.

In accordance with the strategy of de facto targeting of the Denar exchange rate against the Euro, the Denar exchange rate relative to other foreign currencies depends on their parity with the Euro on the international foreign exchange markets. However, the downward trend of the US Dollar relative to the Euro on the international foreign exchange markets (that commenced in January 2002) continued also in 2004, and it was especially obvious in the second half of 2004 (reflecting the continuing increase in the trade and the budget deficit of the USA). However, the lowest value of the US Dollar (within the June 2001 - December 2004 period) was registered at the end of December 2004, with Euro 0.74 being traded per one US Dollar.

Figure 60
Nominal exchange rate Euro/US Dollar
(Euros per one US Dollar)



Source: the National Bank of the Republic of Macedonia

The Denar exchange rate relative to the US Dollar on the foreign exchange market followed up such movements with the value of the US Dollar registering a significant decrease in the second half of the year (Denar appreciation by 10.6% on December 31, 2004 compared to June 30, 2004). On December 31, 2004, the Denar exchange rate relative to the US Dollar on the foreign exchange market equaled Denar 45.07 per one US Dollar (annual appreciation of the Denar by 8.1%), which is the lowest value of the US Dollar registered until now.

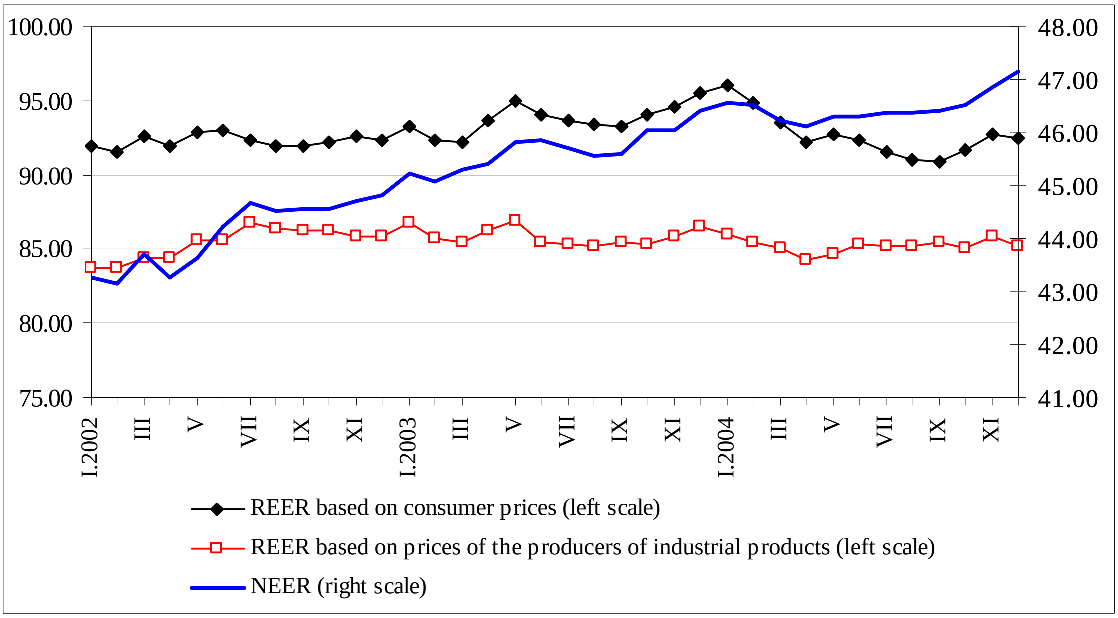
The value of the US Dollar also decreased on the currency exchange market, and in December 2004, Denar 45.31 per one US Dollar were traded, which is an annual appreciation of 8%.

The real effective exchange rate (REER) is one of the indicators for the competitiveness of the economy. It shows the changes in the price competitiveness of the national economy relative to most important foreign trading partners. Calculated as a correlation between the nominal effective exchange rate index (NEER)[44] and the relative price index[45], at the end of 2004 the Denar REER index shows depreciation on annual basis (measured through the consumer price index). In conditions of appreciation of the NEER of 1.5% (caused by the decrease in the value of the US Dollar), the depreciation of the REER of the Denar (of 3.2%) according to the consumer prices, is primarily due to the increase in the foreign consumer prices[46]. According to the price index of the producers of industrial products, the real effective exchange rate

[44] It represents weighted geometric average of the average foreign exchange rates on bilateral basis (currency unit of the economies of the most important foreign trade partners per domestic currency unit). Serbia and Montenegro are not included.
[45] Correlation between the foreign and domestic prices.
[46] Preliminary data pertaining to November and December 2004.

depreciated by 1.5% on annual basis, given the more intensive increase in the foreign prices of the industrial producers[47] relative to the domestic ones.

Figure 61
REER and NEER of the Denar
(May 1993=100, weights HTP 1998)



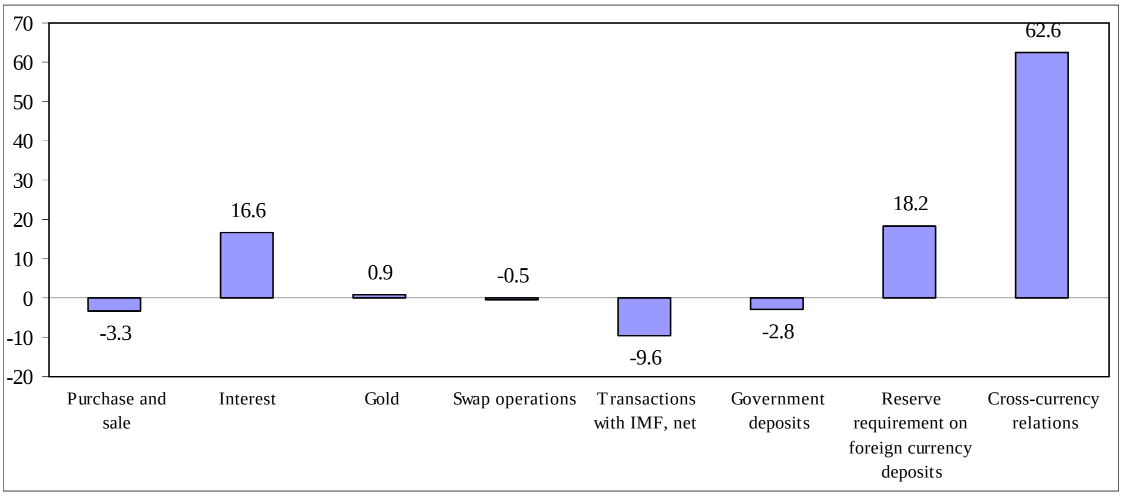
Source: National Bank of the Republic of Macedonia

7.3. Foreign reserves

At the end of 2004, the gross foreign reserves of the NBRM equaled US Dollar 985.7 million, which is an annual increase of US Dollar 82.3 million, or 9.1%. From the aspect of the main factors of change in the gross foreign reserves, given the depreciation of the US Dollar relative to the Euro and in accordance with the currency structure of the gross foreign reserves, 76.1% of the increase (or US Dollar 62.6 million) is generated from the positive exchange rate differentials. The increase in the gross foreign reserves was influenced by the allocated funds on the basis of the bank's reserve requirement on the foreign currency deposits and inflows in the amount of US Dollars 18.2 million and US Dollar 16.6 million, respectively. On the other hand, in 2004 an insignificant outflow of foreign assets on the basis of net sale of foreign assets to the commercial banks by the NBRM in the amount of US Dollar 3.3 million was registered. The Government deposits, which reduced by US Dollar 2.8 million on annual basis, also acted towards decrease in the gross foreign reserves.

[47] Preliminary data for November and December 2004.

Figure 62
Factors of change in the gross foreign reserves in 2004
(in millions of US Dollars)



The analysis of the dynamics indicates a mild decrease in the foreign reserves in the first quarter, which is primarily due to the negative exchange rate differentials. On the other hand, foreign inflows for supporting the balance of payments (credit from the International Bank for Reconstruction and Development and the International Development Agency in the amount of US Dollar 12 million and US Dollar 9.1 million, respectively on the basis of the FESAL II Arrangement) acted towards the increase in the gross foreign reserves, together with the inflows from the interest of the foreign currency deposits, as well as the realized net purchase of foreign currency on the foreign exchange market. In the second quarter of the year, the foreign reserves dropped, mainly as a result of the higher demand for foreign currency on the foreign exchange market, with the NBRM intervening with a net sale on the foreign exchange market.

Table 26
Inflows and outflows of gross foreign reserves of the Republic of Macedonia
(in millions of US Dollars)

	31.12.2003	Q1	Q2	Q3	Q4	01.01 - 31.12.2004
Amount of the foreign reserves of the Republic of Macedonia	**903.4**	**901.9**	**859.9**	**914.6**	**985.7**	
Net increase in the foreign reserves		-1.5	-42.0	54.7	71.0	82.3
Purchase and sale		2.6	-27.1	35.4	-14.2	-3.3
Interest on the foreign currency deposits		5.2	3.5	3.8	4.1	16.6
Gold		1.1	-0.2	0.0	0.0	0.9
Swap operations		0.0	0.0	-0.5	0.0	-0.5
Transactions with IMF, net		-4.3	-8.2	8.8	-5.9	-9.6
Government deposits		6.6	-9.7	-10.0	10.3	-2.8
Reserve requirement on foreign currency deposits		1.1	3.8	2.8	10.5	18.2
Cross currency correlation		-13.9	-4.0	14.2	66.3	62.6

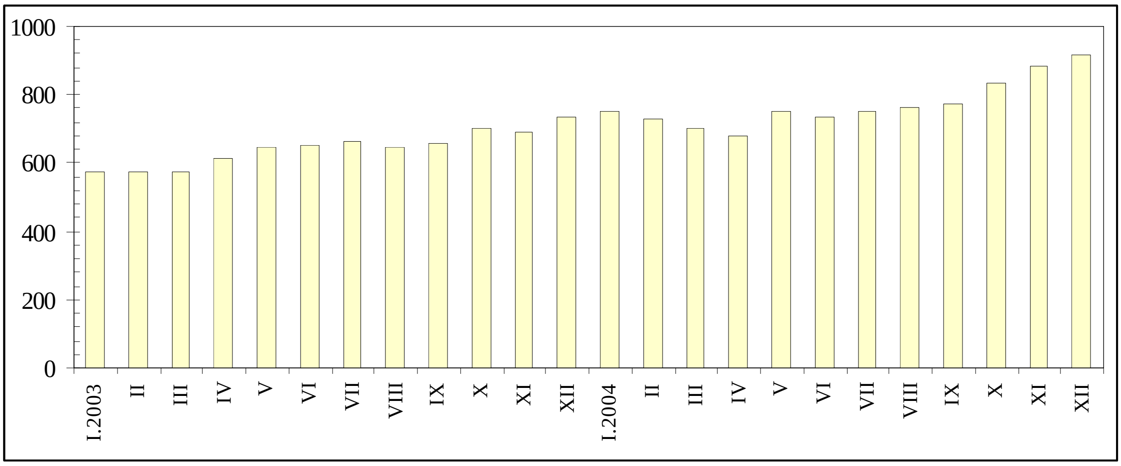
Source: National Bank of the Republic of Macedonia

Contrary to the movements in the first half, positive dynamics of the gross foreign reserves in the second half of the year was registered. The main factors of increase in the gross foreign reserves in the third quarter of the year are the NBRM interventions through a net purchase of foreign currency, the external foreign currency inflows (US Dollar 11.6 million from the IMF on the basis of the Stand-By Arrangement and US Dollar 10 million from the International Bank for Reconstruction and Development aimed at the Public Sector Management Adjustment Loan) as well as the registered positive exchange rate differentials. In the last quarter of the year, the high positive exchange rate differentials are the main cause for the increase in the gross foreign reserves. Also the external foreign currency inflows (US Dollar 11.8 million as a donation from the Netherlands and US Dollar 11.9 million as a credit from the EBRD for the pre-privatization of ESM) as well as the inflows originating from the interest act towards the increase in the gross foreign reserves.

The total foreign assets of the National Bank of the Republic of Macedonia[48] in 2004 increased by US Dollar 56.7 million, and at the end of the year they equaled US Dollar 991.5 million. In 2004, the amount of funds used as collateral with foreign banks as a support to the economic activities in the country was reduced by US Dollar 26.4 million, US Dollar 20.7 million of which are collected collateral of one domestic bank by a foreign creditor. The remaining amount of US Dollar 5.6 million, represent unrestricted collateral, which acted towards increase in the gross foreign reserves. From the aspect of the structure, the increase is registered in the foreign currency deposits with foreign banks and monetary gold, with their share in the structure of the foreign assets being higher on annual basis by 2.3 percentage points and 4.8 percentage points, respectively (and it equaled 88.3% and 8.7%, respectively).

The liabilities of the Republic of Macedonia towards the International Monetary Fund at the end of December 2004 equaled US Dollar 62.5 million, which is an annual decrease of US Dollar 5.8 million. In August 2004, funds from this international financial institution received on the basis of the last two trenches of the Stand-By Arrangement were used, with the liabilities being regularly serviced during the year. The net foreign assets of the National Bank of the Republic of Macedonia (difference between foreign assets and the liabilities towards the IMF) reached US Dollar 923.1 million (by US Dollar 88.1 million more than the level registered at the end of 2003).

Figure 63
Foreign assets with banks
(in millions of US Dollars)



Source: National Bank of the Republic of Macedonia

At the end of 2004, the total foreign assets with the commercial banks registered an annual increase of US Dollar 180.7 million, thus reaching the level of US Dollar 914.5 million. The continuous strengthening of the propensity for saving of the households, as well as the trend of increase in the foreign currency deposits of the enterprises resulted in a significant increase in the liabilities of the banks on the basis of the foreign currency deposits. Thus the households and the enterprises' foreign currency deposits registered an annual increase of US Dollar 161.4 million (29.1%) and US Dollar 71.6 million (57%), respectively. The other foreign liabilities (mainly foreign credits and other short-term foreign currency deposits) registered an increase of US Dollar 106.6 million and they equaled US Dollar 237.7 million. Consequently, the foreign

[48] The amount of the foreign assets differs from the amount of the gross foreign reserves. The amount of the foreign assets given as collateral in foreign banks is included in the foreign assets, and it is not included in the gross foreign reserves.

currency deposits of the economic agents and the other foreign liabilities with the banks equaled US Dollar 1,151.8 million on December 31, 2004, which is an increment of US Dollar 339.6 million (of 29.1%) in comparison with December 31, 2003.

7.4. External debt of the Republic of Macedonia[49]

At the end of 2004, the external debt of the Republic of Macedonia (based on used short-term and long-term credits and loans) equaled US Dollar 2,034.5 million, US Dollar 1,962.6 million (or 96.5%) of which refer to the liabilities based on long-term liabilities, while US Dollar 71.9 million (3.5%) account for the short-term liabilities. In comparison with the end of the previous year, the total external debt registered an increase of US Dollar 203.6 million, or by 11.1%. The annual change in the debt is generated from the higher amount of used funds relative to the paid principal (51.8% of the total increase), as well from the positive exchange rate differentials (46.7% of the increase), with significant depreciation of the US Dollar relative to the Euro and the other currencies being recorded in the second half of 2004.

Besides the increase in the external debt, the indicators for the level of indebtedness for 2004[50] show positive trend. Namely, according to three indicators (correlation between the total external debt and the average export of goods and services in the last three years, correlation between the debt servicing and the average export of goods and services in the last three years and the repayment of interest relative to the average export of goods and services in the last three years), the Republic of Macedonia is classified in the group of less indebted countries. The indicator total external debt relative to the average GDP in the last three years shows moderate indebtedness of the Republic of Macedonia. However, all indicators show decrease in the level of indebtedness relative to the previous year.

Table 27
Indictors for the indebtedness of the Republic of Macedonia

Indicators	31.12.2000	31.12.2001	31.12.2002	31.12.2003	31.12.2004
Total external debt/GDP (criterion: moderate indebtedness 30-50%)	42.83%	41.91%	45.44%	46.40%	44.37%
Total external debt/export of goods and services (criterion: lower indebtedness 0-165%)	102.26%	99.62%	111.41%	123.42%	118.96%
Debt servicing/ export of goods and services (criterion: lower indebtedness 0-18%)	12.55%	13.82%	16.13%	16.91%	14.41%
Repayment of interest/export of goods and services (criterion: lower indebtedness 0-12%)	4.39%	4.15%	3.61%	3.59%	2.78%

Source: National Bank of the Republic of Macedonia

7.4.1. Debt structure

At the end of 2004, the short-term external debt of the Republic of Macedonia (credits with maturity of one year, approved to residents by non-residents) amounted to US Dollar 71.9 million. Amount of US Dollars 64.2 million (or 89.4%) refers to liabilities based on principal, while the remaining share is overdue interest and estimated late interest. From the aspect of the debtors, the short-term debt completely originates from the private sector, i.e. banks and enterprises. The analysis of the short-term credits according to the types of credits indicates a dominant share of the financial credits (99.8%), while the share of the commercial credits equals 0.2%.

[49] Preliminary data of the NBRM.
[50] Calculation made by the NBRM according to the World Bank methodology.

Table 28
External debt of the Republic of Macedonia

		As of 31.12.2004		Structure	Changes compared to 31.12.2003	
		in millions of US Dollars	(in %)	(in %)	in millions of US Dollars	(in %)
Long-term credits and loans		**1,962.6**	**100.0**	**96.5**	**173.6**	**9.7**
	Principal	1,939.2	98.8		167.6	9.5
	Interest	23.4	1.2		6.0	34.8
Short-term credits		**71.9**	**100.0**	**3.5**	**30.0**	**71.7**
	Principal	64.2	89.4		27.1	72.8
	Interest	7.7	10.6		3.0	63.3
Total debt		**2,034.5**		**100.0**	**203.6**	**11.1**

Source: National Bank of the Republic of Macedonia

At the end of 2004, the long-term external debt (liabilities of residents to non-residents on the basis of credits and loans with maturity exceeding one year) equaled US Dollar 1,962.6 million, with US Dollar 1,939.2 million (or 98.8%) of the total long-term debt representing liabilities on the basis of principal, while the liabilities for the overdue interest and estimated late interest equal US Dollar 23.4 million (or 1.2%).

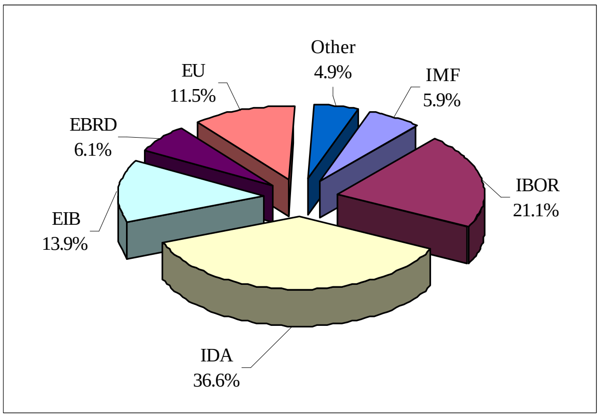
Table 29
Structure of the long-term debt by individual creditors
(in millions of US Dollars)

	Amount of the debt		Annual changes		Structural share	
	31.12.2003	31.12.2004	iznos	vo %	2003	2004
Official creditors	**1,193.4**	**1,313.3**	**119.9**	**10.0**	**66.7**	**66.9**
of which:						
Multilateral creditors	**922.1**	**1,061.7**	**139.6**	**15.1**	**51.5**	**54.1**
IMF	68.3	62.5	-5.8	-8.5	3.8	3.2
IBRD	180.9	223.6	42.7	23.6	10.1	11.4
IFC	13.3	9.2	-4.0	-30.4	0.7	0.5
IDA	357.9	388.1	30.2	8.4	20.0	19.8
EIB	115.8	148.0	32.2	27.8	6.5	7.5
ERFC	7.6	8.3	0.7	9.1	0.4	0.4
Council of Europe Development Bank	17.4	23.0	5.6	32.3	1.0	1.2
EBRD	40.2	65.1	24.9	61.9	2.2	3.3
EU	112.5	122.4	10.0	8.9	6.3	6.2
IFAD	6.8	10.7	4.0	58.9	0.4	0.5
EAR	1.4	0.6	-0.9	-61.8	0.1	0.0
Bilateral	**271.2**	**251.6**	**-19.7**	**-7.3**	**15.2**	**12.8**
Paris Club (reschedule 1995)	168.7	152.0	-16.7	-9.9	9.4	7.7
Non-rescheduled debt	9.5	9.0	-0.5	-5.0	0.5	0.5
Paris Club (reschedule 2000)	18.0	9.5	-8.5	-47.1	1.0	0.5
Newly concluded credits	75.0	81.0	6.0	8.0	4.2	4.1
Private creditors	**595.6**	**649.3**	**53.7**	**9.0**	**33.3**	**33.1**
of which:						
London Club	**243.3**	**232.8**	**-10.5**	**-4.3**	**13.6**	**11.9**
Other private creditors	**352.3**	**416.5**	**64.2**	**18.2**	**19.7**	**21.2**
Banks and financial institutions	215.1	252.6	37.5	17.5	12.0	12.9
Non-financial private sector	137.2	163.9	26.6	19.4	7.7	8.3
TOTAL	**1,789.0**	**1,962.6**	**173.6**	**9.7**	**100.0**	**100.0**

Source: National Bank of the Republic of Macedonia

From the aspect of the structure of the long-term debt by separate creditors, no significant structural movements in 2004 were registered. Thus the share of the official creditors with their share of 66.9% is still dominant, with the most significant share accounting for the multilateral creditors (54.1%). However, the most significant multilateral creditors are the International Development Agency (a share of 19.8%), the International Bank for Reconstruction and Development (11.4%) and the European Investment Bank (7.5%).

Figure 64
Structure of the debt within the multilateral creditors
(as of December 31, 2004)



IMF - International Monetary Fund
IBRD - International Bank for Reconstruction and Development
IDA - International Development Agency
EIB - European Investment Bank
EBRD - European Bank for Reconstruction and Development
EU - European Union
Other
IFC - International Financial Corporation
ERFC - European Railway Funding Company
Council of Europe Development Bank
IFAD - International Fund for Agriculture Development
EDA - European Development Agency

Source: National Bank of the Republic of Macedonia

In 2004, the debt towards the bilateral creditors in the total long-term debt participates with 12.8%, 8.2% of which refer to the rescheduled debt to the Paris Club of Creditors (since 1995 and 2000). From the aspect of the structure of the external debt towards the private creditors (with a share of 33.1%), the debt towards the London Club of Creditors participates with 11.9% (decrease of 1.7 percentage point regarding the previous year). On the other hand, the share of the debt towards the other private creditors increased by 1.5 percentage points and at the end of the year it equaled 21.2%.

7.5.2. Registered movements in 2004

The external debt of the Republic of Macedonia at the end of 2004 equaled US Dollar 2,034.5 million, which is an increase of US Dollar 203.6 million, or by 11.1% compared to the previous year. The long-term external debt of the Republic of Macedonia registered an increase of US Dollar 173.6 million, or by 9.7%, given the simultaneous increase in the short-term liabilities of US Dollar 30 million, or 71.7%. The increase in the long-term debt is a result of the high amount of positive exchange rate differentials (US Dollar 89 million), as well as to the higher amount of withdrawn funds on the basis of paid interest.

In 2004, the withdrawn funds on the basis of the short-term credits and long-term credits and loans amount to US Dollar 320 million, which are by US Dollar 28.5 million less relative to 2003. However, total amount of US Dollar 44.4 million were withdrawn on the basis of short-term credits (US Dollar 82.8 million in 2003). The withdrawals of short-term funds are realized by the private sector and in the largest part (99.8%) they refer to financial credits.

In 2004, funds in the amount of US Dollar 275.5 million were withdrawn on the basis of long-term credits and loans (an annual increase of US Dollar 9.9 million). Within the multilateral creditors, US Dollar 134.1 million were withdrawn from the multilateral creditors (by US Dollar 2.9 million more than in 2003), while the withdrawals from the bilateral creditors are lower by US Dollar 3.5 million and they equal US Dollar 19.9 million. Amount of US Dollar 124.9 million are withdrawn from the private creditors, which is an annual increase of US Dollar 10.6 million. During the year, the largest amount was withdrawn in July (US Dollar 47 million). Such a tendency of increased indebtedness of the private sector represents an effect of the liberalization of the capital transactions and points to the positive perceptions of the private creditors for the Macedonian economy.

From the aspect of the multilateral creditors, the largest amount of US Dollar 42.9 million was withdrawn from the International Bank for Reconstruction and Development, primarily on the basis of the Financial and Enterprise Sector Adjustment Loan - FESAL II (US Dollar 12 million), Public Sector Management Adjustment Loan (US Dollar 10.2 million), Transport Sector Project - Road Fund (US Dollar 9.8 million) and the Electrical Power of the Republic of Macedonia (US Dollar 7.7 million).

In 2004, total amount of US Dollar 29 million was withdrawn from the European Investment Bank on the basis of the global finance, the Road Projects and the ESM substation in the Republic of Macedonia.

Amount of US Dollar 27.9 million was used from the European Bank for Reconstruction and Development for the Municipal Environmental Action Project (MEAP), the Road Project, the Civil Aviation Project and the Power Transmission Project.

Funds in the amount of US Dollar 14.2 million were used from the International Development Agency on the basis of Financial and Enterprises Sector Adjustment Credit - FESAC II (US Dollar 9.1 million), the Trade and Transport Facilitation in Southeast Europe and Community Development Project.

In August 2004, US Dollar 11.6 million were withdrawn from the International Monetary Fund on the basis of the last two tranches of the Stand-By Arrangement concluded in the previous year.

In 2004, funds in the amount of US Dollar 16.9 million were withdrawn from bilateral creditors (completely originating from the newly concluded credits). The largest share accounts for the private sector crediting, the Italian credit line aimed at the import of equipment, and for the funds extended by the German KWF bank for financing of small-size and medium-size enterprises, and reconstruction of the irrigation system.

In 2004, funds in the amount of US Dollar 124.6 million were withdrawn from the private creditors, which is an annual increase of US Dollar 10.6 million. The largest share of the used funds originate from banks and other private financial institutions (US Dollar 92.8 million), while the remaining share originate from foreign private enterprises (US Dollar 31.9 million).

Table 30
Withdrawn funds and paid liabilities in 2004
(in millions of US Dollars)

	Withdrawn funds	Paid liabilities		
		Total	Principal	Interest
LONG-TERM CREDITS AND LOANS	**275.5**	**245.7**	**198.9**	**46.9**
MULTILATERAL CREDITORS	134.1	75.6	55.0	20.5
International Monetary Fund	11.6	21.2	20.3	0.9
International Bank for Reconstruction and Development	42.9	16.7	10.7	6.0
International Financial Corporation	1.0	6.0	5.4	0.6
International Development Agency	14.2	3.5	0.7	2.9
European Investment Bank	29.0	13.6	8.8	4.8
European Railway Funding Company	0.0	0.4	0.0	0.4
Council of Europe Development Bank	3.9	0.5	0.0	0.5
European Bank for Reconstruction and Development	27.9	10.2	8.2	2.0
European Union	0.0	2.4	0.0	2.4
International Fund for Agriculture Development	3.5	0.1	0.0	0.1
European Reconstruction Agency	0.0	0.9	0.9	0.0
BILATERAL CREDITORS	16.9	55.0	46.6	8.4
Paris Club (total)	0.0	38.9	32.4	6.4
Newly concluded credits	16.9	16.2	14.2	2.0
PRIVATE CREDITORS	124.6	115.1	97.2	17.9
London Club	0.0	15.3	10.5	4.8
Other private creditors	124.6	99.8	86.7	13.1
Banks and private financial institutions	92.8	77.4	68.5	8.8
Enterprises	31.9	22.4	18.2	4.3
SHORT-TERM CREDITS	**44.4**	**16.2**	**15.5**	**0.7**
Commercial credits	0.2	0.9	0.9	0.0
Financial credits	44.2	15.3	14.7	0.7
Short-term bank credit lines	0.0	0.0	0.0	0.0
TOTAL	**320.0**	**262.0**	**214.4**	**47.5**

Source: National Bank of the Republic of Macedonia

In 2004, the total amount of serviced liabilities to foreign creditors based on used short-term and long-term credits and loans equals US Dollar 262 million (US Dollar 341.5 million in 2003), US Dollar 245.7 million of which account for the repayments of the long-term debt, while US Dollar 16.2 million refer to the repayment of liabilities on the basis of used short-term credits.

The serviced liabilities based on short-term credits decreased by US Dollar 76.8 million in 2004 compared to the previous year, which is due to the transformation of part of the liabilities into a long-term debt. US Dollar 15.5 million are repaid principal, while US Dollar 0.7 million account for the interest.

In 2004, the total amount of serviced liabilities to foreign creditors based on used long-term credits equaled US Dollar 245.7 million (US Dollar 248.6 million in 2003). US Dollar 198.9 million of this amount refer to the serviced principle, while US Dollar 46.9 million account for the serviced interest. The analysis by individual creditors indicates that the largest share of the funds (US Dollar 130.6 million), was repaid to the official creditors. Amount of US Dollar 75.6 million was paid to the multilateral creditors, and US Dollar 55 million to the bilateral ones. Within the multilateral creditors, the largest amount was repaid to the International Monetary Fund (US Dollar 21.2 million) and the International Bank for Reconstruction and Development (US Dollar 16.7 million), while among bilateral creditors, the largest amount was paid to the Paris Club of Creditors (US Dollar 38.9 million).

During 2004, liabilities in the amount of US Dollar 115.1 million were repaid to the private creditors (in 2003, US Dollar 108.3 million), with the repayments based on principal and interest being equal to US Dollar 97.2 million and US Dollar 17.9 million, respectively. The largest share of the total repayments to the private creditors (US Dollar 77.4 million) accounts for the regulation of the liabilities to foreign banks and private financial institutions, while the remaining share accounts to the non-financial private sector (US Dollar 22.4 million) and the London Club of Creditors (US Dollar 15.3 million).

In 2004, the amount of the newly concluded credits and loans equaled US Dollar 254.9 million, which is a decrease of US Dollar 156.6 million compared to the previous year. During the year, the largest amount of credits of US Dollar 79.1 million was concluded in July. The concluded loans and credits referred to the following creditors and projects:

- The International Bank for Reconstruction and Development approved credits in the amount of US Dollar 30 million aimed at Public Sector Management Adjustment Loan (PSMAL II), US Dollar 10 million for the Health Sector Management Project, US Dollar 9.8 million for SPIL, and US Dollar 5 million for the Education Modernization Project;

- The European Bank for Reconstruction and Development extended credits to the private banks in the amount of US Dollar 34 million, and credit in the amount of US Dollar 10.9 million to a private non-financial trade company;

- The German KFW bank extended a credit to the Macedonian Bank for Development Promotion in the amount of US Dollar 8.4 million;

- In July 2004, the Macedonian Railways concluded a new credit agreement with the International Railway Union in the amount of US Dollar 15.1 million for the purpose of rescheduling of the previous debt.

VIII. Other activities of NBRM

8.1. Payment system in the Republic of Macedonia

The payment system in the Republic of Macedonia continued to operate and develop successfully also in 2004. The NBRM manages with the Macedonian Interbank Payment System (MIPS) through which gross settlement in real time is executed, and the banks are performing their function as entities responsible for conducting payment operations.

In order to coordinate the entities in the payment system of the Republic of Macedonia, National Payment System Council of the Republic of Macedonia was established, composed of four members, the NBRM, the Ministry of Finance and the Banking Association of the Economic Chamber of the Republic of Macedonia each.

8.1.1. The role of the NBRM in the payment operations

In order to provide efficient and reliable payment system in the Republic of Macedonia, the NBRM performs its role in the payment system through the following functions*:*

- operational;
- regulatory; and
- oversight.

8.1.1.1. Operational function

Within the performance of its operational function, the NBRM manages the settlement system - MIPS[51]. In 2004, the MIPS operated in real time during all 253 working days with accessibility of 99.89%, i.e. it was not accessible only for 164 minutes out of the projected time for the whole year. The average dynamics of the system was 7,952 orders per day, while the maximal number of processed orders equaled 24,319.

No new participants joined the payment system during the year, with one bank ceased operating. Thus the total number of participants equaled twenty seven.

In 2004, in performing its operational function, the NBRM received and processed 1,636 decisions on forced collection, 974 of which were realized completely, while the remaining were incomplete and returned to the courts for revision and completion, or the procedure was called off by the courts.

8.1.1.2. Regulatory function

In 2004, no amendments to the legal framework pertaining to the payment systems were made. The recommendations given by the Financial System Assessment Program in 2003 and those of the IMF technical mission in 2004 were considered, with the preparations for the suggestions for amending the respective regulations, with which these recommendations will be encompassed, being underway. The suggestions for the amendments are submitted to the National Payment Systems Council of the Republic of Macedonia, with the appropriate amendments to the regulations being envisaged for 2005.

[51] The MIPS is processing all transactions regardless of their amount, while only the transactions up to Denar 1 million are processed through the Clearing House.

8.1.1.3. Oversight function

As part of the oversight function of the payment systems, in 2004 the NBRM was conducting a constant oversight over the operations of the banks and the Clearing House[52]. The oversight was carried out indirectly and directly. The payment system was monitored regularly through the implemented information system developed on the basis of the Manual for the internal and the external clearing, according to which the data on the payment operations of the banks are submitted electronically. On the other hand, the operations of the entities responsible for conducting payment operations were subjected to immediate inspections on various bases, with recommendations for lawful, efficient and transparent execution of the activities being given. In 2004, ten oversights were conducted.

Besides that, in 2004 the National Bank commenced an initiative for introducing the International Bank Account Number, the so-called IBAN. The initiative was accepted by the banks and they started its implementation. It was agreed that the part of the account number characteristic for each country should consist of fifteen digits, the first three of which are the sorting code of the bank, the following ten are on the bank's disposal, while the last two digits will represent a control number. The assigning of this number by the banks shall become obligatory from July 01, 2005.

In addition, in 2004 the National Bank of the Republic of Macedonia introduced payment operations data collection and distribution system (the system was tested successfully, so the publishing of the data started in 2005). The data refer to the total number of opened accounts, the use of the payment instruments, the use of the payment cards and the number of places where they can be used. However, there are certain information on the accounts which are available through computer or through other terminal, while as for the payment instruments, besides the division by the manner of submission (electronically or in hard copy) there is also a division by types of instruments (credit or debit). All these data can be found on the web site of the National Bank of the Republic of Macedonia.

Also an analysis of queuing in the MIPS was made, with the payments execution with no larger use of queuing being determined. Namely, only 0.26% out of the total number of transactions were queuing, with the average time of queuing equaling 8.02 minutes.

8.1.2. Indicators for the payment system in the Republic of Macedonia

8.1.2.1. Opened accounts

In 2004, total 24,955 new accounts were opened and 4,003 accounts were closed in the Single Registry of Account Holders with the Entities Responsible for Conducting Payment Operations, with which the total number of opened accounts with the Single Registry of Account Holders reaching 11,104 at the end of the year. Owners of these accounts are 83,550 different entities (individuals and legal entities), 79.06% of which have only one account, while on average, there is about 1.33 accounts per entity.

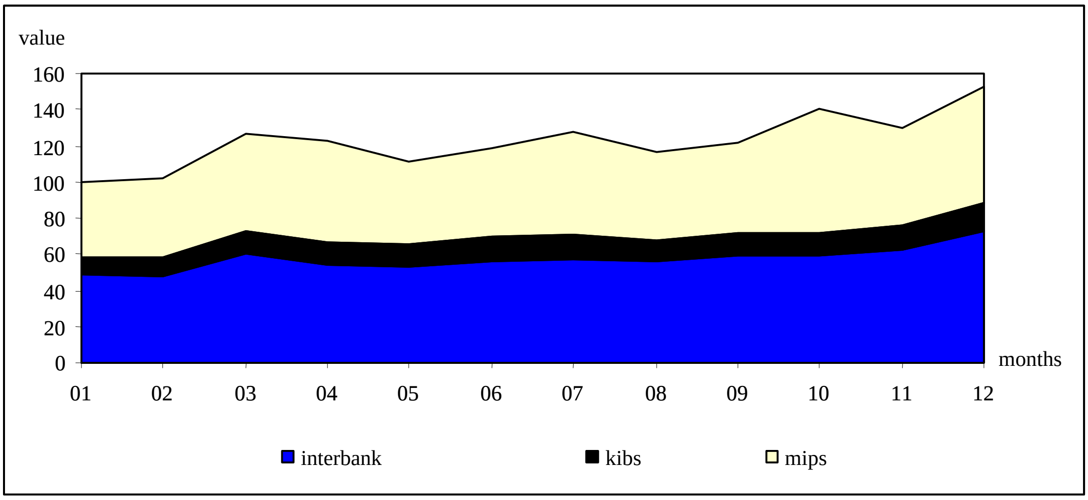
Since the implementation of the new payment system until the end of 2004, the total number of 5,571 accounts was blocked. In 2004, 12,886 blockades were initiated, 7,141 were closed (unblocked accounts), which is 55.42% of the total number of initiated blockades.

[52] The MIPS is processing all transactions regardless of their amount, while only the transactions up to Denar 1 million are processed through the Clearing House.

8.1.2.2. Total payment operations in the Republic of Macedonia

In 2004, the total value of the performed payment operations equaled Denar 1,468.92 billion. The total payment operations do not encompass the transactions for settlement of the net balance of the Clearing House KIBS. However, 46.8% of the total amount are interbank operations (among accounts within the same bank), 42.95% refer to the interbank payment operations through MIPS, and 10.25% account for the interbank operations through KIBS.

Figure 65
Total domestic payment operations in 2004 by months
(in billions of Denars)

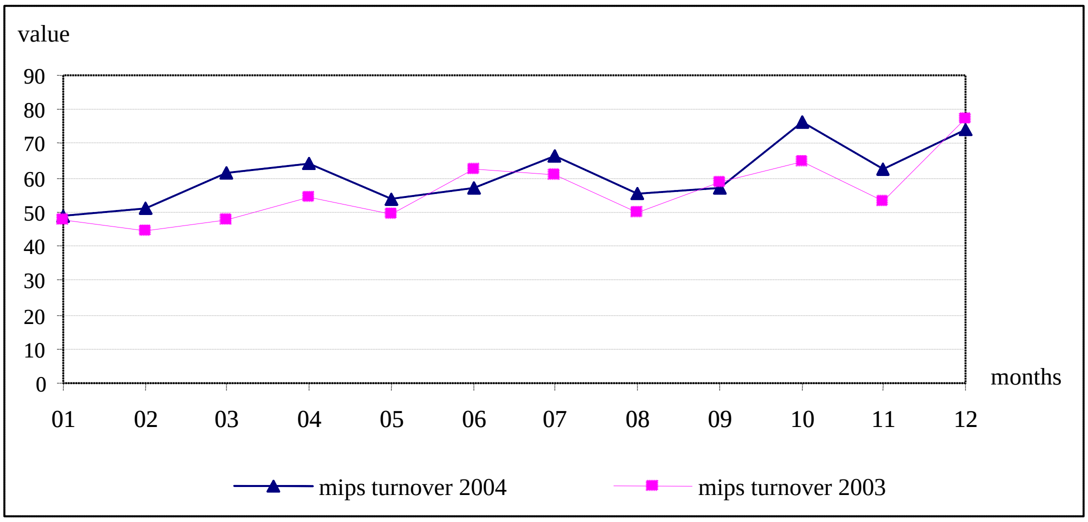


The total number of executed transactions in the domestic payment operations in 2004 equals 19,509,609, 10.29% of which are executed through the MIPS, 46.63% through the KIBS system, and 43.08% are transactions executed through the internal clearing.

8.1.2.3. Payment operations and number of transactions executed through MIPS in 2004

In 2004, total payment operations in the amount of Denar 727.81 billion were carried out through the MIPS system of the NBRM, with total number of 2,011,988 transactions being executed, including also the transactions for settlement of the net balances of the clearing house KIBS. The payment operations registered through the MIPS in 2004 increased by 8.53% in comparison with the previous year. 53.2% out of the total payment operations carried out through MIPS account for the interbank payment operations initiated by other entities responsible for conducting payment operations, while 46.48% are turnover initiated by Government institutions (the National Bank of the Republic of Macedonia, the Treasury System, etc).

Figure 66
Payment operations carried out through the MIPS by months
(in billions of Denars)



In 2004, the total number of executed transactions compared to the previous year increased by 9.97%. 65.47% of the total number of transactions executed through MIPS are initiated by the other entities responsible for conducting payment operations, while 34.53% are transactions initiated by the Government institutions (the National Bank of the Republic of Macedonia, the Treasury System etc.).

8.1.2.4 Interbank payment operations in 2004

The analysis of the conducted payment operations in 2004 among the accounts of depositors opened in the system of same entity responsible for conducting payment operations indicates an annual decrease in the value of the interbank payment operations of 6.49%. The realized turnover amounts to Denar 687.52 billion, while the number of executed transactions equaled 8,405,523, which is an increment of 17% compared to the previous year.

8.2. Issuance of operating license and oversight over the operating of the exchange offices and the entities providing fast money transfer

8.2.1. Currency exchange operations

As of December 2004, the total number of authorized exchange offices equaled 320, which operated on 599 points of cash exchange. Nineteen out of the total number of authorized exchange offices are banks having 261 points of cash exchange, thirteen are savings houses with nineteen points of cash exchange, while 288 are other trade companies performing currency exchange operations at 319 points.

8.2.2. Providing fast money transfer services

Pursuant to the Law on Providing Fast Money Transfer Services adopted at the end of 2003, in 2004 the National Bank adopted by-laws regulating the fast money transfer services, from the aspect of both, licensing and the regular operating of these entities.

In 2004, the National Bank licensed one provider of fast money transfer services and recorded fifteen agreements with subagents.

8.3. Issuance of approvals pursuant to the Law on Foreign Exchange Operations

8.3.1. Collection of claims in cash foreign currency

In 2004, pursuant to the Decision on the terms under which the residents may collect claims and make payments in cash foreign currency when operating with non-residents on different basis, the National Bank of the Republic of Macedonia issued total number of 3,807 approvals for collection of claims in cash foreign currency on the basis of which cash in the amount of Euro 145.5 million is taken into the country through authorized banks. The structural analysis of these approvals points to the following:

- in 2004, total of 3,000 approvals for collection of claims in cash foreign currency in the total amount of about Euro 192 on the basis of export of goods were issued, with Euro 126 million being paid in authorized banks during the same period;
- in 2004, 651 approvals for collection of claims in cash foreign currency in the amount of Euro 11 million on the basis of the export of services were issued, with Euro 10.5 million being paid in authorized banks during the same;
- the remaining 156 approvals for collection of claims in cash foreign currency in 2004 are made on the other bases stipulated in the Decision, 136 of which pertain to keeping of cash foreign currency in foreign exchange vault for the payment of the operating costs related to vehicles.

In 2004, four approvals for collection of claims in cash foreign currency from non-residents on the basis of games of chance in gambling rooms were issued, due to which Euro 7.7 million were paid in in the authorized banks, while two approvals were issued on the basis of collection of taxes from non-residents on the cross boarders, due to which total amount of Euro 2.39 million was paid in.

8.3.2. Approvals for holding foreign currency on foreign bank account

Pursuant to the Decision on the manner and the terms under which the residents that are not authorized banks may open and hold accounts abroad, the National Bank of the Republic of Macedonia issued total of twenty seven approvals in 2004. From structural aspect, three approvals refer to opening an account with foreign bank on the basis of performing investment operations abroad, thirteen refer to opening an account in foreign bank for covering the expenses of the representative office abroad, and eleven approvals pertain to opening an account with foreign bank by companies performing international transport of goods and services aimed at covering the operating costs.

In 2004, the National Bank of the Republic of Macedonia registered ninety eight settlement accounts of residents for settlement of their mutual claims and liabilities with non-residents, with ninety settlement accounts are based on the concluded agreements for postal services and eight settlement accounts for concluded agreements on the basis of services in the international commodity and passenger traffic.

8.3.3. Payment of cash foreign currency by non-residents on their accounts with authorized banks

Pursuant to the Decision on the manner and the conditions for opening and running accounts of non-residents, the banks submit monthly reports of payments in cash foreign currency to the National Bank of the Republic of Macedonia. The monthly reports submitted by the authorized banks revealed that in 2004 cash foreign currency in the amount of US Dollar 26,875,568 was paid on the accounts of the non-resident legal entities, while cash foreign currency in the amount of US Dollar 11,171,804 were paid on the account of the non-resident individuals.

8.2. Printing of banknotes and minting of coins and numismatic activity

The issuance of banknotes and coins, as well as the distribution of cash are part of the NBRM functions. In 2004, the payment operations in cash were executed smoothly and in compliance with the Law on Payment Operations and the agreed operating principles with the commercial banks. The maintenance of the necessary cash minimum in foreign means of payments, as part of foreign reserves, enabled smooth servicing of the needs of the Ministries.

With the aim of smooth and successful functioning as institution responsible for payment operations, the NBRM organizes both, printing of banknotes and minting of coins. In 2004, 9.6 millions and 10.5 millions banknotes in denomination of Denar 100 and Denar 10, respectively were printed. The process of supply of cash was completed in April when special machine for disintegration of wear out banknotes was installed. In 2004, 11.5 million of such banknotes were destroyed through this system (wear out and damaged banknotes to the extent that makes their processing in the sorting machine impossible).

In 2004, ten million pieces of administrative stamps and 200 thousands bill of exchange forms were printed in accordance with the agreement concluded with the Ministry of Finance, the sale of which is performed smoothly and in compliance with the agreement.

From the aspect of the activities that are not included within the regular tasks, in 2004 minting of 500 jubilee gold coins on the occasion of 60 years of AAPLM was organized, as well as minting of additional 100 jubilee gold coins and 200 silver coins thus celebrating 100 years of Ilinden Uprising.

Within the NBRM operates the Museum of Numismatics. In function of its more successful operating, special program for appropriate electronic record of the collection containing more than 17,000 old coins was installed successfully at the end of 2004. In the first half of the previous year, coins of extremely high numismatic value were purchased, with the NBRM collection of this type being among the richest in the world.

8.5. Internal Audit

The main objectives and responsibilities of the internal audit in 2004 are accomplished through regular reporting to the management of the NBRM about the adequacy and the efficiency of the functioning of the internal control systems. The reports contained the assessments whether the internal control systems in the processes function as projected. In case of stated weaknesses, recommendations for their elimination were given, simultaneously monitoring the accomplishment of the recommendations incorporated in the last year audit reports.

Besides the regular activities related to the assessment of the control systems, the internal audit also had consultative function, which was mainly focused on improvement of the risk management process when performing the business process. The internal audit performed this function through giving appropriate guidelines to the management of the departments for the manner of risk management. The risk management means appropriate analysis and description of the business processes, identification of the possible risks, their assessment, as well as assessment of appropriate control measures that will reduce the risks at acceptable level.

The audits in 2004 were planned according to certain criteria on the assessment of the processes risk. The significance of the processes for conducting of the main functions of the NBRM, the period from the last audit, the changes in the processes, as well as the information on the weakness in the processes were mainly used as a starting point. In 2004, total of sixteen regular audits and nine supervisions over the realization of the recommendations given in the last year audit reports were carried out. The audits performed in 2004 resulted in 47 recommendations for improvement in the internal control systems. Generally, the findings from the completed audits point to satisfactory control procedures in the operating of certain organizational parts of the National Bank of the Republic of Macedonia, although there is a need of their continuous improvement.

8.6. Improvement of the institutionalized capacity of the NBRM

The NBRM was actively included in the establishment of the bases for development of the Government securities market, not only through participation in the defining of the strategic directions for the development of the securities market, but also through implementation of the prepared strategy. Namely, the NBRM participated in the establishment of the regulation framework for the primary Government bills market by the preparation of the *Rules for the manner and the procedure for issuing and payment of Government bills.* As a result of the activities it undertakes in the establishment of the bases for the development of the Government securities market, as well as because of the personnel and technical resources, and primarily the previous long-time experience in the implementation of the auction procedures, the NBRM performs its function of a Government agent for issuance of Government bills[53].

In order to enable smooth accomplishment of this function, the NBRM upgraded its electronic system, thus enabling an access to the Government bills auctions not only to the bank and the NBRM, but to the Ministry of Finance, as well. The upgrading of the electronic system enabled the NBRM to be mediator in submitting the data on the successful participants on the Government bills auction from the banks to the Central Securities Depositary where the ownership of the Government bills is registered. In addition to this, the NBRM also mediates, through the electronic system, in the submission of data on due Government bills from the Central Securities Depositary to the Ministry of Finance and banks, in order pay the funds to the owners of Government bills on the day of their maturity.

For the purpose of better coordination between the monetary and the fiscal policy, the NBRM has its own representative in the Auction Commission established by the Ministry of Finance. The Auction Commission decides upon the issues referring to the market share of individual bidder, application of minimal price, i.e. maximal interest rate, determining and overcoming the technical problems during the auctions, etc.

As a continuing activity related to the development of the Government securities market, and generally, the financial markets, in 2004 the NBRM worked on laying grounds for development of the secondary Government bills market, as well. Thus the NBRM undertook a lot of activities for establishing the regulation framework on trading with Government bills through the OTC markets, the initiation of which is planned for the first half of 2005. Simultaneously, the NBRM worked on the establishment of electronic system for settlement of the concluded transactions with Government bills on the OTC market which is using the existing infrastructure of the Macedonian Interbank Payment System (MIPS), expecting that the transaction costs will decrease, which is a significant precondition for more active trading with the Government bills on the secondary market.

In 2004, in order to improve the supervision, the following projects were completed (in cooperation with the European Agency for Reconstruction):

- Practical and regulatory aspects for implementation of the International Accounting Standards in the banking;

[53] In the beginning of 2004, the Ministry of Finance, on the behalf of the Republic of Macedonia, commenced issuing short-term securities (three-month Government bills) on continuing basis for the first time. The issuance of the Government bills is in accordance with the *Strategy for development of Government securities market* which was prepared by the Ministry of Finance and the National Bank of the Republic of Macedonia.

- Determining the level of compliance with the European Directives from the banking area[54];

- Preparations for the implementation of the New Capital ASgreement[55];

- Preparation of diagnostic scheme and technical documentation for creating of the so-called Bank File[56], which is a complex informative management system which should enable aggregating all the data the NBRM has for each bank in the Republic of Macedonia, as well as all the data and information related to the current regulations from the banking area.

Box 4
New regulations in the legal framework in 2004

On July 20, 2004, the new **Law on Prevention of Money Laundering and Other Proceeds from Crimes** ("Official Gazette of the Republic of Macedonia" no. 46/04) was put into effect. The new Law widens the scope and defines the entities obliged to undertake the measures prescribed in the Law very precisely, as well as the deadlines and the activities that the authorized departments should undertake in order to prevent money laundering. According to this Law, also the financial institutions (banks, savings houses, insurance activities, operations with securities for own account and for the client's account, keeping of and management with securities, products made of precious metals and other financial activities prescribed in law) are deemed as competent entities. Pursuant to the Law, the financial institutions are required to determine the identity of their clients when opening an account, or savings book, depositing shares, bonds and other securities, utilization of vaults; management with the property or effectuation or receiving payment by third party.

According to the new Law, the amount on which the entities are obliged to identify the client through each transaction increased. Also, the cash payment of funds exceeding Euro 15,000 is not allowed, in order to reduce the cash payment of larger amounts, as well as to distinct the responsibilities of the institutions in their combat against the money laundering.

According to the new Law, the currency exchange offices and the entities performing fast money transfer shall be obliged to determine the identity before each transaction higher than Euro 2,500 denominated in Denars.

The Anti-Money Laundering Department, established as a body of the Ministry of Finance, is competent for the collection, processing, analysis, keeping and the submission of data received from the entities that are obliged to undertake measures and activities for detection and prevention of money laundering. Also, the National Bank of the Republic of Macedonia is stated among the entities cooperating with the Anti-Money Laundering Department, and it may submit written reports whenever it suspects of money laundering.

[54] It can be concluded that generally, the regulations from the banking area adhere to the European Directives to great extent, and the level of compliance is satisfactory. Several areas where amendments are needed are identified, especially in direction of including the market risk in the determining of the level of capital adequacy of the banks in the Republic of Macedonia.
[55] Realized through organizing a seminar for getting information on the bases of the New Capital Agreement and the new methodology for determining the capital adequacy.
[56] All planned activities are completed, while the activities for the implementation of this project are within the competence of the National Bank of the Republic of Macedonia.

The new **Law on Trade Companies** ("Official Gazette of the Republic of Macedonia" no. 28/04) enables:

- simplified procedure for registration of the trade companies and lower number of institutions participating in the registration procedure, thus accelerating the process of registering of the trade companies;
- novelty in the keeping of the trade registry, which is entrusted to a non-judiciary institution, i.e. the Central Registry, which will keep the trade registry in electronic form, thus representing part of the central information basis of the Central Registry;
- introduction of one-window system, the objective of which is through the registration offices of the Central Registry to provide all necessary data from one place in order to enable one legal entity to participate in the payment operations;
- introduction of shareholders' equal position principle;
- introduction of one-tier (Board of Directors) and two-tier system (Management Board or Manager and Supervisory Board) of management with companies, with the company having the right to choose its own management system..

The **Law on the Amendments to the Law on Securities** which was adopted on December 30, 2004 ("Official Gazette of the Republic of Macedonia" no. 96/04) introduced only one amendment to Article 174 of the current Law, according to which the deadline for trading with already issued securities which is not registered on the Stock Exchange official markets and that will be performed on the Stock Exchange unofficial market is extended until December 31, 2005.

The **Law on Amendments to the Law on Compulsory Capital Financed Pension Insurance** (published in the "Official Gazette of RM" no. 40/2004) stipulates that National Bank of the Republic of Macedonia will be custodian of the pension funds within a five-year period starting from the date of initiating the payment of the contribution for compulsory capital financed pension insurance. Consequently, amendments to the **Law on the National Bank of the Republic of Macedonia** were made ("Official Gazette of RM", no. 40/2004), which enlarge the NBRM functions, i.e. amendments to Article 10 of this Law were made, stating that the NBRM functions as a custodian of the pension funds.

After the expiration of the four-year custody of the National Bank of the Republic of Macedonia over the pension funds, the Capital Financed Pension Funds Supervision Agency will make an assessment whether the banks in the Republic of Macedonia are prepared to function as custodian, and it will inform the Government of the Republic of Macedonia and the National Bank of the Republic of Macedonia. This assessment will be the basis for determining whether the NBRM will continue to act as custodian after the expiration of that five-year period, or that function will be transferred to the commercial banks in the Republic of Macedonia.

In the National Bank of the Republic of Macedonia, as a custodian of the pension funds, pursuant to the amendments, the provisions for the conditions and the manner for performing the role of custodian prescribed under the Law on Compulsory Capital Financed Pension Insurance will also be applied.

The amendments stipulate that the employees and the members of the National Bank of the Republic of Macedonia Council can not be members of the Management Board, Supervisory Board, i.e. member of Management Board or Supervisory Board can not be appointed as general manager or manager of the company, or to work as general manager in:

- other pension funds management company;
- foreign manager appointed to manage with the pension funds;
- custodian which keeps the pension funds;
- each entity having a status of entity related to the entities stated in the aforementioned lines.

Box 5
Survey of Decisions adopted by the National Bank of the Republic of Macedonia Council

No.	Name of the Decisions	Date of adoption	Published in the "Official Gazette of RM"
1.	Decision on the cessation of the decisions on appointing a receiver in Export Import Bank a.d. Skopje	January 08, 2004	no. 1/04
2.	Decision on the prices of the precious metals valid on December 31, 2003	January 08, 2004	no.1/04
3.	Decision on determining the core capital, general reserves and closing of Fixed Assets Fund, Joint Consumption Fund and Reserve Fund	January 29, 2004	no. 4/04
4.	Decision on adopting the Fixed Assets Investments Plan of the NBRM for 2004	January 29, 2004	no. 4/04
5.	Decision on obtaining license for providing fast money transfer services	January 29, 2004	no. 4/04
6.	Decision on the manner of keeping record for each transaction of fast money transfer	January 29, 2004	no. 4/04
7.	Decision on the amendments to the Decision on single tariff according to which the fees for the NBRM services are paid	January 29, 2004	no. 4/04
8.	Decision on the amendments to the Rules and Procedures of the NBRM Council	January 29, 2004	no. 4/04
9.	Decision on the amendments to the Decision on the manner and the conditions of non-residents' operations with securities of the Republic of Macedonia	March 11, 2004	no. 14/04
10.	Decision on the amendments to the NBRM Statute	March 11, 2004	
11.	Decision on the approval for the purchase of gold ingots	March 11, 2004	
12.	Decision on the Annual Statement of NBRM for 2003	May 06, 2004	no. 30/04
13.	Decision on submitting and distributing data on the payment operations	May 06, 2004	no. 30/04
14.	Decision on the amendments to the Decision on obtaining license for providing fast money transfer services	May 06, 2004	no. 30/04
15.	Decision on the amendments to the Decision on the terms under which residents may collect and pay in cash foreign currency when operating with non-residents	May 06, 2004	no. 30/04
16.	Decision on appointing an employee	May 06, 2004	
17.	Decision on the amendments to issuance, sale, circulation and payment of CB bills	April 08, 2004	no. 23/04
18.	Decision on the amount of the interest rate according to which the NBRM calculates and pays interest on foreign currency deposit on the basis of concluded international agreement	June 24, 2004	no. 42/04

19.	Decision on the amendments to the Decision on the interest rates of the NBRM	July 13, 2004	no. 48/04
20.	Decision on the amendments to the Decision on banks' reserve requirement in Denars	July 13, 2004	no. 48/04
21.	Decision on using part of the foreign reserves of the Republic of Macedonia for minting jubilee coins on the occasion of 100 years of Ilinden Uprising	July 13, 2004	no. 48/04
22.	Decision on using part of the foreign reserves of the Republic of Macedonia for minting jubilee coins on the occasion of 60 years of the First Assembly of the AAPLM	July 13, 2004	no. 48/04
23.	Decision on the contents and the manner of functioning of the Credit Registry	September 09, 2004	no. 61/04
24.	Decision on the amendments to the Decision on the banks' reserve requirement in Denars	September 09, 2004	no. 61/04
25.	Decision on the amendments to the Decision on the conditions and the manner of obtaining a license for performing currency exchange operations	September 09, 2004	no. 61/04
26.	Decision on the amendments to the manner of keeping the record for each transaction of fast money transfer	September 09, 2004	no. 61/04
27.	Decision on the short-term credit for liquidity in last resort	October 21, 2004	no. 82/04
28.	Decision on the amendments to the NBRM Statute	October 21, 2004	no. 82/04
29.	Decision on the monetary policy objective in 2005	November 25, 2004	no. 85/04
30.	Decision on the documentation necessary for issuing approvals to banks and on the submission of notice for change in the ownership structure of the voting shares	November 25, 2004	no. 85/04
31.	Decision on the amendments to the Decision on the interest rates of the NBRM	November 25, 2004	no. 85/04
32.	Decision on sale of jubilee coins	November 25, 2004	no. 85/04
33.	Decision on the amendments to the Decision of single tariff according to which the fees for the services performed by the NBRM are paid	November 25, 2004	no. 85/04
34.	Decision on the amendments to the NBRM Statute	November 25, 2004	
35.	Decision on the adoption of the Financial Plan of NBRM for 2005	December 29, 2004	no. 96/04
36.	Decision on the adoption of the Plan of investments in fixed asset of NBRM for 2005	December 29, 2004	no. 96/04
37.	Decision on the adoption of the Procurement Plan for 2005	December 29, 2004	no. 96/04
38.	Decision on the single tariff of fees for services performed by the NBRM	December 29, 2004	no. 96/04
39.	Decision on the amendments to the Decision on the banks' reserve requirement in Denars	December 10, 2004	no. 89/04

40.	Decision on the amendments to the Decision on the banks' reserve requirement in foreign currency	December 10, 2004	no. 89/04

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA

Financial Statements

31 December 2004

CONTENTS

GENERAL INFORMATION

Members of the Council

Petar Gosev, Governor
Emilija Naceska, Vice Governor
Slobodan Kosev
Marina Kavrakova
Fadil Bajrami
Risto Gogovski
Lubomir Kekenovski

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INDEPENDENT AUDITORS' REPORT

To the Council of National Bank of the Republic of Macedonia

1. We have audited the financial statements of the National Bank of the Republic of Macedonia (the NBRM) on pages 2 to 40, which comprise the balance sheet as of 31 December 2004 and the statement of income, cash flows statement, and the statement of changes in equity for the year then ended, and the related notes. These financial statements are the responsibility of the NBRM's management. Our responsibility is to express an opinion on these financial statements based on our audit.

2. Except for the matter described in paragraph 3 below, we conducted our audit in accordance with International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

3. As disclosed in note 27 to the accompanying financial statements, included in other liabilities there is an amount of MKD 280.820 thousand, carried forward from prior years, for which it has not been possible to fully classify and reconcile. NBRM is in the process of reclassifying this amount and therefore the effect on the financial statements, if any, may not be determined with any reasonable accuracy.

4. In our opinion, except for the effects of such adjustments on the financial statements, if any, as might have been determined to be necessary had we been able to satisfy ourselves as to the matter discussed in the preceding paragraph 3, the financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2004 and the results of its operations and cash flows for the year then ended in accordance with International Financial Reporting Standards.

Ernst & Young

Ernst & Young,
Certified Auditors Ltd. - Skopje
Skopje, 1 July 2005

ЕРНСТ И ЈАНГ
ОВЛАСТЕНИ
РЕВИЗОРИ
ДООЕЛ
СКОПЈЕ

BALANCE SHEET

At 31 December 2004

all amounts in MKD'000

ASSETS

	Note	2004	2003 Restated
FOREIGN ASSETS			
Sight deposits	4	**11.122.400**	13.544.733
Term deposits	4	**27.962.641**	24.511.489
Gold	5	**3.896.865**	1.818.581
Foreign currencies	6	**204.322**	312.017
Special Drawing Rights (SDR) holdings	7	**33.981**	13.771
Foreign securities	8	**1.115.001**	4.323.307
		44.335.210	44.523.898
RECEIVABLE FROM THE GOVERNMENT			
Loans to Government	9	-	4.027
Receivables from Government related to IMF	10	**586.427**	686.015
Government securities held to maturity	11	**2.491.531**	2.778.826
		3.077.958	3.468.868
RECEIVABLE FROM BANKS			
Loans to banks	12	**37.100**	53.753
Other accounts receivable	13	-	9.154
		37.100	62.907
OTHER ASSETS			
Premises and equipment	14	**979.440**	987.919
Inventories	15	**96.184**	93.416
Receivables	16	**29.778**	210.758
Other assets	17	**65.026**	181.286
		1.170.428	1.473.379
TOTAL ASSETS		**48.620.696**	49.529.052

The financial statements were adopted by the Council of the National Bank of the Republic of Macedonia on 30.06. 2005 and signed on its behalf by:

Petar Gošev,
Governor

НАРОДНА БАНКА НА МАКЕДОНИЈА РМ СКОПЈЕ

The accompanying notes form an integral part of these financial statements

BALANCE SHEET all amounts in MKD'000
At 31 December 2004

LIABILITIES AND CAPITAL

	Note	2004	2003 Restated
MONEY IN CIRCULARISATION		**15.071.504**	15.011.282
BANK DEPOSITS	18	**2.665.851**	3.234.523
RESERVE REQUIREMENTS OF BANKS AND SAVING HOUSES	19	**3.371.477**	2.776.421
NBRM BILLS	20	**4.551.854**	4.379.215
BORROWING FROM IMF	21	**2.818.696**	3.352.542
RESTRICTED DEPOSITS	22	**219.481**	641.878
DEPOSITS OF THE GOVERNMENT			
Denar deposits of the government	23	**6.438.948**	3.828.934
Foreign exchange deposits of the government	24	**6.281.043**	8.352.071
		12.719.991	12.181.005
OTHER DEPOSITS	25	**1.567.373**	1.313.593
OTHER LIABILITIES			
Payables	26	**203.517**	77.817
Other liabilities	27	**621.890**	795.053
		825.407	872.870
SDR ALLOCATION LIABILITY	28	**586.427**	610.698
CAPITAL AND RESERVES			
Capital	29	**1.289.789**	1.289.789
General reserves	30	**-**	853.564
Revaluation reserves	31	**3.677.780**	4.190.371
Unrealized losses on investment securities available-for-sale		**(12.445)**	(75.706)
Accumulated loss		**(732.489)**	(1.102.993)
		4.222.635	5.155.025
TOTAL LIABILITIES AND CAPITAL		**48.620.696**	49.529.052

The accompanying notes form an integral part of these financial statements

INCOME STATEMENT all amounts in MKD'000
For the year ended 31 December 2004

	Note	***2004***	*2003 Restated*
Interest income	32	**907.215**	1.097.493
Interest expense	33	**(539.053)**	(815.310)
NET INTEREST INCOME		**368.162**	282.183
Unrealized exchange losses		**(512.591)**	(2.273.065)
Fee income	34	**132.268**	127.384
Other operating income	35	**81.901**	209.212
OPERATING INCOME		**214.169**	336.596
Staff expenses		**(293.592)**	(285.507)
Depreciation	14	**(64.947)**	(64.433)
Fee expense	36	**(42.908)**	(23.742)
Other expenses	37	**(204.778**)	(183.695)
OPERATING EXPENSES		**(606.225)**	(557.377)
Provisions and write offs	38	**(449.479)**	(753.946)
(LOSS) BEFORE TAXES		**(985.964)**	(2.965.609)
Income tax	2q	**-**	(58.313)
NET (LOSS) FOR THE YEAR		**(985.964)**	(3.023.922)

APPROPRIATIONS

NET (LOSS) FOR THE YEAR	**(985.964)**	(3.023.922)
Net effect of IFRS adjustments	**584.607**	(3.036.035)
OPERATING (LOSS) / PROFIT PER STATUTORY STATEMENTS	**(1.570.571)**	12.113
General reserves	**-**	2.426
FOR TRANSFER TO THE BUDGET	**-**	9.687

The accompanying notes form an integral part of these financial statements

STATEMENT OF CASH FLOWS

all amounts in MKD'000

Year Ended 31 December 2004

	2004	*2003 Restated*
Net (loss) before allocation	**(985.964)**	(3.023.922)
Adjustments for:		
Interest income	**(907.215)**	(1.097.493)
Interest expense	**539.053**	815.310
Depreciation	**64.947**	64.169
Net (loss) before changes in assets and liabilities	**(1.289.179)**	(3.241.936)
Gold	**(2.078.284)**	2.161.063
Restricted deposits	**23.338**	(490.130)
Foreign securities	**3.208.306**	(3.855.859)
Receivable from government	**366.639**	4.272.114
Receivable from banks	**25.807**	9.053
Other assets	**184.355**	(56.624)
Money in circularization	**60.222**	196.590
Deposits of banks	**(568.672)**	120.575
Reserve requirements of banks and saving houses	**595.056**	2.591.246
Deposits of government, including restricted and other deposits	**370.369**	(4.825.809)
Borrowings from IMF	**(533.846)**	(596.191)
Other liabilities	**(57.115)**	(679.846)
Interest received	**1.017.332**	1.004.686
Interest paid	**(539.088)**	(817.092)
NET CASH FLOWS FROM / (USED IN) OPERATING ACTIVITIES	**785.240**	(4.208.160)
Fixed assets additions, net of write offs	**(56.468)**	(20.652)
NET CASH FLOWS USED IN INVESTING ACTIVITIES	**(56.468)**	(20.652)
NBRM bills issued	**172.639**	1.381.462
Net appropriations for premises and equipment	**-**	(10.217)
NET CASH FLOWS USED IN FINANCING ACTIVITIES	**172.639**	1.371.245
Unrealized gains / (losses) effects	**63.261**	(75.706)
Net increase / (decrease) in cash and cash equivalents	**964.672**	(2.933.273)
Cash and cash equivalents at the beginning of the year	**37.891.880**	40.825.153
Cash and cash equivalents at the end of the year	**38.856.552**	37.891.880
Analysis of cash and cash equivalents at end of the year		
Sight deposits	**11.122.400**	13.544.733
Term deposits	**27.962.641**	24.511.489
Foreign currencies in vault	**204.322**	312.017
SDR holdings, net	**33.981**	13.771
Less: restricted deposits	**(466.792)**	(490.130)
Total	**38.856.552**	37.891.880

The accompanying notes form an integral part of these financial statements

STATEMENT OF CHANGES IN EQUITY

all amounts in MKD'000

Year ended 31 December 2004

	Capital	*General reserves*	*Revaluation Reserves*	*Investment securities available-for-sale*	*Accumulated loss*		*Total capital and reserve accounts*
					Operating loss	*IFRS adjustments*	
At 1 January 2004	1.289.789	853.564	4.190.371	(75.706)	12.113	(1.115.106)	5.155.025
Appropriation to general reserves	-	2.426	-	-	(2.426)	-	-
Appropriation to budget	-	-	-	-	(9.687)	-	(9.687)
Unrealized FX (losses) / gains	-	-	(512.591)	63.261	-	512.591	63.261
IFRS adjustments to current year profit	-	-	-	-	-	584.607	584.607
Loss for the year	-	-	-	-	(1.570.571)	-	(1.570.571)
Covering of losses	-	(855.990)	-	-	855.990	-	-
At 31 December 2004	1.289.789	-	3.677.780	(12.445)	(714.581)	(17.908)	4.222.635

The accompanying notes form an integral part of these financial statements

STATEMENT OF CHANGES IN EQUITY

Year ended 31 December 2003

all amounts in MKD'000

	Capital	*General reserves*	*Revaluation Reserves*	*Investment securities available-for-sale*	*Fixed Assets Fund*	*Employee Amenities Funds*	*Accumulated loss*		*Total capital and reserve accounts*
							Operating profit	*IFRS adjustments*	
At 1 January 2003									
As previously reported:	-	723.636	6.483.455	-	1.258.046	173.988	-	(372.155)	8.266.970
Change of accounting policy (note 3)	-	-	(20.019)	-	-	-	-	20.019	-
Restated	-	723.636	6.463.436	-	1.258.046	173.988	-	(352.136)	8.266.970
Transfer to capital account (note 29)	1.289.789	129.928	-	-	(1.257.950)	(161.767)	-	-	-
Unrealized FX (losses)	-	-	(2.273.065)	(75.706)	-	-	-	2.273.065	(75.706)
IFRS adjustments	-	-	-	-	-	(12.221)	-	(3.036.035)	(3.048.256)
Profit for allocation	-	-	-	-	-	-	12.113	-	12.113
Other	-	-	-	-	(96)	-	-	-	(96)
At 31 December 2003	1.289.789	853.564	4.190.371	(75.706)	-	-	12.113	(1.115.106)	5.155.025

The accompanying notes form an integral part of these financial statements

1 GENERAL INFORMATION

The National Bank of the Republic of Macedonia ("NBRM") is the central bank of the Republic of Macedonia and the sole issuer of money in the country. NBRM organization and its operations are regulated by the Law on the National Bank of the Republic of Macedonia, ("NBRM Law"), dated 22 January 2002, and the amendments to the Law on the National Bank of the Republic of Macedonia from 31 July and 31 December 2003 and 21 July 2004. According to the Law, NBRM is a legal entity under the sole ownership of the state, with financial and administrative independence. NBRM was established during 1946, and was constituted as a central issuing bank during 1992.

Under the NBRM Law, main objective of NBRM is to maintain the price stability. In addition, without compromising its primary objective, NBRM is expected to support the economic policy and the financial stability of the country. The performance of these functions takes priority over the achievement of profit.

NBRM submits to the Parliament of the Republic of Macedonia a semi-annual and annual report on its operations, on the supervision and on handling the foreign exchange reserves, and financial statements audited by an external independent auditor.

Net income of NBRM is appropriated so that first the revaluation gains are allocated to the revaluation reserves, then 20% is allocated to the general reserves (until the level of initial capital is reached), initial NBRM capital is increased (if approved by the Government of the Republic of Macedonia), and the rest is regarded as revenue of the Budget of the Republic of Macedonia. The loss of NBRM shall be covered from its general reserves, and if there is a shortage of funds, it shall be covered with funds from the Budget of the Republic of Macedonia or by issuing government securities.

The bodies of NBRM are the Council and the Governor.

The total number of employees as of 31 December 2004 was 393 (31 December 2003: 397).

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a) Basis of preparation of financial statements

The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"), which comprise standards and interpretations approved by the IASB, and International Accounting Standards and International Financial Reporting Interpretation Committee interpretations approved by the IASC that remain in effect.

The financial statements are prepared under the historical cost convention as modified for the measurement at fair value of available for sale investment securities, gold and by the revaluation of premises and equipment, and related amortization and depreciation, in accordance with the regulations of the Republic of Macedonia.

b) Foreign currency translation

Foreign exchange transactions are recorded at the rate ruling at the day of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the rate of exchange ruling at the balance sheet date. All differences are taken to the income statement.

At the balance sheet date, the unrealized exchange gains and losses are appropriated to revaluation reserves, to the extent that this reserve has a positive balance after the transfer for the period.

c) Deposits with banks

Deposits with banks are stated at cost, less any provisions for impairment.

d) Monetary gold

Gold transactions are valued at the market value based on the quoted London fixing rate at the transaction date. Gold holdings are revalued on a monthly basis. At year-end, gold is valued at fair value, based on the morning market price for 1 fine ounce of gold on the London stock exchange.

Realized and unrealized gains and losses from month-end revaluations, resulting from changes in the market price of gold and changes in the exchange rate of the Denar and the USD, are taken to the income statement. At the balance sheet date, the unrealized gains and losses from month-end revaluations are appropriated to revaluation reserves, to the extent that this reserve has a positive balance after the transfer for the period

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

e) Cash and cash equivalents

For the cash flow statement purpose, cash and cash equivalents comprise balances with maturities of less than 90 days, including foreign currencies in NBRM vault and deposits with banks and other financial institutions, excluding any restricted deposits.

f) Investments

Investment at the balance sheet date are classified as investments held to maturity and investments available for sale.

All investments are initially recognized at cost, being the fair value of the consideration given, including acquisition costs.

Held to maturity
Investments, which have fixed or determinable payments and are intended to be held to maturity, are carried at amortised cost, less provision for impairment in value.

Available for sale
After initial recognition, investments, which are classified as “available for sale” are remeasured at fair value, except those whose fair value cannot be reliably measured, which are measured at cost, less provision for impairment. Unrealised gains and losses are reported as a separate component of equity until the investment is derecognised or the investment is determined to be impaired. On derecognition or impairment the cumulative gain or loss previously reported in equity is included in the statement of income for the period.

g) Fair values

For financial instruments traded in organized financial markets, fair value is determined by reference to quoted market prices. Bid prices are used for assets and offer prices are used for liabilities.

For unquoted equity investments fair value is determined by reference to the market value of a similar investment, or is based on the expected discounted cash flows.

h) Impairment and uncollectability of financial assets

An assessment is made at each balance sheet date to determine whether there is objective evidence that a specific financial asset may be impaired. If such evidence exists, the estimated recoverable amount of that asset is determined and any impairment loss is recognized in the statement of income.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

i) Trade and settlement date accounting

All "regular way" purchases and sales of financial assets are recognized on the settlement date, i.e. the date the asset is obtained from, or delivered to, the counter-party. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place.

j) Loans and advances

These are stated at amortized cost, net of provisions for impairment. The provision for loan losses is calculated as described in note 2h above.

k) Premises and equipment

All items of premises and equipment are initially recorded at cost. Depreciation is provided on a straight-line basis over the estimated useful lives of all premises and equipment, which are as follows:

Buildings	10 to 77 years
Equipment	5 to 10 years
Vehicles	6 to 7 years
Furniture and fixtures	5 to 10 years
Intangible assets (software)	5 years

Land and works of art are not depreciated.

Fixed assets (and related depreciation) were revalued at year-end using official revaluation coefficients based on the general manufactured goods price index. Such coefficients were applied to historical cost or later valuation and to accumulated depreciation. The resulting net revaluation surplus was capitalized through a corresponding increase in the Fixed Assets Fund. Following a change in the legislation, the revaluation is not compulsory and therefore the NBRM ceased to apply such revaluation starting from 1 January 2004.

l) Jubilee coins

The NBRM mints jubilee coins based on Decisions of the Government of the Republic of Macedonia. The production costs are borne by the NBRM and are recovered from revenues from sale of jubilee coins. Golden and silver coins minted to commemorate important anniversaries are valued at a sale price as set by NBRM, obtained by adding a mark-up of about 20% on average to the production costs. The production costs include the price of gold used for that purpose and the minting expenses. The mark-up percentage varies to compensate for varying fixed production costs of different quantities of specific coins, in order to obtain similar prices for the whole range of jubilee coins. Revenue from sale of jubilee coins is recognized when it is probable that future economic benefits will flow to the bank and these benefits can be measured reliably.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

m) Notes and coins in circulation

Notes and coins in circulation issued by NBRM and are presented in the balance sheet as a liability in favor of the holder, at face value. When coins and notes are withdrawn from circularization the inventory of notes and coins increases and the liability in favor of the holders is reduced.

n) Short-term bills issued

Short-term bills issued by NBRM for monetary policy purposes are recorded at discounted values, reflecting the consideration paid by banks to acquire them. Interest is accrued and expensed at maturity.

o) Deposits

Deposits are carried at cost less amounts repaid.

p) Revenue recognition

Interest income is recognized as it accrues using the effective interest rate.

Recognition of interest income from loans and deposits with banks is discontinued when the payment of interest or principal is doubtful due to initiation of a bankruptcy procedure. In such cases, any interest previously accrued but not received is reversed, and interest income is subsequently recognized only when received. The recognition of interest income on an accruals basis is reinstated only when the doubt about collectability is removed and when the outstanding arrears of interest and principal are cleared.

Fee and other income are recognized when earned.

Similar to the treatment of interest income from loans and deposits with banks, fee income is discontinued when its payment is considered doubtful, previously accrued fees and commissions that are not received are reversed, and income is recognized only when received.

q) Taxation

Under the provisions of article 36c of the amended Corporate Income Tax Law, as published on 31 July 2003 and effective as of 1 January 2003, NBRM is exempt from corporate income tax.

Prior to this date, NBRM was applying deferred taxation by using the liability method on all temporary differences at the balance sheet date. Deferred income tax assets and liabilities were measured at the tax rates that were expected to apply to the period when the asset was realized or the liability was settled, based on laws that have been enacted at the balance sheet date.

The carrying amount of deferred income tax assets previously recognized has been written down during 2003, since all of the deferred income tax asset will not be utilized in the future, due to the above mentioned tax exemption.

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

3 CHANGE IN ACCOUNTING POLICY

The comparative balances for the year ended 31 December 2003 have been restated. The effect of these restatements on the income statement for the year ended 31 December 2003 and the equity at 31 December 2002 are analyzed below.

	Net loss for the year 2003	*IFRS adjustments 31 December 2002*
As previously reported Net loss / IFRS adjustments	**(750.857)**	**(372.155)**
Adjustments:		
Unrealized foreign exchange differences	(2.273.065)	20.019
Restated: Loss / IFRS adjustments	**(3.023.922)**	**(352.136)**

Up to 31 December 2003, the NBRM accounted for unrealized exchange gains and losses on translation of foreign currency items through the revaluation reserve and not through the profit and loss as required by IAS 21. With effect from 2004, NBRM is applying IAS 21 properly and therefore the effects of this treatment are adjusted retrospectively in accordance with IAS 8.

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

4 FOREIGN EXCHANGE DEPOSITS

Foreign exchange deposits are analyzed as follows:

a) Foreign exchange deposits by type of deposit

	2004	*2003 Restated*
Sight deposits	**11.468.727**	14.038.211
Provisions	**(346.327)**	(493.478)
Subtotal	**11.122.400**	13.544.733
Term deposits	**27.962.641**	25.382.596
Provisions	**-**	(871.107)
Subtotal	**27.962.641**	24.511.489
Total deposits (sight and term)	**39.431.368**	39.420.807
Provisions	**(346.327)**	(1.364.585)
Total	**39.085.041**	38.056.222

Sight deposits earn interest at rates mostly based on the currency of the deposit and range from 0,03% to 5,32% per annum (2003: up to 6,26% per annum). The majority of the foreign sight deposits are placed on a daily, automatic basis which provides opportunity for higher yield, while maintaining an adequate level of flexibility and liquidity.

Term deposits earn interest at rates based mostly on the currency of the deposit, ranging from 1,04% to 2,81% per annum (2003: 0,95% to 6,75% per annum). The structure of term deposits per remaining period to maturity is included in note 39a).

Sight deposits include MKD 466.792 thousand of deposits that are not freely available to NBRM use. These deposits were pledged as security for a guarantee in the same amount that was obtained in favor of a foreign bank (currently under liquidation) as a condition for releasing NBRM deposits of MKD 962.828 thousand in this bank. NBRM has provided MKD 120.989 thousand for losses on these deposits. According to the latest representations of the liquidators of the foreign bank, the potential losses on these deposits that NBRM should sustain are MKD 74.475 thousand. NBRM has made a subordinated loan with the same bank of USD 5 million (MKD 225.338 thousand) maturing in 2002, which is fully provisioned. As the bank is in liquidation, the maturity of this loan did not change its subordinated status.

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

4 FOREIGN EXCHANGE DEPOSITS (Continued)

The movements in provision for losses in sight and term deposits were as follows:

	Sight deposits	*Term deposits*	*Subordinated loan*	*Total*
At 31 December 2002	211.720	149.082	292.990	653.792
Reclassifications arising upon the FX valuation	-	47.739	(47.739)	-
Release of provisions	(86.226)	-	-	(86.226)
Charge for the year	122.733	674.286	-	797.019
At 31 December 2003	248.227	871.107	245.251	1.364.585
Reclassifications arising upon the FX valuation	19.913	-	(19.913)	-
Reclassification of provision to other accounts receivable (note 13)	(147.151)	(871.107)	-	(1.018.258)
At 31 December 2004	120.989	-	225.338	346.327

b) <u>Foreign exchange deposits by counter-party</u>

	2004	*2003 Restated*
International financial institutions	**11.705.700**	15.525.999
Central banks	**22.495.069**	16.912.593
Commercial banks	**5.230.599**	6.982.215
Subtotal	**39.431.368**	39.420.807
Provisions	**(346.327)**	(1.364.585)
Total	**39.085.041**	38.056.222

Provisions relate to deposits in foreign commercial banks.

c) <u>Foreign exchange deposits by geographical area</u>

	2004	*2003 Restated*
Europe	**29.490.070**	27.856.192
Other	**9.941.298**	11.564.615
Subtotal	**39.431.368**	39.420.807
Provisions	**(346.327)**	(1.364.585)
Total	**39.085.041**	38.056.222

Provisions relate to deposits in Europe.

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

5 GOLD

Gold is analyzed as follows:

	2004	*2003 Restated*
Gold in NBRM vault	**52.291**	49.543
Gold deposits	**3.844.574**	1.769.038
Total	**3.896.865**	1.818.581

Total gold reserves of NBRM as of 31 December 2004 consisted of 197.413,690 fine troy ounces (2003: 88.857,553 fine troy ounces) at a market value of USD 438 (MKD 19.740) per fine troy ounce (2003: USD 417,25 or MKD 20.466 per fine troy ounce). Gold deposits of 194.764,685 fine troy ounces are held at three correspondent banks as non-interest bearing sight deposits (2003: gold deposits of 86.436,935).

6 FOREIGN CURRENCIES

Foreign currencies comprise foreign currencies and cheques held in the vault of NBRM.

7 SPECIAL DRAWING RIGHTS (SDR) HOLDINGS

NBRM keeps a SDR-denominated current account with IMF for processing and settling transactions with IMF. This current account earns interest at the so-called basic rate of IMF, which is obtained weekly as a weighted average of selected rates of 3-month money-market instruments of five countries whose currencies constitute the SDR valuation basket. During 2004, the basic rate ranged between 1,57% and 2,24%, per annum (2003: 1,99% to 2,41% per annum).

8 FOREIGN SECURITIES

Foreign securities are analyzed as follows:

	2004	*2003 Restated*
Held to maturity:		
2,625% semi-annual Treasury note denominated in USD, maturing November 2006	**135.203**	147.151
3,5% annual government note denominated in EUR, maturing October 2008	**91.047**	90.780
4,75% semi-annual BIS bond denominated in GBP, maturing March 2007	**259.300**	261.055
Available-for-sale:		
Fixed-income foreign government bonds	**591.831**	3.785.144
Other foreign securities	**37.620**	39.177
Total	**1.115.001**	4.323.307

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

8 FOREIGN SECURITIES (Continued)

Fixed-income foreign government bonds, maturing between 2006 and 2008 bear fixed annual and semi-annual coupons ranging between 3% and 4,5% per annum.

Other foreign securities comprise ordinary shares of BIS, with nominal value of SDR 5.000 each (paid up at 25% of their nominal value).

9 LOANS TO GOVERNMENT

These relate to loans granted to the Government of the Republic of Macedonia in 1993 for settling the government obligations to commercial banks in connection with the payment of household foreign exchange deposits guaranteed by the Republic of Macedonia. The term of the loan with original amount of MKD 64.348 thousand was 10 years, to be settled in 20 equal semi-annual installments, with the last installment due and repaid on 1 January 2004. The loan earned interest at the rate of 5% per annum.

10 RECEIVABLES FROM GOVERNMENT RELATED TO IMF

Receivables from Government are analyzed as follows:

	2004	*2003 Restated*
Receivable from the Government related to repayment of foreign debt (Note 21)	**-**	75.317
Receivable related to SDR allocation liability (Note 28)	**586.427**	610.698
Total	**586.427**	686.015

The receivable from the Government related to repayment of foreign debt represents an outstanding balance based on a financial arrangement originating from 1994 when the outstanding arrears of the Government towards the International Bank for Reconstruction and Development ("IBRD") were settled by withdrawal of a single trance of a loan granted by the IMF known as Systemic Transformation Facility 1 (STF - 1). The receivable of MKD 75.317 thousand has been fully recovered during 2004. NBRM charges the government the same interest rate incurred on the borrowing from IMF, which is the basic rate of IMF (see note 7).

The receivable related to SDR allocation concerns only the corresponding liability for the Macedonian share of the obligation towards IMF for the SDR allocated to, and received by, the former Yugoslavia, based on the Law on the Legal Succession of the Republic of Macedonia in the Membership of the IMF (see note 28).

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

10 RECEIVABLES FROM GOVERNMENT RELATED TO IMF (Continued)

Pursuant to the IMF Statute, ratified by the Parliament of the Republic of Macedonia, and the related Law on the Legal Succession of the Republic of Macedonia in the Membership of the IMF, NBRM acts as a fiscal agent of the Republic of Macedonia, and as a depository of IMF in the Republic of Macedonia. In this capacity, NBRM records the membership quota in IMF of the Republic of Macedonia, and also Accounts No.1, and No.2 with IMF. The membership quota in IMF at the end of 2004 was MKD 5.173.685 thousand, account No.1 amounted to MKD 12.967 thousand and account No.2 amounted to MKD 152 thousand (2003: MKD 5.312.502 thousand, MKD 13.315 thousand, and MKD 156 thousand, respectively).

11 GOVERNMENT SECURITIES HELD TO MATURITY

Government securities are analyzed as follows:

	2004	*2003 Restated*
Bond issued for rehabilitation and restructuring of one commercial bank	**649.451**	629.732
Other Bonds	**1.842.080**	2.149.094
Total	**2.491.531**	2.778.826

Government securities held to maturity represent Bonds issued on behalf of the Republic of Macedonia, based on the provisions of the 1995 Law on Rehabilitation and Restructuring of Part of Banks in the Republic of Macedonia. The Bond issued for rehabilitation and restructuring of one commercial bank is maturing in one lump-sum payment in April 2020, with a nominal value of MKD 1.039.318, does not earn any interest. For IFRS reporting purposes, this Bond is valued at the fair value of the assets that were given up in exchange, subsequently amortized to maturity.

The other Bonds issued on behalf of the Republic of Macedonia are repayable in equal annual installments of MKD 307.013 thousand until 1 April 2010. These Bonds earn interest at a variable rate equal to the NBRM discount rate, which during 2004 was 6,5% per annum (2003: 10,7% until March 2003, 8% until 15 April 2003 and 6,5% per annum thereafter).

12 LOANS TO BANKS

Loans to banks are analyzed as follows:

	2004	*2003 Restated*
Long-term loans from the conversion of selective loans in:		
1993	**17.511**	29.431
1996	**19.574**	24.253
Long-term loans from other conversions	**15**	69
Total	**37.100**	53.753

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

12 LOANS TO BANKS (Continued)

These loans were obtained upon restructuring selective loans of the former National Bank of Macedonia used to refinance mainly agricultural loans of the banks in former Yugoslavia. Loans converted in 1996 mature on 31 March 2020, while loans converted in 1993 mature from 2003 to 2008, in ten equal semi-annual installments. All selective loans carry an annual fee of 1,5%, payable in semi-annual installments.

13 OTHER ACCOUNTS RECEIVABLE

Overdue receivable are analyzed as follows:

	2004	*2003 Restated*
Receivable from bankrupt bank	**1.034.569**	-
Overdue deposit auctions	**9.268**	9.268
Other receivables from banks	**-**	6.711
	1.043.837	15.979
Provisions	**(1.043.837)**	(6.825)
Total	**-**	9.154

The movement of provision is analyzed as follows:

	Total
At 31 December 2003	6.825
Reclassified from foreign deposits (note 4)	1.018.258
Charge for the year (note 38)	18.754
At 31 December 2004	1.043.837

During January 2004, NBRM paid the amount of MKD 1.018.258 thousand, to foreign banks as security for guarantees given for the borrowings of a local commercial bank, in accordance with the "Decision on Criteria and Conditions for Using Part of Foreign Reserves for Providing Guarantees to Banks Authorized for Foreign Operations", which was canceled effective March 2003. The NBRM recorded a receivable from the local commercial bank. A bankruptcy procedure was initiated against the local bank was initiated during March 2004. The NBRM claimed the receivable for issued guarantees from the bankrupt bank in total amount of MKD 1.034.569 thousand. The receivable was disputed by the bankruptcy trustee and therefore the NBRM has made provision for the whole amount as of 31 December 2003. During the year ended 31 December 2004 the provision was increased by MKD 16.311 thousand to MKD 1.034.569 thousand.

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

13 OTHER ACCOUNTS RECEIVABLE (Continued)

Auction sales of deposits represent a monetary instrument designed to provide additional liquidity into the banking system by auctioning NBRM deposits to commercial banks for short periods of time and carrying interest rates set at the respective auction. Overdue receivable from banks represent auction deposits to one bank that were not repaid in time. In 1999, the bankruptcy procedure was instituted against this bank and is still continuing. According to the Law on Banks, the claims of NBRM, together with the claims of the Republic of Macedonia, have priority over the claims of other creditors.

14 PREMISES AND EQUIPMENT

Premises and equipment are analyzed as follows:

	Buildings and land	*Furniture, equipment and vehicles*	*Works of art*	*Computer software*	*Construction in progress*	*Total assets for business purposes*	*Assets for recreation*	*Total fixed assets*
At 1 January 2004, net of accumulated depreciation	742.623	149.868	25.923	27.678	12.820	958.912	29.007	987.919
Additions	6.019	31.638	17.774	83	-	55.514	1.000	56.514
Write-offs	-	(37)	-	-	-	(37)	(9)	(46)
Depreciation charge for the year	(11.052)	(41.987)	-	(10.155)	-	(63.194)	(1.753)	(64.947)
At 31 December 2004	737.590	139.482	43.697	17.606	12.820	951.195	28.245	979.440
At 1 January 2004								
Revalued amount	842.995	404.396	25.923	57.898	12.820	1.344.032	35.072	1.379.104
Accumulated depreciation	(100.372)	(254.528)	-	(30.220)	-	(385.120)	(6.065)	(391.185)
Net carrying amount	**742.623**	**149.868**	**25.923**	**27.678**	**12.820**	**958.912**	**29.007**	**987.919**
At 31 December 2004								
Revalued amount	849.014	426.933	43.697	57.981	12.820	1.390.445	35.958	1.426.403
Accumulated depreciation	(111.424)	(287.451)	-	(40.375)	-	(439.250)	(7.713)	(446.963)
Net carrying amount	**737.590**	**139.482**	**43.697**	**17.606**	**12.820**	**951.195**	**28.245**	**979.440**

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

14 PREMISES AND EQUIPMENT (Continued)

Assets for recreation include two buildings and other furniture and equipment, in those buildings. As part of the 2001 payments system reform, NBRM took over the function of cash provision from the former Payments Operations Bureau ("ZPP"), as well as part of ZPP premises, equipment and furniture associated with that function in ten cities in Macedonia. The premises were transferred from ZPP, they are currently used and maintained by NBRM, and NBRM has made capital improvements shown as construction in progress in the above schedule. Due to the fact that the responsible authorities have not yet reached a final decision for the distribution of the ZPP assets, NBRM has not yet acquired legal title over this property. Therefore, the NBRM has not determined the value of this property and the premises have not been recorded in the NBRM financial statements.

15 INVENTORIES

Inventories are analyzed as follows:

	2004	*2003 Restated*
Jubilee coins	**69.917**	66.910
Other inventories	**26.267**	26.506
Total	**96.184**	93.416

Jubilee coins represent golden and silver coins, which based on Government Decisions are produced to honor anniversaries deemed important for the country. At 31 December 2004, NBRM held 8.464 golden coins and 470 silver coins (2003: 8.209 golden coins and 510 silver coins). The jubilee coins held in the NBRM vault are intended for sale.

Other inventories include mainly office supplies, materials for printing money and other small inventories for NBRM use.

16 RECEIVABLES

Receivables are analyzed as follows:

	2004	*2003 Restated*
Income tax	**-**	120.484
Interest	**10.125**	40.879
Fees and commissions	**12.657**	36.972
Other	**6.996**	12.423
Total	**29.778**	210.758

The income tax receivable balance relates to the excess of the monthly income tax advances paid during 2002 and January 2003, over the final tax expense for the year ended 31 December 2002 per the annual income tax return. The income tax receivable has been audited and confirmed by the Central Tax Authorities. The income tax was reimbursed to the NBRM in four installments during 2004.

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

16 RECEIVABLES (Continued)

During 2004, NBRM wrote off interest and fees that are not recoverable in amount of MKD 62.864 thousand (note 38).

17 OTHER ASSETS

Other assets are analyzed as follows:

	2004	*2003 Restated*
Accrued interest income from sight and term deposits	**5.402**	15.392
Accrued interest income from available-for-sale financial assts	**17.444**	86.817
Prepaid expenses for printing money	**41.071**	68.129
Assets with special purpose	**615**	615
Other	**494**	10.333
Total	**65.026**	181.286

Assets with special purpose include membership deposits in the Multilateral Investment Guarantee Agency and the International Development Association, members of the World Bank Group, on behalf of the Republic of Macedonia.

During 2004, NBRM wrote off non-recoverable other assets in amount of MKD 7.017 thousand (note 38).

18 BANK DEPOSITS

Bank deposits represent the settlement accounts' balances in the banking clearing system. The balances of these accounts are included as part of the statutory reserves of the banks in denars, for which NBRM pays a fee at a prescribed rate (note 19).

19 RESERVE REQUIREMENTS OF BANKS AND SAVING HOUSES

The reserve requirements of banks and saving houses are analyzed as follows:

	2004	*2003 Restated*
Reserve requirements of saving houses in Denars	**8.145**	6.565
Reserve requirements of banks in foreign currencies	**3.363.332**	2.769.856
Total	**3.371.477**	2.776.421

According to regulation, the banks are required hold reserve requirements at NBRM in denars and in foreign currency.

19 RESERVE REQUIREMENTS OF BANKS AND SAVING HOUSES (Continued)

The statutory reserve requirement of the banks in denars is set at a rate of 7,5% of the denar liabilities towards resident and non-resident, legal and physical persons, in accordance with the relevant regulations. The reserve requirement of banks in denars is fulfilled in part with the settlement accounts of banks held at NBRM (note 18) and in part with the banks cash in vaults.

NBRM pays remuneration on the amount of reserve requirement in denars based on the average holdings of each bank during the relevant period. For the part of the reserve requirement originating from cash in vaults, as well as any reserve holdings above the requirement determined by NBRM, no remuneration is paid. During 2004, the remuneration rate paid on the reserve requirement in denars was: January-August 4% and August-December 2% (2003: January-March 6%, April-October 5% and November-December 4%).

The statutory reserve requirement of the banks in foreign currency is set at a rate of 7,5% of the foreign currency liabilities towards resident and non-resident, legal and physical persons, in accordance with the relevant regulations. The reserve requirement of banks in foreign currencies is deposited in a separate foreign currency account at NBRM. NBRM pays interest on the foreign reserve requirement of banks at the rate equivalent to the Deposit Standing Facility interest rate of ECB, which during 2004 amounted to 1% per annum (2003: 1% per annum). Commencing January 2005, no interest is paid on foreign currency reserve requirement of banks.

According to the regulation, saving houses are required to hold reserve requirements at NBRM in denars. The saving houses calculate the reserve requirement at a rate of 2,5% and deposit the reserve in a separate account at the NBRM. The reserve requirement of saving houses is fulfilled in a fixed amount. NBRM pays remuneration on the reserve requirement of saving houses at the same rate as for the reserve requirements of banks in denars.

20 NBRM BILLS

NBRM bills represent a monetary instrument designed to manage the overall liquidity by withdrawal of the excess liquidity from the banking system. The maturity of the NBRM bills is standardized on 28 days. Depending on the goals of the monetary policy, the maturity of the NBRM bills can be shorter. The bills are sold to banks through an auctioning process, either through interest rate tenders (banks auction for amounts they want to purchase and interest rates) or volume tenders (banks auction only with amounts they want to purchase, while the interest rate is pre-determined by the NBRM).

During 2004, the NBRM bills were with two maturities, 7 and 28 days. Both types of auctioning processes were applied: up to 13 February, interest rate tenders were applicable and from 18 February till the end of the year volume tenders where applicable. The interest rate on NBRM bills increased during 2004. The lowest level was during January, when the monthly weighted average interest rate was 6,75%, while the highest level was during December when the monthly weighted average interest rate was 8,95% (2003: the interest rates on NBRM bills decreased from 14.75% during January to 6,12% during November 2003).

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

21 BORROWING FROM IMF

The remaining portion of the borrowings that NBRM has withdrawn from IMF arising from the following arrangements:

	2004	*2003 Restated*
Systemic Transformation Facility - Part 1 (STF-1)	**-**	75.317
Systemic Transformation Facility - Part 2 (STF-2)	**72.324**	225.951
Enhanced Structural Adjustment Facility (ESAF)	**1.145.636**	1.590.738
Compensatory Contingency Financing Facility (CCFF)	**-**	376.644
Poverty Reduction and Growth Facility (PRGF)	**120.558**	125.548
Extended Fund Facility (EFF)	**80.372**	83.698
Stand-by	**1.399.806**	874.646
Total	**2.818.696**	3.352.542

The funds from the withdrawn borrowings from the IMF are for the purpose of supporting the balance of payments.

CCFF and STF-1 were repaid during 2004.

STF-2, ESAF, PRGF and EFF arrangements are for a period of ten years, including a grace period of four and a half years (STF-2 and EFF) or five and a half years (ESAF and PRGF). These borrowings are payable in semi-annual installments and should be settled fully between 2005 and 2010, depending on the arrangement type. The Stand-by loan is for a period of five years, including a grace period of three years and three months, with quarterly payments maturing between 2006 and 2009. ESAF and PRGF arrangements incur interest at fixed rates of 0,5% per annum. Other borrowing arrangements incurs interest at the basic rate of IMF (see note 7).

22 RESTRICTED DEPOSITS

Restricted deposits mainly include foreign exchange funds of depositors (government) pending completion of wire transfers abroad and funds of depositors (government) that represent a 100% cover of letters of credit issued by NBRM on their behalf. NBRM does not pay interest on these deposits.

23 DENAR DEPOSITS OF THE GOVERNMENT

Denar deposits of the government are analyzed as follows:

	2004	*2003 Restated*
Single treasury account (Budget)	**4.313.611**	1.976.633
Other denar accounts	**2.125.337**	1.852.301
Total	**6.438.948**	3.828.934

23 DENAR DEPOSITS OF THE GOVERNMENT (Continued)

In accordance with the provisions of the Law on the National Bank of the Republic of Macedonia, NBRM performs deposit activities for the Government and the governmental bodies. NBRM maintains the Central government account (Budget) and the accounts of the compensatory accounts from foreign donations. The interest rate is renegotiated annually.

During 2004, NBRM did not pay interest on these deposits (2003: the interest rate was 3% per annum). During April 2005, the NBRM concluded an agreement to pay interest on these deposits for the period October-December 2004 at an interest rate of 1% per annum.

24 FOREIGN EXCHANGE DEPOSITS OF THE GOVERNMENT

In accordance with the Law on the National Bank of the Republic of Macedonia and the Foreign Exchange Law, NBRM acts as an agent of the Government for performing foreign operations abroad. The central Government and some of the governmental entities place their foreign currency receipts at the NBRM, on the condition that, the opening of such accounts is formally approved by the Ministry of Finance.

Up till 18 November 2003, NBRM paid interest on USD deposits at 70% of Federal Reserve System discount rate, amounting to rates between 0,5% and 0,9%, per annum and on EUR deposits at 70% of ECB refinancing tender rate, amounting to rates between 1,2% and 1,6%, per annum, with the exception of the special foreign exchange privatization deposit denominated in EUR amounting to MKD 6.698.477 thousand, which earns interest at the full amount of the above mentioned benchmark rates for EUR deposits.

With the cancellation of the decision for the criteria and procedure under which NBRM pays interest on these deposits as of 18 November 2003, NBRM does not pay any interest on these deposits. During April 2005, the NBRM concluded an agreement to pay interest on these deposits for the period October-December 2004 at an interest rate of 0,5% per annum.

25 OTHER DEPOSITS

Other deposits comprise of deposits of brokerage houses client accounts, the Central Depository of Securities account, and the Deposit Insurance Fund. The brokerage houses client accounts and the Central Depository of Securities account are settlement accounts arising from securities transactions. NBRM does not pay any interest on these deposits. The account of the Deposit Insurance Fund is maintained at the NBRM as required by the Deposit Insurance Law of the Republic of Macedonia. This account bears interest of 1% per annum.

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

26 PAYABLES

Other payables are analyzed as follows:

	2004	*2003 Restated*
Interest payables	**35.963**	37.070
Payables from appropriation of net income	**9.691**	26.993
Liabilities from BNT bankruptcy	**157.747**	9.873
Payables arising from annuities received from sale of socially-owned flats	**-**	2.882
Other payables	**116**	999
Total	**203.517**	77.817

Interest payables include mainly interest accrued on NBRM bills and compulsory reserves of banks for December, paid in the beginning of January 2004.

Payables from appropriation of net income relate to NBRM net income after taxes and appropriation of net income to NBRM reserves, which is due to the Budget, in accordance with the provisions of the NBRM Law.

With the appropriation of the liquidation estate of one commercial bank, which was declared bankrupt in 1995, NBRM acquired liabilities in the amount of MKD 292.442 thousand for the purpose of compensating depositors of the bankrupt bank. NBRM also received certain property as a compensation for the acquired liabilities that was immediately transferred to the government of the Republic of Macedonia without any compensation. In 2001, NBRM recorded part of these liabilities in total amount of MKD 24.761 thousand. Cumulatively, until the end of 2004, the NBRM paid MKD 120.233 thousand to meet claims by the bank depositors. During 2004, the NBRM revised its original estimate on the amount that was to become payable for this purpose in the foreseeable future and recorded additional MKD 152.646 thousand in relation to this liability (see note 38).

Payables arising from annuities received from the sale of socially-owned flats represent liabilities to the central budget of the Republic of Macedonia for outstanding denar equivalent of foreign currency inflows from annuities received from sale of socially-owned flats to their residents. The annuities received from residents are collected by the commercial banks and transferred to a special forex account of the Budget of the Republic of Macedonia held at the NBRM. The foreign exchange collected this way is transferred to NBRM and accumulated in a special account, with the MKD denomination being transferred to government on a weekly basis. These have been fully reimbursed during 2004.

NBRM does not pay interest on either of these payables.

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

27 OTHER LIABILITIES

Other liabilities are analyzed as follows:

	2004	*2003 Restated*
Liabilities from servicing foreign borrowings of the Government (NBRM Apex unit)	**317.423**	583.537
Contra accounts	**(280.820)**	(401.288)
Bank deposits related to swap operations	**147.144**	193.113
Temporarily confiscated foreign currencies	**144.553**	144.834
Expected litigation outlays	**161.662**	73.932
Jubilee coins counterpart	**58.312**	57.241
Equity payments pending operational license	**42.917**	-
Accrued interest to IMF	**11.406**	10.334
IBRD special deposit	**3.019**	15.412
Trade creditors	**5.584**	12.646
Other liabilities	**10.690**	105.292
Total	**621.890**	795.053

Collected funds (principle and interest) from the commercial banks recipients of foreign credit lines which are administered through the NBRM Apex unit, mainly comprise of collected principle from the two Private Sector Development Loans granted by IBRD. The collected funds from the commercial banks (principle and interest) are allocated by the NBRM Apex unit to the relevant accounts for administering the granted loans and they are eventually paid to the creditors. NBRM does not pay interest on these funds.

Bank deposits related to swap operations consist of foreign exchange deposits of domestic commercial banks which in accordance with local regulations are made available for intra-day swap operations (i.e. granting denar funds for bridging the timing gaps between inflows and outflows of denars during one working day trough the MIPS system). Starting from 18 November 2003, NBRM does not pay any interest on these funds.

Temporarily confiscated foreign currencies represent foreign currency holdings of individuals that are confiscated for a variety of reasons and deposited with NBRM by the confiscating authority, until the court resolution of the dispute, when the foreign currencies are either returned to the original holder or conferred to the government. NBRM also maintains temporary deposited foreign currencies that are recorded on memo accounts. Those foreign currencies recorded off-balance sheet amount to MKD 150.843 thousand at 31 December 2004 (2003: MKD 100.050 thousand). NBRM does not pay interest on these funds.

Equity payments pending operational license include deposits related to a license application to the Ministry of Finance for an insurance company license, made in accordance with the Insurance Supervision Law. NBRM does not pay interest on these funds.

Jubilee coins counterpart arises as a result of the accounting policy for jubilee coins (as explained in the note 2l).

27 OTHER LIABILITIES (Continued)

Expected litigation outlays relate to estimated amounts of principle and interest that NBRM management expects to pay to insurance companies that have sued NBRM (for foreclosing on their giro accounts the amounts that these insurance companies owed to NBRM with regard to insuring NBRM advances to exchange bureaus) and commercial banks (not executing the security instrument against a bank under administration).

IBRD special deposit represent advances made to cover administrative expenses of the IBRD Resident Office in Skopje.

The contra accounts in amount of MKD 280.820 thousand (2003: MKD 401.288 thousand), represent prior years balances in relation to monetary transactions. The NBRM is in the process of reclassifying/clearing these balances.

28 SDR ALLOCATION

By decision of the Executive Board of IMF dated 14 December 1992 and upon written approval of all successor states in the process of distributing the IMF quota of former Yugoslavia, the Republic of Macedonia received 5,4% of the net cumulative SDR allocation obligation of former Yugoslavia, in the amount of SDR 8.378.694. This amount represents the share of Republic of Macedonia of the obligation towards IMF of former Yugoslavia, for the SDR that were previously allocated to, and received by, former Yugoslavia.

According to IMF statute, the liability for SDR allocations is due only in the case of cancellation of SDR allocations. Such cancellation may be effected by a decision of the Board of Governors of IMF, with an 85% majority of the total voting power, or in the case of termination of the country's participation in the IMF SDR Department or in the event of liquidation of the IMF SDR Department.

NBRM pays the IMF basic rate on the outstanding amount of the SDR allocation liability.

29 CAPITAL

For the purpose of compliance with the NBRM Law, the NBRM Council adopted a decision for allocating the amount of MKD 1.289.789 thousand from the fund for fixed assets and the fund for employee amenities to the capital account of NBRM in respect to the year ended 31 December 2003. Based on the same decision, the remaining portion in amount of MKD 129.928 thousand was transferred to the General reserve account.

The fund accounts were originally a quasi-equity account for its fixed assets for business purposes and fixed assets for employee amenities, including the NBRM accounts that are used to finance those fixed assets. In accordance with the NBRM Law, the funds were increased by appropriations of net profit and when receiving fixed assets without compensation.

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

30 GENERAL RESERVES

As stipulated by the NBRM Law and following the allocation of unrealized gains to the revaluation reserves, 20% of the remaining income is transferred to the general reserves until the level of initial NBRM capital is reached. The general reserves are utilized to cover the general risks related to NBRM operations. As of 31 December 2004 these reserves where fully utilized to cover the negative financial results.

31 REVALUATION RESERVES

These reserves represent accumulated net unrealized foreign exchange gains from periodic exchange rate revaluations of monetary assets and liabilities, which serve as a reserve against potential future adverse movements in exchange rates.

32 INTEREST INCOME

Interest income is analyzed as follows:

	Loans granted	*Deposits made*	*Securities purchased*	***Total 2004***	*Total 2003 Restated*
Government	101	-	140.848	**140.949**	180.551
Domestic banks	1.288	-	-	**1.288**	49.828
Foreign entities	-	711.963	53.015	**764.978**	867.114
Total 2004	**1.389**	**711.963**	**193.863**	**907.215**	1.097.493
Total 2003, Restated	50.322	679.599	367.572	1.097.493	

33 INTEREST EXPENSE

Interest expense is analyzed as follows:

	Loans received	*Deposits received*	*Securities issued*	***Total 2004***	*Total 2003 Restated*
Government	-	19.119	-	**19.119**	294.170
Domestic banks	-	121.776	351.440	**473.216**	480.977
Foreign entities	46.718	-	-	**46.718**	40.163
Total 2004	**46.718**	**140.895**	**351.440**	**539.053**	815.310
Total 2003, Restated	40.163	427.608	347.539	815.310	

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

34 FEE INCOME

Fee income is analyzed as follows:

	2004	*2003 Restated*
Fees from providing cash to commercial banks	**59.772**	41.264
Fees from domestic bank payments clearing (RTGS)	**35.065**	28.510
Fees from issued guarantees	**3.142**	22.464
Fees from sales of duty stamps	**14.472**	14.772
Fees from foreign exchange payments	**4.567**	11.956
Other fees	**15.250**	8.418
Total	**132.268**	127.384

Fees from providing cash to commercial banks and fees from domestic bank payments clearing (RTGS) relate to services to domestic commercial banks, which NRBM commenced providing as from the beginning of 2002.

Fees from issued guarantees in accordance with the NBRM Council "Decision on Criteria and Conditions for Using Part of Foreign Reserves for Providing Guarantees to Banks Authorized for Foreign Operations" include fees of 0,1% a month, charged on the balance of guarantees issued by NBRM. Effective 25 March 2003, the NBRM Council "Decision on Criteria and Conditions for Using Part of Foreign Reserves for Providing Guarantees to Banks Authorized for Foreign Operations" has been canceled.

Fees from sales of duty stamps relate to proceeds from sales of administrative and legal duty stamps that are earned by NBRM for its role in their printing and distribution.

Fees from foreign exchange payments are mainly generated when NBRM sells foreign exchange to government entities and from conducting payment operations abroad.

Fees for all NBRM operations are determined with a special NBRM Council decision on the tariff structure, as amended from time to time.

35 OTHER OPERATING INCOME

Other income is analyzed as follows:

	2004	*2003 Restated*
Realized foreign exchange gains, net	**47.032**	83.876
Realized gains from available-for-sale securities	**254**	46.809
Fees from administering foreign credit lines (note 27)	**11.909**	11.699
Dividend income from BIS (note 8)	**7.183**	6.794
Revenues from jubilee coins	**2.071**	8.865
Other income	**13.452**	17.580
Cancelled liabilities	**-**	33.589
Total	**81.901**	209.212

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

35 OTHER OPERATING INCOME (Continued)

Realized foreign exchange gains, net, arise mainly from operations of buying and selling foreign exchange with domestic banks and from the spread between the middle and buying official exchange rates when NBRM sells foreign exchange to government for foreign payments.

Canceled liabilities were outstanding from the dismantling of the former Payments Operations Bureau ("ZPP"). These liabilities have been outstanding for a number of years and are not related to any creditor.

36 FEE EXPENSE

Fee expense is analyzed as follows:

	2004	*2003 Restated*
Fees to banks	**18.995**	23.715
Fees from gold swap	**23.889**	-
Other fees to domestic banks	**24**	27
Total	**42.908**	23.742

Fees to foreign banks relate to charges on transactions with NBRM deposits and other foreign exchange transactions with foreign banks.

The fees from gold swap arise from a single gold swap transaction of 108.327,680 fine troy ounces that was concluded during August 2004.

37 OTHER EXPENSES

Other expense is analyzed as follows:

	2004	*2003 Restated*
Services	**75.310**	80.365
Costs for production of banknotes and coins	**60.409**	61.806
Realized losses from available-for-sale securities	**34.876**	-
Materials	**26.581**	28.140
Other administrative expenses	**5.113**	8.643
Other expenses	**2.489**	4.741
Total	**204.778**	183.695

Costs for production of banknotes and coins relate mainly to special paper imported for the banknotes. The banknotes are produced by a Macedonian company not related to NBRM. NBRM defers the costs for production of the coins and banknotes over the period of their use.

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

38 PROVISIONS AND WRITE OFFS

Provisions for potential losses are analyzed as follows:

	2004	*2003 Restated*
Provision for BNT bankruptcy (note 26)	**152.646**	**-**
Write off balances not recoverable	**120.468**	**-**
Expected litigation outlays (note 27)	**87.730**	43.153
Provision for interest and fees (note 16)	**62.864**	-
Provisions charged against other receivables / bank deposits (note 13 and 4)	**18.754**	797.019
Reversal of provisions	**-**	(86.226)
Other allowances (note 17)	**7.017**	**-**
Total	**449.479**	753.946

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

39 FINANCIAL INSTRUMENTS

The balance sheet of NBRM is largely comprised of financial instruments. These instruments expose NBRM to a number of risks, including liquidity risk, interest rate risk, foreign exchange risk, and credit risk.

a) Liquidity risk

Liquidity risk is the risk that insufficient foreign currency funds will be available to the NBRM in order to perform its normal operations.

Regarding liabilities in domestic currency, NBRM is not exposed to this risk due to its central bank character. Regarding liabilities in foreign currencies, NBRM limits this risk by managing foreign assets with liquidity in mind.

The table below summarizes the maturity profile of the bank's assets and liabilities based on contractual repayment determined on the basis of the remaining period at the balance sheet date to the contractual maturity date, at **31 December 2004**:

	Up to 1 month	*1 to 3 months*	*3 months to 1 year*	*1 to 5 years*	*over 5 years*	*Total*
ASSETS						
Foreign assets	43.745.450	66.590	-	485.550	37.620	44.335.210
Receivable from the government	586.427	-	307.013	1.228.054	956.464	3.077.958
Receivable from banks	-	-	4.393	13.133	19.574	37.100
Other assets	86.124	-	8.681	-	1.075.623	1.170.428
Total assets	44.418.001	66.590	320.087	1.726.737	2.089.281	48.620.696
LIABILITIES						
Money in circularization	15.071.504	-	-	-	-	15.071.504
Deposits of banks	2.665.851	-	-	-	-	2.665.851
Reserve requirements	3.371.477	-	-	-	-	3.371.477
NBRM Bills	4.551.854	-	-	-	-	4.551.854
Borrowings from IMF	-	-	467.613	2.337.689	13.394	2.818.696
Restricted deposits	1.734	48.182	169.565	-	-	219.481
Deposits of the government	12.719.991	-	-	-	-	12.719.991
Other deposits	1.567.373	-	-	-	-	1.567.373
Other liabilities	1.091.495	9.691	1.813	3.228	(280.820)	825.407
SDR allocation liability	586.427	-	-	-	-	586.427
Capital and reserves	-	-	-	-	4.222.635	4.222.635
Total liabilities and capital	41.627.706	57.873	638.991	2.340.917	3.955.209	48.620.696
GAP ANALYSIS						
Gap per individual band	2.790.295	8.717	(318.904)	(614.180)	(1.865.928)	
Cumulative gap	2.790.295	2.799.012	2.480.108	1.865.928		

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

39 FINANCIAL INSTRUMENTS (Continued)

a) Liquidity risk (Continued)

The maturity profile of the assets and liabilities at 31 December 2003 was as follows:

	Up to 1 month	*1 to 3 months*	*3 months to 1 year*	*1 to 5 years*	*over 5 years*	*Total Restated*
ASSETS						
Foreign assets	43.640.085	345.650	-	498.986	39.177	44.523.898
Receivable from the government	610.698	75.317	311.040	1.228.053	1.243.760	3.468.868
Receivable from banks	9.154	-	8.856	20.575	24.322	62.907
Other assets	1.154.777	41.108	45.459	-	232.035	1.473.379
Total assets	45.414.714	462.075	365.355	1.747.614	1.539.294	49.529.052
LIABILITIES						
Money in circularization	15.011.282	-	-	-	-	15.011.282
Deposits of banks	3.234.523	-	-	-	-	3.234.523
Reserve requirements	2.776.421	-	-	-	-	2.776.421
NBRM Bills	4.379.215	-	-	-	-	4.379.215
Borrowings from IMF	-	200.865	774.086	2.299.472	78.119	3.352.542
Restricted deposits	641.878	-	-	-	-	641.878
Deposits of the government	12.181.005	-	-	-	-	12.181.005
Other deposits	1.313.593	-	-	-	-	1.313.593
Other liabilities	1.235.052	-	-	-	(362.182)	872.870
SDR allocation liability	610.698	-	-	-	-	610.698
Capital and reserves	-	-	-	-	5.155.025	5.155.025
Total liabilities and capital	41.383.667	200.865	774.086	2.299.472	4.870.962	49.529.052
GAP ANALYSIS						
Gap per individual band	4.031.047	261.210	(408.731)	(551.858)	(3.331.668)	
Cumulative gap	4.031.047	4.292.257	3.883.526	3.331.668		

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

39 FINANCIAL INSTRUMENTS (Continued)

b) Interest rate risk

Interest rate risk arises from the possibility that certain changes in the value of the foreign reserves will occur as a result of changes in the market interest rates of the instruments composing the foreign exchange reserves. NBRM is exposed to interest rate risk as a result of mismatches of interest rate re-pricing of assets and liabilities.

With regard to domestic assets and liabilities, NBRM has power to influence interest rates, indirectly, through influencing the overall level of interest rates via its monetary policy. However, these powers are used in the context of the monetary policy and in the interest of the economy as a whole, are constrained by the overall framework of the country's economic policy, and are not guided by NBRM balance sheet or profitability considerations. With regard to foreign assets and liabilities, the exposure of the NBRM to interest rate risk is low and is in accordance with the principles of security and liquidity when managing foreign reserves.

The Bank’s interest sensitivity position based on contractual re-pricing arrangements at **31 December 2004** was as follows:

	Interest-bearing items					*Non-interest*	
	Up to 1 month or at variable rate	*1 to 3 months*	*3 months to 1 year*	*1 to 5 years*	*over 5 years*	*bearing items*	*Total*
ASSETS							
Foreign assets	39.644.263	66.590	-	485.550	-	4.138.807	44.335.210
Receivable from the government	-	-	307.013	1.228.054	956.464	586.427	3.077.958
Receivable from banks	-	-	4.393	13.133	19.574	-	37.100
Other assets	-	-	-	-	-	1.170.428	1.170.428
Total assets	39.644.263	66.590	311.406	1.726.737	976.038	5.895.662	48.620.696
LIABILITIES							
Money in circularization	-	-	-	-	-	15.071.504	15.071.504
Deposits of banks	2.665.851	-	-	-	-	-	2.665.851
Reserve requirements	3.371.477	-	-	-	-	-	3.371.477
NBRM Bills	4.551.854	-	-	-	-	-	4.551.854
Borrowings from IMF	1.552.502	-	381.894	884.300	-	-	2.818.696
Restricted deposits	3.550	-	-	-	-	215.931	219.481
Deposits of the government	-	-	-	-	-	12.719.991	12.719.991
Other deposits	1.549.738	-	-	-		17.635	1.567.373
Other liabilities	-	-	-	-	-	825.407	825.407
SDR allocation liability	586.427	-	-	-	-	-	586.427
Capital and reserves	-	-	-	-	-	4.222.635	4.222.635
Total liabilities and capital	14.281.399	-	381.894	884.300	-	33.073.103	48.620.696
GAP ANALYSIS							
Gap per individual band	25.362.864	66.590	(70.488)	842.437	976.038	(27.177.441)	
Cumulative gap	25. 362.864	25.429.454	25.358.966	26.201.403	27.177.441		

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

39 FINANCIAL INSTRUMENTS (Continued)

b) Interest rate risk (Continued)

The bank's interest sensitivity position based on contractual re-pricing arrangements at 31 December 2003 was as follows:

	Interest-bearing items					*Non-interest*	
	Up to 1 month or at variable rate	*1 to 3 months*	*3 months to 1 year*	*1 to 5 years*	*over 5 years*	*bearing items*	*Total Restated*
ASSETS							
Foreign assets	41.518.499	345.650	-	498.986	-	2.160.763	44.523.898
Receivable from the government	-	75.317	311.040	1.228.053	1.243.760	610.698	3.468.868
Receivable from banks	2.443	-	8.856	20.575	24.322	6.711	62.907
Other assets	-	-	-	-	-	1.473.379	1.473.379
Total assets	41.520.942	420.967	319.896	1.747.614	1.268.082	4.251.551	49.529.052
LIABILITIES							
Money in circularization	-	-	-	-	-	15.011.282	15.011.282
Deposits of banks	3.234.523	-	-	-	-	-	3.234.523
Reserve requirements	2.776.421	-	-	-	-	-	2.776.421
NBRM Bills	4.379.215	-	-	-	-	-	4.379.215
Borrowings from IMF	1.636.255	-	410.016	1.256.052	50.219	-	3.352.542
Restricted deposits	-	-	-	-	-	641.878	641.878
Deposits of the government	2.321.814	-	-	-	-	9.859.191	12.181.005
Other deposits	-	-	-	-		1.313.593	1.313.593
Other liabilities	-	-	-	-	-	872.870	872.870
SDR allocation liability	610.698	-	-	-	-	-	610.698
Capital and reserves	-	-	-	-	-	5.155.025	5.155.025
Total liabilities and capital	14.958.926	-	410.016	1.256.052	50.219	32.853.839	49.529.052
GAP ANALYSIS							
Gap per individual band	26.562.016	420.967	(90.120)	491.562	1.217.863	(28.602.288)	
Cumulative gap	26.562.016	26.982.983	26.892.863	27.384.425	28.602.288		

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

39 FINANCIAL INSTRUMENTS (Continued)

c) Foreign exchange risk

Currency risk is the risk that the value of the NBRM foreign reserves will be reduced as a result of fluctuation in the foreign exchange rates and the monetary gold.

The current foreign exchange system of the Republic of Macedonia is theoretically based on freely floating exchange rates, as set by market participants. However, the exchange rate of MKD versus the Euro (German Mark) is a basic anchor of the monetary policy and the overall economic policy and NBRM has wide powers to influence the exchange rate of MKD. NBRM also publishes the official indicative list of exchange rates, which is used for accounting translation of foreign exchange values to MKD, including the translations in NBRM records. NBRM balance sheet and profitability considerations have not historically played any role in setting the exchange rates. In addition to the constraints posed by the overall economic policy, the NBRM is constrained to a limited extent also by market forces that may render the official exchange rates incomparable to market rates. Keeping in mind the fixed rate of the Denar toward the Euro, the foreign exchange risk of NBRM toward the Euro is minimal. The foreign exchange risk toward the USD is present due to the fluctuations between the USD and Euro, and its impact on the Denar exchange rate.

The table below shows main categories of assets and liabilities analyzed by their currency of denomination, as at **31 December 2004**:

	EUR	USD	SDR	other	MKD	Total
ASSETS						
Foreign assets	30.257.760	13.958.997	33.981	430.799	(346.327)	44.335.210
Receivable from the government	-	-	586.427	-	2.491.531	3.077.958
Receivable from banks	-	935.582	-	-	(898.482)	37.100
Other assets	13.167	906	-	3.645	1.152.710	1.170.428
Total assets	30.270.927	14.895.485	620.408	434.444	2.399.432	48.620.696
LIABILITIES						
Money in circularization	-	-	-	-	15.071.504	15.071.504
Deposits of banks	-	-	-	-	2.665.851	2.665.851
Reserve requirements	3.363.332	-	-	-	8.145	3.371.477
NBRM Bills	-	-	-	-	4.551.854	4.551.854
Borrowings from IMF	-	-	2.818.696	-	-	2.818.696
Restricted deposits	41.926	177.555	-	-	-	219.481
Deposits of the government	5.304.364	974.924	-	1.756	6.438.947	12.719.991
Other deposits	-	-	-	-	1.567.373	1.567.373
Other liabilities	643.120	4.578	-	7.942	169.767	825.407
SDR allocation liability	-	-	586.427	-	-	586.427
Capital and reserves	-	-	-	-	4.222.635	4.222.635
Total liabilities and capital	9.352.742	1.157.057	3.405.123	9.698	34.696.076	48.620.696
GAP ANALYSIS						
Gap per currency	20.918.185	13.738.428	(2.784.715)	424.746	(32.296.644)	

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

39 FINANCIAL INSTRUMENTS (Continued)

c) Foreign exchange risk (Continued)

The table below shows main categories of assets and liabilities analyzed by their currency of denomination, as at 31 December 2003:

	EUR	USD	SDR	other	MKD	*Total Restated*
ASSETS						
Foreign assets	29.238.452	14.228.032	52.947	2.369.052	(1.364.585)	44.523.898
Receivable from the government	-	-	610.698	75.317	2.782.853	3.468.868
Receivable from banks	-	-	-	-	62.907	62.907
Other assets	94.280	3.006	1.031	4.923	1.370.139	1.473.379
Total assets	29.332.732	14.231.038	664.676	2.449.292	2.851.314	49.529.052
LIABILITIES						
Money in circularization	-	-	-	-	15.011.282	15.011.282
Deposits of banks	-	-	-	-	3.234.523	3.234.523
Reserve requirements	2.769.856	-	-	-	6.565	2.776.421
NBRM Bills	-	-	-	-	4.379.215	4.379.215
Borrowings from IMF	-	-	3.352.542	-	-	3.352.542
Restricted deposits	22.985	609.589	-	9.304	-	641.878
Deposits of the government	7.301.585	1.049.456	-	1.031	3.828.933	12.181.005
Other deposits	-	-	-	-	1.313.593	1.313.593
Other liabilities	914.903	5.099	9.281	7.862	(64.275)	872.870
SDR allocation liability	-	-	610.698	-	-	610.698
Capital and reserves	-	-	-	-	5.155.025	5.155.025
Total liabilities and capital	11.009.329	1.664.144	3.972.521	18.197	32.864.861	49.529.052
GAP ANALYSIS						
Gap per currency	18.323.403	12.566.894	(3.307.845)	2.431.095	(30.013.547)	

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

39 FINANCIAL INSTRUMENTS (Continued)

d) Credit risk

Credit risk is the risk of reducing the value of the foreign reserves due to a change in the financial position of the contractual financial institution or commercial bank where the foreign reserves are placed. The size and concentration of the exposure of NBRM to credit risk can be obtained directly from the balance sheet and notes to balance sheet positions that describe financial assets. In the case of NBRM, the main credit risk arises in respect of correspondent banks where foreign exchange deposits and other foreign assets are placed and in respect of domestic banks regarding the use of NBRM guarantees. The table below shows main concentrations of credit risk by counter-party:

	Deposits	*Securities*	***Total 2004***	*2003*
BIS Basle	12.528.221	259.300	**12.787.521**	15.787.054
Federal Reserve Bank of New York	9.284.545	224.268	**9.508.813**	11.637.428
Banque de France	11.358.306	62.637	**11.420.943**	4.801.368

While managing the foreign reserves the credit risk is determined as the primary risk. The main instrument for managing credit risk is by determining a financial institution – commercial bank or issuer of a security. The determination of a financial institution is performed by monitoring several criteria, which are approved by the NBRM Council.

e) Fair value

The table below sets out the differences between carrying values and estimated fair values of those financial instruments where fair values are materially different from carrying amounts in the financial statements.

	31 December 2004			*31 December 2003*		
	Carrying value	***Fair value***	***Difference***	*Carrying value*	*Fair value*	*Difference*
Financial assets						
Non-interest earning government bond (Note 11)	**649.451**	**358.759**	**(290.692)**	629.732	232.084	(397.648)
Investments held to maturity (note 8)	**485.550**	**488.468**	**2.918**	498.986	502.959	3.973
Net difference between			**(287.774)**			(393.675)

The fair values were estimated by discounting to net present value the future cash flows associated with the financial instruments using the discount rate of NBRM of 7,75% (2003: 9.08%) prevailing during the last two years. All of the above financial assets are carried at amortized cost. It is the NRBM intention to hold the assets until maturity and there is no intention to sell these financial instruments earlier should market conditions change. There is no need to reduce the carrying amount of the bond as all amounts due will be collected according to the contractual terms of the bond.

39 FINANCIAL INSTRUMENTS (Continued)

e) Fair value (Continued)

As explained in note 8, included under available-for-sale investments are BIS shares with a value of MKD 37.620 thousand (2003: MKD 39.177 thousand), for which fair value cannot be reliably determined due to the fact that these shares are not actively traded. Carrying amounts of other financial assets and liabilities approximate their fair values.

40 COMMITMENTS AND CONTINGENCIES

a) Litigation

NBRM is a defendant in several legal proceedings arising from its operations. The total amount claimed as at 31 December 2004 amounts to MKD 507.456 thousand. NBRM contests these claims and based on legal advise considers that no other material liabilities will be incurred, except for the amounts already provided for (see note 27).

b) Derivatives

NBRM had no derivatives as of 31 December 2004 (2003: nil).