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CONTENT

Governor's foreword.....	7
 I. Economic developments in the world	14
1.1. Developed countries in 2005.....	16
1.2. Countries in transition in 2005	18
 II. Economic developments in the Republic of Macedonia	24
2.1. Gross domestic product	24
2.2. Prices	27
2.3. Industrial output	31
2.4. Other economic activities	34
2.5. Labor market and wages	37
Annex 1: Analysis of the productivity in the Republic of Macedonia	39
2.6. Government budget.....	42
 III. Monetary developments in the Republic of Macedonia	50
3.1. Monetary policy in 2005	50
3.2. Liquidity of banks	52
3.2.1. Basic monetary policy instruments	58
Annex 2: Chronology of the modifications in the design of monetary instruments and undertaken measures in 2005	60
3.3. Monetary aggregates	62
3.3.1. Total deposits.....	66
3.4. Banks' placements	70
3.5. Interest rates	74
 IV. Financial markets in the Republic of Macedonia	82
4.1. Money market	82
4.2. Stock Exchange	85
4.2.1. Government securities market	89
Annex 3: Yield curve of short-term Treasury bills in the Republic of Macedonia ...	92
4.3. Foreign exchange and currency exchange market	95
Annex 4: Measuring pressures on the foreign exchange market	98
 V. External sector	102
5.1. Balance of payments	102
5.1.1. Current account	102
5.1.2. Capital and financial account	113
5.2. Denar exchange rate	116

5.3. Foreign reserves	119
5.4. External debt of the Republic of Macedonia	123
5.4.1. Debt structure	124
Attachment 5: Issue of the first Macedonian Eurobonds	126
5.4.2. Registered movements in 2005	127

VI. Other activities of NBRM134

6.1. Payment system in the Republic of Macedonia	134
6.1.1. The role of the NBRM in the payment operations.	134
6.1.2. Indicators for the operating of the payment system in the Republic of Macedonia	137
6.2. Vault operations	139
6.2.1. Currency in circulation	139
6.2.2. Supply of cash to banks	140
6.2.3. Processing and withdrawal of banknotes	140
6.2.4. Expertise of doubtful - forged banknotes	141
6.2.5. Printing banknotes and other valuables	141
6.2.6. Other vault operations	141
6.3. Internal Audit	142
6.4. Improvement of the institutionalized capacity of the NBRM	143

Report of independent auditors'147

Managing bodies of the NBRM195

Organizational chart of the NBRM197



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

Governor's foreword,

According to the macroeconomic performances, 2005 is considered to be one of the more successful years in the transitional history of the Macedonian economy. The price and financial stability preserved by the NBRM, the disciplined fiscal policy and the stable banking system were accompanied by essentially improved performances in the external sector. Once again, relatively high economic growth rate was achieved, and for the first time after three years, the statistics registered higher employment rate.

The significant import growth rate, having a simultaneous increase in the domestic consumption, brought about 4% real GDP growth rate, while the considerably higher private transfers and the trade balance, that improved despite the negative external shock of the increase in oil prices on the international markets, reduced the balance of payments current account deficit from 7.7% in 2004, to 1.3% of GDP in 2005.

In 2005, the average inflation rate equaled 0.5%, thereby the NBRM demonstrating its determination for low and stable inflation rates, aimed at maintaining stable inflation expectations and favorable macroeconomic environment. Such inflation rate was achieved by further application of the targeting strategy of the nominal exchange rate of the Denar relative to the Euro and by conducting prudential fiscal policy. The further decrease of the customs rates in line with the obligations arising from the World Trade Organization membership and consequently, the lower food costs, which in part offset the effect of the increase in the tobacco excise, due to the harmonization with the European directives and the higher oil prices, was dominant macroeconomic factor.

The favorable macroeconomic performances, particularly in the external sector, resulted in high inflow of foreign currency in the economy enabling the NBRM to make high net-purchase of foreign currency on the foreign exchange market. Thus, the gross foreign reserves registered exceptional annual growth reaching four-month coverage of import of goods and services in the current year, excluding the inflow from the Euro bonds. Liquidity created on the basis of considerable inflow of foreign currency in the economy was offset by a combination of monetary operations and lower public consumption, showing solid coordination between the monetary and the fiscal sector. Instead of the planned deficit, the consolidated budget for 2005 registered slight surplus of 0.2% of the gross domestic product.

In absence of price pressures, high inflow of foreign currency and fulfillment of the demand for foreign currency by the banks, the NBRM made changes in the operational design of the monetary policy. In the last quarter of the year, the NBRM switched the CB bills auctions - as a basic monetary instrument, from volume tender to interest rate tender, enabling higher activity on the market in the area of interest rate setting. In environment of relatively high level of liquidity and higher, on average, demand for relative to supply of CB bills, the CB bills interest rates dropped from 10% at the beginning of October at volume tender auctions, to 8.52% in December 2005 at interest rate tender auctions.

Taking into account the time lag in the transmission of monetary policy signals, and the unsatisfactory functioning of the interest rate transmission channel, such decrease in the CB bills interest rate - as a reference interest rate, did not cause any significant changes in the banks' interest rate policy in 2005. Notwithstanding the still relatively high level of banking interest rates, the bank credits represented a dominant source of financing the economic entities in 2005. The total credits to the private sector in 2005 went up by 20.5%, accounting for 22.3% of GDP. The accelerated credit activity is a result of the higher and diversified offer of credits by the banks, given the enhanced deposit base, active exploitation of the banks' foreign assets and their borrowing from abroad. On the other hand, the higher lending reflects the continuous, and to a certain extent, inelastic demand for credits, particularly of the household sector. It should be highlighted that typical for 2005 is the apparent propensity of the banks for long-term lending to the households and enterprises, which is additional incentive to the economic growth acceleration process by encouraging the consumption and investments. The tendency of denar borrowing by the households and foreign exchange borrowing by the enterprises continued in this period.

Main source of the accelerated credit activity in 2005 is the further expansion of the banks' deposit potential. In 2005, the total deposits of the private sector with the banks increased by 18.3% on annual basis, making up 25.9% of GDP, which is by 3 percentage points more compared to 2004. The several-year continuous trend of expanding the deposit base of the banks confirms the strengthened confidence of the economic entities in the banking sector, which has permanently increased the financial intermediation over the recent years and represents essential driving force of the investment activity in the country. Observing the currency of denomination, substantial growth was registered in both denar and foreign exchange deposits by 15% and 20.2%, respectively, indicating a propensity to save in both domestic and foreign currency. The increase in the deposits within the banking system also brought about high monetary growth rates, with the annual growth rate of the money supply M4 reaching 15.1% in 2005.

In 2005, the NBRM and the Ministry of Finance continued jointly acting towards promoting the securities markets. After the establishment of the regulatory framework and creation of necessary technical and institutional preconditions, the over the counter market started operating at the end of April, thereby officially becoming a part of the market infrastructure of the Republic of Macedonia. Even though only treasury bills have been traded, the everyday listing of the treasury bills on the over the counter market is expected to trigger the occurrence and development of other financial instruments. The increase in the treasury bills liquidity contributes to their higher attractiveness and results in lower costs of financing the budget deficit. From the aspect of monetary policy, it is significant that these changes are likely to increase the number of alternative possibilities for placing available funds, and more importantly, it is expected to strengthen the interrelation and interdependence of the interest rates on any financial instrument, which would eventually lead to more efficient monetary policy transmission through interest rates. It is important to point out that in 2005, the government securities portfolio was enriched by the issuance of the first two-year government bond, listed on the Stock Exchange. Along with these activities, the NBRM started gradually adjusting and modernizing the monetary instruments. In early October, it replaced the Lombard credits with overnight credit, made by the means of repo-transaction. Simultaneously, the allowed overdraft approved

to the banks for smooth conduct of transactions in the payment operations was replaced by intraday repo. Changes were also made in the NBRM interventions on the foreign exchange market, for the purposes of reducing the Central Bank presence on the foreign exchange market. Unlike before, when the NBRM intervened on the foreign exchange market daily, in August 2005, the "banks-market makers" concept started being applied, which granted those banks an exclusive right to trade with NBRM on the basis of mutual agreement, which also binds them to quote bid and ask rates, permanently, in a certain spread, with a view to meet the interbank needs for foreign currency.

The year this report refers to will also be remembered by the first participation of the Republic of Macedonia in the international capital market. The favorable macroeconomic performances led to improvement of the long-term credit rating of the Republic of Macedonia in domestic and foreign currency assigned by the international rating agency "Standard & Poor's" and favorable rating by the credit agency "Fitch". Once the Republic of Macedonia was given the credit rating by the two internationally recognized agencies, it met all formal and essential requirements to participate in the international capital market, and on December 2, 2005, the first Macedonian Eurobonds were issued at the London Stock Exchange in the amount of Euro 150 million. The demand considerably exceeded the supplied amount, reaching a favorable interest rate of 4.625%, indicating the interest and the confidence of the foreign investors. The inflows from Eurobonds were used for redemption of the existing debt to the London Club of Creditors at the beginning of 2006.

Ladies and Gentlemen,

In December 2005, the Republic of Macedonia acquired the EU member candidate status. The reports of the European Union, and the reports of the most relevant international institutions emphasize the prudence of the macroeconomic policies, particularly the monetary and fiscal policy, confirming that these policies largely contributed to the positive decision of the European Union to assign our country a candidate status. Furthermore, the prudence of monetary and fiscal policy, in particular, should not be put at stake in the future, since the macroeconomic stability is a basic precondition for sustainable economic growth. The higher growth rates and reduction of the high unemployment should be achieved primarily by further implementation of the structural reforms in the economy. Ultimately, it remains to be our key challenge in the achieving the desired and necessary growth. Although the new three-year Stand-By Arrangement with the IMF, concluded in August 2005, the arrangement with the World Bank, the Association and Stabilization Agreement with the European Union and the Report of the European Commission prepared for assessment of our application for candidate status, highlight the importance of further maintenance of macroeconomic stability, they unanimously and unambiguously stress the need of more flexible and more efficient labor market; more efficient judiciary; public sector and public administration reforms; highly professional and non-political institutions, that serve, most economically and efficiently, all citizens equally; further reforms of the financial sector; efficient corruption suppression.

Therefore, the deeper the structural reforms are, the better the conditions for higher economic growth rates would be. Hence, we once again emphasize that the main force should be directed towards faster and more efficient performance of the structural reforms. We believe that the mix of monetary and fiscal policy, which has proven to be efficient, is an optimal combination, even though there is always a need and necessity of improvements, since this mix is aimed at performing the following combination: deep structural reforms - macroeconomic stability - sustainable economic growth.

Petar Goshev, MSc.



*Governor and President
of the NBRM Council*

Skopje, May 2006



Altan (gold), issued by the Ottoman Emperor
Murad II (1574-1595).
From the NBRM collection.



Economic developments
in the world

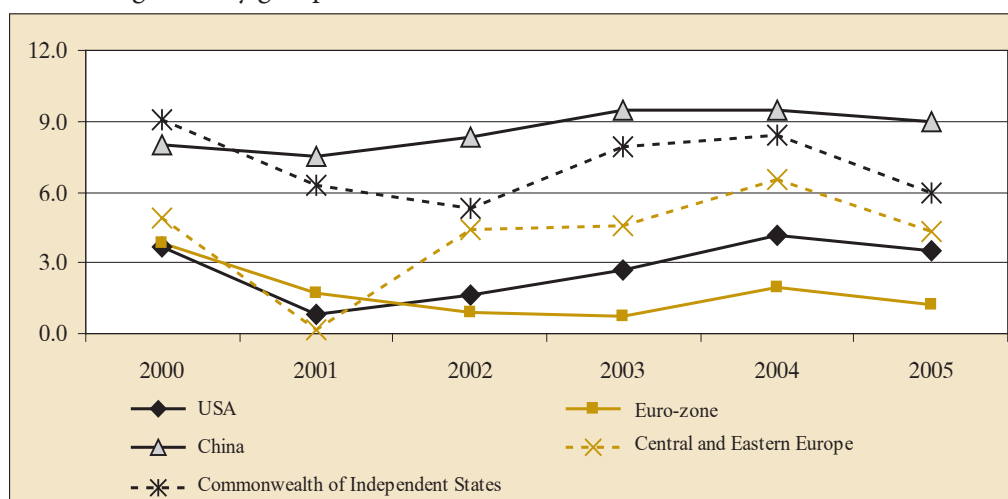
I. Economic developments in the world ¹

The global gross domestic product (GDP) comprehensively mirrors the economic developments worldwide. Still, the change in the global product is primarily caused by the economic conditions in the developed countries, which, at the same time, are the main generators of the overall economic growth.

Global economic developments in 2005 indicate relative slowdown of the world economy, compared with the performances in the previous year. From the viewpoint of the quarterly dynamics, in the first quarter of 2005 faster economic growth was registered (after the short-term deceleration in mid 2004), as a result of the significant contribution of the "services" sector, while in the second quarter of 2005, the leading indicators point to a decelerated economic activity and lower business confidence worldwide, partly due to the increase in the world price of oil. Later on, the improved global trends in production and trade were contained due to the continuous increase in the price of crude oil and oil derivatives (under the influence of the catastrophic consequences from the hurricanes in the USA). Thus, in 2005, in line with the aforementioned developments, the global GDP real growth was estimated at a level of 4.3%, which is 0.8 percentage points less relative to the real growth registered in the previous year.

Figure 1

Real GDP growth by groups of countries and individual countries



Source: IMF World Economic Outlook, September 2005

Main generators of the global economic growth in 2005 were the USA and China, while the growth in the Euro-zone was significantly below the world level. The analysis of the movements in the current account indicates deepening of the deficit in the current account in the USA (6.1% of GDP in 2005), as a result of the higher oil

1. The analysis is based on the IMF World Economic Outlook, September 2005 and the EBRD Transition Report 2005.

prices and the continuous pressure of the high domestic demand. On the other hand, surplus in the current account was registered in Japan, China, and the Middle East countries - oil exporters, which due to the increasing oil prices register higher surpluses (expressed in US Dollars) in comparison with the Asian developing countries and the Commonwealth of Independent States (CIS). Nevertheless, despite the further increase in the current account deficit, in the first nine months of 2005, the US Dollar and the Canadian Dollar registered slight appreciation, while the Yen and the Euro depreciated. On July 21, 2005, China changed the exchange rate of its national currency, i.e. the Yuan was revalued by 2.1% relative to the reference currency basket and set a daily interval of fluctuation of the Yuan relative to the US Dollar of 0.3%. From the viewpoint of the monetary policy, in the first nine months of 2005, the US Federal Reserve and the Central Bank of Canada increased their interest rates, the European Central Bank and the Central Bank of Japan retained the interest rates unchanged, while the Bank of England reduced its interest rates. In December 2005, the ECB increased the interest rate by quarter percentage point, with the interest rate equaling 2.25% at the end of 2005.

Table 1
Indicators for the world economy

	2000	2001	2002	2003	2004	2005***
	(in %)					
<i>Real GDP growth rate</i>	4.7	2.4	3.0	4.0	5.1	4.3
Developed countries	3.9	1.2	1.5	1.9	3.3	2.5
USA	3.7	0.8	1.6	2.7	4.2	3.5
Euro-zone*	3.8	1.7	0.9	0.7	2.0	1.2
Germany	3.1	1.2	0.1	-0.2	1.6	0.8
Greece	4.5	4.3	3.8	4.7	4.2	3.2
Italy	3.0	1.8	0.4	0.3	1.2	-
China	8.0	7.5	8.3	9.5	9.5	9.0
Central and Eastern Europe	4.9	0.2	4.4	4.6	6.5	4.3
CIS**	9.1	6.3	5.3	7.9	8.4	6.0
Russia	10.0	5.1	4.7	7.3	7.2	5.5
<i>Growth in the world trade</i>	12.4	0.1	3.4	5.4	10.3	7.0
<i>Inflation rate</i>						
Developed countries	2.2	2.1	1.5	1.8	2.0	2.2
USA	3.4	2.8	1.6	2.3	2.7	3.1
Euro-zone*	2.1	2.3	2.3	2.1	2.1	2.1
Germany	1.4	1.9	1.3	1.0	1.8	1.7
Greece	-	-	3.9	3.4	3.1	3.5
Italy	2.6	2.3	2.6	2.8	2.3	2.1
China	0.4	0.7	-0.8	1.2	3.9	3.0
Central and Eastern Europe	22.7	19.6	14.7	9.2	6.5	4.8
CIS**	24.6	20.3	13.8	12.0	10.3	12.6
Russia	20.8	21.5	15.8	13.7	10.9	12.8
<i>Average change in prices</i>						
Oil	57.0	-13.8	2.5	15.8	30.7	43.6
Primary products	4.8	-4.9	1.7	6.9	18.5	8.6
	(% of GDP)					
<i>Saving rate</i>	22.5	21.4	20.6	20.9	21.5	22.1
<i>Investments</i>	22.6	21.6	20.9	21.1	21.9	22.2
	(USD per unit of national currency)					
<i>Nominal exchange rate (US Dollar/ EUR)</i>	0.924	0.896	0.944	1.131	1.243	1.249***

Source IMF World Economic Outlook, September 2005.

* Countries listed are the most important trading partners of the Republic of Macedonia

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

*** Estimation

The rise in the world price of crude oil continued also in 2005, when an average growth of 43.6% was registered. The increased demand for oil, given the limited supply, is still the main factor behind the movements in the world oil markets. During 2005, the issue of global shortage of oil became even more articulated due to the huge damages to the production and manufacturing plants in the Mexican Gulf in the USA caused by the hurricanes. The impact of this natural disaster on the oil price was contained by releases from the strategic oil reserves in the USA and the increased production of crude oil by Saudi Arabia. Still, the shortages in refining capacity had an impact on the prices of refined products, particularly in the United States. In 2005, the prices of primary products registered an average increase of 8.6%, in line with the increased global demand (especially for metals) and the reduced supply (caused by the natural disasters).

The effects from the increase in the world oil price in most of the countries had an insignificant influence on the inflation level. Despite the low inflation and stable inflationary expectations, the level of real interest rates (long-term interest rates) is below the historical averages. This global phenomenon² is explained with the fact that the increased level of saving in the developing countries leads to an extremely high level of saving on a global level, causing a decline in the interest rates on a global level, and by influencing the asset prices, contributes to lower level of saving in the industrial countries. However, other factors also influence this phenomenon. Thus, despite the significant reduction of global savings starting from 2000, due to the deteriorated fiscal positions of the industrial countries, the growing profits of the corporate sector in the developed countries are surprising. Despite the fact that the profits expressed as percentage of GDP are on a historically high level, foreign investments are extraordinarily low, which points to refrained investment consumption of the enterprises. This trend is evident in a number of countries in transition, especially in Asia (exception is China, where corporate savings and investments are significantly rising).

1.1. Developed countries in 2005

The economic growth of the developed countries is expected to equal 2.5% in 2005 and it is lower relative to the growth registered in the previous year (3.3%). United States are still the main generator of growth of the industrial countries (growth rate of 3.5%), where the economic growth is supported by a strong income growth, steady improvements in the labor market conditions, good financial market conditions and rising real estate prices. However, the positive performances were overshadowed by the significant loss of life and property caused by the hurricanes. From the economic viewpoint, the immediate direct effect of the natural disaster caused a disruption in the operations of the refining capacities, which is expected to be offset in the future by a significant increase in the budget spending for reconstruction of the damaged areas.

2. Bernanke (2005)

On the other hand, the indirect effects, particularly evident in the increase in the prices of gasoline, given the low level of households' saving, represent potential threat for a decline in personal consumption.

In the euro area, the economic growth for 2005 has been estimated at the level of 1.2%, which is lower than the level registered in the previous year (2%), and is mainly a result of the insufficient domestic demand. On the political front, the rejection of the European Union (EU) constitution by France and the Netherlands, as well as the failure to agree on the EU budget, have had a limited effect on confidence and on financial markets, as well as a temporary influence for depreciation of the euro. The latest data from the euro area point to an increase in the production, exports, and continuous increase in the enterprises' profits, but also refrained investment on their part.

The inflation in developed countries in 2005 was at a low and stable level of 2.2%. The inflation in the euro area has been maintained at a constant level of 2.1%, while in the United States an annual growth in the inflation was registered (of 0.4 percentage points). Among the developed countries, over the past few years only in Japan a deflation was registered (of 0.4% in 2005). The downward trend in the unemployment rate in the developed countries continued also in 2005, and it is expected to equal 6.1%.

Table 2

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)		
	2003	2004	2005*	2003	2004	2005*	2003	2004	2005*	2003	2004	2005*	2003	2004	2005*
Developed countries	1.9	3.3	2.5	1.8	2.0	2.2	6.6	6.3	6.1	-219.6	-314.0	-451.1	-0.8	-1.0	-1.3
Euro-zone	0.7	2.0	1.2	2.1	2.1	2.1	8.7	8.9	8.7	26.7	46.7	23.7	0.3	0.5	0.2
Germany	-0.2	1.6	0.8	1.0	1.8	1.7	9.6	9.2	9.5	51.1	103.8	121.1	2.1	3.8	4.3
France	0.9	2.0	1.5	2.2	2.3	1.9	9.5	9.7	9.8	7.9	-8.4	-27.3	0.4	-0.4	-1.3
Italy	0.3	1.2	-	2.8	2.3	2.1	8.7	8.5	8.1	-19.6	-15.0	-29.9	-1.3	-0.9	-1.7
Greece	4.7	4.2	3.2	3.4	3.1	3.5	9.7	10.5	10.5	-9.8	-8.0	-8.6	-5.6	-3.9	-3.9
USA	2.7	4.2	3.5	2.3	2.7	3.1	6.0	5.5	5.2	-519.7	-668.1	-759.0	-4.7	-5.7	-6.1
Japan	1.4	2.7	2.0	-0.2	-	-0.4	5.3	4.7	4.3	136.2	172.1	153.1	3.2	3.7	3.3

Source IMF World Economic Outlook, September 2005.

* Estimation

Among the countries of the euro area, which are the most important trading partners of the Republic of Macedonia, highest economic growth in 2005 was registered in Greece (of 3.2%), which also had the highest inflation rate (of 3.5%) and highest unemployment rate (of 10.5%). The economic growth of Germany slowed down dramatically, unemployment picked up by 0.3 percentage points, while positive developments were registered in the balance of payments, where a significant surplus was evident (4.3% of GDP).

1.2. Countries in transition in 2005³

Despite the unfavorable economic environment, from a macroeconomic point of view, countries in transition performed well in 2005 (real GDP growth of 5.3%). Domestic demand, and to a lesser extent net exports, continue to be the main driving forces behind the growth in most of the countries from this group. Also, the increase in the domestic lending to the private sector is a significant factor stimulating consumption and supporting investments, though in several countries it has caused deepening of the external imbalances.

Table 3

Interest rates

(in %, p.a.)

	Reference interest rate			Banks' lending interest rate		
	2003	2004	2005	2003	2004	2005
Albania	6.50	5.25	-	14.27	11.76	-
Bosnia and Herzegovina*	-	-	-	10.87	10.28	9.61
Bulgaria	2.83	2.37	2.05	8.82	8.77	7.81
Croatia	4.50	4.50	4.50	11.58	11.75	11.19
Macedonia*	6.15	10.00	8.52	14.53	11.99	12.10
Romania**	18.84	20.27	9.59	26.55	24.85	12.90
Serbia and Montenegro***	9.00	8.50	8.50	14.81	14.59	14.41

Source: IFS (data for 2005 are estimated)

*Source: NBRM

**Source: The data on the lending interest rate are from the Central Bank of Romania

***Source: Central Bank of Serbia and Montenegro

Credit expansion reflects the improved financial intermediation throughout the region, however simultaneously increasing the threat of deterioration in the credit portfolio quality and the possible risks for the banking sector and for the macroeconomic stability, in general.

Table 4

Economic indicators for the countries in transition

	GDP			Inflation			Current Account of the Balance of Payments			Foreign direct investments		
	(real growth rate in %)			(growth in %)			(in % of GDP)			(in millions of US dollars)		
	2003	2004	2005*	2003	2004	2005*	2003	2004	2005*	2003	2004	2005*
Countries in transition	5.7	6.6	5.3	6.7	6.7	6.6	-5.1	-5.6	-4.5	21,603	39,148	47,614
<i>Central and Eastern Europe</i>	3.8	5.1	4.2	2.9	4.3	3.3	-5.7	-6.6	-6.2	8,339	16,288	24,354
<i>Southeastern Europe</i>	4.5	6.5	4.8	5.7	5.4	5.8	-9.4	-10.3	-9.0	7,989	9,162	11,525
Albania	6.0	5.9	6.0	2.4	2.9	2.1	-8.2	-6.1	-7.2	178	343	288
Bosnia and Herzegovina**	4.0	5.7	5.0	0.6	0.4	1.0	-21.8	-24.7	-18.6	382	490	540
Bulgaria	4.5	5.6	5.5	2.3	6.1	4.2	-9.3	-7.5	-7.5	2,070	1,232	2,697
Macedonia***	2.8	4.1	4.0	1.2	-0.4	0.5	-3.2	-7.7	-1.4	95	157	99.8
Romania	5.2	8.3	5.5	15.4	12.0	9.2	-6.1	-7.5	-8.7	2,156	5,020	5,300
Serbia and Montenegro	2.7	7.2	4.0	11.3	9.5	16.2	-9.7	-13.1	-9.8	1,405	1,028	1,600
Croatia	4.3	3.8	3.5	1.8	2.1	2.9	-7.2	-4.8	-5.0	1,700	898	1,000
<i>Commonwealth of Independent States</i>	7.6	7.9	6.2	9.8	8.9	9.1	-2.1	-2.3	-0.6	5,276	13,699	11,685

Source: EBRD Transition Report 2005.

* Estimation, excluding Macedonia, where data pertain to actual macroeconomic indicators.

** The date on the inflation is taken from the IMF World Economic Outlook, September 2004.

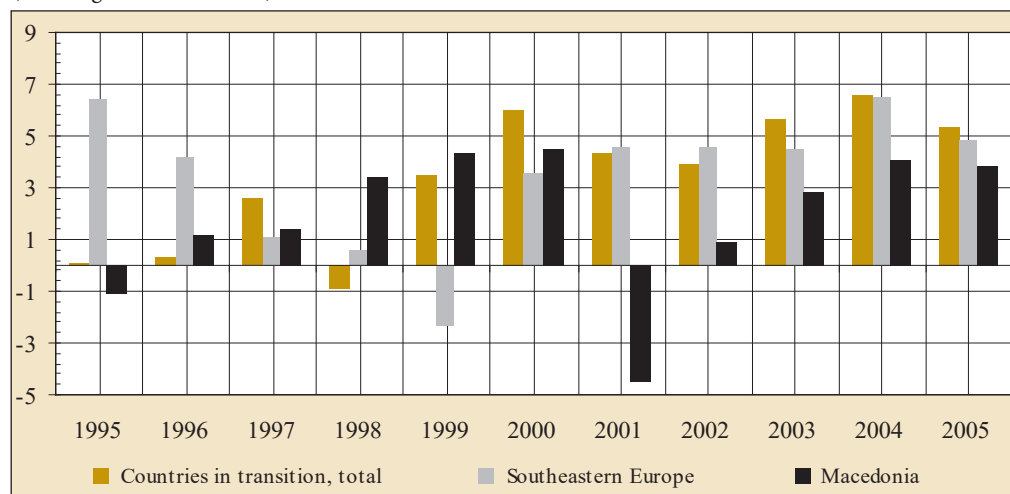
*** Source of the data for the Republic of Macedonia are the relevant official institutions.

3. Pertains to the countries of Central Eastern Europe and the Baltic States (CEB), South-eastern Europe (SEE) and the Commonwealth of Independent States (CIS).

In 2005, the process of intensive investment activity and exports (as main features in 2004) in the countries of Central Eastern Europe and the Baltic States (CEB) registered gradual slowdown, with the economic growth being slower by 0.9 percentage points relative to the preceding year, and equaling 4.2%. The main factors behind the economic development in the countries of Southeastern Europe (SEE), were the maintaining of the political stability, achieved progress in the structural reforms, and the run-up to EU accession (in Bulgaria, Macedonia, Croatia and Romania). In 2005, however, real GDP growth in the SEE countries was lower than that registered in the preceding year and it equaled 4.8%. Among the group of countries of the Western Balkans, the highest growth rate was registered in Albania, generated primarily from the construction and services and transport sectors, as well as from the expansion of the bank loans to the private sector.

Figure 2

Gross domestic product
(annual growth rates, in %)



Inflation in the SEE countries for 2005 is estimated at an average level of 5.8%, and in most of the countries it has been maintained on a low and stable level. Exception to this is Serbia and Montenegro, which still registers a double-digit inflation (16.2%), reflecting the increase in the administrative prices and oil prices, as well as the significant rise in wages. In 2005, the inflation in Romania was reduced to a single-digit level of 9.2%, as a result of the decline in the interest rates by the monetary authorities, given the shift towards flexible exchange rate and inflation targeting strategy.

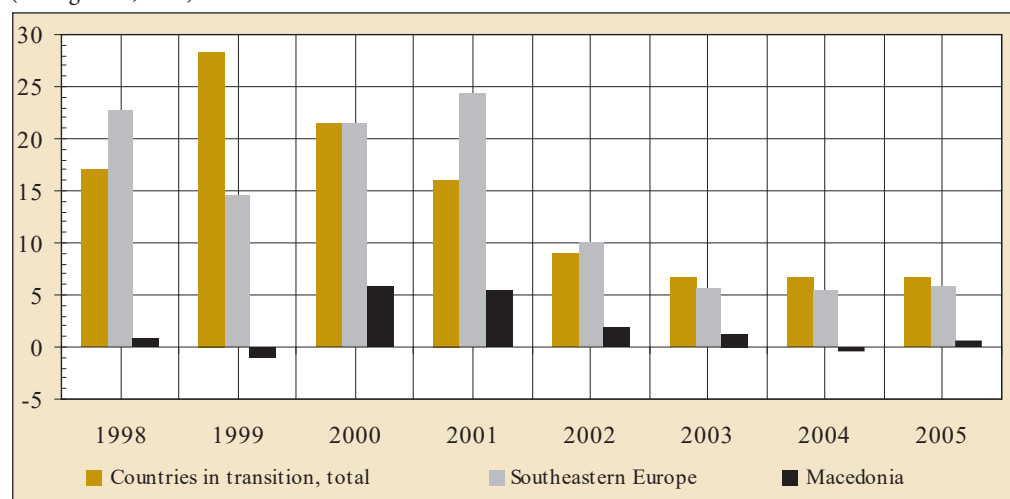
Despite the fact that some of the SEE countries register improvements in the balance of payments, the countries of this group still register high current account deficits. In 2005, given the high level of private transfers and the improved foreign trade, the most significant annual drop in the current account deficit, expressed as a percentage of GDP, was registered in Macedonia (of 6.3 percentage points), which at the end of the year equaled only 1.4% of GDP. In spite of the fact that also in Bosnia and Herzegovina huge drop of the current account deficit on annual basis was registered (of 6.1 percentage points), it is still high and equals 18.6% of GDP. As for the foreign direct investments (FDI) in the SEE countries, in 2005 the largest portion of them were directed toward Romania (46%), Bulgaria (23.4%) and Serbia and Montenegro

(13.9%). According to the indicator average level of foreign direct investments per capita⁴ for the 2003 - 2005 period, the level in the Republic of Macedonia approximates that in Albania and Bosnia and Herzegovina.

Figure 3

Inflation

(average rate, in %)



In 2005, the countries in transition continued the process of structural and institutional reforms. Most of the countries register improvement in the corporate governance, enterprises and financial sector restructuring, reduction of the problems related to the business regulation, as well as reduction of corruption and organized crime. The CEB countries registered significant improvements in the functioning of the market sphere, as a reflection of the strengthened institutions, while the improvements in the CIS countries are mainly due to the significant political changes. Still, in 2005, certain SEE countries registered slowdown in the reforms, as a reflection of the political uncertainty in the period of accession to the EU. Thus, in 2005, among the SEE countries insignificant changes in the transition process indicators were registered, except in Serbia and Montenegro, where progress was registered in the privatization process of the large enterprises, in managing and restructuring the enterprises, trade, liberalization of foreign exchange operations and banking reforms, which is partly due to the late start of the reforms in this country.

4. According to the data of the EBRD Report, in the 2003 - 2005 period foreign direct investments per capita in Macedonia, Albania, and in Bosnia and Herzegovina amounted to US Dollar 50, US Dollar 84, and US Dollar 124, respectively.

Table 5

Transition indicators for 2004

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

Source: EBRD Transition Report 2005.



Dinar (silver), issued by the “master” of Ohrid,
Andrea Gropa (around 1380).
From the NBRM collection.



Economic developments in the Republic of Macedonia

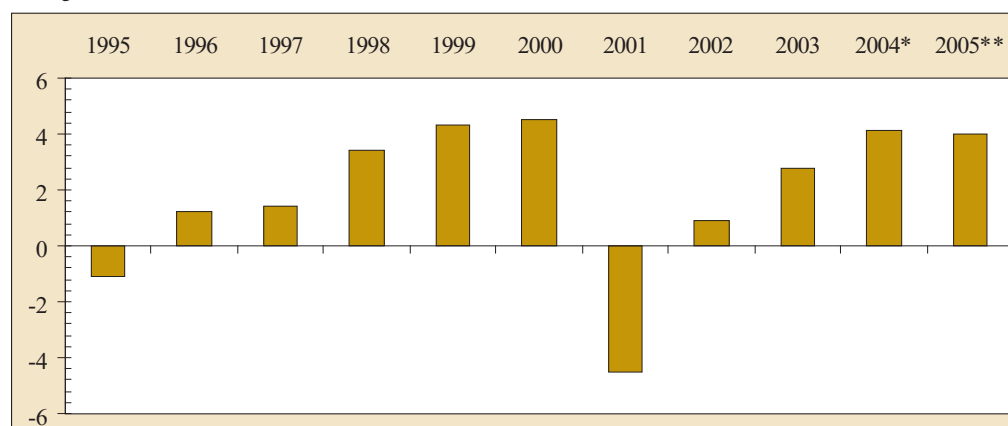
II. Economic developments in the Republic of Macedonia

2.1. Gross domestic product⁵

In 2005, there was a significant increase in the economic activity in the Republic of Macedonia, which is a continuation of the three-year trend of economic growth (after the drop in 2001, the year of crisis). Positive economic performances in 2005, caused by the increased domestic and external demand, in circumstances of price stability and accelerated credit activity of banks, led to real economic growth of 4%⁶, which was higher than expected (3.8%), given the unrealized capital investments of the government. The real GDP growth rate in 2005 was almost identical with that registered in 2004 (4.1%⁷). Real GDP growth rates realized in 2004 and in 2005 are amongst the highest economic growth rates, close to the level registered in the successful year 2000, which indicates gradual restoring of the Macedonian economy to the level prior to the crisis.

Figure 4

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



* Preliminary data

** Estimated data

Source: State Statistical Office

The increased activity in industry has the most important contribution to the economic growth achieved in 2005 (around 40%). The share of this sector in the total GDP in 2005 equaled 24%, which is a real growth of 6.8% relative to 2004, given the successful operations of the metallurgic plants and the restarting of one mine. Thus, industry is the main driving force behind the growth in 2005 (in 2004 its contribution

5. 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).

6. Estimated data of the State Statistical Office.

7. Preliminary revised data of the State Statistical Office.

to GDP growth was negative). Second most important sector that generated 27% of the total economic growth in 2005, and with share of 13.4% in GDP, is trade. In 2005, trade registered real annual growth of 7.9%. Increased activity was registered also in the other sectors of the economy, except for "construction" (with a share of 5.3% in GDP), where a decline was registered (of 5% due to the delay in the realization of major infrastructural projects).

Table 6

Gross domestic product - production side

	2005				2005/2004		2004 2005	
	I Q. 2005 / I Q. 2004	II Q. 2005 / II Q. 2004	III Q. 2005 / III Q. 2004	IV Q. 2005 / IV Q. 2004	(growth rates, in %)	(contribution to growth, in %)	(share, in %)	
	(growth rates, in %)							
Gross domestic product	2.9	5.0	4.1	3.8	4.0			
Agriculture	4.1	3.6	2.8	1.8	3.1	7.4	9.7	9.6
<i>Agriculture, hunting and forestry</i>								
<i>Fishing</i>								
Industry	4.7	13.0	5.9	4.0	6.8	41.1	23.3	24.0
<i>Mining and quarrying</i>								
<i>Manufacturing</i>								
<i>Electricity, gas and water supply</i>								
Construction	-9.7	-8.9	-3.0	-0.2	-5.0	-6.7	5.8	5.3
<i>Wholesale and retail trade, repair of vehicles, motorcycles and items for personal use and for households</i>	5.9	8.2	8.6	8.7	7.9	26.8	12.9	13.4
<i>Hotels and restaurants</i>	3.9	8.6	8.6	4.9	6.6	2.9	1.7	1.7
<i>Transport, storage and communication</i>	6.4	7.4	8.0	3.0	6.1	11.5	7.3	7.4
<i>Financial intermediation; Real estate, renting and business activities</i>	0.2	0.9	1.5	2.9	1.4	4.5	13.3	13.0
<i>Public administration and defence, Compulsory social security; Education, Health and Social work and Extraterritorial organizations and bodies</i>	0.5	0.3	2.0	3.4	1.5	5.2	13.9	13.6

Source: State Statistical Office

From the viewpoint of the year-on-year quarterly dynamics, positive real growth rates were registered in all quarters. Faster growth was registered in the second and in the third quarters (real growth rates of 5% and 4.1%, respectively), while in the first and in the last quarters growth rates were more moderate (2.9% and 3.8%, respectively). All sectors registered continuous quarterly increase in the activities, except for construction, which registers negative quarterly growth rates over the entire 2005. The highest year-on-year quarterly growth rate in 2005 was registered in industry (13%, registered in the second quarter).

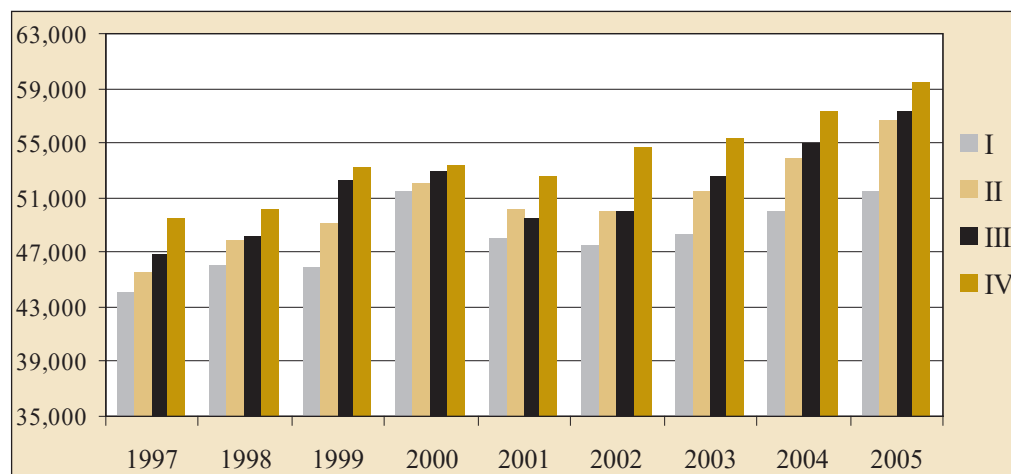
The available data of the SSO indicate that the expenditure components of GDP⁸ in 2005 registered nominal growth. Having in mind the faster growth of the *exports of goods and services* (20.4%) relative to the growth of the *imports* (10.7%), in 2005, net imports registered a decline (of 6.7%) and had smaller negative contribution to the total GDP compared with 2004. *Investments in machines and equipment* and the *public consumption* registered nominal increase of 4.9% and 1.1%, respectively.

8. 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.

Figure 5

Quarterly distribution of the gross domestic product*

(in millions of denars, at constant prices in denars from 1997)



* Data on 2004 are preliminary, while data on 2005 are estimated.

Source: State Statistical Office

In the absence of adequate data⁹, it is estimated that also the *personal consumption* went up in 2005, on the basis of the movement of the indicative categories: annual increase in wages (of 2.5%), retail trade (of 11.2%), lending to households (of 52.6% on average p.a.), import of consumer goods (of 10.6%) and revenues from the value added tax (of 5.1%). In line with the registered increase of public consumption and the estimation of the increase in personal consumption, increase also in the *final consumption* is assumed for 2005.

The estimation of the movement of *gross-investments* in 2005 has become more difficult, because of the fact that the investments in machines and equipment (for which data is available) explain only one third of the gross-investments and because of the divergent movement of the indicative categories. The average amount of loans extended to enterprises and the import of capital goods register an increase (of 14.3% and 11.2%, respectively). On the other hand, domestic production of capital products and completed construction works register a decline (of 3.2% and 23.3%, respectively) which indicates lower investment activity. The net-change in gross-investments is contingent upon the level of neutralization of the divergent movements in the abovementioned categories, which can not be determined precisely. Having in mind that most of the gross-investments categories went up, an increase in gross-investments in 2005 is estimated.

9. Pertains to data on individual (personal) consumption and gross investments. The analyses made in this context are based on estimations of available data on other categories of indicative importance and should be considered with precaution.

2.2. Prices

For many years the NBRM has been confirming its ability and determination to maintain price stability, as one of the crucial aspects of the overall macroeconomic stability and a prerequisite for sustainable economic growth. Stable price movements were registered also in 2005, in an environment of stable inflationary expectations, caused by the stable nominal exchange rate as an intermediary target of the monetary policy.

In 2005, the average rate of inflation in the Republic of Macedonia equaled 0.5%¹⁰ (measured through the consumer price index) and it was mainly a result of the combined effect of the following factors:

1. The increase in the excise on cigarettes in January 2005, for the purpose of harmonization with the EU Directives, led to a significant increase in the average costs for these products of 10.9%;

2. The high increase in the price of crude oil on the world markets respectively affected the domestic prices of oil derivatives, which in 2005 picked up by 10.7%, on average.

3. The higher prices of footwear by 4.4%, in 2005;

4. The comparison effect in the prices of certain telephone services (i.e. the price of the impulse and the subscription for the PSTN) caused higher costs for these services in 2005. This refers to a lower comparison basis in the first half of 2004, since the prices of the abovementioned services rose in July 2004 and retained that level also during 2005;

5. The fall in the prices of the food products, under the influence of two factors: 1/ further decline in the customs duties¹¹ on imported agricultural and industrial food products (in accordance with the membership of the Republic of Macedonia in the World Trade Organization - WTO), which led to a decline in the retail prices of these products, but also of the prices of the same products from domestic producers under pressure of the competition from the imports, and 2/ reduction of the price of the main type of white bread in 2005. Accordingly, in 2005, the costs of food, which are the dominant category in the structure of the inflation index¹², registered an average decline of 1.2%;

6. The lower costs for procurement of hygiene products (by 4.2%) and health products (by 3.0%).

The aforementioned factors have a respective effect on the individual categories within the inflation index structure. The costs of food are most important in determining the general inflation rate, in line with their dominant share in the inflation index structure. Their drop of 1.2% in 2005 significantly offset the increase in the categories "transport equipment and services" (3.7%), "tobacco and beverages" (5.5%) and "clothing and footwear" (2.2%).

10. Source: State Statistical Office.

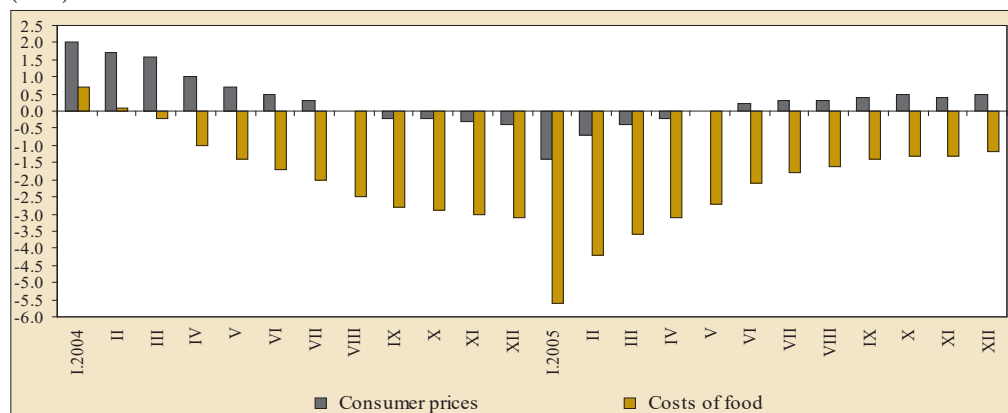
11. As of January 1, 2005 a reduction was made in the customs duties on approximately 3,700 out of the total number of 12,000 tariff codes, with the average tariff rate being reduced from 11.09% as it was in 2004, to 10.05% in 2005. The average tariff rate on agricultural products dropped from 19.79% in 2004 to 18.02% in 2005, while that on the industrial products fell from 8.49% in 2004 to 7.66% in 2005.

12. Since January 2005, the State Statistical Office has been applying new structure of weights and contents of the index list, which is being revised every five years.

Figure 6

Average change in the total consumer prices and costs of food

(in %)



Source: State Statistical Office

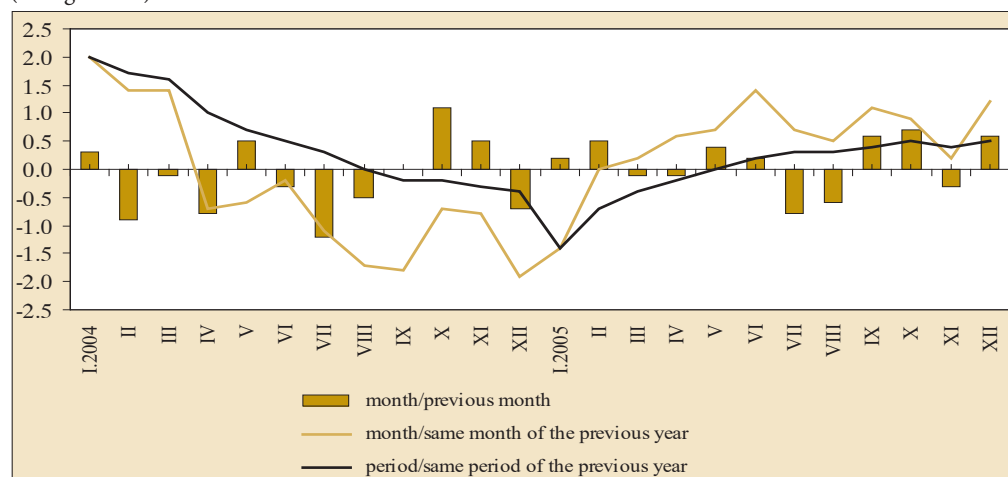
The analysis of the costs for procurement of goods and using of services indicates more intensive growth in the costs of services (of 1.3%, due to the higher prices of transport services) compared with the increase in the costs of goods (of 0.3%, mainly due to the lower prices of food products).

The inflation rate registered in 2005 was lower relative to the initially projected level of 1.2%. Besides the continuous decline in the prices of agricultural and food products, main reason for the deviation is the unrealized, yet projected increase in the price of electricity. The core inflation rate, which excludes the effect of the decline in the prices of food products and the increase in the prices of energy, in 2005 equaled 1.21%, on average.¹³ The annual inflation rate equaled 1.2% in December 2005.

Figure 7

Consumer prices

(changes in %)



Source: State Statistical Office

13. The calculation of the core inflation rate is made according to a methodology of the NBRM.

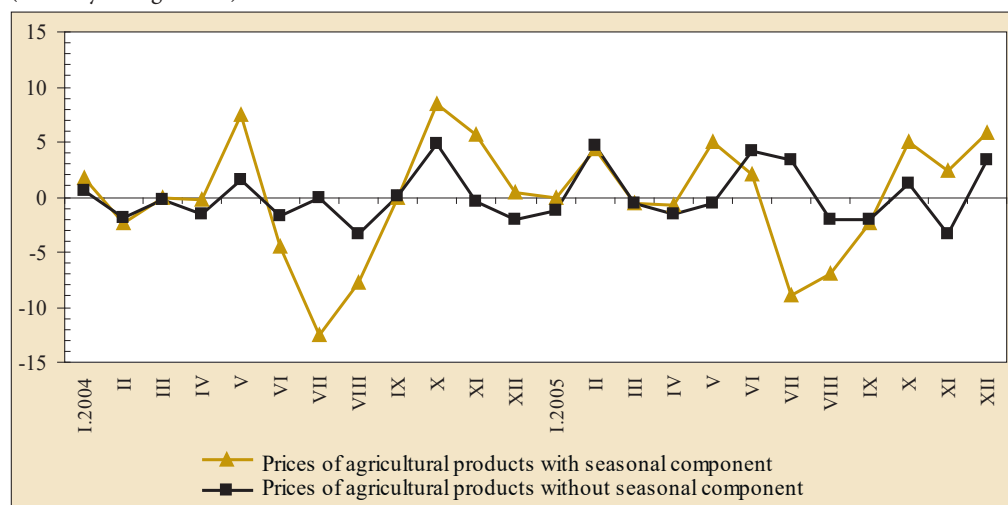
The monthly dynamics of consumer prices was mainly under the influence of seasonal changes in the prices of agricultural products and changes in the prices of oil derivatives, caused by the movement in the prices of oil on the international markets.

In the first half of 2005, low monthly growth rates of consumer prices were registered, except in March and in April, when they registered minimum decline. The monthly increase in January (0.2%) corresponds with the change in the excise on cigarettes, while the increase in February (0.5%) is a result of the higher prices of fuels and the increase in the prices of agricultural products. Higher prices of raw vegetables in May caused a monthly increment in the consumer prices of 0.4%, while the increase of 0.2% in June was mainly a result of the higher prices of fresh fruit.

In the second half of 2005, more significant monthly changes were registered. Thus, in July and in August, monthly rates of deflation were registered (of 0.8% and 0.6%, respectively) under the influence of the seasonal drop in the prices of agricultural products. In September, monthly inflation rate of 0.6% was registered, which was mainly due to the higher prices of fuels, while in October and in December, the monthly inflation rates (of 0.7% and 0.6%, respectively) were caused by the increase in the prices of vegetables. In November, a monthly rate of deflation of 0.3% was registered, under the influence of the reduced prices of the main type of white bread and the fuels.

Figure 8

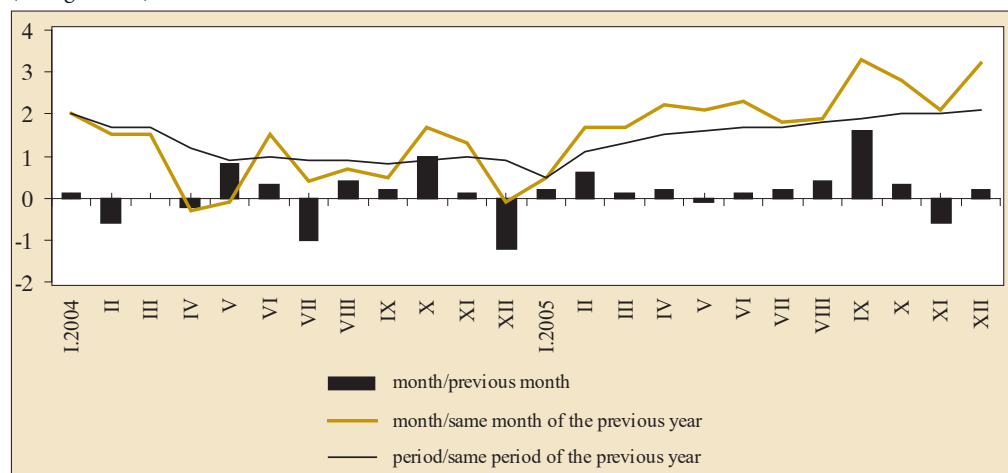
Prices of agricultural products with and without seasonal component
(monthly changes in %)



Source: State Statistical Office

Retail prices in 2005 registered an average increase of 2.1%, mainly under the influence of the increased prices of non-food industrial products (by 3.0% mostly due to the rise in the prices of oil derivatives) and of beverages (by 1.3%). In 2005, the prices of services registered more intensive average increase (3.1%, which derives mainly from the comparison effect in the PTT services) relative to the prices of goods (1.5%).

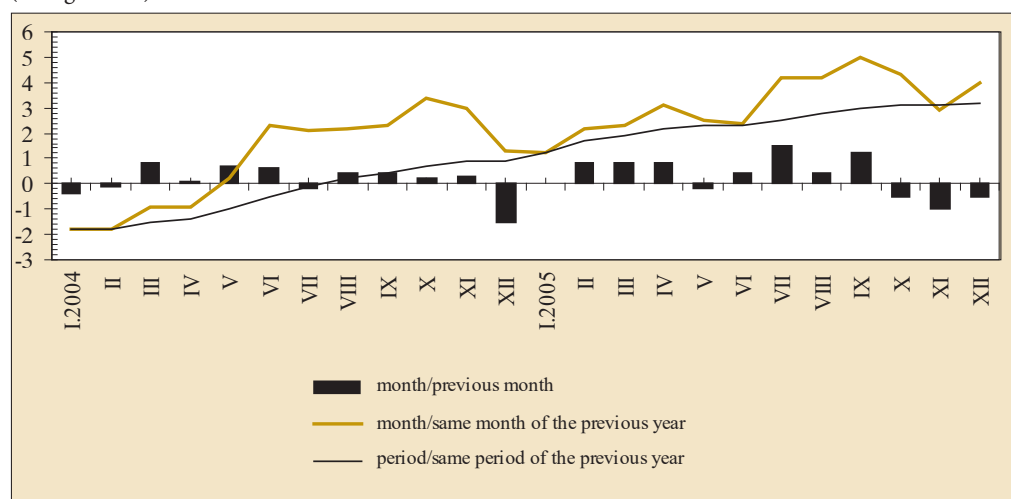
Figure 9
Retail prices
(changes in %)



Source: State Statistical Office

Under the influence of the reduced customs duties on agricultural and industrial food products, the decline in the prices of food products caused lower costs for satisfying a household's average needs for food and beverages in 2005. Thus, the value of the *consumers' basket for food and beverages*¹⁴ in 2005 amounted to Denar 9,831 on average, which relative to the previous year is a decline of 1.2%. The decline is a result of the lower value in the categories "wheat and cereals", "raw and processed vegetables", "fats" and "milk and dairy products", which altogether comprise 50% of the value of the consumers' basket.

Figure 10
Prices of the producers of industrial products
(changes in %)



Source: State Statistical Office

14. 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.

In 2005, the *prices of the producers of industrial products* registered an average increase of 3.2%. Increase in the production prices was registered in ten out of twenty-two industrial branches, but the main driving force behind the increase were the higher prices of the producers of oil derivatives (by 32.7%), which follow the movement of the world prices of oil and oil derivatives. The rise in the prices of the producers of electrical machinery and apparatus (of 3.0%) significantly contributed to the increased level of production prices. In 2005, a decline in the prices was registered only with the producers of textiles (of 0.4%, which may be partly explained with the lower prices of imported raw materials, and partly with the competition from the imports, due to the reduction of the tariff rates¹⁵) and the producers of basic metals (of 0.1%), while in the other ten industrial branches prices remained unchanged.

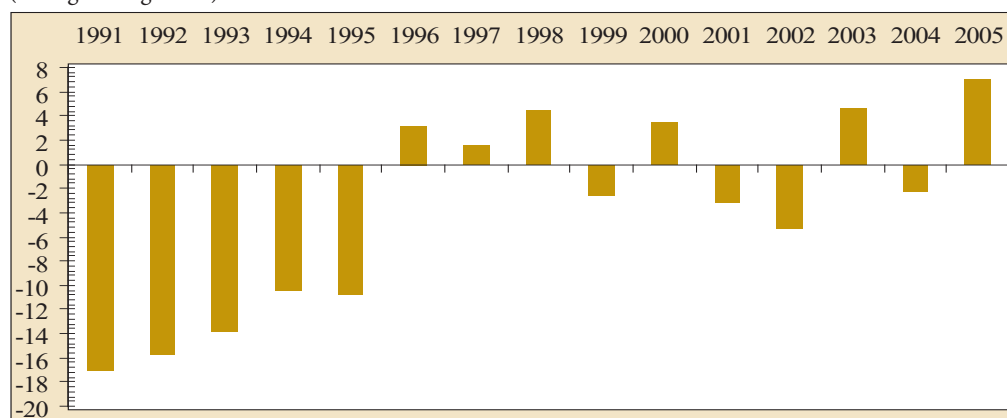
2.3. Industrial output¹⁶

In 2005, the industrial output in the Republic of Macedonia significantly accelerated, in comparison with the weak performances in 2004. The successful operations of the metal-processing plants, as opposed to the malfunction of one of them in the first half of 2004, the restarting of one important mine in May 2005, the increased demand for construction materials, the increased production of wine, the increased production of oil derivatives motivated by the rise in their export price, the increased production of finished textile products mainly intended for export, as well as the increased production of electricity necessary for realization of the intensified industrial activity, are the most important determinants of the positive performances in industry in 2005.

Figure 11

Industrial output

(average change in %)



Source: State Statistical Office

15. In 2005, the average tariff rate on textiles equaled 7.36%, and it was lower than the average tariff rate in 2004, which equaled 8.56%.

16. Source: State Statistical Office.

Thus, the volume of the industrial output in 2005 registered cumulative increase of 7% relative to 2004, with accelerated activity in fifteen out of twenty-four industrial branches (82.1% of the total industrial output). The rise is mostly a result of the increased production in the categories "basic metals", "other non-metal minerals", and "manufacture of fabricated metal products", the joint share of which in the increase of the overall production is 64.8%. Accordingly, the category "intermediary products (except energy)", in which the abovementioned industrial branches are included, registered cumulative growth of 14.2%, thus making highest contribution to the increase in the total industrial output. It is important to note that the registered high increase in the production of basic metals of 33.4% is partially due to the low comparison basis from the first half of 2004, when none of the major metallurgic plants was active, but also it is partially a result of the further rise in the prices of metals on the world markets, which is also shown in the an increase in the total exports of these products.

The increased production of food products and beverages, and of wearing apparel, significantly contributed (with 17%) to the increase in the industrial output in 2005. The rise in these two branches caused an increase in the group of "non-durable goods for joint consumption" (of 3.8%), which has the largest structural share in the calculation of the index. The increased production of energy (production of oil derivatives and production and distribution of electricity), caused mainly by the accelerated production activity in 2005, had a share of around 15% in the total growth of the industrial output. The increased industrial output in 2005 corresponds with the bigger quantity of imported energy products (mostly oil, oil derivatives and electricity).

The analysis from the viewpoint of the industrial sectors points to an increased activity in all three sectors in 2005. Although the mining sector registered the highest cumulative growth rate (40.4%), manufacturing had the most significant contribution to the increase in the total industrial output, as the dominant sector, whose cumulative growth rate equaled 7.3%. In 2005, the increase in the output in the energy sector equaled 2.5%.

During 2005, the industrial output registered common monthly dynamics. The highest industrial output monthly growth rates were registered in February (increase of 11.3%, due to the commonly low comparison basis from the preceding month and the seasonal activities related to the purchase and processing of tobacco), in September (increase of 10.5%, due to the low comparison basis from the preceding month and the seasonal production of wine) and in December (increase of 11%, as a result of the increased activity in all three industrial sectors). As it is the case every year, the fastest monthly decline in the industrial output was registered in January (30.5%, due to the smaller number of working days in the month). There was an uncommon decline registered in October (of 3.2%), which was due to the high comparison basis from the preceding month, in which this year the processing of grapes was concentrated.

Table 7

Industrial output

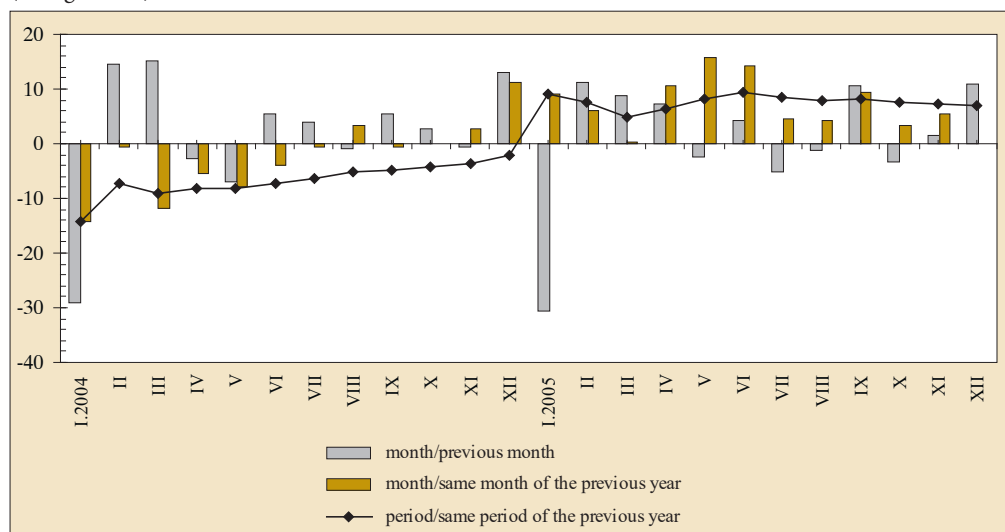
	structure	I-XII.2005 I-XII.2004	
		growth rates	contribution to growth
		in %	
Total	100.0	7.0	100.0
Energy	21.8	4.6	14.6
Intermediate products, ex cept energy	33.8	14.2	69.7
Capital goods	4.8	-3.2	-2.2
Durable consumer goods	1.4	-14.9	-3.0
Non-durable consumer goods	38.1	3.8	21.0
Mining and quarrying	1.8	40.4	10.6
Manufacturing	79.4	7.3	84.1
Manufacture of food products and beverages	20.0	4.0	11.6
Manufacture of tobacco products	3.9	2.0	1.1
Manufacture of tex tiles	2.5	0.4	0.1
Manufacture of w earing apparel; dressing and dyeing of fur	8.6	4.3	5.4
Publishing, printing and reproduction of recorded media	3.9	-3.3	-1.9
Manufacture of coke, refined petroleum products and nuclear fuel	3.0	16.6	7.2
Manufacture of chemicals and chemical products	5.9	-0.1	-0.1
Manufacture of rubber and plastic products	2.6	-5.4	-2.0
Manufacture of other non-metalic mineral products	8.1	21.5	25.3
Manufacture of basic metals	6.0	33.4	29.1
Manufacture of fabricated metal products, ex cept machinery and equipment	3.8	18.9	10.4
Manuafacture of electrical machinery and apparatus	3.2	8.8	4.1
Electricity, gas and water supply	18.8	2.5	6.8

Source: State Statistical Office

According to the Survey on the business tendencies in the manufacturing¹⁷ as of December 2005, main restrictive factor of the volume of the production activity is the insufficient domestic demand, which is significantly more important relative to December 2004. Financial problems of production enterprises are no longer the most important restrictive factor, as it was the case in December 2004, but they are still considered a significant limiting factor in the production. During 2005, the pressure from the competition of foreign producers was more emphasized. The lack of raw materials, as a restrictive factor, is halved relative to December 2004, while the perception of the uncertain economic environment as a restrictive factor, is almost at the same level as in December 2004. The average utilization of the enterprises' capacity in December 2005 reached 63.8% of the regular utilization, and it registered a slight increase compared with December 2004 (61% of the regular utilization).

17. 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.

Figure 12
Industrial output
(changes in %)



2.4. Other economic activities

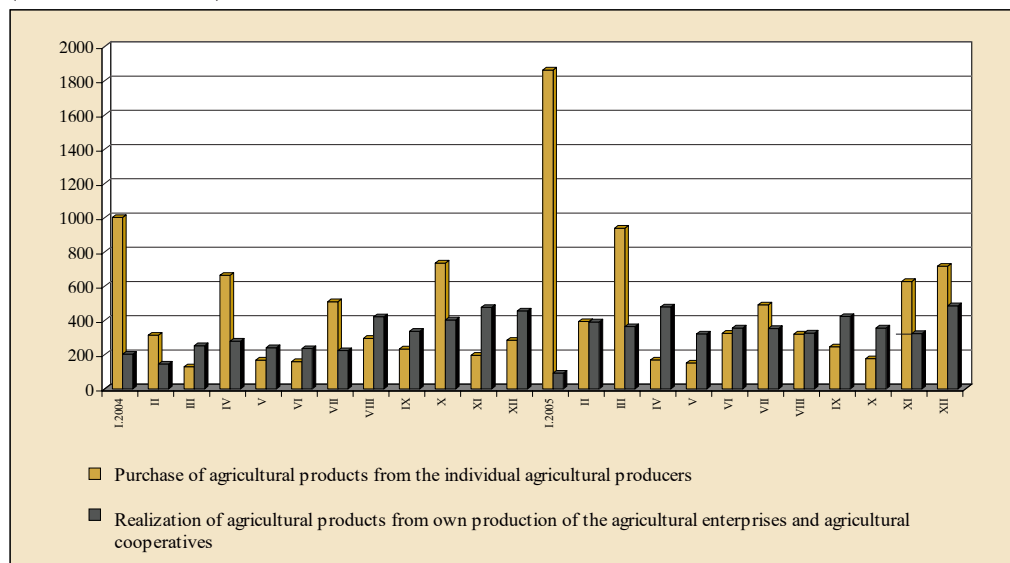
In 2005, the total *agricultural production* in the Republic of Macedonia increased by 2.2%¹⁸, with a simultaneous rise in the plant production and in livestock breeding. The increase in plant production (of 2.7%) is a result of the upsurge in the production in "field crops" (of 1.6%, due to the intensive increase in the production of industrial plants, especially sugar beet and tobacco), as well as to the increase in the production in viticulture (of 7.2%) and fruit orchards (of 6.4%).

In 2005, the total value of the sold agricultural products from agricultural enterprises' and co-operatives' own production amounted to Denar 4,269 million, which is an annual increase of 16.2%. The annual increase is a result of the higher sale of almost all types of agricultural products. The sale of garden plants, fruit and grapes, alcoholic beverages and livestock, whose share in the total sale is 65.4%, increased by 45.8%, 12.9%, 28.7%, and 60%, respectively.

The total value of agricultural products purchased from the individual agricultural producers in 2005 was by 36.9% higher relative to the previous year, and amounted to Denar 6,418 million. The highest increase was registered in the purchase of industrial crops and milk and dairy products (of 62.4% and 32.2%, respectively). In 2005, positive changes were registered in the purchase of vegetables, fruit and grapes.

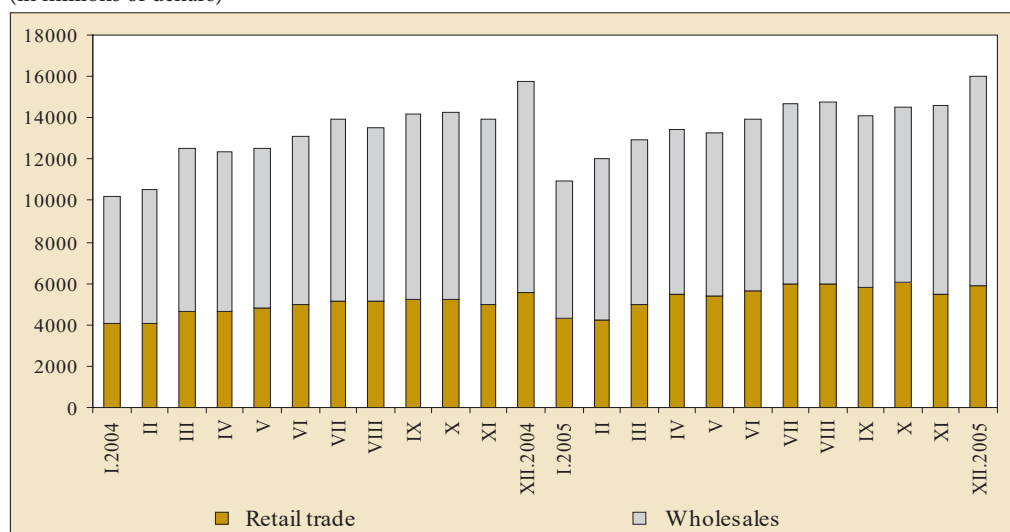
18. Estimated data of the State Statistical Office.

Figure 13
Sale of agricultural products
(in millions of denars)



Accelerated trade activity was registered in 2005. The increase in wages and in lending to households and enterprises in 2005 encouraged the trade turnover. Thus, the total trade turnover in 2005 amounted to Denar 165,280 million, which is an increase of 5.4%, relative to the preceding year. Observed by quarter, in the first two quarters faster annual growth was registered (of 8.4% and 7%, respectively, compared with the same periods of the preceding year), while in the third and the fourth quarters growth was more moderate (4.3% and 2.7%, respectively). The highest value of the trade was registered in the fourth quarter of 2005 (Denar 45,152 million), which is mainly due to the high turnover in December (common seasonal effect in this period of the year, due to the increased trade activity before the New Year and Christmas holidays).

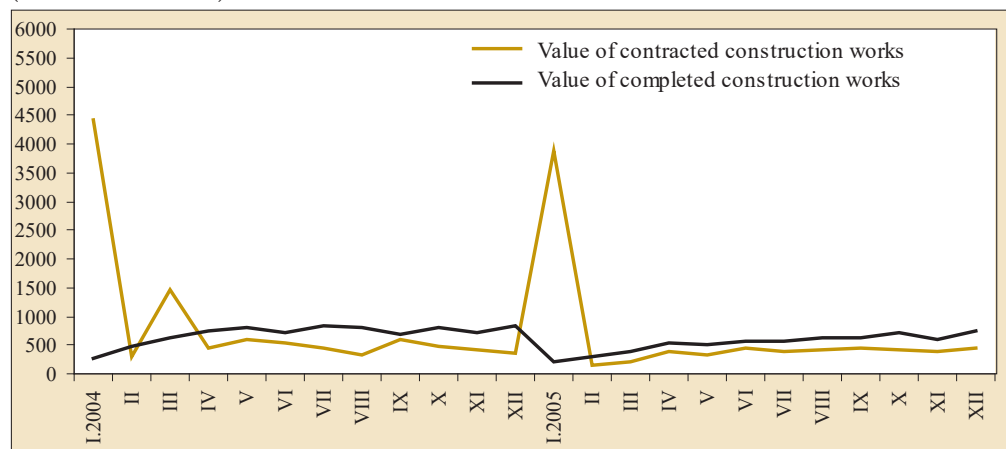
Figure 14
Total trade turnover
(in millions of denars)



From a viewpoint of the structure, in 2005 the turnover in the *retail trade* totaled Denar 65,057 million, which is an increase of 11.2% *Wholesale trade*, where the turnover was in the amount of Denar 100,223, registered more moderate growth of 1.9%. The highest monthly growth rate in retail trade turnover was registered in March (18.2%) while the wholesale trade turnover registered the fastest increase in February (16.7%).

Figure 15

Value of contracted and completed construction works
(in millions of denars)



Unlike the movements in the abovementioned sectors, in 2005, the activity in construction¹⁹ dropped significantly. The decline in the construction activity is mostly a result of the late beginning of few major infrastructural projects scheduled for 2005, and it is reflected through a reduced number of employees in the construction industry. However, in 2005, increase in the production of construction materials (of 21.5%) was registered.

In 2005, construction works in total amount of Denar 7,881 million were contracted, which is by 24.1% less compared with the preceding year. From the viewpoint of the quarterly dynamics, only in the fourth quarter of 2005 higher amount of construction works was registered, while in the other three quarters, they are below the level registered in the preceding year. The lower value of contracted construction works generally indicates lower level of completed construction works. Thus, the total value of completed construction works in 2005 stood at Denar 6,411 million, which is a drop of 23.3% compared with the preceding year. Lower realization in construction reflects the lower amount of completed construction works in all four quarters of 2005, with the fastest decline being registered in the first quarter (of 35.2%, relative to the same quarter of the preceding year).

19. The data on the construction activity are based on a sample of fifty largest construction companies in the Republic of Macedonia.

2.5. Labor market²⁰ and wages

In 2005, the unemployment rate²¹ equaled 37.3% and it is almost unchanged relative to the preceding year. The total number of unemployed persons (323,934 persons) went up by 4.7%, with a simultaneous increase (of 4.3%) being registered in the number of employed persons (545,253 persons). After the three-year continuous decline in the employment rate, in 2005 it picked up by 1.1 percentage point relative to the preceding year and reached 33.9%. Simultaneously, the indices labor productivity and unit labor costs register positive movements on the labor market.²² Thus, in an environment of increased number of employees and a concurrent faster growth of GDP, labor productivity (GDP / number of employees) picked up by 2.7% in 2005. Given the almost unchanged level of the wage bill, unit labor costs (wage bill/number of employees) dropped by 4% in 2005 (in the previous year they increased by 1.5%), which indicates improved competitiveness of the Macedonian economy.

In July 2005, a new Law on Labor Relations was adopted, which is the base for implementation of the reforms on the labor market. Its main objective is to increase the flexibility of the labor market, improve the legal and regulatory framework, which will provide increased legal protection of the labor force, reduction of grey economy on the labor market and improved quality of the services of the employment bureaus in order to encourage employment.

Figure 16

Rates of employment and unemployment

(in %)



Source: State Statistical Office

20. According to the data of the Labor Force Survey for 2005. 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, the results are being processed quarterly.

21. 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

22. Productivity and unit labor costs are calculated in the NBRM.

With respect to the individual activities, the increased number of employed persons in 2005 is entirely a result of the increased employment in agriculture and in industry (by 21% and by 2.6%, respectively). Within the industrial sector, increase was registered in all branches, except construction (decline of 3.2%). In the manufacturing industry (branch with the largest number of employees, i.e. 22% of the total number of employees) employment went up by 3.1%. In the services sector, the number of employees registered minimum decline of 0.1%.

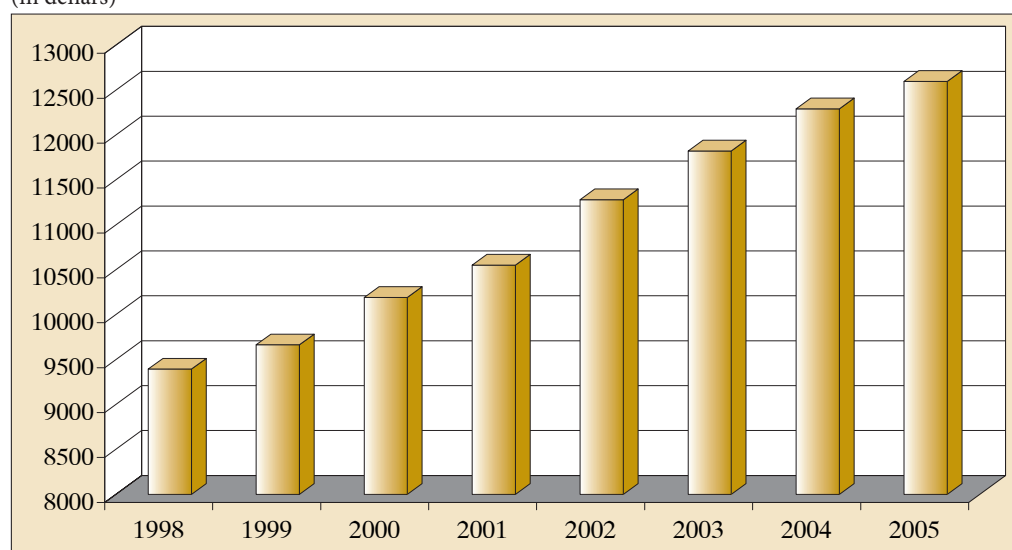
From the viewpoint of the gender structure, 60.9% of the employed persons are males (332,179 persons), while 39.1% are females (213,074 persons). The unemployment rate with the male population is 36.5%, whereas the employment rate is 41.2%. On the other hand, female population registered higher unemployment rate (38.4%) and lower employment rate (26.6%) compared with the male population.

With respect to the age, the highest unemployment rate is registered with the population aged between fifteen and twenty-four years of age (62.6%), while the highest employment rate is registered with the population aged between twenty-five and forty-nine years of age (49.8%).

Analyzed by quarter, the highest unemployment rate of 38.7% was registered in the first three months of 2005, when the unemployed persons totaled 320,030. The employment rate and the number of employed persons were highest in the third quarter, when 564,880 persons were employed, and the employment rate equaled 35.1%.

The increase in the wages in the Republic of Macedonia continued in 2005, although at a slower pace, and it is a result of the combined influence of two factors. The increasingly larger share of the private sector, where wages are freely set, on the one hand, and the gradual process of decompression of the wages of civil servants in order to increase the efficiency of the public administration on the other, acted toward an increase in the average wage in the Republic of Macedonia.

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



In 2005, the nominal average net-wage paid per employee stood at Denar 12,597, which is a nominal increase of 2.5% relative to 2004 (the real increase is 2%, with the average inflation rate being 0.5%). The increase is a result of the rise in the wages in all branches except manufacturing industry. The highest increase was registered in the wages in "fishing" (minimum structural share in the total number of employees of 0.1%). Significant increase was registered also in the wages of the branch "public administration and defense, compulsory social security" (12.9%), which corresponds with the commenced process of decompression of the wages of civil servants. In 2005, the highest wages, in the amount of Denar 26,095 were paid in the "financial intermediation", where an annual increase of 3.5% was registered.

Table 8

Net-wage paid per employee in the Republic of Macedonia

	Amount in denars	Nominal grow th 2005/2004	Real grow th 2005/2004
	2005	(in %)	
Average monthly wage, total	12,597	2.5	2.0
<i>Agriculture, hunting and forestry</i>	10,042	3.6	3.1
<i>Fishing</i>	12,772	24.5	24.0
<i>Mining and quarrying</i>	14,718	6.5	6.0
<i>Manufacturing</i>	10,298	-1.8	-2.3
<i>Electricity, gas and water supply</i>	16,072	4.3	3.8
<i>Construction</i>	9,782	4.6	4.1
<i>Wholesale and retail trade, repair of motor vehicles, motorcycles, and personal and household goods</i>	12,920	5.2	4.7
<i>Hotels and restaurants</i>	10,844	4.1	3.6
<i>Transport, storage and communication</i>	15,995	5.8	5.3
<i>Financial intermediation</i>	26,095	3.5	3.0
<i>Real estate, renting and business activities</i>	13,524	0.7	0.2
<i>Public administration and defense, Compulsory social security</i>	15,392	12.9	12.4
<i>Education</i>	11,677	0.6	0.1
<i>Health and social work</i>	12,141	0.8	0.3
<i>Other community, social and personal service activities</i>	12,323	1.0	0.5

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

Annex 1

Analysis of the productivity in the Republic of Macedonia

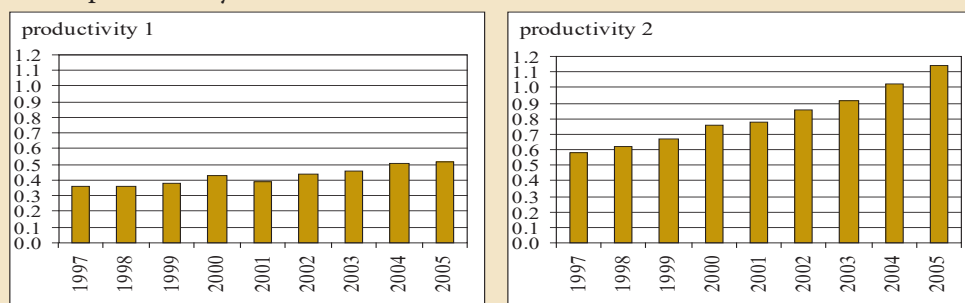
The labor force efficiency in production is measured through the labor force productivity, as a ratio between the gross domestic product and the number of employed persons. Alternatively, labor force productivity may also be calculated as a ratio between the value added and the number of employed persons, or between the gross domestic product and the total number of working hours throughout

the year. Changes in labor productivity (increase/decline) refer to changes in the technical and organizational performances of the companies, the level of qualification of the labor force, the influence of the economy of scale, different levels of utilization of the capacities available, and in the terms of trade.

In the 1997 - 2005 period, labor productivity in the Republic of Macedonia registered positive movements, which is due to the increase in the gross domestic product, with a simultaneous decline being registered in the number of employed persons²³. Differences in the levels and the growth dynamics shown in Figure 1, arise from the use of two different sources of data on the number of employed persons. In the first case, productivity increases at a slower pace due to the larger number of registered employed persons, as well as their uneven movement (faster growth in productivity in 2000 is due to the favorable macroeconomic performances in the economy, when real GDP growth of 4.5% was registered).

Figure 18

Labor productivity



productivity 1 - quarterly data on the number of employed persons from the Labor Force Survey, conducted by the SSO.
productivity 2 - monthly data on the number of employed persons from the publication "Short-term statistical data on the economic developments in the RM" of SSO.

The analysis of sector productivity²⁴ usually includes definition of two sectors in the economy: tradables sector and non-tradables sector²⁵. There are different definitions of classification of activities in the sectors into tradable and non-tradable goods²⁶, with four definitions being used in your case:

1. The tradables sector includes only industry, while the non-tradables sector includes agriculture and services;

23. The number of employed persons, according to the publication "Short-term statistical data on the economic developments in RM" falls throughout the entire analyzed period, while according to the Labor Force Survey until 2001 an increase in employment was registered, whereas in the 2002-2004 period the number of employed persons registered a decline.

24. The analysis of productivity from a viewpoint of the individual sectors in the economy explains, partially or in full, the movement of the real exchange rate (appreciation/depreciation) through the so-called Balassa-Samuelson effect. According to the hypothesis of Balassa-Samuelson (Balassa, 1964; Samuelson, 1964), the increased productivity in the tradable goods sector leads to higher real wages in the same sector. Under assumption of perfect mobility of labor force in the country, real wages in the non-tradables sector will also increase, which leads to a rise in the prices of nontradables and consequently, in the general price level in the economy. The higher inflation in the country leads to appreciation of the real exchange rate.

25. Productivity in both sectors is calculated as a ratio between the value added and the number of employed persons in the respective sector. For classification of the employees and the value added, the same definitions as for classification of activities are used, as since the beginning of 2000 the State Statistical Office has been using the New National Classification of Activities for publishing the number of employees and the value added. For analyzing the sector productivity, data on the employees from the publication "Short-term statistical data on the economic developments in RM" of SSO, are used.

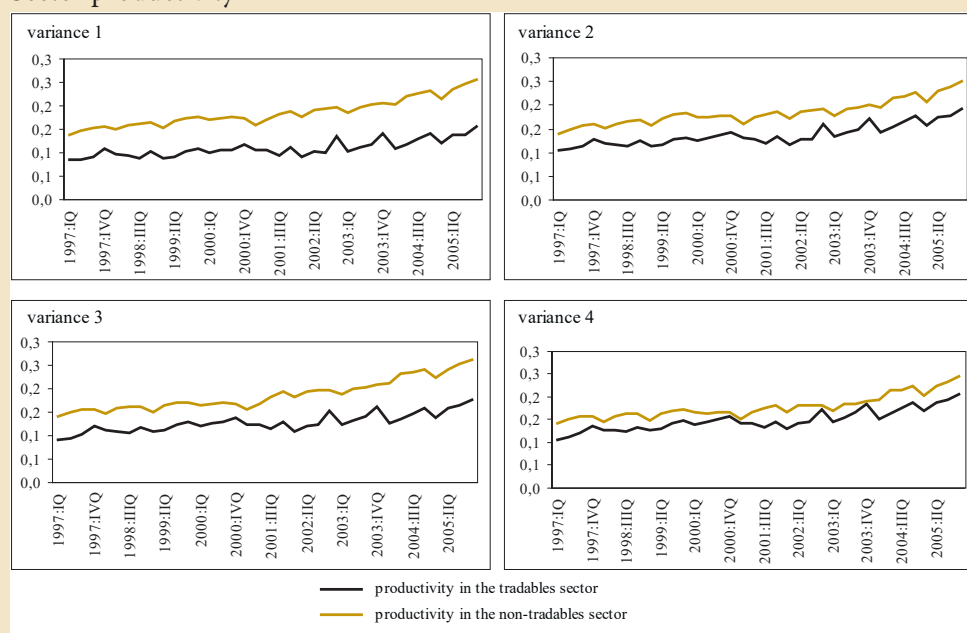
26. Balazs Egert, "Equilibrium Exchange Rates in Southeastern Europe, Russia, Ukraine and Turkey: Health or (Dutch) Diseased?"

2. The tradables sector includes industry and agriculture, while the non-tradables sector includes only services;

3. The tradables sector includes industry and two service providing activities ("hotels and restaurants" and "transport, storage and communication"), while the non-tradables sector includes agriculture and the remaining part of the services sector;

4. The tradables sector includes industry, agriculture, and two service providing activities ("hotels and restaurants" and "transport, storage and communication"), while the non-tradables sector includes the remaining part of the services sector;

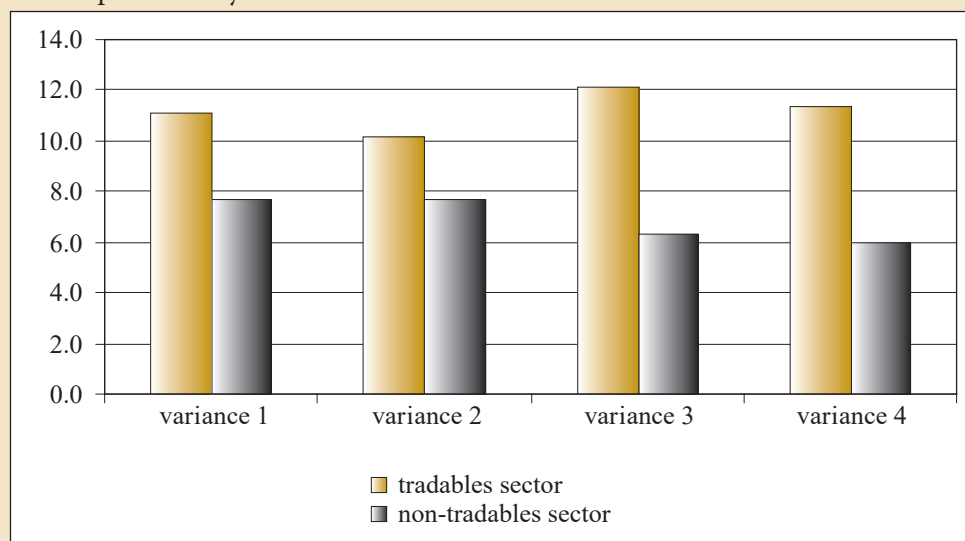
Figure 19
Sector productivity



Generally speaking, higher level of productivity in the Republic of Macedonia was registered in the non-tradables sector, in an environment of higher value of the production, as well as a smaller number of employed persons compared with the tradables sector. Still, this is not uncommon, having in mind that foreign investments in the Republic of Macedonia are mainly concentrated in the services sector (primarily telecommunications and financial intermediation) which enables innovations in the production process and increased efficiency in the operations, and consequently, increased productivity in the non-tradables sector.

Figure 20

Sector productivity in 2005



On the other hand, in 2005, with an increase in productivity being registered in both sectors (2005 / 2004), higher growth rate in all four options was registered in the tradables sector. The faster growth in the productivity in the tradables sector in 2005 indicates finalization of the restructuring process, higher level of political and economic stability, presence of international companies, and introduction of new technologies in the production.

2.6. Government budget²⁷

The policy of disciplined spending in the fiscal area, in order to achieve fiscal sustainability in a medium run, continued also in 2005. Given the change in the initial assumptions (mainly due to the higher dividend from one enterprise with state capital, in July a supplementary budget was adopted²⁸.

In 2005, the successful coordination between fiscal and monetary policies continued. Thus, the liquidity created on the basis of the significant inflow of foreign currency in the economy was offset through a combination of monetary operations and lower public spending. The share of public spending in GDP dropped by 1.1 percentage point p.a., and in 2005 it equaled 19% of GDP²⁹.

From the viewpoint of the government budget components, total public revenues³⁰ amounted to Denar 92.805 million, which is complete realization of the

27. Source: Ministry of Finance.

28. Source: "Official Gazette of RM" No. 63/2005.

29. Estimation of the NBRM, in accordance with the data on the GDP components of the SSO.

30. Public revenues include the revenues of the central government budget and the funds.

projected inflow. On the other hand, total government expenditures³¹ were slightly lower than projected, which is due to the lower amount of realized current and capital expenditures compared with the projected (97.9% of the projected amount were spent) and they stood at Denar 92,228 million. Accordingly, instead of the planned deficit, consolidated budget registered slight surplus in 2005, which reached 0.2% of the gross domestic product.

Table 9

Consolidated government budget
(in millions of denars)

	Q.1.2005	Q.2.2005	Q.3.2005	Q.4.2005	2005		
					amount	structural share in %	2005 / 2004 change in %
Total revenues	20,097	22,608	25,637	24,462	92,805	100.0	5.2
Tax revenues and contributions	18,904	21,097	21,215	23,060	84,276	90.8	3.7
<i>Tax revenues:</i>	<i>12,314</i>	<i>13,944</i>	<i>14,107</i>	<i>15,316</i>	<i>55,681</i>	<i>60.0</i>	<i>4.7</i>
- personal income tax	1,834	2,052	1,951	2,260	8,097	8.7	5.1
- profit tax	1,080	600	623	534	2,837	3.1	20.2
- VAT	5,745	6,767	6,652	7,918	27,082	29.2	5.1
- ex cises	2,461	2,937	3,385	2,965	11,748	12.7	6.8
- customs duties	1,026	1,441	1,335	1,464	5,266	5.7	-9.4
- other tax es	168	147	161	175	651	0.7	18.8
<i>Contributions</i>	<i>6,590</i>	<i>7,153</i>	<i>7,108</i>	<i>7,744</i>	<i>28,595</i>	<i>30.8</i>	<i>1.9</i>
Non-tax revenues:	1,081	1,404	3,835	1,275	7,596	8.2	20.5
-profit from public and financial institutions	83	260	2,837	139	3,319	3.6	2.1 times
- administrative tax es and remunerations	387	459	358	453	1,657	1.8	13.3
- revenues from participation	127	122	69	116	434	0.5	-22.8
- other administrative tax es	58	69	55	64	246	0.3	-4.3
- other non-tax revenues	87	53	53	71	264	0.3	-64.2
- compensation for use of a motorway	340	442	463	431	1,675	1.8	0.2
Capital revenues	112	107	587	127	933	1.0	55.5
Total expenditures	21,365	21,973	22,575	26,315	92,228	100.0	4.6
Current expenditures	20,481	20,671	20,334	22,478	83,965	91.0	2.2
- wages and salaries	5,473	5,561	5,400	5,726	22,159	24.0	3.4
- goods and services	2,351	2,029	1,617	2,548	8,545	9.3	4.2
- transfers	12,092	12,419	12,603	13,570	50,684	55.0	1.1
- interest	566	662	715	633	2,577	2.8	11.5
Capital costs	883	1,301	2,241	3,837	8,263	9.0	37.0
Budget balance	-1,268	636	3,062	-1,853	577		
Financing	1,268	-636	-3,062	1,853	-577		
<i>External financing, net</i>	<i>-1,221</i>	<i>762</i>	<i>-180</i>	<i>11,078</i>	<i>10,439</i>		
<i>Financing from domestic sources, net</i>	<i>2,224</i>	<i>-1,629</i>	<i>-3,029</i>	<i>-9,268</i>	<i>-11,702</i>		
<i>Revenues from privatization</i>	<i>265</i>	<i>231</i>	<i>147</i>	<i>43</i>	<i>686</i>		

Source: Ministry of Finance of the Republic of Macedonia

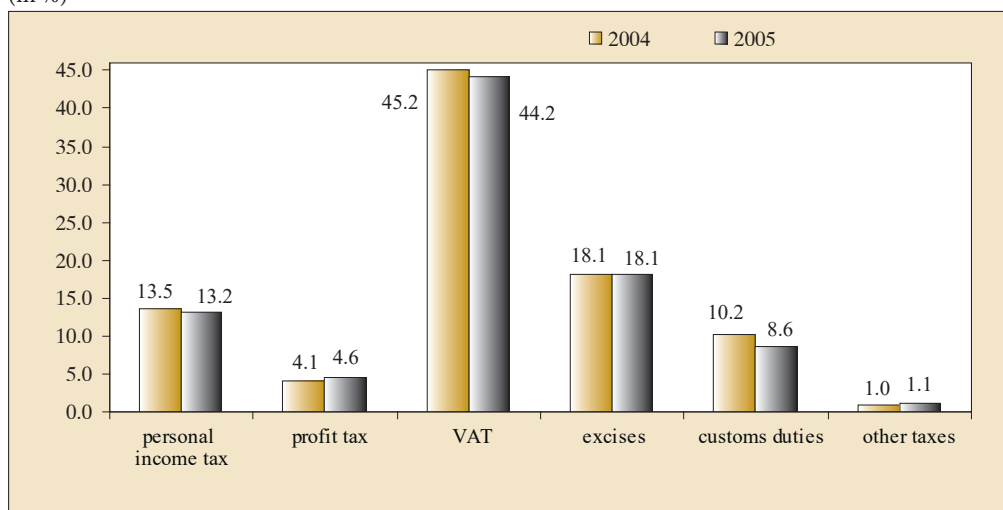
In 2005, public revenues were higher by 5.2% p.a., reflecting the increased tax, non-tax and capital revenues. The increased revenues from the value added tax and the revenues from dividend of one company with state capital most significantly contributed to the annual growth rate. Having in mind the increase in all categories of public revenues, total public revenues registered an increase of 4.6% relative to the preceding year.

31. Public expenditures include the expenditures of the central government budget and the funds.

In 2005, the revenues of the central government budget stood at Denar 61,239 million, and registered an increase of 7.5% relative to the previous year. Given the accelerated economic activity, tax revenues increased by 4.8% (dominant share in the total revenues of 89.8%), reflecting the increased revenues from all tax categories except the revenues from the collection of customs duties (decline of 9.4%³², in line with the reduction of tariff rates according to the Agreement for accession to the WTO and the free trade agreements). Main reasons behind the increase in tax revenues are the value added tax (increase of 5.1% under circumstances of increased turnover, more efficient tax collection and increased fiscalization (use of fiscal cash registers by the tax payers) of tax payers) and the excises (increase of 7.3%, which corresponds with the amendment to the Law on Excise³³.) In 2005, the fastest increase was registered in the revenues from the collection of the profit tax (of 20.2%), which indicates improved financial results of the companies in 2004, compared with 2003³⁴.

Figure 21

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



In 2005, non-tax revenues were higher by 37.5%, mostly due to the dividend of the enterprise with state capital paid in the third quarter of 2005, which led to almost double annual increase in the revenues from profits of entities with state capital. The revenues from administrative taxes and compensations, as an important non-tax item in 2005, increased by 13.3%.

The increase in the total budget revenues in 2005 was supported also by the upsurge in the capital revenues, which registered annual increase of 55.5%, on the basis of selling state-owned land and selling state-owned apartments.

32. Revenues from customs duties exceed the projection by 8.2%, due to the increased import of goods and services in 2005.

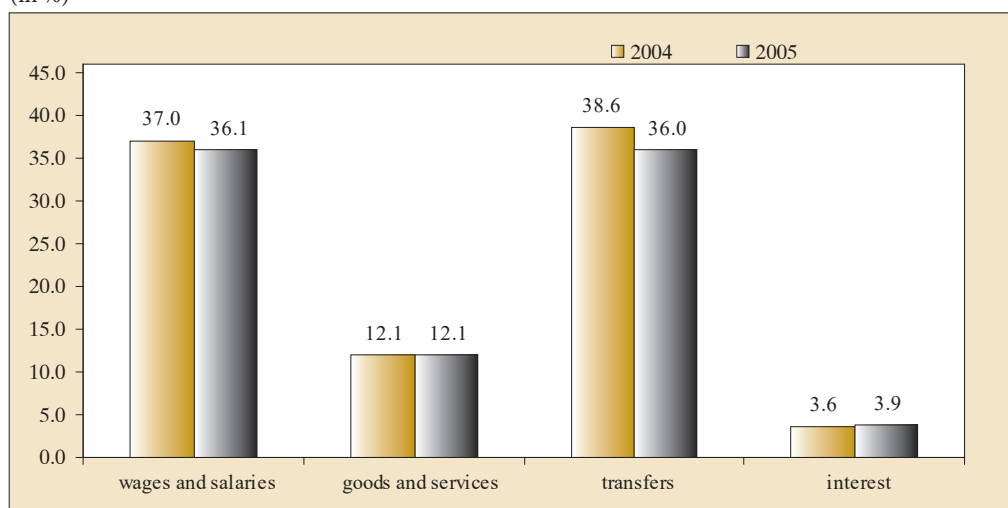
33. As of January 1, 2005, in accordance with the Law on amending and consolidating the Law on Excise ("Official Gazette of RM" No. 96/04), the excise on motor cars with engine capacity exceeding 1000 cm³ was increased (Denar 15,000 - 550,000), an excise was introduced on the synthetic lubricants, the excise on minerallubricants was transformed, and the excise on cigarettes was increased.

34. Profit tax is paid in the first quarter of the current year for the previous year.

Figure 22

Structural share of the individual categories of current expenditures in the total expenditures of the central government budget

(in %)



In 2005, total budget expenditures in the total amount of Denar 60,056 million were registered, which represents an annual increase of 6.1%. The increased spending of the central government in 2005 is a result of the higher current and capital expenditures. Current expenditures picked up by 2.2%, which is a result of the higher expenditures for payment of wages and transfers, due to the commenced process of decompression of the wages of civil servants in the public sector and fulfillment of the obligations arising from the Framework Agreement. At the same time, capital expenditures went up by 22.4%, mainly as a result of the increased investments in fixed assets³⁵. During 2005, 2.6% of the total budget expenditures were intended for import of goods³⁶, which is an increase of 2 percentage points compared with 2004 (caused by the import of an aircraft in the first half of 2005).

In 2005, the revenues of social funds amounted to Denar 50,900 million, which is an annual drop of 0.8%. Lower inflows were registered in the Pension and Disability Insurance Fund, and the Employment Fund (by 0.4% and 6.9%, respectively), while the revenues of the Health Insurance Fund went up (by 1.3%). The social funds' expenditures, which totaled Denar 51,159 million in 2005, were almost unchanged on annual basis. The reduced costs of the Pension and Disability Insurance Fund and the Employment Agency (by 0.4% and 5.3%, respectively) were compensated with the increased costs of the Health Insurance Fund (increase of 3.3%). In 2005, revenues and expenditures of the Road Fund dropped by 8.1% and 12.9%, respectively.

Analyzing the structure, 59.4% of the revenues of the Pension and Disability Insurance Fund are wage contributions, while around one third are revenues from the government budget. The reduction in the revenues from the budget by 2.3%, as opposed to the more moderate increase in the wage contributions of 1.6%, led to lower total

35. The annual change pertains to capital expenditures excluding the capital transfer intended for covering the loss of NBRM.

36. Estimated data of the NBRM.

revenues of the Fund. The lower expenditures of the Pension and Disability Insurance Fund are primarily due to the lower amount of funds paid for pensions (by 0.6%), which is a result of the reduced transfers for retroactive payment of the difference in pensions of 8%³⁷.

The intensified reforms in the health sector in 2005³⁸, aimed at creating an appropriate policy and its implementation, strengthened Fund governance, and provision of health services of higher quality, caused an increase in the revenues and the expenditures of the Fund. From the total funds of the Fund, 59.5% account for health insurance contributions, which are higher by 2.5% p.a. The increase in the expenditures reflects the higher costs for outpatient treatment and for hospital treatment (structural share of 88.5%).

Main structural component of the funds of the Employment Agency are the subsidies from the government budget (share of 82.7%). Thus, the reduction in the Fund's revenues in 2005 is almost entirely due to the decline in the subsidies (of 8.9%). On the other hand, lower expenditures are caused by the reduced funds for compensations for unemployed and the contributions for pension and disability insurance.

The reduced funds of the Road Fund in 2005 are a result of the lower amount of budgetary funds (by 18%), having in mind that they are the main source of revenues for the Fund (share of 43.6%). The largest portion of the expenditures (41.5%) are for investments. Still, compared with the previous year, the value of realized investments is by 19.8% lower, which is the reason behind the lower amount of total expenditures.

37. In 2001, the payment of the previously unpaid 8% of the pensions of a particular group of retired persons started to be paid via the Pension and Disability Insurance Fund. The retroactive payment of pensions ends with 2005 year-end.

38. The reform of the health sector is financed with a loan from the International Bank for Reconstruction and Development. The project started in September 2004, and it is expected to be wrapped up in June 2009.



Solidus (gold), issued during the reign
of the Byzantine Emperor Anastasius I (491 - 518).
From the collection of the Museum of Macedonia.



Monetary developments in
the Republic of Macedonia

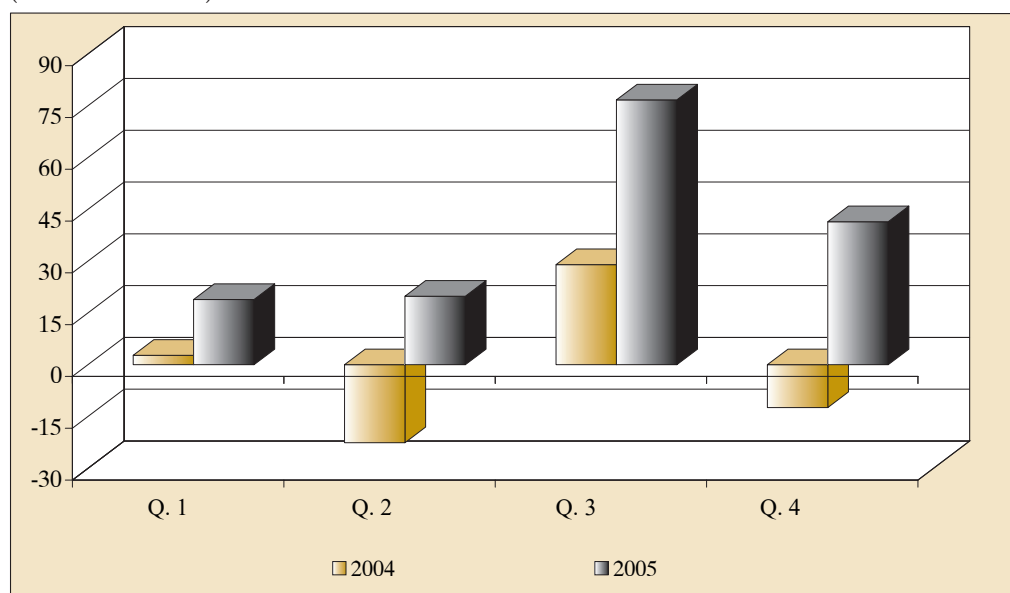
III. Monetary developments in the Republic of Macedonia

3.1. Monetary policy in 2005

During 2005, the monetary policy of NBRM was conducted in a favorable macroeconomic environment, evident through the positive performances in the external sector, continuous achievement of positive GDP growth rates, prudent fiscal policy and stable banking system. The accelerated export activity and high inflow of private transfers in 2005 led to lower balance of payments current account deficit and pressures for appreciation of the denar exchange rate, which were present on the foreign exchange market throughout most of the year. In order to maintain the *stability of the nominal denar exchange rate relative to the euro*, thus maintaining the *ultimate monetary policy objective - price stability*, in 2005, high net-purchase of foreign exchange on the foreign exchange market was made, through the foreign exchange transactions of the NBRM.

Figure 23

NBRM interventions on the foreign exchange market
(in millions of euros)



Source: National Bank of the Republic of Macedonia

From an operational aspect, during 2005, CB bills auctions were the main monetary policy instrument. In the first three quarters, NBRM continued to conduct CB bills auctions according to the "volume tender" procedure, with fixed interest rate of 10% and maturity of twenty-eight days (CB bills with a seven-day maturity were phased out in the beginning of March 2005). Favorable macroeconomic performances and the significant share of banks in meeting the demand on the foreign exchange

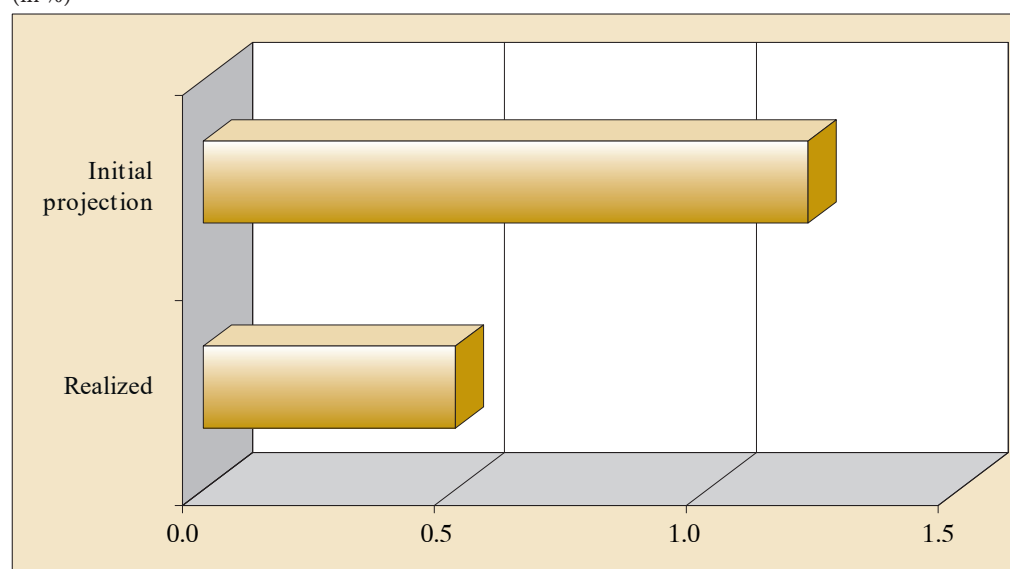
market (including the increased demand for foreign exchange for payment of dividend to the foreign investor by one company³⁹, which introduced uncertainty regarding the monetary policy implementation), in combination with the disciplined budgetary spending, created preconditions for changing the layout of the main monetary policy instrument in the fourth quarter of the year. Thus, on October 26, 2005, NBRM made a shift toward conducting CB bills auctions according to the "interest rate tender" procedure, which assumes market-based setting of the interest rates on CB bills, through bidding by the banks. Given the relatively high level of liquidity and, on average, higher demand relative to the supply of CB bills, market decline in the interest rates on the CB bills auctions was registered (in December 2005, the average weighted interest rate on CB bills equaled 8.52%, as opposed to 10% in the beginning of October 2005 when "volume tender" auctions were conducted).

In 2005, the set monetary policy objectives were successfully realized. Thus, in 2005, low and stable inflation rate was registered, which measured through the consumer price index equaled 0.5%, on average. The accomplished rate of inflation is lower relative to the initially projected level of 1.2%, which is mostly due to the unrealized assumption for a rise in the price of electricity.

Figure 24

Average inflation rate in 2005

(in %)



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

The projection of the monetary and credit aggregates is usually based on the projections of the key indicators from the real sector of the economy (GDP and inflation), on the expectations about the fiscal policy stance, as well as on the forecasted movements in the external sector. The initial monetary projection for 2005 was prepared in November 2004, while during 2005, in line with the changes in the key assumptions, two revisions were made (the latest one in November, during the IMF mission). The most important change in the assumptions pertained to the

39. The dividend to the Government was paid in July 2005, while the repatriation to the foreign investor took place in July and in August 2005.

payment of an unexpectedly high amount of dividend (to the government and the foreign investor) by one domestic company, which caused budget surplus in the first three quarters of the year (instead of the projected deficit) and lower level of deposits relative to the projection. Accordingly, with the latest revised projection an increase in the money supply M4 and in the credits extended to the private sector of 14.3% and 19.8%, respectively, was projected.

From a viewpoint of the banking system⁴⁰, in 2005, despite the one-time effect from the payment of the dividend (which acted toward a reduction of the enterprises' denar deposits), the total deposit potential of banks increased by 18.3%, which led to exceeding the projected level of the money supply M4 by 0.8 percentage points. The higher deposit potential of banks, accompanied by the more active policy of banks for using foreign exchange funds, led to the achievement of an annual rate of growth of credits to the private sector of 20.5% and excess of the projected growth of the total credits by 0.7 percentage points, at the end of 2005.

3.2. Liquidity of banks

During 2005, liquidity of banks fluctuated under the influence of the autonomous factors (government denar deposits with the NBRM, foreign exchange transactions of the NBRM and currency in circulation) and the changes in the NBRM's monetary policy stance. The general level of liquidity was maintained on a relatively high level, which is primarily due to the favorable movements on the foreign exchange market, as well as to the change in the monetary instrument reserve requirement⁴¹, which imposed the need of higher amount of banks' funds with the NBRM.

At the end of 2005, relative to the end of the preceding year, banks' liquidity increased by Denar 2,417 million, or by 1.7 times, and at the end of December 2005 it reached Denar 6,000 million. Higher liquidity corresponds with the increase in the net domestic assets of the NBRM, which, on cumulative basis, represents the only flow of liquidity creation in 2005. Part of the created liquidity is sterilized through the components of the net domestic assets of the NBRM (government deposits, NBRM bills, and other items, net), and the higher demand for cash.

40. Movements in the banking sector are presented in details in the Report on the Banking Supervision and the Banking System of the Republic of Macedonia.

41. On January 11, 2005, the Decision of the NBRM (adopted in December 2004) on increasing the rate of reserve requirement (on denar and foreign currency deposits) from 7.5% to 10%, became effective.

Table 10

Flows of liquidity creation and withdrawal*

(in millions of denars)

	Balance as of 31.12.2004	Changes by quarters				Total	Balance as of 31.12.2005
		I Q.	II Q.	III Q.	IV Q.		
Banks' liquidity	3,583	264	844	-700	2,009	2,417	6,000
Liquidity creation						24,458	
1. Net foreign assets	41,824	1,315	2,678	5,238	15,227	24,458	66,282
Liquidity withdrawal						-22,041	
1. Net domestic assets	-24,079	-2,006	-1,651	-5,838	-12,269	-21,764	-45,843
of which:							
CB bills	-4,552	-1,482	-19	-401	-2,467	-4,369	-8,921
Government denar depositis w ith the NBRM	-4,696	-364	186	-4,714	2,595	-2,297	-6,993
Government foreign currency deposits with the NBRM	-6,260	1,688	-296	341	-10,759	-9,026	-15,286
Other items, net	-11,506	-1,845	-1,222	-1,052	-2,353	-6,472	-17,978
2. Currency in circulation	14,162	955	-183	-100	-949	-277	14,439

* Liquidity of banks includes the banks' account with the NBRM and the vault cash; (+) liquidity creation; (-) liquidity withdrawal.

Source: National Bank of the Republic of Macedonia

The average daily balance of liquid funds of banks⁴² in 2005 amounted to Denar 5,019 million, which is a rise of 38.7% relative to the previous year. From the viewpoint of the quarterly dynamics, in the first three months of the year, the average daily liquidity of banks was maintained at a relatively higher level (quarterly rise of Denar 957.4 million), mainly as a result of the increased reserve requirement (which is maintained at banks' account with the NBRM), introduced in January 2005. The banks mainly fulfilled the higher reserve requirement by net-sale of foreign exchange on the foreign exchange market and by withdrawing part of the CB bills. In the second quarter, as a result of the net-purchase of foreign exchange on the foreign exchange market by the NBRM, despite the partial mopping up of the liquidity from the banking channels through the monetary instruments, the average liquidity of banks increased by Denar 534 million on a quarterly basis and amounted to Denar 5,183 million (the highest average level of liquidity in 2005). Given the significant accumulation of funds by the government (as a result of the payment of dividend by one domestic company where the state is a shareholder) and increased demand for cash, in the third quarter of the year, lower average daily balance of banks' liquid funds was registered (quarterly drop of Denar 103 million). In the last quarter of 2005, under the influence of the foreign exchange transactions of the NBRM towards net-purchase of foreign exchange on the foreign exchange market, and simultaneous increase in the budgetary spending, the banks' average liquidity again registered positive quarterly change (increment of Denar 98 million).

Changes in the setup of the monetary policy instrument - reserve requirement, introduced in December 2004, when the NBRM adopted a decision on increasing the rate of reserve requirement (on denar and foreign currency deposits) from 7.5% to 10%, which became effective in January 2005, initially imposed the need of holding additional funds on banks' accounts with the NBRM⁴³. In line with the features of the instrument reserve requirement (average system of allocation), the funds may be used

42. Includes the banks' account with the NBRM and the vault cash.

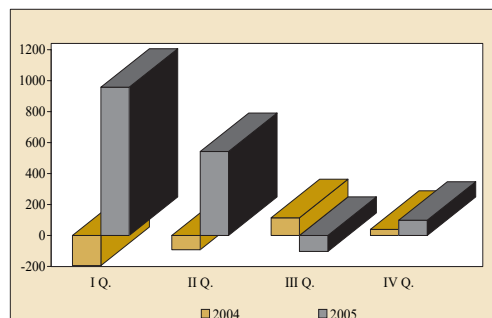
43. According to the estimations of the NBRM, the additional amount of liquid funds in the banking system on the basis of the higher reserve requirement totals Denar 961 million.

for banks' short-term liquidity needs of up to 80%, within the period of allocation. The decline in the average excess of funds over the prescribed reserve requirement (10% in 2005, as opposed to 15% in 2004) indicates more rational and more efficient liquidity management by particular banks.

Figure 25

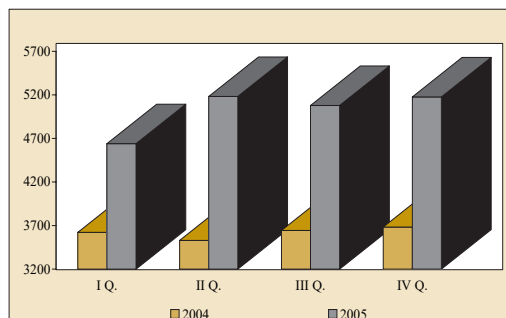
Quarterly change of the average liquidity *

(in millions of denars)



Average daily balance of the banks' liquid funds

(in millions of denars)



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

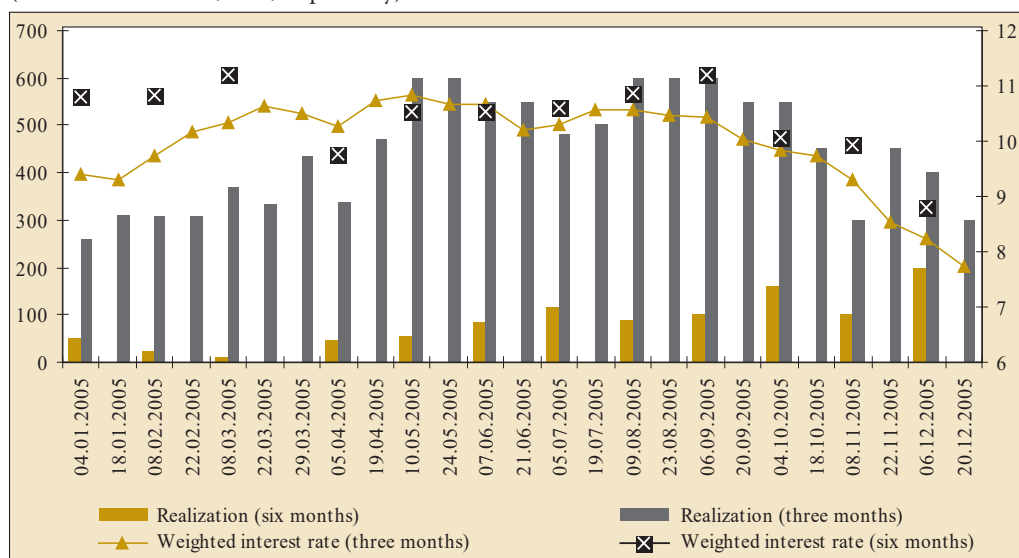
Source: National Bank of the Republic of Macedonia

In 2005, the *foreign exchange transactions of the NBRM* represented the main flow of creating liquidity in the banking system. The accelerated export activity, along with the foreign exchange inflows on the basis of the purchase from the currency exchange operations, led to favorable movements on the foreign exchange market, expressed through higher supply relative to the demand for foreign exchange (on the NBRM - banks segment). As a result of such movements, in 2005 NBRM was continuously making a net-purchase of foreign exchange (except for January, when the foreign exchange transactions were almost neutral), thus supporting the maintenance of a stable level of the nominal Denar exchange rate relative to the Euro, as an intermediary target of the monetary policy. Analyzing the dynamics, in the first half of the year, NBRM intervened with a net-purchase of foreign exchange as a reply to the favorable developments in the balance of payments, supplemented with the effect of the higher reserve requirement and the needs for denar liquidity of banks. Significantly higher amount of net-purchase of foreign exchange was made in the second half of 2005, which was mostly a result of the relatively high inflows on the basis of the net-purchase from currency exchange operations (especially in the third quarter), with the banks being more active in supplementing the supply on the banks - enterprises segment.

Figure 26

Realization of three-month and six-month government securities and average weighted interest rate

(in millions of denars, in %, respectively)



Source: Ministry of Finance

At the end of 2005, government denar deposits with the NBRM stood at Denar 6,993 million, which was an increase of 1.5 times relative to the preceding year. Hence, they acted towards withdrawing liquidity from the banking sector. From a viewpoint of the quarterly dynamics, the funds on the government denar account with the NBRM accumulated in the first quarter were partially withdrawn in the second quarter, when higher budgetary spending was registered, partially due to the payment of the regular installment of the government bonds for the old foreign currency saving⁴⁴. In the third quarter, the balance on the government denar account with the NBRM registered a significant quarterly rise, which is due to the higher non-tax revenues in the budget from the payment of dividend by a company where the state is a shareholder, in the beginning of July. In line with the government spending for the regular payment of the liability on the basis of the bonds for old foreign currency saving in October, as well as the increased budgetary spending towards the end of the year, government denar deposits with the NBRM in the last quarter of 2005 represented a flow of liquidity creation (quarterly drop). During the year, the government obtained additional funds in the amount of Denar 1,508.4 million through the auctions of short-term Treasury bills⁴⁵. Besides Treasury bills with three and six-month maturity, in 2005, Treasury bills with maturity of twelve and twenty-four months were issued for the first time. Government foreign currency deposits increased by 2.4 times p.a., thus totaling Denar 15,286 million at the end of December 2005. The significant annual increase in the

44. The government pays out principle and interest from the bond for old foreign currency saving twice a year (in April and in October). This government bond with maturity of ten years was issued in 2000 for compensating the depositors on the basis of the old foreign currency saving.

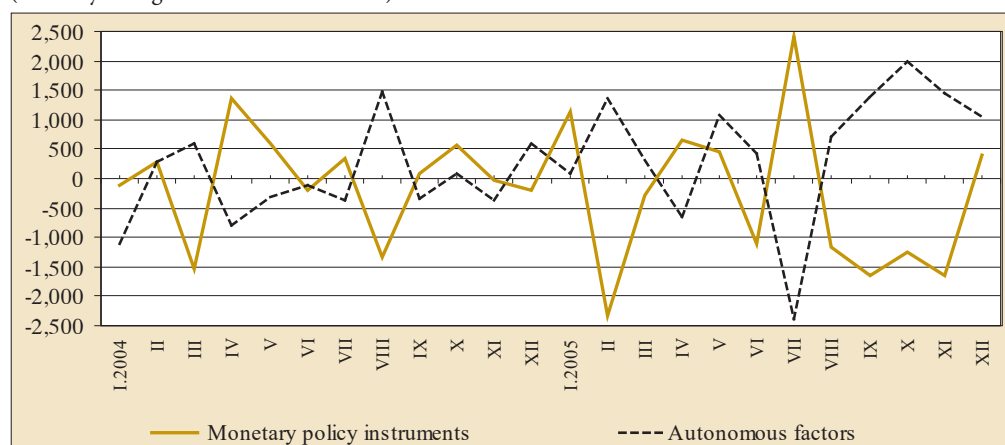
45. Difference between the amount of Treasury bills as of December 20, 2005 (last auction conducted in 2005) and as of December 21, 2004 (last auction conducted in 2004).

government foreign currency deposits with the NBRM, primarily mirrors the high external inflows on the basis of the eurobonds⁴⁶ in December 2005.

Figure 27

Monetary policy instruments and autonomous factors of liquidity creation and withdrawal*

(monthly changes in millions of denars)



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

Source: National Bank of the Republic of Macedonia

In 2005, NBRM used the CB bills auctions as the main monetary policy instrument in order to mop up liquidity from the banking sector. Thus, at the end of December 2005, CB bills stood at Denar 8,921 million, which is an additionally withdrawn liquidity of Denar 4,369 million relatively to the end of the preceding year. From the viewpoint of the quarterly dynamics, in all four quarters of 2005, CB bills were aimed at sterilization of the liquidity of banks, which enabled NBRM to offset partially the effects of the influence of the autonomous factors (NBRM interventions on the foreign exchange market, currency in circulation and budgetary spending). Thus, in the first quarter, the level of CB bills increased by Denar 1,482 on a quarterly basis, reflecting the high interest of banks in investing in CB bills in February 2005⁴⁷. As of January 20, 2005, NBRM abolished the daily auctions of CB bills with seven-day maturity, and continued to conduct the auctions twice a week until March 9, 2005, when they were abolished. Moderate increase in the level of CB bills of Denar 19 million was registered also in the second quarter, which, given the lower preference of banks to invest in CB bills in April and in May, is entirely due to the higher level of CB bills in June 2005⁴⁸. In the third quarter, when significant amounts were accumulated on the government denar account, the level of CB bills registered a quarterly rise of Denar 401 million, which completely offset the inflow of liquid funds in the banking system on the basis of the high net-purchase of foreign exchange on the foreign exchange market by the NBRM. Despite the reduction in the average weighted interest rate on CB bills after the shift towards the "interest rate tender" procedure in October 2005,

46. On December 2, 2005, the first Macedonian eurobonds in the amount of Euro 150 million, with maturity of ten years, and coupon rate of 4.625% were issued on the London Stock Exchange. The inflows from the eurobonds are intended for purchasing the current debt to the London Club of Creditors in the beginning of 2006.

47. The level of CB bills increased by Denar 2,328 million on a monthly basis, which is mostly due to the temporary investing of the funds of one bank on the basis of a deposit of one company, until the payment of dividend.

48. Monthly rise of Denar 1,116 million for the same reasons as in February 2005.

the level of CB bills continued to rise also during the fourth quarter, which indicates high liquidity of banks and simultaneously retained attractiveness of this instrument (quarterly increment of Denar 2,467 million). An exception is their common decline in the last month of the year. Contemporaneously, in November 2005, the highest level of CB bills during the year was registered, in the amount of Denar 9,332 million.

Throughout 2005, decelerated activity on the official money market was registered, which is mainly due to the relatively high level of liquidity in the banking system, as well as to the increased transaction costs. On the other hand, the average monthly turnover in the bilateral interbank trading stood at Denar 1,108.5 million, which is by 1.4% higher than the average registered in the previous year. The average weighted interest rate on the money market (official money and bilateral interbank trading market) in 2005 equaled 8.6% (increment of 1.6 percentage points relative to the preceding year). During 2005, in line with the high level of liquidity, only four lombard credits⁴⁹ were extended to four banks, with maturity of one day and interest rate of 13%.

Table 11

Reserve money

(in millions of denars)

	Balance as of	Changes by quarters					Balance as of
	31.12.2004	Q.1	Q.2	Q.3	Q.4	Total	31.12.2005
Reserve money	17,745	-691	1,027	-600	2,958	2,694	20,439
- currency in circulation	14,162	-955	183	100	949	277	14,439
- banks' liquidity*	3,583	264	844	-700	2,009	2,417	6,000

*Banks' liquiding includes bank's account with the NBRM and cash in vault.

Source: National Bank of the Republic of Macedonia

Currency in circulation increased by 2% p.a., thus equaling Denar 14,439 million at the end of December. Throughout the year, the demand for currency in circulation oscillated under the influence of the common seasonal factors. Thus, in the first quarter of 2005, when the effects of the seasonal growth at the end of the preceding year were exhausted, lower level of currency in circulation was registered (by 6.7% on a quarterly basis), while in the second quarter, they registered a moderate increase of 1.4%. In the third quarter, the demand for currency in circulation was almost unchanged, as opposed to the fourth quarter, when a seasonal increase prior to the New Year and Christmas holidays of 7% was registered.

At the end of 2005, reserve money increased by 15.2% relative to the end of the previous year, thus reaching Denar 20,439 million in December 2005. The registered increase in the reserve money is mostly a result of the higher liquidity of banks, as well as of the increased demand for currency in circulation.

49. Loans that the NBRM extends to commercial banks on the basis of pledge of securities.

Table 12
NBRM Survey
 (in millions of denars)

	Balance as of 31.12.2004	Changes by quarters					Balance as of 31.12.2005
		Q.1	Q.2	Q.3	Q.4	Total	
Reserve money	17,745	-691	1,027	-600	2,958	2,694	20,439
Net foreign assets ¹	41,824	1,315	2,678	5,238	15,227	24,458	66,282
Foreign assets	44,686	1,340	2,482	5,955	15,041	24,818	69,504
Foreign liabilities	2,862	25	-196	717	-186	360	3,222
Net domestic assets	-24,079	-2,006	-1,651	-5,838	-12,269	-21,764	-45,843
1. Banks' credits, net	-4,498	-1,485	-12	-413	-2,468	-4,378	-8,876
- credits	54	-3	7	-12	-1	-9	45
- instruments	-4,552	-1,482	-19	-401	-2,467	-4,369	-8,921
2. Net Government position with the NBRM	-8,075	1,324	-417	-4,373	-7,448	-10,914	-18,989
- Claims on the Government	2,881	0	-307	0	716	409	3,290
- Government deposits ²	-10,956	1,324	-110	-4,373	-8,164	-11,323	-22,279
3. Other items, net	-11,506	-1,845	-1,222	-1,052	-2,353	-6,472	-17,978

1/ Foreign currency categories are valued at current exchange rate.

2/ As these are liabilities accounts recorded in the assets, the amounts on December 31, 2004 and December 31, 2005 are presented with a minus sign. As for changes by quarters, a change with a negative sign denotes increase in the deposits, and vice versa.

Source: National Bank of the Republic of Macedonia

Analyzing the components of the NBRM balance sheet, the higher level of reserve money is a result of the NBRM net foreign assets, which in 2005 represented a flow of creating reserve money. Observing the dynamics, the level of NBRM net foreign assets continuously increased in 2005. The outflows based on servicing the government liabilities to foreign creditors (most of which registered in January) were entirely offset with the realized net-purchase of foreign exchange on the foreign exchange market, which resulted in a quarterly increase in the NBRM net foreign assets in the first quarter. The movements in the second quarter acted in the same direction, as a result of the NBRM interventions on the foreign exchange market with net-purchase of foreign exchange, and the higher foreign exchange inflows on the basis of a credit extended by the World Bank in June 2005. In the third quarter, in line with the higher foreign currency inflows from currency exchange operations, caused by seasonal factors, NBRM made higher net-purchase of foreign currency on the foreign exchange market, which combined with the inflows realized on the basis of a tranche of the Stand-by arrangement with the IMF⁵⁰ (in September 2005), caused a quarterly increase in the NBRM net foreign assets. The significant quarterly increase in the NBRM net foreign assets in the fourth quarter reflects the high external inflows on the basis of the Eurobonds and the funds approved by the World Bank in December 2005, as well as the quarterly net-purchase of foreign currency on the foreign exchange market by the NBRM. The changes in the NBRM foreign liabilities in 2005 reflected the regular payments of the liabilities to the IMF. In 2005, given the Government's accumulation of funds and the higher interest of the banks to invest in CB bills, the NBRM net domestic assets were directed towards withdrawing reserve money.

3.2.1. Basic monetary policy instruments

In 2005, the short-term securities issued by the NBRM - CB bills were the core instrument in the operational NBRM monetary policy framework. In the environment of structural excess of Denar liquidity in the banking system, underdeveloped financial market and insignificant securities portfolio owned by the banks, the CB bills auctions

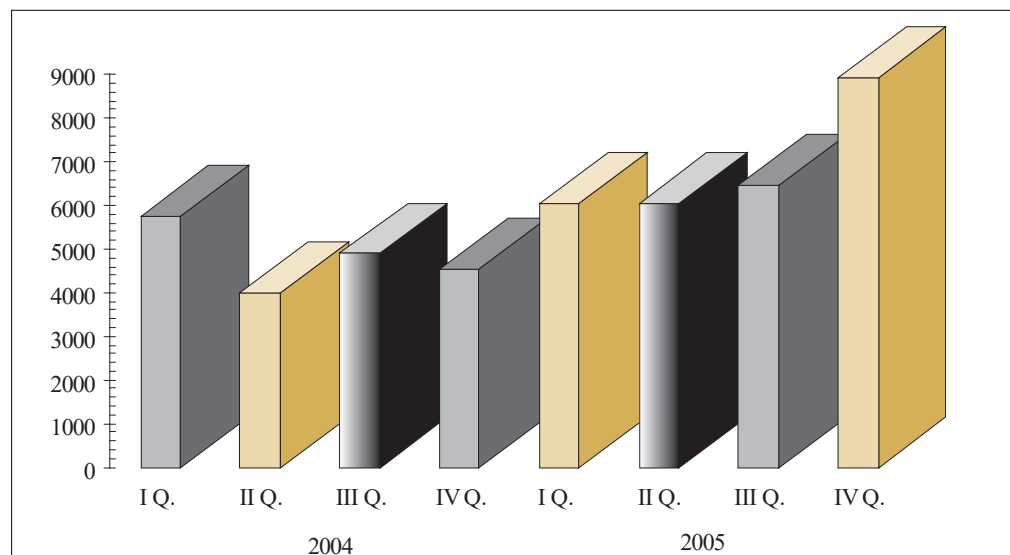
50. On August 31, 2005, the IMF Board of Directors approved a three-year "precautionary" Stand-by arrangement (total value in the original currency of SDR 51.7 million).

were a suitable instrument for efficient liquidity management. When applying a nominal exchange rate targeting strategy, this monetary instrument considerably contributes towards offsetting the effects of the autonomous factors on the liquidity, and consequently on the exchange rate stability.

Figure 28

CB bills*

(in millions of denars)



*Shows the discounted amount of CB bills.

Source: National Bank of the Republic of Macedonia.

In 2005, the NBRM made several modifications in the design of the CB bills auction instrument directed towards offsetting the effects of the autonomous factors and stabilizing the foreign exchange market developments. Thus, on January 20, 2005, the stabilization of the public consumption made the NBRM abolish the everyday 7-day CB bills auctions⁵¹ and continued holding them twice a week (same as the 28-day CB bills). On the basis of favorable developments on the foreign exchange market since 2004, and achievement of the planned pace of government spending, on March 9, 2005, the NBRM passed a decision on abolishing 7-day CB bills (introduced in February 2004). The abolishment of the 7-day CB bills, with interest rate of 7% in March 2005 was directed towards reducing the presence of the NBRM on the primary short-term securities market, stimulating the development of interbank money market and the secondary securities market. After the abolishment of 7-day CB bills in October 2005, the NBRM has held CB bills "volume tender" auctions with fixed interest rate of 10% and maturity of 28 days.

51. The everyday dealing in 7-day CB bills was introduced at the end of December 2004, owing to the withdrawal of the potentially high liquidity in the banking sector created by the higher government spending at the end of the budget year.

As a result of the solid macroeconomic results and favorable foreign exchange market developments, in the last quarter of 2005, conditions were created for modifying the design of the basic monetary instrument. Thus, on October 26, 2005, the NBRM switched from "volume tender" to "interest rate tender" CB bills auctions (auctioning with interest rate and their market-based setting). Having higher demand for relative to supply of Cb bills, the shift in the tender contributed to gradual reduction of the average weighted interest rate, with its level of 10% in early October, by applying "volume tender", reduced to 8.52% in December 2005.

In 2005, the banks showed high preferences to invest in CB bills, primarily due to the following factors: a) high inflows of foreign currency on the foreign exchange market, and consequently, high net-purchase of foreign currency by the NBRM, resulting in excess liquidity in the banking system; b) attractive CB bills interest rate (including the last quarter, when as a result of the application of "interest rate tender" it reduced), as a financial form of investing the excess liquidity of the banks; c) limited amount of supply of Treasury bills, owing to the application of interest rate tender auctions of Treasury bills, which corresponds with the budget financing structure plan; d) underdeveloped financial market.

Observing the reserve requirement, the NBRM Decision (adopted in December 2004) on increasing the reserve requirement allocation rate (on Denar and foreign currency deposits) from 7.5% to 10% entered into force on January 11, 2005. The reserve requirement allocation rate on Denar deposits was increased with a view to reducing the structural excess liquidity in the banking system. On the other hand, the reserve requirement on foreign exchange deposits was increased in order to ensure higher coverage of the short-term foreign exchange liabilities with liquid funds, having an intensive lending in foreign currency (after the liberalization of foreign exchange lending in July 2003).

In order to promote the repo-transactions in the Republic of Macedonia, and increase the security of the approved funds, in early October, the NBRM replaced the extension of Lombard credits with overnight credit, approved by the means of repo-transaction. Simultaneously, the overdraft allowed to the banks for smooth execution of the transactions in the payment operations was replaced by intraday repo. The NBRM accepts CB bills and Treasury bills as collateral for concluding intraday and Lombard repo. The transaction collateralization level is determined by the maturity of the securities and ranges from 101.25% on one-month maturity to 115% on securities with maturity of up to one year.

Annex 2

Chronology of the modifications in the design of monetary instruments and undertaken measures in 2005

January 11, 2005

The NBRM Decision (adopted in December 2004) on increasing the reserve requirement allocation rate (on Denar and foreign currency deposits) from 7.5% to 10% entered into force.

January 20, 2005

The NBRM abolished the everyday 7-day CB bills auctions and continued holding them twice a week, same as the 28-day CB bills.

March 9, 2005

The NBRM abolished the 7-day CB bills (introduced in February 2004).

April 23, 2005

The Rulebook on over-the-counter markets entered into force, and the OTC market officially started operating on April 25, 2005. Initially, short-term Treasury bills were traded on the OTC market.

August 18, 2005

Start of the application of new rules in the functioning of the foreign exchange market in the Republic of Macedonia aimed at promoting the operations and improving the performances of the foreign exchange market. The new rules include certain technical improvements in the trading, by introducing electronic platform for monitoring the exchange rate movements at real time, by direct electronic interbank trade in foreign currency. In addition, certain essential modifications were made in the manner of NBRM dealing on the foreign exchange market, with the NBRM signing a Market Makers Agreement with four commercial banks. The banks-signatories of the Agreement play the role of foreign exchange market makers and possibility to deal with NBRM according to previously defined rules, while the rest of the banks on the market will deal only with the banks - market makers.

September 29, 2005

The NBRM adopted a decision on replacing the approval of Lombard credit with overnight credit. So far, the NBRM was approving securities collateralized Lombard credit, whereas the Decision on overnight credit allows for the credit approval by the means of repo-transaction, with the securities used as credit collateral are transferred to the NBRM. Also, the daily overdraft allowed to the banks for the purposes of smooth conduct of transactions in the payment operations was replaced with an intraday credit. The credit is approved as a repo-transaction on request of the bank (automatically in the previous period).

October 26, 2005

The NBRM modified the monetary instrument design, switching from "volume tender" to "interest rate tender" CB bills auctions. This tender implies auctioning of the banks by interest rates at a restricted (given) amount of CB bills by the NBRM, with the CB bills interest rates being set on a market basis.

November 30, 2005

The NBRM adopted a decision on abolishing the acceptance of cash in vault as a means of fulfilling the reserve requirement for the purpose of more efficient banks' liquidity planning and management. The decision enters into force on January 11, 2006.

3.3. Monetary aggregates

The dynamics of the money supply in 2005 was under the influence of the usual seasonal movements of the demand for currency in circulation, the higher propensity of the households to save within the banking system, the creation of additional income available to the households with the payment of the regular installments of the government bonds for old foreign currency savings, the favorable movements in the foreign trade and the high level of private transfers and the required liquidity for payment of dividend to foreign investors.

At the end of 2005, the monetary aggregate M1 (currency in circulation and demand deposits) totaled Denar 29,663 million, which is by Denar 2,068 million, or by 7.5% more compared to the end of the preceding year. Having a moderate annual increase in the currency in circulation of 1.9%, the positive annual change in the money supply M1 is primarily determined by the higher level of demand deposits (of 13.3%). With respect to the money multiplication, the faster annual increase in the reserve money relative to the money supply M1 slowed down the money multiplication process. Thus at the end of 2005, the money multiplier of the money supply M1 equaled 1.45 (1.56 in December 2004). In 2005, the average annual growth rate of the money supply M1 equaled 4.8%.

Analyzing by quarters, at the end of the first quarter of 2005, relative to the end of the preceding year, the money supply M1 dropped by 2.3%, which having an increase in the demand deposits, reflects the lower preferences of the economic agents to hold cash after the intensive usual increase prior to the New Year's and Christmas holidays. In the second quarter of the year, the monetary aggregate M1 slightly increased by 0.7%, whereas the increase in the last two quarters of 2005 was faster and equaled 2.8% and 6.3%, respectively. The increase in the fourth quarter of the year corresponds with the higher demand for currency in circulation (prior to the New Year's and Christmas holidays) and by usual accumulation of funds on the companies' transaction accounts at the end of the year.

Table 13

Monetary review *

(in millions of denars)

	Balance as of 31.12.2004	Changes by quarters					Balance as of 31.12.2005
		Q.1	Q.2	Q.3	Q.4	Total	
Money supply M4 (total)	95,071	3,466	6,288	-2,245	6,703	14,212	109,283
Money supply M4 (non-government sector)	93,947	3,476	6,418	-2,190	6,523	14,227	108,174
Net foreign assets of the monetary system*	68,865	-444	5,951	958	14,408	20,873	89,738
Net domestic assets	26,206	3,910	337	-3,203	-7,705	-6,661	19,545
Domestic credits	61,356	5,436	2,167	-1,673	-4,904	1,026	62,382
Credits ex tended by banks	69,431	4,112	2,584	2,700	2,544	11,940	81,371
of w hich:							
Credits to non-government sector	62,272	3,402	2,724	3,048	2,727	11,901	74,173
- in Denars	50,925	1,839	1,194	1,436	1,674	6,143	57,068
- in foreign currency*	11,347	1,563	1,530	1,612	1,053	5,758	17,105
Credits to government sector	7,159	710	-140	-348	-183	39	7,198
NBRM's claims on the Government, net	-8,075	1,324	-417	-4,373	-7,448	-10,914	-18,989
Other items, net	-35,150	-1,526	-1,830	-1,530	-2,801	-7,687	-42,837

1/ (+) Money supply creation; (-) money supply withdrawal.

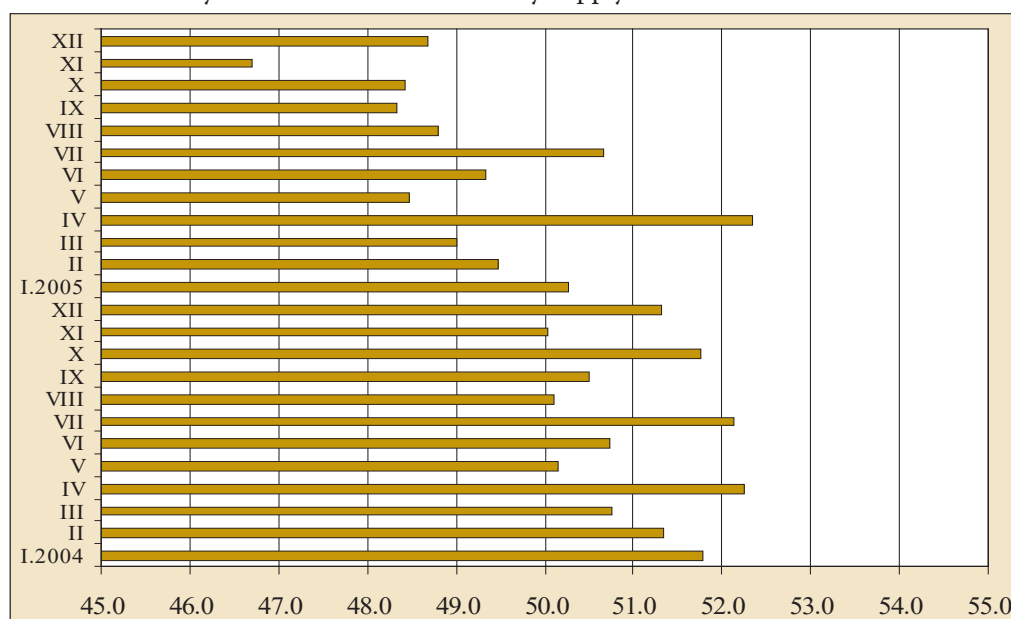
* The foreign currency categories are valued at current exchange rate.

Source: National Bank of the Republic of Macedonia.

At the end of 2005, in line with the movements of the composite categories, their shares in the money supply M1 structure registered positive movements. Thus the faster increase in the demand deposits, relative to the moderate increase in the currency in circulation was reflected by the annual fall in the share of the currency in circulation in the money supply M1 of 2.6 percentage points, which equaled 48.7% on December 31, 2005. The average monthly share of the currency in circulation in the money supply M1 in 2005 equaled 49.2%, i.e. by 1.9 percentage points less relative to the average of the preceding year.

Figure 29

Share of currency in circulation in the money supply M1

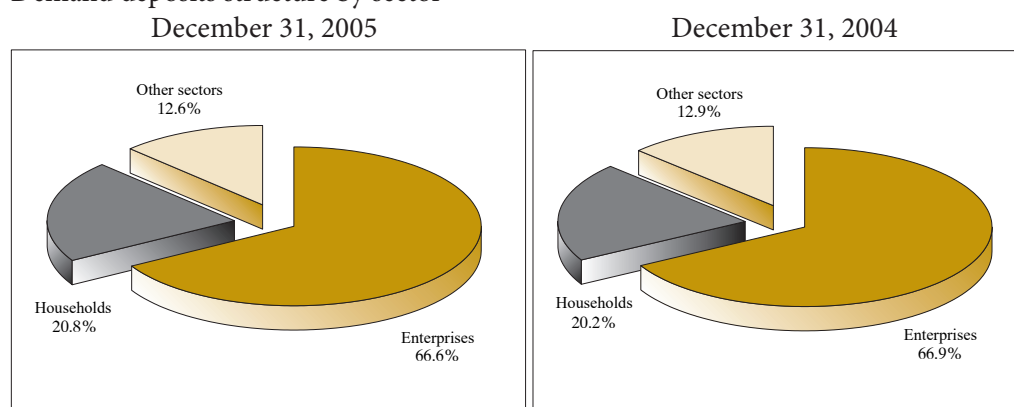


Source: National Bank of the Republic of Macedonia.

The movement of currency in circulation in 2005 was determined by the usual seasonal factors. Thus in line with the lower demand for currency in circulation, at the end of the first quarter, the currency in circulation went down by 6.7%. The moderate increase of 1.4% at the end of the second quarter primarily reflects the increase in the demand for currency in circulation prior to the Easter and Labor Day holidays. In the third quarter of the year, the currency in circulation insignificantly increased by 0.7%, while at the end of the last quarter of 2005 their level went up by 7%, which is in line with the higher seasonal demand at the end of the year, prior to the New Year's and Christmas holidays.

Figure 30

Demand deposits structure by sector



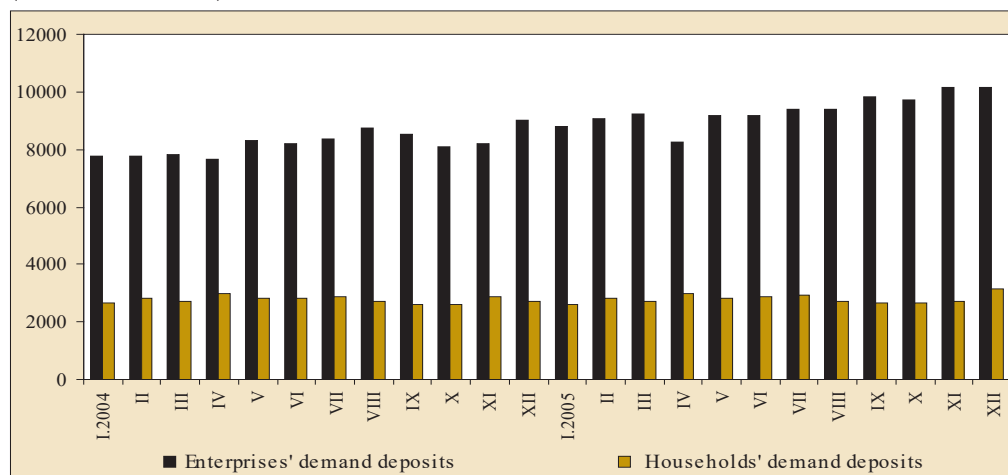
Source: National Bank of the Republic of Macedonia.

The upward trend of the total demand deposits (transaction deposits) went on in 2005, having a simultaneous increase in the transaction deposits of the enterprises and the households. The demand deposits of the enterprises were by 12.9% higher at the end of 2005, relative to the preceding year. Quarterly observed, notwithstanding the usual decrease in the funds on the transaction accounts in the first quarter of the year, the in the first three months of 2005 the enterprises cumulated funds, resulting in a quarterly increase of 2.5%. The second quarter registered a fall in the corporate demand deposits of 0.3%, as a result of the quarterly payment of the value added tax by the small size enterprises and the higher level of import of goods. In the third and the fourth quarter, the enterprises carried on cumulating funds on the transaction accounts, thus resulting in a quarterly increase of 7% and 3.2%, respectively. In 2005, the average monthly level of corporate demand deposits stood at Denar 9,368 million, which is an annual increase of 14.2%. Yet, at the end of 2005, the corporate demand deposits accounted for 66.6% of the total demand deposits structure, which is by 0.3 percentage points less relative to the preceding year.

Figure 31

Demand deposits of enterprises and households

(in millions of denars)



Source: National Bank of the Republic of Macedonia.

The annual growth rate of the household demand deposits in December 2005 equaled 17%. Typical for the household demand deposits over the year was the high variability, resulting in different quarterly dynamics. Thus, in the first quarter of the year, the funds on the households' transaction accounts dropped by 0.6%, whereas in the second quarter they rose by 6.4%. In the third quarter of 2005, in line with the higher need of the households to hold cash prior to the summer vacation period and Ilinden holidays, the household demand deposits dropped by 6.4%. Most significant changed, however, was registered in the last quarter of the year, when the household demand deposits significantly increased by 18.2%. Such dynamics corresponds with the higher level of non-cash transactions on the basis of non-cash payment instruments. At the end of 2005, the household demand deposits made up 20.8% of the total demand deposits, which is an increase of 0.6 percentage points.

Table 14

Components of monetary aggregates *

(in millions of denars)

	Balance as of					Changes by quarters				
	31.12.2004	31.03.2005	30.06.2005	30.09.2005	31.12.2005	I	II	III	IV	Total
Currency in circulation	14,162	13,207	13,390	13,490	14,439	-955	183	100	949	277
Demand deposits	13,433	13,741	13,752	14,416	15,224	308	11	664	808	1,791
Money supply M1	27,595	26,948	27,142	27,906	29,663	-647	194	764	1,757	2,068
Quasi Denar deposits	20,483	23,336	26,335	20,732	24,364	2,853	2,999	-5,603	3,632	3,881
Quasi foreign ex change deposits	40,808	42,495	45,462	48,142	49,107	1,687	2,967	2,680	965	8,299
Money supply M2	88,886	92,779	98,939	96,780	103,134	3,893	6,160	-2,159	6,354	14,248
Non-monetary Denar deposits	3,360	3,111	3,093	3,130	3,057	-249	-18	37	-73	-303
Non-monetary foreign ex change deposits	1,701	1,533	1,809	1,741	1,983	-168	276	-68	242	282
Money supply M4	93,947	97,423	103,841	101,651	108,174	3,476	6,418	-2,190	6,523	14,227

* The foreign exchange categories are evaluated at current exchange rate.

Source: National Bank of the Republic of Macedonia.

In the environment of substantial increase in the total deposit potential of the banking system, in 2005, the broader monetary aggregates went up on annual basis. Thus, at the end of 2005, the monetary aggregate M2 (money supply M1, sight deposits

and deposits with maturity of up to one year) reached Denar 103,134 million and registered an annual growth of Denar 14,248 million, or 16%. The monetary aggregate M2- Denar component went up by 12.4% on annual basis (primarily due to the higher level of short-term deposits in domestic currency with maturity of over three months). The broadest money supply M4 (money supply M2, restricted deposits and long-term time deposits) went up by Denar 14,227 million or 15.1% on annual basis, reaching Denar 108,174 million at the end of the year. At the end of 2005, the monetary multipliers of the money supply M2 and M4 equaled 5.01 and 5.29, remaining unchanged relative to the end of the preceding year.

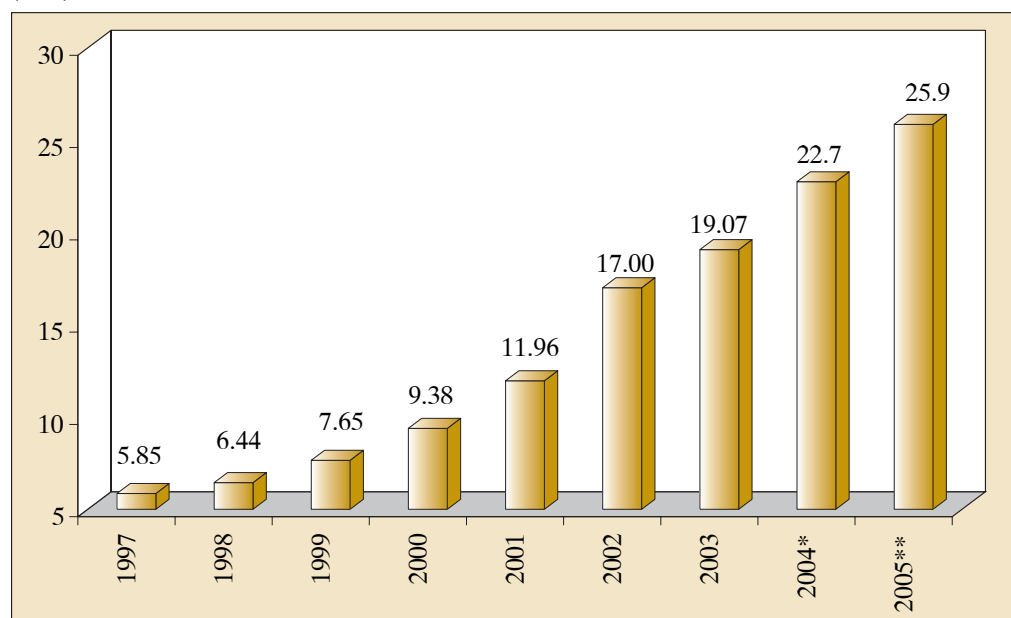
3.3.1. Total deposits

In 2005 (except for July and August) the total deposit potential of the banks steadily increased. The long-year trend of expanding the banks' deposit base is an indicator for the higher confidence of the economic agents in the banking sector, and consequently, higher preferences to save in banks. Also, the higher level of deposits is a basis of strengthening the financial intermediation of the banking sector and therefore, a determinant of the overall investment activity in the country. The positive movements of the deposits is also confirmed by their higher share in the gross domestic product (GDP) equaling 25.9% in 2005, which is by 3.2 percentage points higher relative to the end of 2004.

Figure 32

Share of deposits in the GDP

(in %)



*Preliminary data

** Estimated data

Source: National Bank of the Republic of Macedonia.

At the end of 2005 the total deposit potential of the banking system was valued at Denar 78,511 million, which is an annual increase of Denar 12,159 million, or 18.3%. Most of the increase in the deposit potential, however, is due to the creation

of additional income available to the households by paying the government bonds of the old foreign currency savings and the higher level of private transfers (remittances, rents, pensions), most of which remained in the banking system. Analyzing the maturity structure, having an annual decrease in the long-term deposits of 0.4%, the growth in the total deposits is solely due to the increase in the short-term deposits which registered a substantial annual increase of 19.9%. With respect to the currency of denomination, the foreign currency deposits, as a prevalent category in the total deposits contribute the most to the total deposit growth of 70.5%. At the end of 2005, the foreign currency deposits were by 20.2% higher compared to the preceding year, while the Denar deposits also registered a substantial annual growth of 15%.

Table 15

Total deposits of the banking system*

(in millions of denars)

	Balance as of					Changes by quarters					Annual changes in %	Structure	
	31.12.2004	31.03.2005	30.06.2005	30.09.2005	31.12.2005	I	II	III	IV	Total		31.12.2004	31.12.2005
Total deposits of non-government sector	66,352	70,475	76,699	73,745	78,511	4,123	6,224	-2,954	4,766	12,159	18.3	(in %)	100.0
- Denar	23,843	26,447	29,428	23,862	27,421	2,604	2,981	-5,566	3,559	3,578	15.0	35.9	34.9
- foreign ex change	42,509	44,028	47,271	49,883	51,090	1,519	3,243	2,612	1,207	8,581	20.2	64.1	65.1
I. Short-term deposits ^{1/}	61,291	65,831	71,797	68,874	73,471	4,540	5,966	-2,923	4,597	12,180	19.9	92.4	93.6
- Denar	20,483	23,336	26,335	20,732	24,364	2,853	2,999	-5,603	3,632	3,881	18.9	33.4	33.2
- foreign ex change	40,808	42,495	45,462	48,142	49,107	1,687	2,967	2,680	965	8,299	20.3	66.6	66.8
II. Long-term deposits ^{2/}	5,061	4,644	4,902	4,871	5,040	-417	258	-31	169	-21	-0.4	7.6	6.4
- Denar	3,360	3,111	3,093	3,130	3,057	-249	-18	37	-73	-303	-9.0	66.4	60.7
- foreign ex change	1,701	1,533	1,809	1,741	1,983	-168	276	-68	242	282	16.6	33.6	39.3

1/ Short-term deposits include sight deposits and deposits with maturity of up to one year.

2/ Long-term deposits include deposits with maturity of over one year and restricted deposits.

* Foreign exchange categories are valued at current exchange rate.

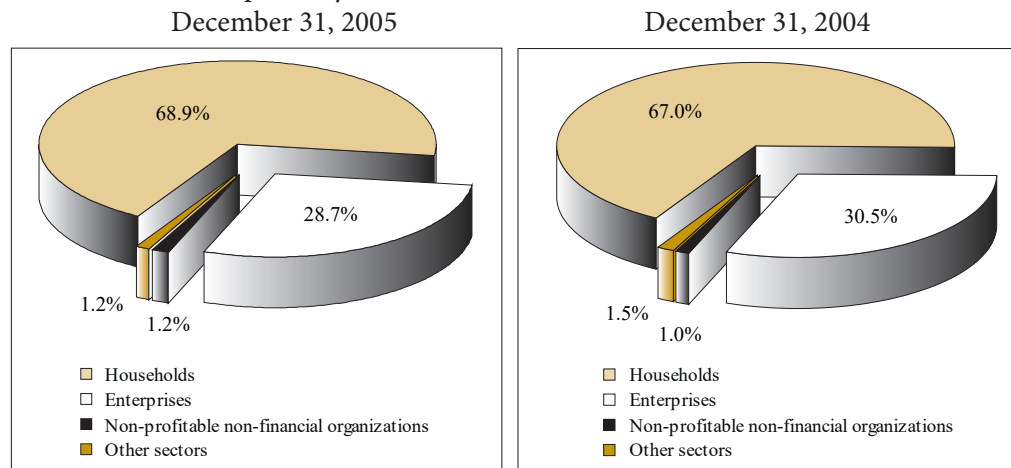
Source: National Bank of the Republic of Macedonia.

The analysis of the quarterly dynamics shows increase in the total banks' deposits in the first two quarters and in the last quarter of 2005, whereas the total deposits with the banks dropped only in the third quarter. Thus, at the end of the first quarter of 2005, relative to the end of the preceding year, the total deposits went up by 6.2%, due to the increase in the short-term deposits (having a simultaneous growth in both the Denar and foreign exchange component). On the other hand, the long-term deposits registered quarterly decrease, primarily due to the fast fall in the long-term deposits of the households. The increase in the second quarter of the year equaled 8.8% and reflects the inflow on the household accounts from the payment of the seventh installment of the government bonds for the old foreign currency savings and the higher amount of cumulated short-term and long-term deposits by the enterprises. The positive quarterly dynamics registered in the previous two quarters was interrupted in the third quarter by the decrease in the total deposits of 3.9%, primarily due to the steep fall in the short-term Denar deposits. Such dynamics was a result of the withdrawal of short-term Denar deposits of one large domestic enterprise for dividend payment⁵². In the last quarter of 2005, the total deposits of the banks rose by 6.5%, owing to the inflows on the household accounts from the payment of the installment of the bond for old foreign exchange savings in October and the higher Denar savings of the enterprises.

52. It was extraordinary higher amount of paid dividend that resulted in deviation of the total deposits movement from the ordinary movements.

Figure 33

Structure of total deposits by sector



Source: National Bank of the Republic of Macedonia.

In 2005, the total households' deposits steadily increased, reaching Denar 54,082 million on December 31, 2005, which is a considerable annual growth of Denar 9,645 million or 21.7%. The positive annual dynamics indicates ongoing strengthening of the confidence of the households in the banking system, and higher propensity to save in the banks, as a result of the attractive interest rates. Thus, most of the increase was generated by the additional inflows on the households' accounts based on the payment of the bonds for the old foreign currency savings, kept by the households in the banking system as short-term deposits (sight deposits and deposits with maturity of up to three months). Having an annual decrease in the long-term deposits, the annual growth in the total deposits of the households is fully determined by the increase in the short-term deposits. Observing the currency of denomination structure, the foreign currency deposits remain a dominant form of savings of the households, constituting 70% of the annual growth. With respect to the quarterly dynamics, the total deposits of the households permanently increased in all four quarters of the year. In the first quarter of 2005, the households' deposits went up by 5.9%, primarily due to the higher preferences of the households to save on a short run in domestic and foreign currency. At the end of the second quarter, the households' deposits went up by 6%, partially due to the inflows in the account on the basis of the payment of the April installment of the government bonds for the old foreign currency savings, and consequently, the faster growth in the Denar deposits (by 8.3%, relative to 5.1% increase in the foreign exchange deposits). Having lower Denar sight deposits, in the third quarter of the year, the positive dynamics of the total households' slowed down, resulting in moderate quarterly growth of 1.7%. In the last quarter of 2005, the growth fastened and equaled 6.6%, primarily a result of the keeping of a portion of the funds based on the payment of the October installment of the government bonds for the old foreign currency savings, and the higher propensity of the households to save in foreign currency on a long run.

Table 16

Total household and corporate deposits

(in millions of denars)

	Households			Enterprises		
	31.12.2005	annual changes (in %)	Contribution to the grow th in total deposits	31.12.2005	annual changes (in %)	Contribution to the grow th in total deposits
Total	54,082	21.7	79.3	22,559	11.6	19.4
- Short-term	51,315	23.4	79.9	21,255	11.4	17.8
- Long-term	2,767	-3.1	-*	1,304	16.3	-*
- Denar	14,777	24.4	80.9	11,037	4.7	14.0
- foreign ex change	39,305	20.7	78.7	11,522	19.2	21.6

* negative change in the total long-term deposits is solely due to the fall in the long-term household deposits

Source: National Bank of the Republic of Macedonia.

At the end of 2005, the total corporate deposits were valued at Denar 22,559 million, which is by Denar 2,353 million, or 11.6% more relative to the end of the preceding year. The positive annual change primarily reflects the preferences of the corporate sector to short-term depositing and indicates an intensified trend of saving in foreign currency. Thus, from the aspect of maturity structure, the short-term deposits still dominate the structure of the corporate deposits, accounting for 92.2% of the total annual growth. Analyzing the currency of denomination, having higher inflows from export and liberalization of the foreign exchange regime, the foreign currency deposits steadily increase their share in the total corporate deposits, illustrated by their contribution of 78.8% in the total annual growth. Observing the quarterly dynamics, at the end of the first quarter of 2005, compared to the end of the preceding year, the total corporate deposits surged by 5.5%, owing to the higher Denar deposits with maturity of over three months and short-term foreign currency deposits. In the second quarter of the year, the increase in the corporate deposits fastened and equaled 16%, having a simultaneous increase in the short-term Denar and foreign currency savings and the restricted foreign currency corporate deposits. The positive dynamics of the corporate deposits was interrupted in the third quarter of the year, registering a fall of 15.3%. In environment of higher foreign currency deposits, the fall in the third quarter of the year is due to the lower Denar deposits, due to the payment of dividend by one larger domestic company. In the last quarter of the year, the total corporate deposits went up by 7.6%, with simultaneous increase being registered in both the short-term and long-term deposits.

Certain movements in the shares by sector in the total deposit structure were registered at the end of 2005. Thus the households' deposits make up 68.9% of the total deposits, which is an annual increase of 1.9 percentage points, whereas the corporate deposits constituted 28.7% of the total deposits, at the end of the year, which is a decline of 1.8 percentage points.

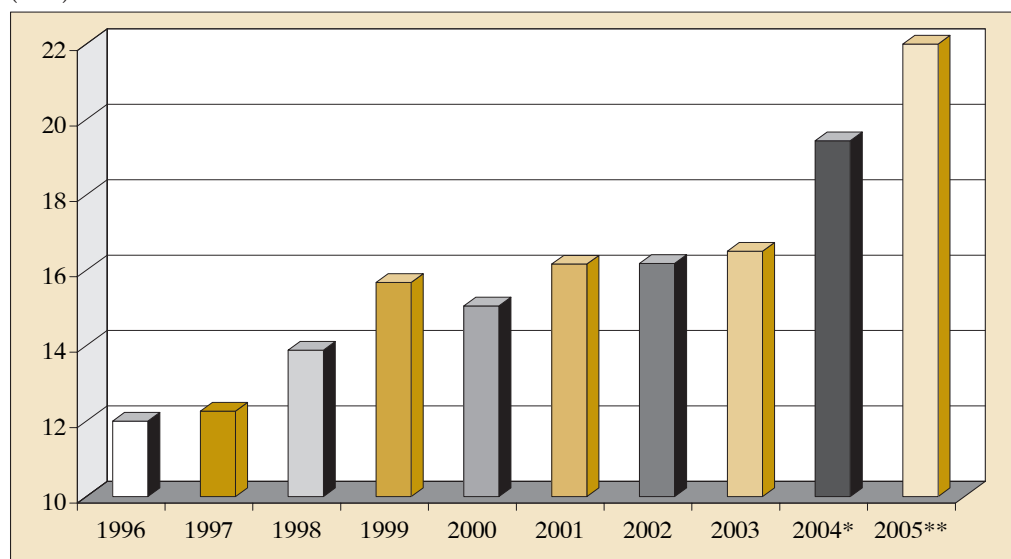
3.4. Banks' placements

In 2005, the banks actively supported the process of accelerating the economic activity by intensive lending to the private sector. Thus, at the end of December 2005, the banks' total placements to the private sector⁵³ amounted to Denar 68,777 million, which is by 20.5% more relative to the end of the preceding year. In line with such movements, the share of banks' placements in the GDP⁵⁴ increased by 2.9 percentage points on annual basis, reaching 22.3%, indicating a strengthened financial intermediation.

Figure 34

Share of credits in the GDP

(in %)



* Preliminary data on the GDP value.

**Estimated GDP value.

Source: National Bank of the Republic of Macedonia.

Several factors account for the more intensive lending to the private sector by the banks in 2005: a) increase in the deposits as a basis of lending activity; b) expansion of the supply of the types of credits and conditions for their approval; c) more active usage of the available foreign currency potential by the banks and their borrowing from abroad. In December 2005, the share of the accounts with foreign banks in the total bank assets dropped by 3 percentage points on annual basis. Simultaneously, the banks showed higher interest in using credit lines from abroad (long-term credits from foreign banks went up by 1.7 times annually), intended for financial support of the private sector. As a result, the foreign currency liabilities of the banks rose by 42.3% on annual basis, which in the environment of moderate annual growth in the banks' foreign assets of 1.8% reduced the net foreign assets of the banking system by 13.2% on annual basis. Consequently, the net foreign assets - to - total foreign currency deposits ratio of the banking sector equaled 0.46 in December 2005, compared to 0.64 in December 2004.

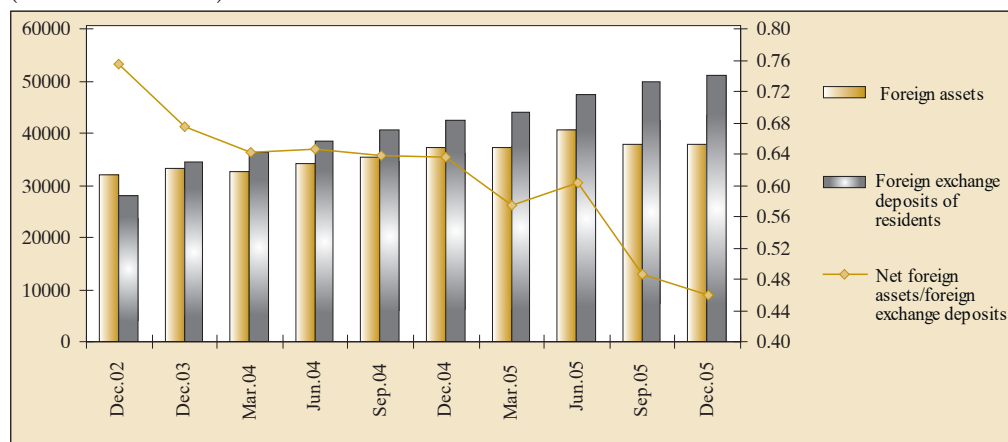
53. Since January 2005, the banks' credits have been analyzed void of the amount of the accrued interest by credit.

54. Estimated GDP data for 2005.

Figure 35

Residents' foreign assets and foreign currency deposits in the banks

(in millions of denars)



Source: National Bank of the Republic of Macedonia.

In 2005, the annual increase in the total banks' placements was almost evenly distributed in all four quarters of the year. Thus, the first quarter registered a quarterly rate of 5,6%, constituting 27.5% of the annual growth in the total credits. In the next three quarters, the total placements grew with identical rate of 4.5%, contributing to the annual increase in the total placements with roughly 24%, respectively, by quarter.

The analysis of the currency of denomination structure of the total placements in 2005 indicates positive dynamics of the domestic and foreign currency credits, registering virtually identical contribution of both Denar⁵⁵ and foreign currency placements to the increase in the total placements (50.7% and 49.3%, respectively). Thus, the denar credits went up by 12.9% on annual basis, reflecting primarily the intensified lending to households by the banking sector.

Table 17

Domestic credits of deposit banks *

(in millions of denars)

	Balance as of 31.12.2005	Annual changes		Contribution to the growth in total placements (in %)
		in millions of denars	in %	
Total placements of banks to private sector	68,777	11,680	20.5	
In Denars	51,672	5,922	12.9	50.7
In foreign currency	17,105	5,758	50.7	49.3
Short-term	30,915	1,148	3.9	9.8
Long-term	37,862	10,532	38.5	90.2
Enterprises	46,987	5,306	12.7	45.4
Households	21,625	6,349	41.6	54.4

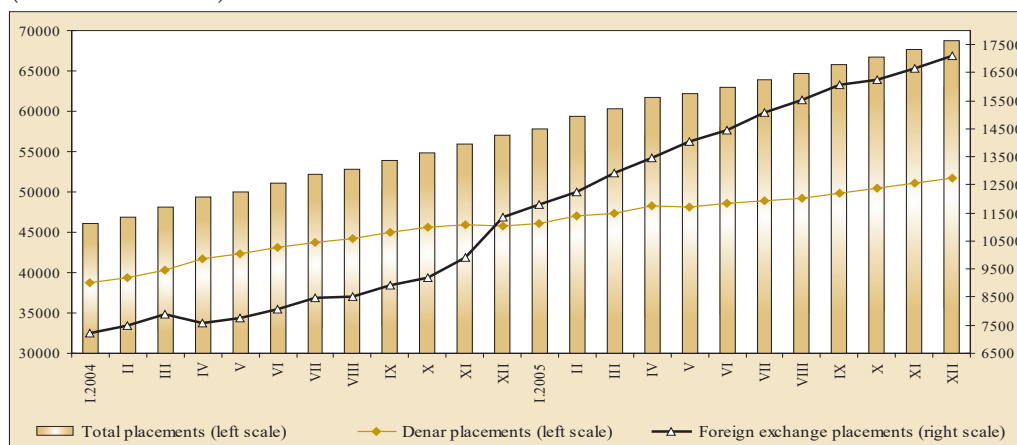
*Foreign exchange categories are valued at current rate.

Source: National Bank of the Republic of Macedonia.

55. Includes foreign exchange indexed lending.

On the other hand, the higher preferences of the enterprises to borrow in foreign currency, as a less expensive source of credit financing, resulted in faster annual increase in the foreign currency placements. Thus, the total foreign currency placements surged by 50.7% at the end of December 2005 relative to the end of the preceding year. A part of the annual change in the foreign currency credits was generated by the additional foreign currency inflows of the banks from international credit lines.

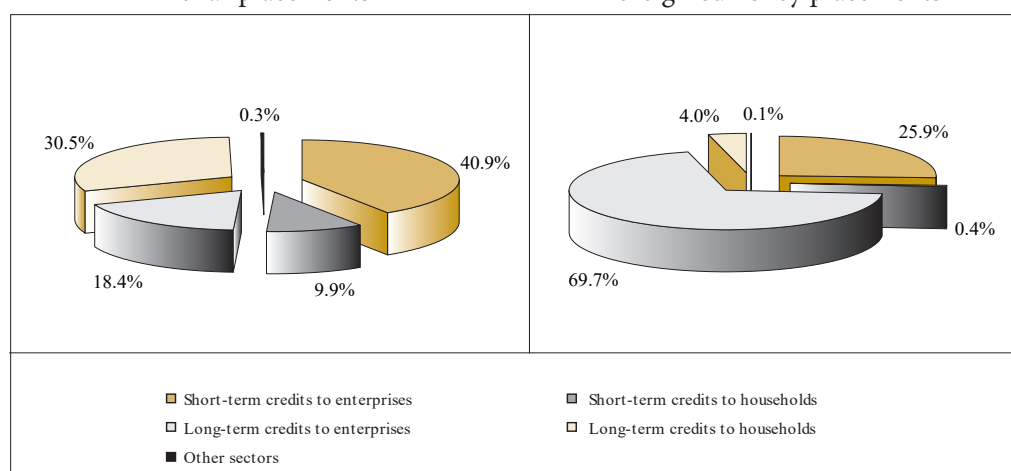
Figure 36
Banks' placements
(in millions of denars)



Source: National Bank of the Republic of Macedonia.

With respect to the maturity, in 2005 the banks were more eager to lend on a long run. The long-term credits increased by 38.5% on annual basis, with their share in the total credits being by 8.5 percentage points higher (in 2005, the long-term credits accounted for 52.1% of the total credits, on average, compared to 43.6% in 2004). The short-term credits grew moderately, being by 3.9% higher at the end of December 2005, relative to the end of the preceding year.

Figure 37
Maturity and sector structure of the banks' placements on December 31, 2005



Source: National Bank of the Republic of Macedonia.

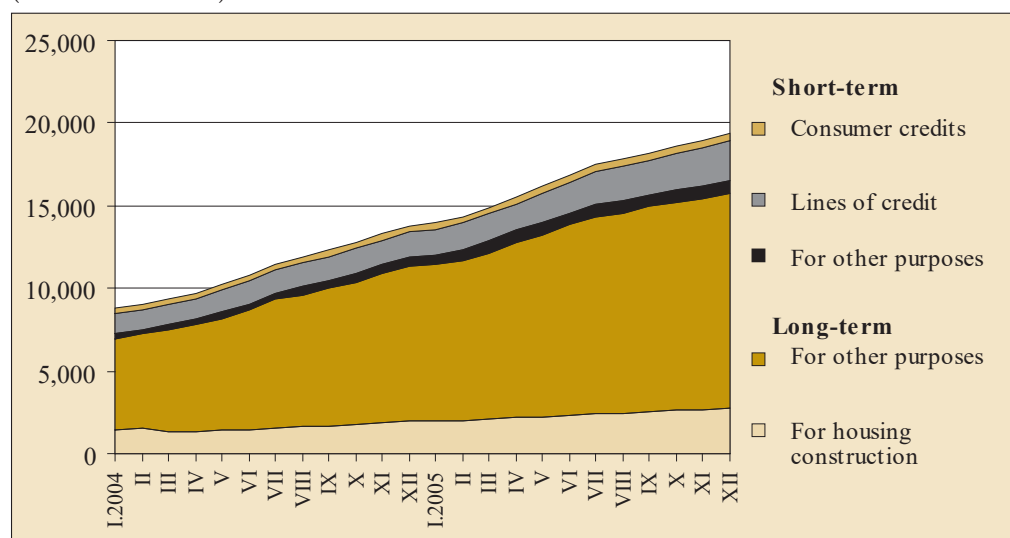
In 2005, the banks permanently lend to enterprises and households, which is an additional incentive to the process of accelerating the economic growth. Thus in 2005, the banks' credit policy was primarily targeted towards the "households" sector by further expansion of the supply of credits and diversification of credit conditions. The credits to the households made up 54.4% of the increase in the total placements, relative to 45.4% of the credits to the corporate sector. This made the lending to the households more important factor in the structure of the banks' Denar placements, and simultaneously acted towards encouraging the demand. On the other hand, the intensive lending to enterprises for the purposes of supplementing their long-term sources of funds is a leading indicator for the higher investment consumption.

At the end of December 2005, the total placements to households stood at Denar 21,625 million, which is an increase of 41.6% relative to December 2004. The analysis of the currency of denomination structure of the total placements to the households shows high preferences of the households to borrow in domestic currency. The Denar credits registered a fast annual increase of 40%, constituting 94% of the increase in the total credits to the households. The foreign currency placements went up by 2.1 times on annual basis, but their share in the total placements to the households remains low, equaling 2.9%, on average, in 2005. With respect to the currency of denomination structure, the long-term lending to the households dominates (in 2005, the long-term lending accounted for 76.2%, on average, of the total credits to the households), making the long-term credits higher by 41.2%. Positive annual change was registered in all categories of long-term credits, with the increase in the domestic currency credits registering faster increase (primarily housing credits and credits for other purposes). The short-term credits went up by 42.9% on annual basis, having a higher volume of approved consumption credits, credit commitments⁵⁶ and credits for other purposes (increase of 11.9%, 1.6 times and 35.1%, respectively).

Figure 38

Distribution of Denar credits to households by type of credit

(in millions of denars)



Source: National Bank of the Republic of Macedonia.

56. Negative balances by current account.

In 2005, the bank credits represented significant sources of financing for the enterprises. The total placements to enterprises increased by 12.7% on annual basis, reaching Denar 46,987 million at the end of December 2005. The annual increase in the placements to enterprises is solely generated by the high level of approved foreign currency credits (growth of 50.3%), mainly owing to the attractive interest rates on such credits. Most of these funds were intended for payment of external due liabilities, making up 48.6% of the total foreign currency credits to the enterprises in December 2005. The Denar placements to enterprises slightly fell by 0.5% on annual basis, given the lower lending in Denars on a short run (by 3% on annual basis). In line with such developments, annual decrease of 1.9% was registered in the short-term credits. Considering that most of the foreign currency credits are long-term, the total long-term credits registered a fast increase of 37.3% on annual basis. Consequently, the maturity structure of the total placements to enterprises registered positive movements, i.e. increase in the share of long-term credits (by 8.2 percentage points relative to the preceding year), indicating higher investment activity and development of the corporate sector.

In 2005 the level of overdue claims and suspicious and contested claims of the banks reduced⁵⁷, implying more suitable credit portfolio management by the banks, higher financial discipline and higher creditworthiness of the clients.

3.5. Interest rates

In 2005, in line with the favorable developments on the foreign exchange market and solid macroeconomic performances, the interest rate movement registered positive changes. The fourth quarter of 2005 witnessed the start of the trend of market reduction of CB bills interest rate (after switching towards "interest rates tender"), followed by the reduction in the interest rate on the money market and Treasury bills. On the other hand, the banks' interest rate policy in 2005 registered no essential changes.

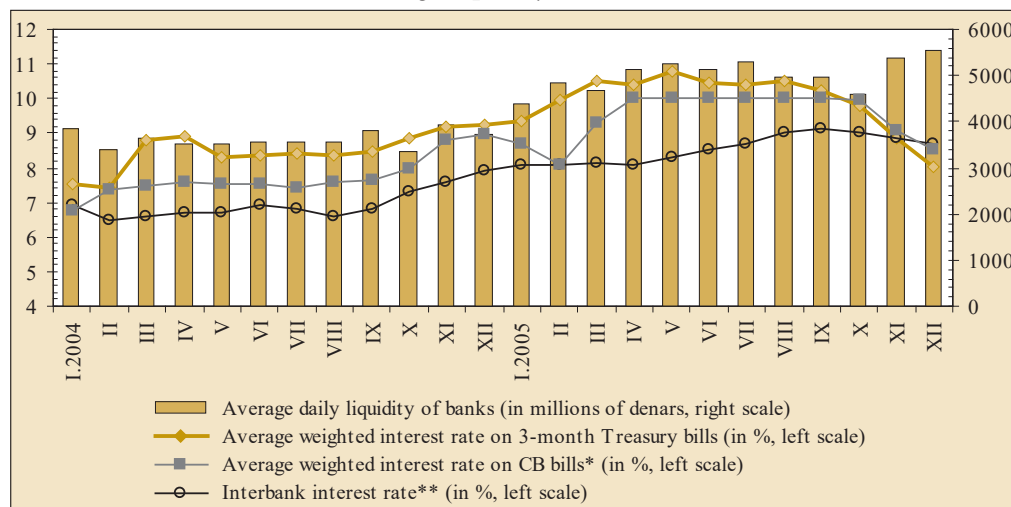
Except for the CB bills interest rate, other NBRM interest rates remained unchanged in 2005. The discount rate (underlying the calculation of penalty interest rates) and the Lombard credit rate⁵⁸ (as an indicator for the maximum interest rate in the interest rates set) remained the same as in the previous year, that is 6.5% and 13%, respectively.

57. The banks' overdue claims classified in three highest risk categories made up 10.9% of the total credit exposure of the banks at the end of 2005, which is by 2.3 percentage points less relative to the preceding year.

58. Collateralized short-term credits for overcoming the temporary liquidity problems of the banks, that belong to the group of monetary instruments - "standing facilities".

Figure 39

Short-term interest rates and average liquidity of banks



* Average weighted interest rate on CB bills in all available maturity periods.

**Average weighted interest rate on the interbank money market (institutionalized and non-institutionalized).

Source: NBRM, Money and short-term securities market and Ministry of Finance.

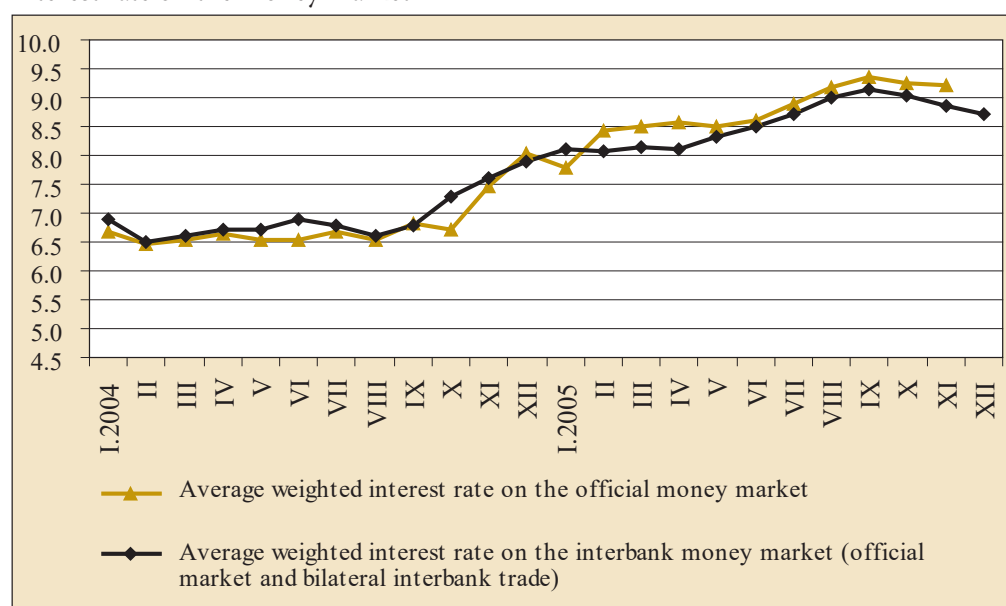
The interest rate on 28-day CB bills, as a reference rate⁵⁹ in the set of NBRM interest rates is the major indicator for the monetary policy design. Thus, in the environment of high liquidity over the year, the interest rate on 28-day CB bills in the first three quarters of 2005 remained at an attractive level of 10%, at "volume tender" auction. It also signalizes the direction of the monetary policy, which by the means of sterilizing the excess liquidity ensured stability of the intermediary goal - exchange rate. Analyzing the dynamics, in the first three months of 2005, the NBRM held 7-day and 28-day CB bills "volume tender" auctions and fixed interest rate of 7% and 10%, respectively. The average weighted interest rate in the first quarter equaled 8.7%. By stabilizing the public consumption and in line with the general liquidity level, in the first quarter, the NBRM made two changes in the CB bills auctions. On January 20, 2005, the NBRM abolished the everyday 7-day CB bills auctions and continued holding them twice a week (same as the 28-day CB bills), and on March 9, 2005, the 7-day CB bills were completely abolished. Such change resulted in higher level of average weighted interest rate on CB bills (from 8.1% in February, to 9.3% in March 2005). Since the second quarter of 2005, the average weighted interest rate refers only to interest rate on 28-day CB bills, which remained unchanged (10%) to the last quarter of the year. In environment of favorable developments on the foreign exchange market and solid performances in the real and the external sector of the economy, on October 26, 2005 the NBRM switched towards CB bills "interest rate tender" auctions, which implies market setting of interest rates. Since the demand was permanently higher relative to the supply, the CB bills interest rate was steadily reducing over the last three months (from 9.95% in October, to 8.52% in December 2005).

59. On the basis of an empirical analysis, the interest rate on 28-day CB bills is being considered to be a reference interest rate.

The changes in the dynamics of holding 7-day CB bills auctions, and their abolishment in the first quarter of 2005, were aimed at reducing the NBRM presence on the liquid funds market and at the same time to make the banks channel the excess, i.e. shortage of liquidity within the institutionalized money market (as well as within the bilateral interbank dealings). Over the recent years, the interest rate on the money market shows the highest responsiveness to the changes in the reference interest rate. This could be illustrated by the fact that having unchanged interest rate on CB bills (over most of 2005), the weighted interest rate on the interbank money market (institutionalized and non-institutionalized market) in 2005 reflected poor monthly variability, and equaled 8.6% on average (increase of 1.6 percentage points compared to the preceding year). The interest rate on the institutionalized money market equaled 8.8%⁶⁰ on average, which is by 2 percentage points higher relative to the average interest rate in 2004.

Figure 40

Interest rate on the money market *



* In December 2005, no transactions were executed on the official money market, so that no interest rate was being set.

Source: National Bank of the Republic of Macedonia and Money and Short-term Securities Market.

With respect to the quarterly dynamics, monitoring the changes in the monetary policy design from the last quarter of 2004⁶¹, the average weighted interest rate on the interbank money market (on its both segments) registered a quarterly increase of 0.5 percentage points, equaling 8.1% on average, in the first quarter of 2005. The upward trend of the average weighted interbank interest rate continued in the following two quarters, having relatively high level of liquidity in the banking system and unchanged reference interest rate. Thus the average interbank interest rate increased from 8.3% in the second quarter, to 8.9% in the third quarter. In the last quarter of 2005, the switch

60. The 2005 average does not include December, when no transactions were being executed on the official money market.

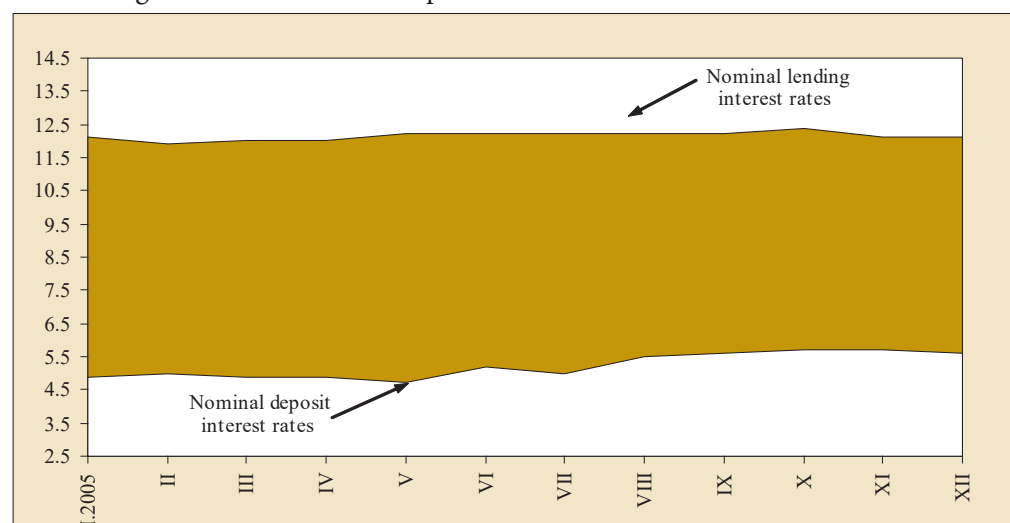
61. The fourth quarter (November 12, 2004), witnessed the last increase in the interest rate on CB bills, with the interest rate on 28-day CB bills equaling 10%.

in the type of tender at the CB bills auctions⁶² resulted in a trend of steady reduction of the average interbank interest rate, reducing it from 9% in October 2005 to 8.7% in December 2005. The average weighted interest rate on the interbank money market equaled 8.9%, on average, in the fourth quarter.

In 2005, there were no significant changes in the banks' interest rate policy⁶³, considering that the interest rate remained unchanged at 10% over the most of the year. Thus, the average weighted lending interest rate on Denar credits in any maturity and sector compared to January 2005⁶⁴ remained unchanged, equaling 12.1% in December 2005. Nevertheless, the interest rates on some categories of credits to households reduced, illustrating the further orientation of the banks towards the households sector, as more diversified and less risky sector. Thus the interest rate on short-term Denar credits to households equaled 19.4% in December 2005, compared to 20.2% in January 2005, whereas the interest rate on short-term indexed foreign currency credits to households reduced from 11% in January 2005 to 8.1% in December 2005. The average weighted deposit interest rate on Denar deposits in any maturity and sector equaled 5.6% in December 2005, which is an increase of 0.7 percentage points relative to January 2005. In line with such movements, the interest spread reduced by 0.7 percentage points relative to January 2005, thus reducing to 6.5 percentage points in December 2005.

Figure 41

Banks' weighted interest rates and spreads *



* Pertain to Denar credits and deposits in any maturity and sector, also including foreign exchange indexed credits and deposits.

Source: National Bank of the Republic of Macedonia.

62. On October 26, 2005, the NBRM switched from "volume tender" to "interest rate tender" CB bills auctions.

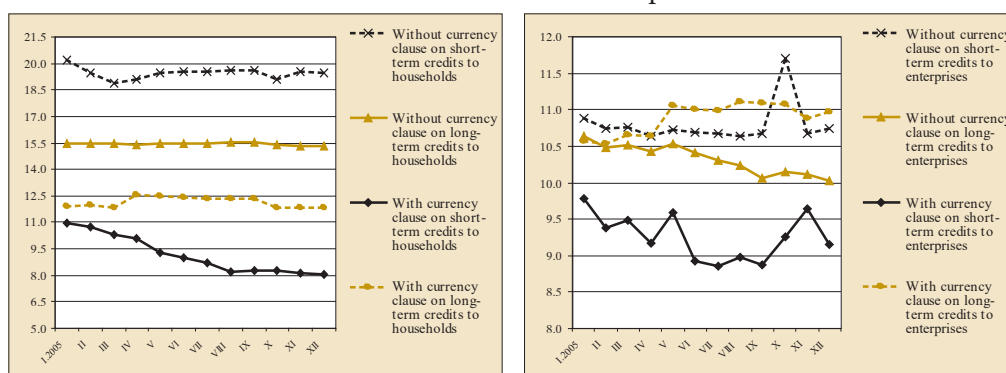
63. In October 2005, the NBRM started applying the new Methodology for calculating the banks' interest rates, with the interest rates since early 2005 being reviewed in line with the new methodology. With the new more analytical approach, the foreign currency interest rate are being treated as equal as the Denar interest rates, while within the Denar interest rates, a distinction between the interest rates on foreign exchange indexed and non-indexed credits was made for the first time.

64. The data on banks' interest rates according to the new methodology have been available from January 2005. As of 2004 inclusive, the lending interest rate on short-term Denar credits and deposit interest rate on three-month Denar deposit were used as reference interest rates, which in 2004 equaled 12.5% and 6.5%, respectively, on average.

Within the set of lending Denar interest rates, in 2005 the highest interest rates were registered in the short-term and long-term Denar credits allocated to the household sector (19.5% and 15.4%, on average, respectively). On the other hand, the interest rates on short-term and long-term foreign currency indexed credits to the households were lower, equaling 9.2% and 12.1%, on average, respectively, in 2005. The analysis of the interest rates on Denar credits made to enterprises shows extremely low spread between the interest rates on short-term and long-term Denar credits, which in 2005 equaled 10.8% and 10.3%, respectively, on average. Taking into account the lower currency risk, the banks offered lower interest rates on foreign currency indexed short-term and long-term credits to the enterprises, which in 2005 equaled 9.3% and 10.9%, respectively, on average. With respect to the deposit interest rates, the most attractive was the average interest rate on corporate Denar deposits with maturity of up to three months and households Denar deposits with maturity of over one year (of 7.9%).

Figure 42

Interest rates on Denar credits to households and enterprises in 2005



* The increase in the interest rate on short-term Denar credits to enterprises in October 2005 is primarily a result of the higher interest rate on such credits of one larger bank, which has a significant share in the total amount of Denar credits allocated to enterprises.

Source: National Bank of the Republic of Macedonia.

In 2005, the average weighted interest rate on foreign currency credits in any maturity and sector equaled 7.7%, on average. The highest interest rates of 16.2% and 10.6%, respectively were registered on short-term and long-term credits to households in Euro. On the other hand, the price of lending to enterprises was lower, on average, equaling 7.4% on short-term credits in Euro (and in US Dollar), and 7.8% on long-term foreign currency credits in Euro. The average weighted interest rate on foreign currency deposits in any maturity and sector equaled 1.3%, on average, in 2005. Thus, in 2005, the interest rate on time Euro deposits (in any maturity) of enterprises and households was identical, equaling 1.8%, on average, whereas the interest rates offered by the banks to enterprises and households on time US Dollar deposits (in any maturity) varied and equaled 2.6% and 1.6%, respectively.



Denarius (silver), issued during the reign
of the Roman Emperor Traianus (103 - 111).
From the NBRM collection.



**Financial markets in
the Republic of Macedonia**

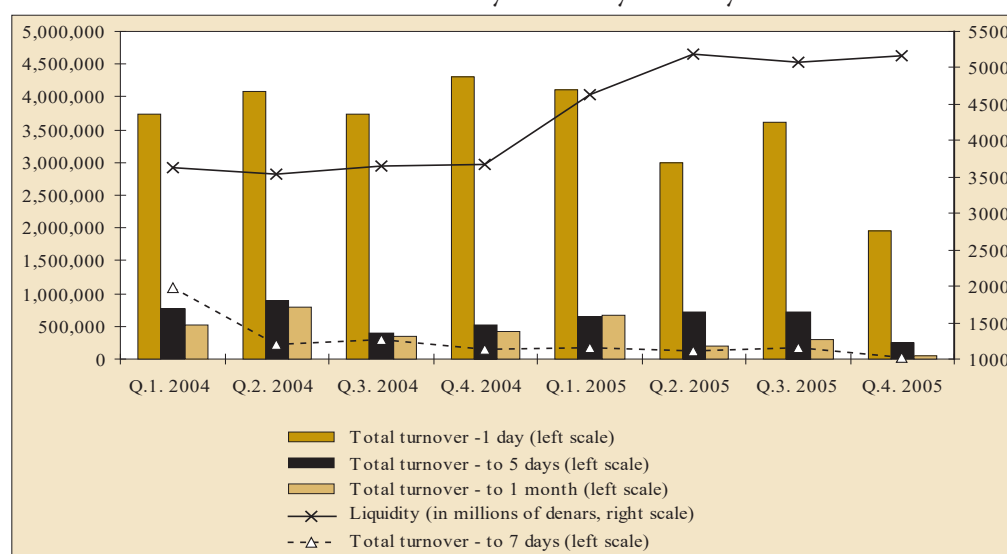
IV. Financial markets in the Republic of Macedonia

4.1. Money market

In 2005, the activity on the interbank money market decreased relative to 2004, which, having larger importance of the bilateral interbank trading, is due to the sharp drop in the turnover on the institutionalized segment. The low volume of trading on the interbank money market indicates high liquidity in the banking system, with lower liquidity management being manifested only in some banks. In 2005, the turnover in the total interbank transactions (institutional and bilateral interbank trade) amounted to Denar 17,163.9 million, which is by 24.8% less relative to the preceding year. The fall is a result of the 60.2% lower institutionalized trading, whereas the volume of bilateral interbank trading increased by 1.4%.

Figure 43

Structure of turnover on interbank money market by maturity



With respect to maturity on the interbank money market, the one-day borrowings dominated in 2005, particularly evident in the first quarter of 2005 when the liquidity of the banking system was lower. The high demand for Denar liquidity in this period partially reflects the NBRM decision on increasing the reserve requirement rate, initially creating the need of higher level of funds on accounts with NBRM⁶⁵. The liquidity of the banking system evidently improved in the second quarter, due to which the overnight interbank credits reduced in volume. In line with the lower average liquidity relative to the preceding quarter, the volume of overnight credits increased in the third quarter. The improved liquidity of the banking system, which is due, to

65. The NBRM Decision on increasing the reserve requirement rate (on Denar and foreign currency deposits) from 7.5% to 10% entered into force on January 11, 2005.

a certain extent, to the switch in the CB bills auctions tender (from volume tender to interest rate tender), effectuated in October, brought about halving the volume of concluded overnight credits in the fourth compared to the first quarter of 2005.

The total turnover in 2005 on the institutionalized money market stood at Denar 3,980 million⁶⁶, which is by 59.5% less, compared to 2004. The turnover was reduced given the simultaneous fall in both the demand and supply of liquid funds of 58.3% and 54.9%, respectively. Thus, the total demand was by 0.7% lower compared to the supply, and the transactions executed made up 75.7% of the demanded liquid funds. The average share of the transactions concluded on the institutionalized interbank money market equaled 21.1% in 2005 (42.4% in 2004).

Opposite of the lower activity on the institutionalized money market, the share and the turnover in the bilateral interbank trade increases, mainly owing to the velocity and the lower costs of the bilateral interbank transactions. June witnessed the highest share of transactions concluded on the institutionalized money market in the total interbank trade (40.7%), whereas no trade was made on this segment in December. In 2005, the total bilateral interbank trade reached Denar 13,301.4 million. The average monthly share of the turnover in the bilateral trade in the total interbank turnover equaled 78.9%, compared to 57.6% in 2004, registering a cumulative growth of 1.4%. Also, March registered the highest preference for direct interbank trade (the turnover constituted 89%, or Denar 2,047.8 million of the total interbank turnover).

The average daily turnover on the institutionalized money market totaled Denar 49.4 million (counting the days of executed purchase and sale transactions). With respect to the transaction maturity, in 2005, 30.3% of the total executed transactions are with maturity of one day, 22.1% are two-day transactions, 27.2% are three-day transactions, whereas the remaining are transactions with maturity of over three days (by fifteen days).

Table 18

Review of trade on the institutional money market

Month	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 %)	
	2004	2005	2004	2005	2004	2005	2004	2005
I	1,038.6	449.5	901.6	487.5	822.6	412.5	6.67	7.77
II	1,774.1	325.0	1,357.6	414.5	1,336.6	258.0	6.48	8.44
III	1,356.5	473.3	712.0	450.3	674.0	256.8	6.52	8.50
IV	1,153.2	441.5	1,245.2	475.5	1,012.2	336.5	6.66	8.59
V	1,308.0	511.5	1,290.0	555.5	1,128.0	452.5	6.55	8.51
VI	1,369.5	633.8	1,431.0	672.0	1,131.0	622.8	6.52	8.61
VII	1,365.5	611.2	1,457.0	1,015.5	1,135.0	541.0	6.67	8.88
VIII	1,285.5	435.5	966.0	445.0	912.0	400.0	6.55	9.20
IX	673.5	512.1	624.5	508.9	489.5	470.9	6.80	9.35
X	589.0	387.5	617.0	193.5	547.0	192.5	6.73	9.24
X I	492.0	512.5	691.5	36.5	432.5	36.5	7.45	9.23
X II	278.4	0.0	368.6	0.0	218.4	0.0	8.03	0.00
Total	12,683.8	5,293.4	11,662.0	5,254.7	9,838.8	3,980.0	6.80	8.03

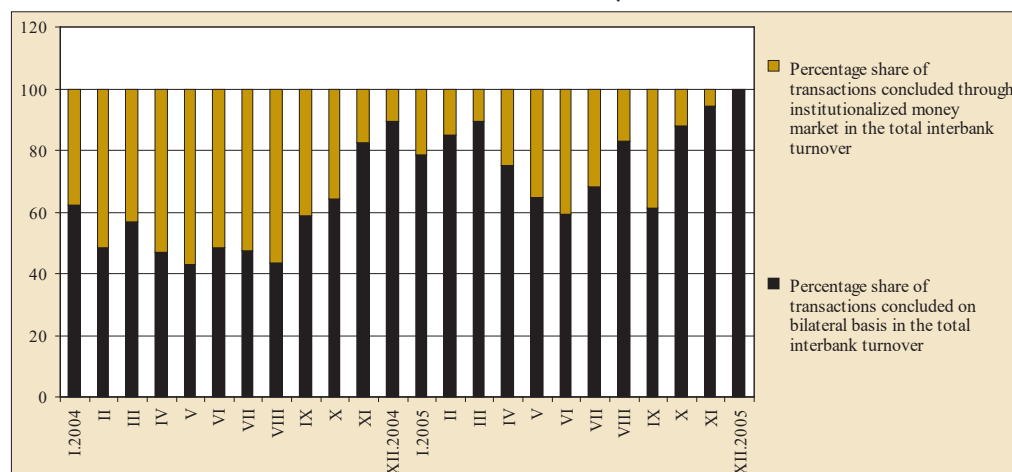
Source: Money market.

66. Including banks and savings houses. The turnover of the savings houses accounts for only 3% of the total transactions conducted on the institutional money market.

Observing the dynamics, the highest turnover on the institutionalized money market in 2005 was registered in June (Denar 622.8 million), when the supply of liquid funds was the highest. Analyzing the ratio between the supply of and the demand for liquid funds, the discrepancy was the most evident in July (the demand exceeded the supply by 66.1%). July witnessed the highest demand for Denar liquidity, partially corresponding to the high net-purchase of foreign currency in this month by the banks, within the currency exchange operations.

Figure 44

Review of the structure of trade on interbank money market



*Does not include the savings house transactions.

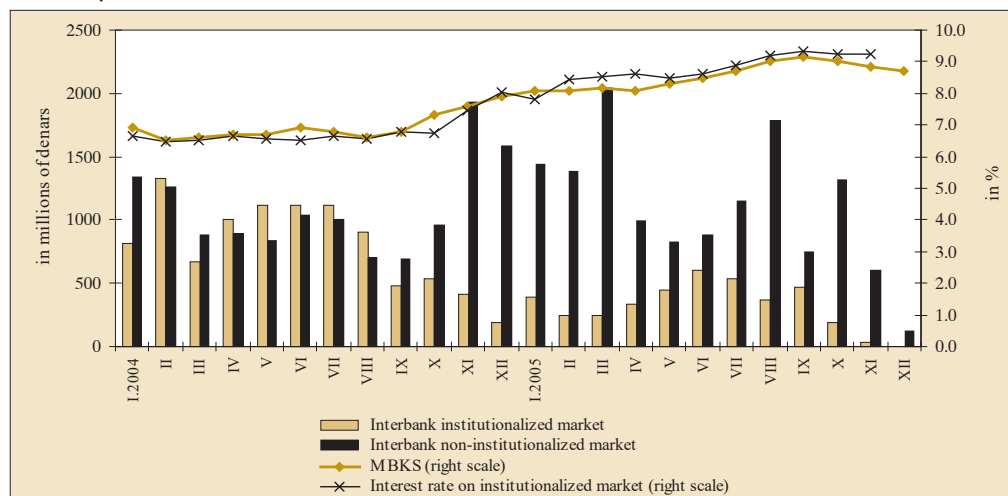
Source: Money market and National Bank of the Republic of Macedonia.

Analyzing the movement of interest rates, the average weighted interbank interest rate (MBKS) on the both money market segments, in 2005 equaled 8.6% (6.9% in 2004), ranging from 8.1% to 9.1%, observed by month in the year. The average monthly weighted interest rate on the institutionalized money market⁶⁷ in 2005 equaled 8.0%, which is an increase of 1.2 percentage points compared to the preceding year. The average monthly interest rate on the institutionalized market segment ranged from 7.8% to 9.4%. Since October, the switch towards interest rate tender CB bills auctions by the NBRM, which results in lower interest rates on this monetary instrument, was also aimed at initiating a downward trend of the MBKS, considering the high degree of their positive inter-correlation.

67. Analyzed only on the basis of interbank transactions.

Figure 45

Turnover on the interbank money market, interbank interest rate (MBKS in any maturity) and interest rate on the institutionalized market



Source: Money market and National Bank of the Republic of Macedonia.

4.2. Stock Exchange

The total stock exchange turnover (including block transactions and government segment) on the Macedonian stock exchange in 2005 stood at Denar 8,889.6 million, which is by 6.9% more relative to the turnover in 2004. The transactions conducted on the official and non-official market⁶⁸ segment constituted 69.7% and 5.7%, respectively, of the total stock exchange turnover. The block transactions make up 19.6% of the total stock exchange turnover, while the government stock exchange segment traded in government-owned shares and stakes accounting for 5% of the total stock exchange trading.

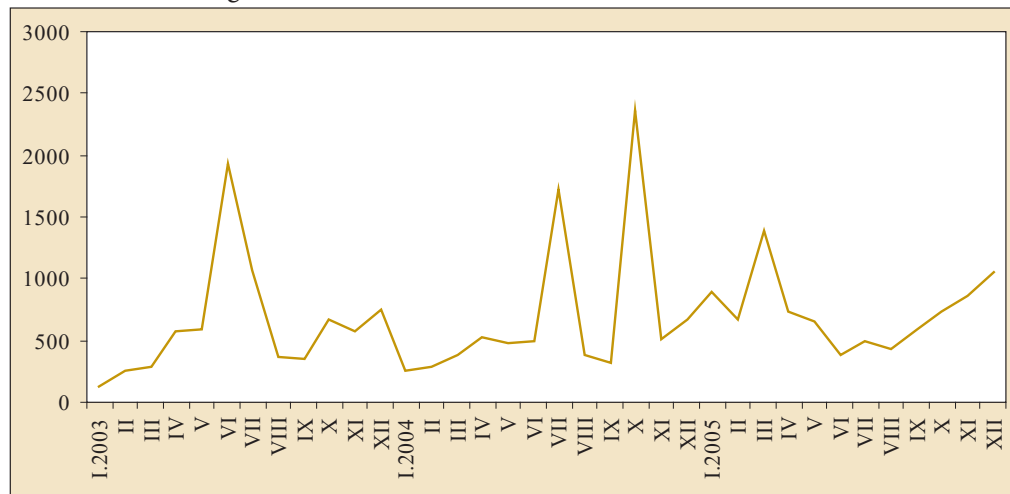
In early 2005, 68 companies were listed on the Stock exchange, but in the meantime 11 companies ceased being listed⁶⁹ since they failed to fulfill their obligations to disclose financial and other price-sensitive information and/or illiquidity in the trade. The cessation of some companies to quote on the stock exchange indicates that the Macedonian companies are still not willing to work transparently.

68. The unofficial market segment registered no trade in convertible certificates issued by the government for indemnification of the savers of the collapsed savings houses. These securities appeared for the first time on the stock exchange in July 2002.

69. The legal obligation for quoting ceased being valid at the end of 2004.

Figure 46

Total stock exchange turnover*



* Includes block transactions and trading on the government segment.

Source: Makedonska berza a.d. Skopje (Macedonian Stock Exchange).

Since early 2005, the Macedonian stock exchange witnessed higher inflow of foreign portfolio-investments. The stock exchange trade included several categories of foreign investors (brokerage houses, banks, investment funds and natural persons), primarily from our region.

The higher demand of the foreign institutional investors for shares of some larger domestic companies is partially due to the announced interest of some foreign investors to invest in some of these companies, and by a reason of expected gain. The foreign institutional investors are also motivated, inter alia, to trade on the Macedonian stock exchange because of the private pension funds that are expected to start operating the next year, which will appear on the demand side, crating a possibility to generate higher capital gains. The demand of the foreign investors for shares in companies with the highest development potential was evident over the whole year. The foreign institutional investors invested in shares, without acquiring a control share in the ownership structure of the companies. In 2005, foreign legal entities and natural persons on the stock exchange also invested in government securities because of their growing yields and risk-free nature.

Additionally, at the end of 2005, the trade on the Macedonian stock exchange accelerated due to the announced amendments to the regulations. The announcement for abolishing the tax release on capital gain⁷⁰ generated by securities, starting from January 1, 2006, and reducing the tax benefit on the profit tax of listed companies⁷¹ resulted in significantly higher supply of over the demand for shares of the most profitable companies (particularly in December). The foreign investors took advantage of such robust sale of shares by the domestic investors, who sought to make use of the

70. By the end of 2005, the capital gain (positive difference between ask and bid price of the sale of securities) was tax-free for the purposes of encouraging the development on the securities market in the Republic of Macedonia. Since January 1, 2006, the capital gain has been subject to 15% tax, and the tax release equals only 25% of the estimated tax.

71. From 50% (from the moment of quotation to the next three years), to only 30% release in the first year and 15% in the second year from the moment of quotation.

old benefits, who accounted for 42.77% of the total turnover on the stock exchange on the purchase side in December 2005 and 11.25% on the side of selling⁷². Also, at the end of December, the foreign investors made up 13.82% of the total principal of the listed companies and of the total nominal value of government bonds, compared to January 2005 when it equaled 11.76%.

Table 19

Review of trade on the Macedonian stock exchange

in millions of denars	January-December 2004	January-December 2005	Changes in %
Turnover (denars)			
Trading in BEST	2,752.0	6,701.7	143.52
Shares	1,277.0	4,625.4	262.22
Bonds	1,459.1	2,076.3	42.30
Average daily turnover (denars)	13.7	33.3	143.52
Average daily number of transactions	86.0	159.0	84.88
Block transactions	5,168.5	1,744.3	-66.25
Government segment	395.4	443.6	12.20
Shares	372.2	35.7	-90.42
Stakes	23.2	407.9	1,660.44
Other securities	15.9		
Total	8,315.9	8,889.6	6.90
Market capitalization (denars)			
Market capitalization of shares - quoted companies	18,616.1	33,171.0	78.18
Market capitalization of bonds	21,278.7	23,972.4	12.66
Mbi/mbi-10	1,351.63	2,292.04	
Number of quoted companies	68	57	-16.18

Source: Makedonska berza a.d. Skopje (Macedonian Stock Exchange).

*The total number of trading days on the stock exchange equals 201 in both years.

The developments on the Stock Exchange in 2005 represent an indicator for the gradual integration of this segment of the Macedonian financial market to the regional financial developments. One of the parameters for recovering the capital market and strengthening the confidence of the investors is the average daily turnover from conventional trading, amounting to Denar 33.3 million in 2005, relative to Denar 13.7 million in 2004 (by 2.4 times more), having the same trading days.

Table 20

Stock exchange turnover structure by market segments

Structure	Turnover (in millions of denars)	Turnover (in millions of Euros)	in %	Number of transactions
Market segment				
Official market	6,199.3	101.1	69.7	29,225
Unofficial market	502.4	8.2	5.7	2,760
Block-transactions	1,744.3	28.4	19.6	85
Government segment	443.6	7.2	5.0	41
Total	8,889.6	145.0	100.0	32,111

Source: Makedonska berza a.d. Skopje (Macedonian Stock Exchange).

As specified by the Methodology for estimating MBI-10⁷³, the first regular audit of MBI-10 was conducted on June 15, 2005, which identified that the common shares of the ten listed companies, already included in the Macedonian Stock Exchange Index, still remain within the MBI-10 structure. The permanent and rapid growth in the stock

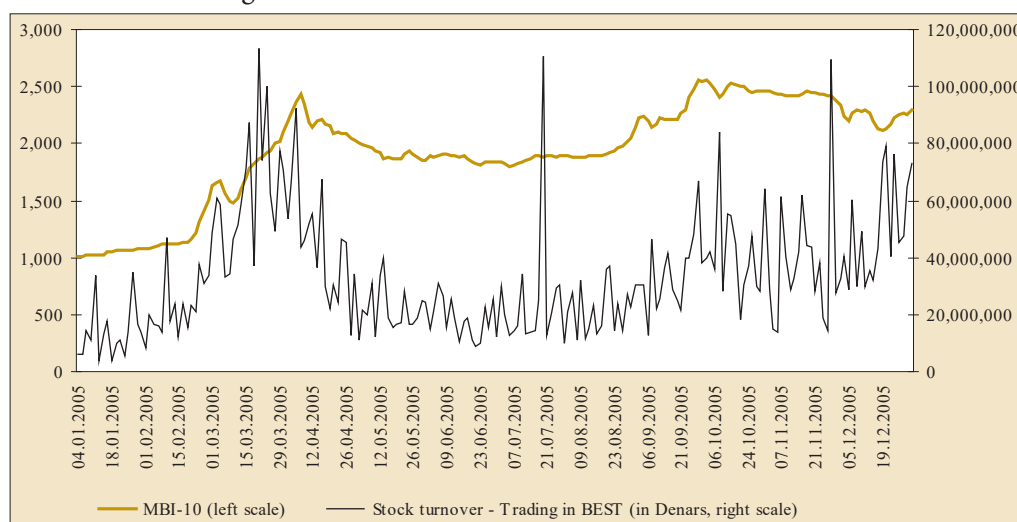
72. According to Central Securities Depository data.

73. Price index weighted with market capitalization, constructed on the basis of common shares of ten companies listed on the official Market.

exchange index value in the first quarter of the year is a result of the higher market prices of shares constituting the index, initiated by the high demand. The reduction of the MBI-10 value in the second quarter is due to the high comparison base of the preceding quarter. In the third quarter, after the stagnation in the second half of July and the first two 10-day periods of August, MBI-10 grew up. Although in short periods of stagnation and growth, in the fourth quarter of 2005, the index generally registered decrease in value, after the annual maximum reached on September 29, 2005. At the end of December, the MBI-10 value equaled 2,292.04, which is by 2.3 times more relative to the beginning of January 2005.

Figure 47

Macedonian stock exchange index (MBI-10) and stock exchange turnover from the conventional trading



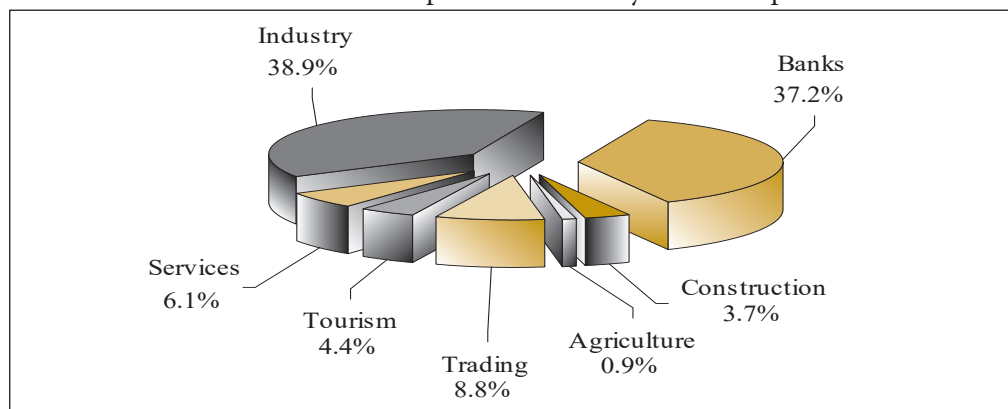
Source: Makedonska berza a.d. Skopje (Macedonian Stock Exchange).

The total market capitalization⁷⁴ of fifty listed companies that submitted data on their financial operations to the Stock Exchange as of December 31, 2005, stood at Denar 31,987.6 million. Analyzing by sector, the market capitalization of the listed companies from the "industry" sector accounted for 38.9% of the total market capitalization of the fifty listed companies; the market capitalization of the listed companies made up 37.2%. The companies from the trade and service sector constitute 8.8% and 6.1%, respectively, and the remaining refers to listed companies that belong to the tourism, construction and agriculture sector.

74. Based on the last financial reports submitted by the listed companies, specified by the Rulebook on listing securities, the Stock exchange publishes selected data on the basis of the last average traded price of shares of the company in the period from January 1, 2005 to December 31, 2005.

Figure 48

Sector distribution of the market capitalization of fifty listed companies in 2005

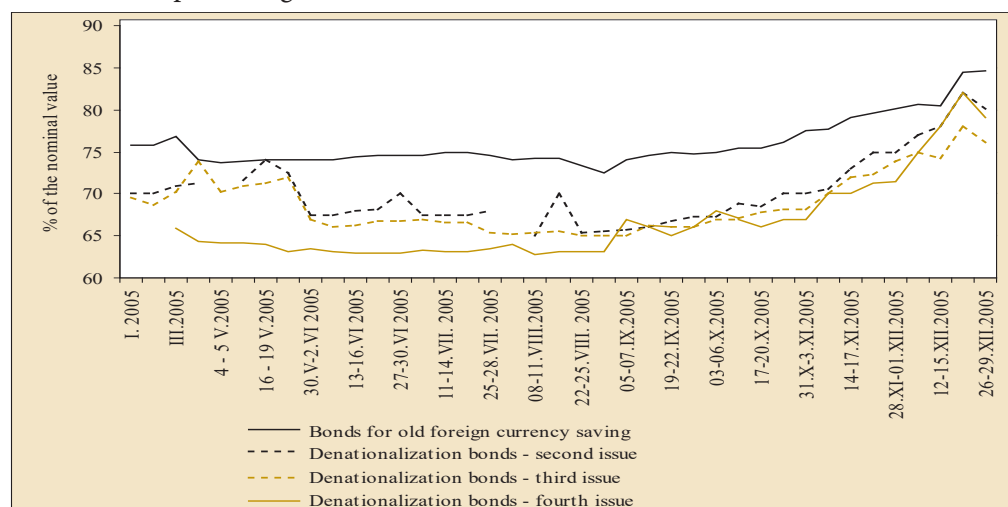


4.2.1. Government securities market

In 2005, government bonds in the amount of Denar 2,076.3 million were traded on the official stock exchange market, which is by 42.3% more relative to the preceding year. Most of the turnover is from the denationalization bonds (fourth issue)⁷⁵. Also, in the January - December 2005 period, the government securities were traded at a price that ranged from 76.42% to 84.88% of the nominal value⁷⁶. The last quarter of 2005 registered upward trend of the prices of government bonds, which corresponds with the reduction in the interest rates on short-term securities (CB bills and Treasury bills), and consequently the higher demand for government bonds.

Figure 49

Movement of prices of government bonds



Source: Makedonska berza a.d. Skopje (Macedonian Stock Exchange).

75. The return to maturity of the government denationalization bonds from the fourth issue equaled 7.32% on December 31, 2005, calculated according to the last average trading price of the bond.

76. Estimated on the basis of the last average daily trading price of the bonds.

According to the previously determined calendar for issuing Treasury bills⁷⁷, 25 auctions of 3-month Treasury bills were held in 2005, with the total supply of 3-month Treasury bills being valued at Denar 12,100 million, and Denar 15,773.1 million were demanded, while the total realization stood at Denar 11,218.9 million. The average weighted interest rate on 3-month Treasury bills at the auctions held over this year equaled 10.08%.

Table 21

Supply, demand and interest rate on Treasury bills

Three-month Treasury bills	Supply	Demand	Realization	Average weighted interest rate
I Q. 2005	2,800	2,471	2,326	10.07
II Q. 2005	3,450	3,411	3,110	10.59
III Q. 2005	3,400	4,609	3,333	10.40
IV Q. 2005	2,450	5,282	2,450	9.00
Total:	12,100	15,773	11,219	10.08
Six-month Treasury bills	Supply	Demand	Realization	Average weighted interest rate
I Q. 2005	250	119	85	10.86
II Q. 2005	245	190	190	10.33
III Q. 2005	350	316	304	10.88
IV Q. 2005	460	1,213	460	9.49
Total:	1,305	1,838	1,039	10.16
One-year Treasury bills	Supply	Demand	Realization	Average weighted interest rate
VI.2005	50	134	50	11.08
XII.2005	200	213	200	9.59
Total:	250	347	250	9.89

* Extraordinary auction of one-month Treasury bills was held on April 8, 2005, which is a so-called reopening of the previously held auction (two months prior to the reopening). The reopening of the already held auction of 3-month Treasury bills, increased the issue of Treasury bills (by Denar 450 million), and the maturity date remained as initially determined, that is May 11, 2005.

Source: National Bank of the Republic of Macedonia.

Analyzing the dynamics, except for the first four months of the year, the demand for 3-month Treasury bills has permanently been exceeding the supplied amount. Thus the amount, as a percentage of the total demand ranged from 35.4% in November, to 100% of the demanded amount of 3-month Treasury bills in February. The highest weighted interest rate was achieved in May (10.76%), with the amount of the 3-month Treasury bills being valued at Denar 1,200 million. Also, starting from October, the interest rate on 3-month Treasury bills was steadily declining in line with the movement of the interest rates on the CB bills auctions.

Twelve 6-months Treasury bills auctions were held in 2005. The total supply was Denar 1,305 million worth, which is by 29% less relative to the demand (Denar 1,837.7 million). Thus, 43.4% of the demanded amount remained unrealized. The supplied amount of 6-month Treasury bills in the first and the second quarter of 2005 was roughly Denar 250 million, while in the second half of the year it reached Denar

77. The calendar of holding government securities auctions is published in advance for a period of six months, and the precise amount of any auction is published four days prior to the holding of auction.

460 million in the last quarter of the year. Such trend reflects the government's strategic direction for borrowing by instruments with longer maturity, within the public short-term debt management. The average weighted interest rate on 6-month Treasury bills at auctions held in 2005 reached 10.16%. In line with the reduction in the interest rates on the CB bills auctions since October, the interest rate on 6-month Treasury bills started steadily declining.

Twelve-month Government bonds were for the first time issued at the auction held on June 21, 2005. Observing the budget liquidity management, it implies extension of the maturity of instruments intended for overcoming the short-term non-equilibrium between the budget revenues and expenditures. The demand for 12-month Treasury bills at the auction exceeded the supply by 2.7 times, that is Denar 133.9 million were demanded, and only Denar 50 million were supplied. The average weighted interest rate on the 12-month Treasury bills auction equaled 11.08%. Denar 213.0 million were demanded at the second 1-year Treasury bills auction held on December 20, 2005, and Denar 200.0 million were realized, which is the same as the offered amount. The interest rate at the auction equaled 9.59%.

In 2005, the Treasury bills auctions acted towards withdrawing Denar liquidity. Denar 1,508.4 million were withdrawn on the basis of Treasury bills issues, Denar 578.2 million of which on the basis of 3-month Treasury bills, and Denar 680.2 million and Denar 250 million were withdrawals on the basis of 6-month and 12-month Treasury bills, respectively.

On November 24, 2005, the Ministry of Finance issued the first domestic continuous bond (2-year government bond)⁷⁸. The 2-year government bond, as a new standard debt instrument triggered the interest on the primary market, also illustrated by the results from the first auction. Denar 100 million was supply, the demand for the bond exceeded the supply by 2.43 times, and the whole supplied amount was realized. The Continuous bond has been listed on the official Stock Exchange market since December 12, 2005.

After the establishment of the regulatory framework and the necessary technical and institutional requirements, the over-the-counter market started operating on April 25, 2005⁷⁹, making it an official part of the market infrastructure of the Republic of Macedonia. The over-the-counter market acted towards creating an environment for more efficient liquidity management, in both the banks and other financial institutions, and the non-financial sector entities.

Initially, only Treasury bills have been traded, but it is expected that the everyday listing of Treasury bills on the over-the-counter market will encourage occurrence

78. The Continuous government bond no.1 was issued in dematerialized form, in Denars, and unlimitedly negotiable. The interest rate offered at the auction equals 10% p.a. and the coupon is paid once a year within 2-year period. The nominal value of the bond falls due on November 28, 2007.

79. The Rules for the Over-the-Counter Markets entered into force on April 23, 2005, while the over the counter market started officially operating on April 25, 2005. On the over the counter market, purchase and sale securities transactions are concluded outside the Stock Exchange and the Money and Short-term Securities Market, and trading is made in all short-term securities issued by the Republic of Macedonia. The transactions are concluded in direct relation between the purchaser and the seller, without intermediaries.

and development of other financial instruments. The increase in the Treasury bills liquidity, and consequently, their demand is expected to bring about lower costs of financing the budget deficit. With respect to the monetary policy, the expected increase in the demand for Treasury bills will increase the number of alternative forms of placing available funds, strengthen the affiliation and interdependence of interest rates on certain financial instruments, which will eventually make the monetary policy transmission through the interest rate channel more efficient.

The first transaction on the over-the-counter market was concluded on May 18, 2005. Since its launching to the end of 2005, the over-the-counter market registered total of 19 transactions, in the amount of Denar 195.2 million. Six of them were interbank transactions, six were made between a bank and a legal entity, and the remaining 7 transactions were between a bank and a natural person. Analyzing the traded amounts, the largest turnover, or 85.74% of the total turnover was made on the segment of trade between banks and legal entities, 9.84% on the interbank segment, and 4.58% on the bank to natural persons segment.

Annex 3

Yield curve of short-term Treasury bills in the Republic of Macedonia

The rate of return on Treasury bills is a basic interest rate or minimum interest rate, considering the fact that it is risk-free investment, where the government appears as issuer. The market participants permanently monitor the movement of interest rates on these papers since their changes signalize essential economic and market trends. The interest rates on Treasury bills with various maturity generally move towards same direction, but historically observed, there have been periods where this is not the case, or even periods when they move to opposite direction. Thus, the Treasury bills with shorter maturity bears lower return. It reflects the theory that the longer the maturity of investment of the investor's funds, the higher the demanded risk premium, for the purposes of compensating the investor's exposure to interest rate risk. Consequently, the investors expect higher return on funds when invested in securities with longer maturity.

For the purposes of more efficient financing of the budget liquidity gap caused by the time mismatch between the public revenues and expenditures, that is the budget deficit of the Republic of Macedonia, in January 2004, the Ministry of Finance started issuing 3-month Treasury bills⁸⁰. Six-month Treasury bills auctions started being held in November 2004, and in June 2005, one-year bills were placed on the primary government securities market for the first time. In November 2005, the Ministry of Finance also issued the first domestic Continuous bond with maturity of two years. The issuance of these government bonds enabled the

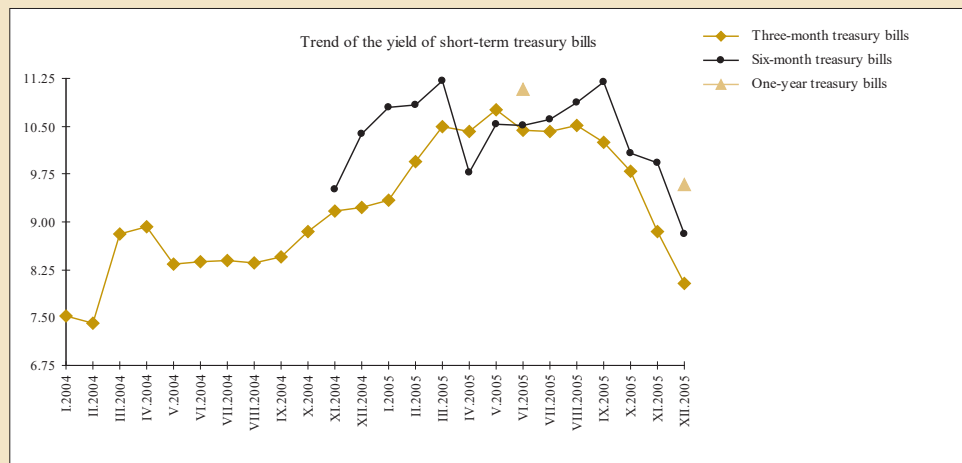
80. By the end of 2003, the government securities market in the Republic of Macedonia was characterized by occasional issues of securities due to the need of solving structural problems (old foreign exchange savings, selective credits, bank rehabilitation and reconstruction, and later on, privatization of "Stopanska Banka" a.d. Skopje, as well as the commencement of the denationalization process). Considering that these bonds were issued for settling some government liabilities, their features do not meet the needs of the potential investors (primarily due to their long terms). Some of these securities, however, are relatively liquid on the secondary market.

drawing of the yield curve of risk-free government securities, as a basis for market setting of the yield of other financial market instruments.

The following figure shows the average monthly weighted interest rates achieved at the Treasury bills auctions with various maturity.

Figure 50

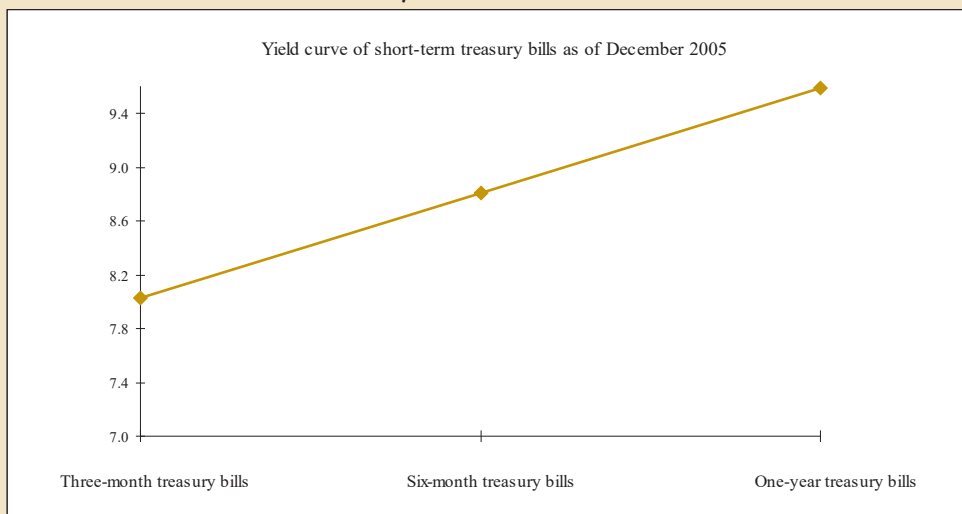
Trend of yield of short-term Treasury bills



The graphic presentation of the interest rates on Treasury bills with varying maturity draws the yield curve. In this case, the figure shows the average weighted interest rate on Treasury bills auctions held in December 2005.

Figure 51

Yield curve of short-term Treasury bills as of December 2005

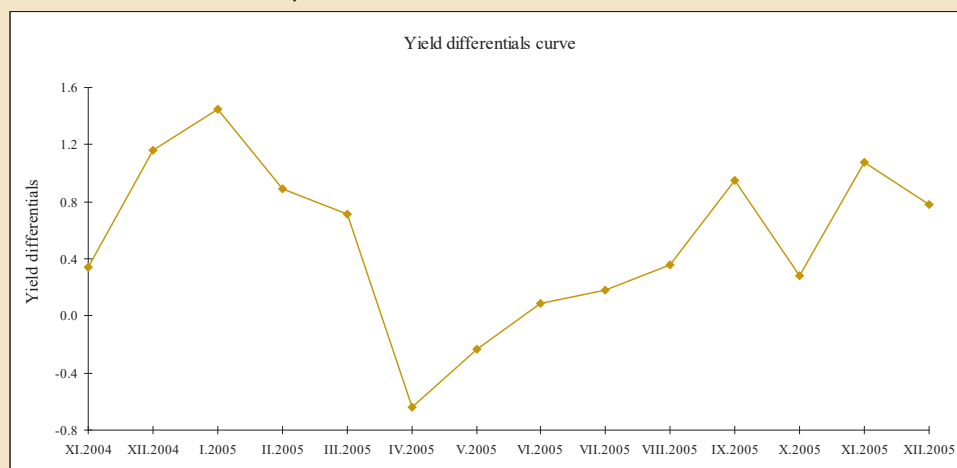


The curve presented has an upward trend, therefore it is being called "regular yield curve". Such form of yield curve, when interest rates progressively grow with the duration of maturity period indicates that the investors expect the economy to grow without substantial shocks within the next year (considering that the Treasury bills are short-term, i.e. with 12-month horizon of investing).

When analyzing the curve that reflects the gap between the yield of 6-month relative to the yield on 3-month Treasury bills, from November 2004 to January 2005, the yield curve shows progressively upward trend. In February 2005, the yield curve started showing moderate upward trend, whereas in April and May 2005, the yield curve was inverse (situation when yields on a longer run are lower relative to the yields on a shorter run, with the shape of the yield showing downward trend).

Figure 52

Curve on differences in yields



Considering that the period is short (only two months), one could not draw a conclusion on the investors preference, but here we discuss several large issues of 3-month Treasury bills in this period, with the effect of higher interest rate on 3-month relative to 6-month Treasury bills is due to the higher realization of the bills with shorter term, which simultaneously appears as a weight in the calculations of the average monthly interest rate at the held auctions of Treasury bills with different maturity in the respective month. Since June 2005, the yield curve shows moderate (in June, July and October 2005) to progressive upward trend (in November 2005). It means that the investors do not give up from the higher income on a longer run at the expense of lower income on a shorter run, which indirectly points to the expectations of the investors concerning the improvement of the economic activity. Nevertheless, one should have in mind that the longer horizon of investing refers to duration of six months (taking into account that only two one-year Treasury bills auctions were held in the analyzed period).

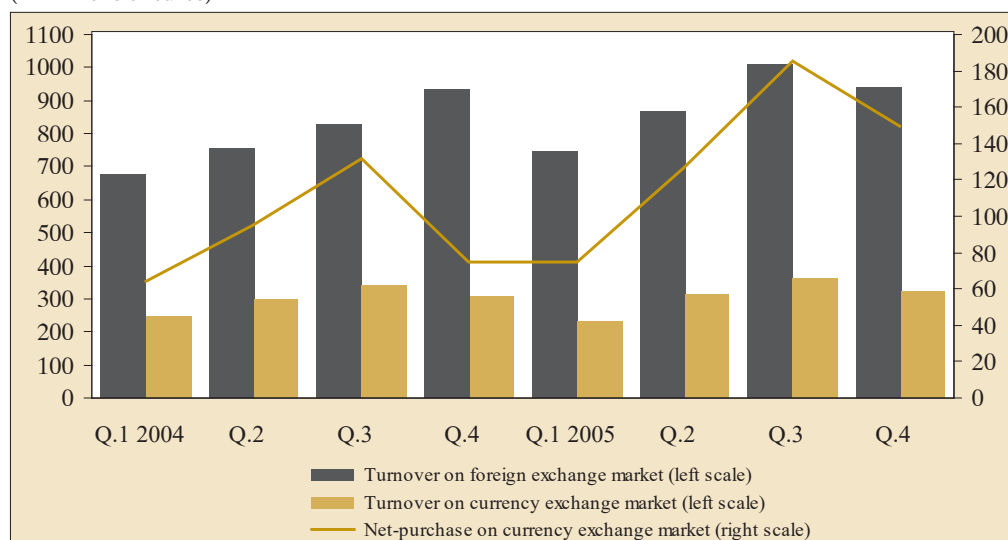
4.3. Foreign exchange and currency exchange market⁸¹

The developments on the foreign exchange market in the Republic of Macedonia in 2005 are primarily determined by the accelerated foreign trade, and the high inflows from currency exchange operations that registered extraordinary high level. In 2005, the total value of transactions executed on the foreign exchange market reached Euro 3,564.4 million, which is an increase of Euro 372.7 million or 11.7% compared to the preceding year. The average monthly turnover on the foreign exchange market over the period under observation amounted to Euro 297 million, compared to Euro 266 million in 2004. Analyzing by segment, the transactions between banks and enterprises⁸² make up 91.6% of the total turnover (87.3% in 2004).

Figure 53

Turnover on foreign exchange and currency exchange market

(in millions of euros)



Source: National Bank of the Republic of Macedonia.

The analysis of transactions between banks and enterprises indicates permanently higher demand for relative to supply of foreign currency by enterprises on the foreign exchange market. In 2005, the demand for foreign currency by enterprises exceeded the supply by 26.9%. In 2004, this discrepancy equaled 29.8%, implying certain moderate improvements on the domestic foreign exchange market segment of trading between banks and enterprises. The narrowing of the gap between the supply and the demand on this segment is partially due to the improved export performances of the enterprises in 2005.

The permanently higher demand for relative to supply of foreign currency by enterprises in 2005 was covered by the net-sale of foreign currency by banks, with the NBRM making a high net-purchase (net-sale was made only in January). It was due to the extraordinary high inflow of foreign currency of the banks from currency exchange

81. Foreign exchange market includes the trade between banks and the NBRM, the interbank trade and the trade between banks and enterprises. The currency exchange market includes currency exchange operations of the banks and private exchange offices with the household sector.

82. Includes the purchase and sale of foreign currency by exchange offices and non-resident firms.

operations with natural persons and exchange offices (particularly in summer). Observing by month, the discrepancy between the supply of and the demand for foreign currency by enterprises in January is seasonal and stems from the needs for payment of liabilities of the domestic importers, in line with the traditionally high import at the end of the year. The intensive demand for foreign currency in June partially reflects the higher needs of enterprises to service oil import-related liabilities, whereas the gap registered in July and August is mainly due to the repatriation of higher amounts of dividends to foreign investors.

With respect to the functioning on the observed market segment, it should be highlighted that May witnessed the highest degree of equilibrium between the supply of and the demand for foreign currency by enterprises (discrepancy of Euro 9 million). The higher import in April and the possibility for deferred payment of the customs debt⁸³, resulted in, inter alia, higher need for Denar liquidity of the enterprises in May, resulting in higher sale of foreign currency by the enterprises, and thus in the establishment of relatively balanced relation between the supply of and the demand for foreign currency.

New rules for functioning of the foreign exchange market in the Republic of Macedonia were introduced on August 18, 2005. Other than the introduction of electronic platform for monitoring the exchange rates in real time with direct electronic interbank trade in foreign currency, essential changes were made in the method of intervening of the NBRM on the foreign exchange market. The NBRM signed a Market Maker Agreement with four commercial banks. The banks voluntarily signed the agreement and assumed the liabilities specified by the agreement. The NBRM meets the demand/supply by intervening on the foreign exchange market through the banks-market maker, while the other banks on the market compensate the excess or shortage of foreign currency only through the banks-market makers. The purchase and sale of foreign currency between banks-market makers is made with ask and bid rate spread per one Euro not larger than Denar 0.07 and minimum amount of Euro 350,000 per transaction. Relative to the other banks, the banks-market makers are bound to quote, at all times, exchange rates with maximum spread of Denar 0.25 between the ask and bid rates per one Euro and minimum amount of Euro 30,000 per transaction. The measures bring about higher interbank purchase and sale of foreign currency and more objective setting of the Denar exchange rate.

According to the new rules for intervening on the foreign exchange market, the NBRM will further participate on the foreign exchange market, with a discretion to intervene (to banks-market makers), implying that only the method of trading and NBRM presence on the foreign exchange market are changed. Such practice is identical to the practice of the central banks in advanced market economies.

In 2005, the currency exchange market registered a turnover of Euro 1,225.6 million, which is an increase of 2.4% relative to the preceding year. The increase in

83. The higher need of Denar liquidity of the enterprises could partially be a result of the application of the new method of deferred collection of customs duties, VAT and excises (since February 1), according to which the importers that timely and fully met their liabilities on the basis of customs debt and import taxes over the last two years will be allowed to pay the aforementioned taxes within 30 days after the date of customs clearance (if they submit a bank guarantee with a sum equal to the amount of the tax the payment of which is deferred).

the total turnover on the currency exchange market was made in environment of 12.9% higher supply of foreign currency, and 17.2% lower demand. In line with the high supply, net-purchase of Euro 537.2 million of foreign currency was made on the currency exchange market, relative to the net-purchase of Euro 365.4 million in 2004.

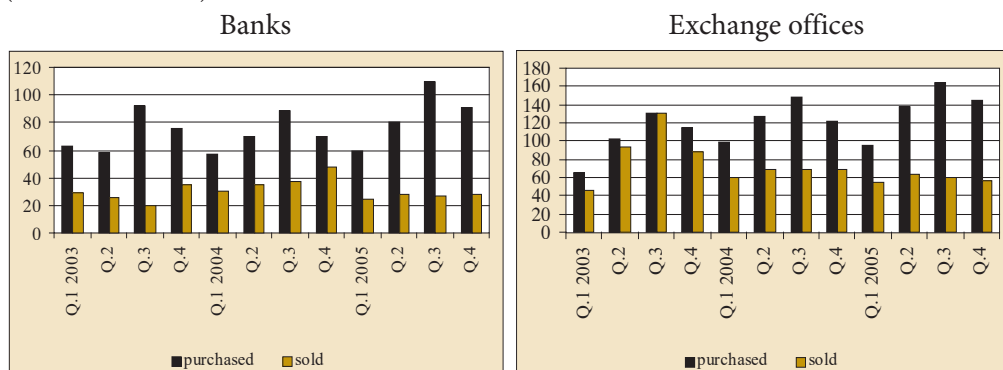
The lowest level of foreign currency supply on the currency exchange market was registered in January (Euro 46.4 million), and the highest was registered in July (Euro 92.8 million). On the other hand, the monthly demand for foreign currency on the currency exchange market ranges from Euro 25.1 million in February to Euro 32.1 million in June.

In 2005, 68.5% of the total demand for foreign currency of natural persons⁸⁴ was met through the exchange offices and 31.5% through commercial banks. Cumulatively observed, in 12 of total of 314 private exchange offices in 2005, the amount of foreign currency purchased by natural persons exceeded the sold amount by more than 10 times. The remaining private exchange offices register relatively balanced relation between the sold and purchased foreign currency by the households.

Figure 54

Movement of the turnover on the currency exchange market

(in millions of euros)



Source: National Bank of the Republic of Macedonia.

With respect to the currency of denomination structure, in 2005, the Euro and the US Dollar constituted 80.7% and 9.8%, respectively, of the structure of demand of foreign currency on the currency exchange market. In 2004, the Euro and the US Dollar constituted 78.7% and 10.7%, respectively, of the structure of demand of foreign currency on the currency exchange market. The analysis of the currency of denomination structure of the supply of foreign currency on the currency exchange market, shows average share of the Euro of 57.5%, the Swiss Franc accounts for 26.4% and the US Dollar - 10.7%. In 2004, the Euro made up 52.9% of the structure of foreign currency on the currency exchange market, the Swiss Franc constituted 32.9%, and the share of the US Dollar was 8.9%.

84. Including residents and non-residents.

Annex 4

Measuring pressures on the foreign exchange market

Exchange Market Pressure Index - EMPI is an indicator of the presence (i.e. absence) of currency crisis and represent an indicator of presence (i.e. absence) of currency crisis and enables location of changes that occurred as a result of the pressures on the foreign exchange market. The EMPI is based on the possibilities available to the central bank to defend its exchange rate: foreign reserve reduction, higher interest rates or exchange rate depreciation. Consequently, the coverage of exchange rate, interest rates and foreign reserves in the index provides a clear picture on the sources of changes under the influence of the pressures on the foreign exchange market. This approach is convenient for countries with managed fluctuating exchange rate regime, but it is also useful for countries with fixed exchange rate regime, since it reflects not only the exchange rate movements, but also the dynamics of the foreign reserves and interest rates.

One of the possible variants for estimating this index includes the percentage changes in the nominal exchange rate (e), the change in the interest rate differential as a difference between domestic and foreign interest rates ($i_{d,t} - i_{f,t}$) and the proportionate change in the foreign reserves - to - narrowest money supply definition ratio ($NIR / M1$), or as presented by formula⁸⁵:

$$EMP = [(\alpha\% \Delta e_t) + (\beta \Delta(i_{d,t} - i_{f,t})) - (\gamma\% \Delta NIR / M1)]$$

The index has critical or so-called extreme values signaling crisis, defined as follows: $EMP > 1.5 \sigma_{EMP} + \mu_{EMP}$, where σ is standard index deviation and μ is a mean index value.

EMPI, for the Republic of Macedonia, was constituted with certain modifications. The index was composed of the following variables (on daily basis): nominal exchange rate MKD/EUR, average weighted interest rate on interbank money market (the foreign interest rate is supposed to be constant, considering the rare and irrelevant changes) and NBRM foreign exchange transactions - to - reserve money ratio.

$$EMP_{mk} = \alpha\% \Delta ER_{mk/eur} + \beta \Delta MMIR - \lambda\% \Delta (FXT / M0)$$

where $ER_{mk/eur}$ is daily nominal exchange rate MKD/EUR, MMIR is daily average weighted interbank interest rate (MBKS) and FXT/M0 is NBRM daily interventions on the foreign exchange market - to - reserve money ratio (usage of M0 in lieu of M1 by the reason of scarcity of available data on M1 on a daily basis).

Taking into account the application of exchange rate targeting strategy in the Republic of Macedonia (fixed exchange rate regime), the turbulence on the foreign exchange market have been offset by changes in the monetary policy design or by direct interventions on the foreign exchange market. Consequently, the changes in EMPI for the Republic of Macedonia would be primarily determined

85. Barry Eichengreen, Andrew Rose and Charles Wyplosz, "Contagious Currency Crises: First Tests," *Scandinavian Journal of Economics* 98(4), 1996, pp. 463-84.

by the changes in the foreign reserves or by the changes in the reference interest rate. Considering that EMPI is a currency crisis indicator, in the case of Republic of Macedonia, this index is a useful tool for assessing the seriousness of the turbulence on the foreign exchange market.

The EMPI estimations were made for the period from 2001 to 2005 (on a daily basis) deriving the following results:

Coefficients: Alpha=950.58

Beta=2.27

Gamma=44.81

EMPI: Standard deviation=1.7656717

Mean value =0.018478

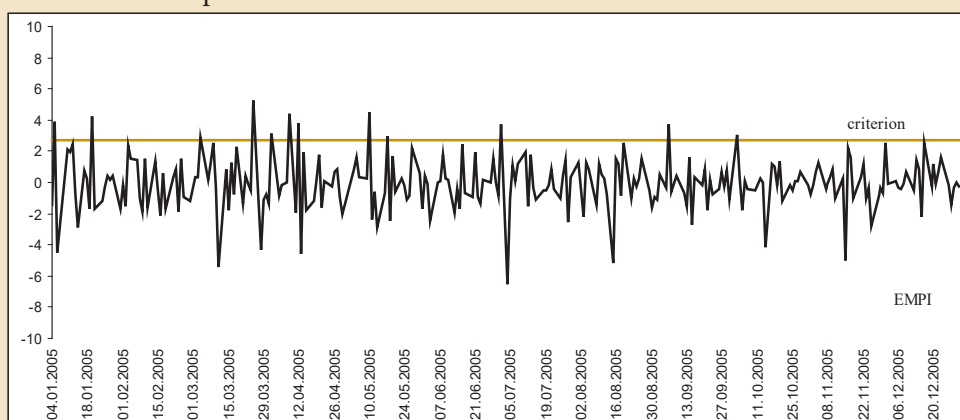
Critical value (criterion)=2.666986

Comparing the obtained EMPI values with the determined criterion, twelve signals for presence of currency crisis were evident in **2005**, i.e. in twelve cases the EMPI values are above the set criterion (all other EMPI values of the total of 253 observations are below the set criterion). Most of the signals were registered in the first half of the year. Most of the signals registered in 2005 (67%) arise from the change in the NBRM foreign exchange transactions (i.e. foreign reserves), indicating that the pressures were offset by NBRM interventions on foreign exchange market (net-purchase of foreign currency).

The results obtained indicate a slight percentage of crisis events in 2005 (only 4.7%). It indicates that, generally, the observed period witnessed no long-lasting changes in the monetary policy design, NBRM intervention policy or nominal exchange rate. The percentage of crisis events from 2001 to 2005 is also very low, equaling 3.6%, on average.

Figure 55

EMPI for the Republic of Macedonia



Source: NBRM.



Tetradrachm (silver), issued in the period when Macedonia was under Roman protectorate (158 - 150/149 BC).
From the NBRM collection.



External sector

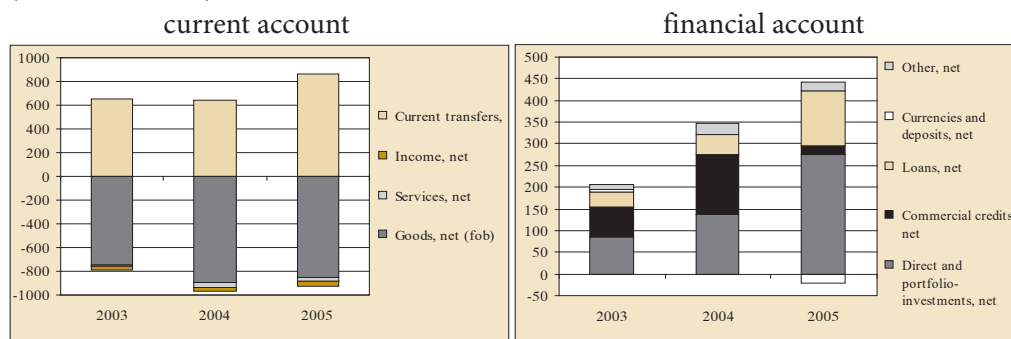
V. External sector

5.1. Balance of payments

The higher foreign trade liberalization by lowering the customs duties after the admission to the World Trade Organization (and in compliance with the Stabilization and Association Agreement with the European Union), the increase in the world oil and metal price, as well as the accelerated output activity brought about further increase in the foreign trade of the Republic of Macedonia in 2005. Having a faster increase in the export relative to the relative to the import of goods in 2005, the trade deficit reduced relative to the preceding year. Such movements in the foreign trade positively affected the balance of services, which registered decline in the deficit. Exceptionally high foreign currency inflows from private transfers were registered within the current transfers. Only the income balance registered increase in the deficit in 2005, due to the high outflows for paid dividends abroad. Such movements in the international current transactions considerably reduced the balance of payments current account deficit, with its share in the GDP decreasing by 6.4 percentage points, reducing to 1.3%⁸⁶. Simultaneously, the balance of payments current account deficit, void of official transfers, equals 2.5% of GDP (9% in 2004). Besides the substantial contribution of the current transfers to the current account balance, the inflows from foreign direct and portfolio investments and long-term loans and credits were major components of financing the current account deficit in 2005.

Figure 56

Components of balance of payments
(in millions of euros)



Source: National Bank of the Republic of Macedonia.

5.1.1. Current account

As a result of the high inflows in some current account components, except for the income, 2005 witnessed considerable reduction in the current account deficit

86. Estimated GDP data for 2005, estimated in Euro at average annual exchange rate of the Denar against Euro.

(by Euro 271.8 million on annual basis), amounting to Euro 61.8 million. Most of the current account deficit reduction is a result of the net-inflows from private transfers worth Euro 229.2 million. Simultaneously, the improved performances in the trade in goods and services reduced the deficit in these categories by Euro 40.5 million and Euro 16.2 million, respectively.

Table 22

Balance of payments current account

(in millions of euros)

	2003	2004	2005
Goods, net (fob)	-750.2	-894.0	-853.4
Ex port	1,203.2	1,343.1	1,642.2
Import	-1,953.5	-2,237.1	-2,495.6
Services, net	-9.0	-43.4	-27.2
Inflow	288.2	327.8	380.6
Outflow	297.2	371.2	407.9
Income, net	-28.2	-33.2	-44.4
o/w : Interest, net	-27.8	-21.2	-20.7
Current transfers, net	650.3	637.0	863.2
Official	89.4	55.4	52.5
Private	560.9	581.5	810.7
Current account	-137.2	-333.6	-61.8
Current account, % of GDP	-3.3%	-7.7%	-1.3%
Current account, without official transfers, % of GDP	-5.5%	-9.0%	-2.5%

1/ Preliminary data.

Source: National Bank of the Republic of Macedonia.

In environment of higher supply of import goods and simultaneous increase in the domestic demand for imported goods, *the total foreign trade*⁸⁷ of the Republic of Macedonia in 2005 increased by 14.7% and reached Euro 4,244.5 million. Thus, its share in the GDP in 2005 went up by 6 percentage points and equaled 91.6%. The faster increase in the export relative to the import of goods led to a 5% annual fall in the foreign trade deficit⁸⁸ of the Republic of Macedonia in 2005, with its share in the GDP reducing by 2.6 percentage points, equaling 20.7%. Simultaneously, the export provides 6 percentage points (63.2%) higher import coverage.

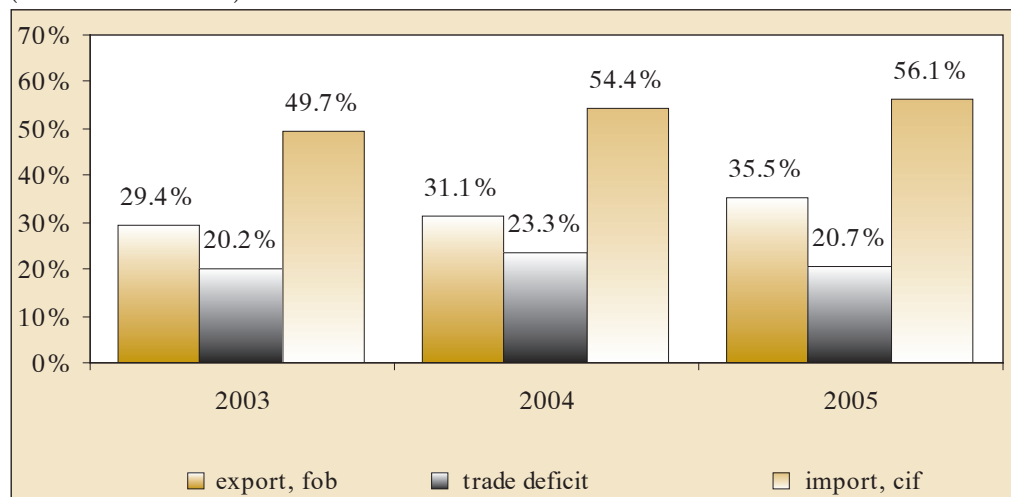
87. Source: Preliminary data of the State Statistical Office, and the estimation in Euro have been made at the National Bank of the Republic of Macedonia. The export of goods is presented on f.o.b. basis, while the import of goods is presented on c.i.f. basis. The exports and the imports differ from the amounts in the balance of payments from methodological reasons.

88. The concentration of the certain foreign trade components of the Republic of Macedonia measured by Hefindahl-Hirschman Index in 2005 indicates higher diversification on the export side (0.251 in 2005, 0.271 in 2004), whereas higher concentration was registered on the import side (0.110 in 2005, 0.097 in 2004).

Figure 57

Export, import and trade deficit

(share in the GDP in %)



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

The intensified production and export activity of the metal manufacturing industry in 2005, the increase in the prices of nickel, iron and steel on the stock exchanges triggered by the higher international demand, as well as the significant increase in the price of oil and oil derivatives on the international stock exchanges, are the main factors for the increase in *the export of goods* of 22.1%. Analyzed by product categories⁸⁹, the largest contribution to the increase in the export of goods from the Republic of Macedonia in 2005 accounts for the higher export of iron and steel, and oil derivatives (by 34.4% and 22.8%, respectively). Namely, the value of the export of iron and steel in 2005 augmented by 31.4% (given the rise in the exported quantities and the average - factual price⁹⁰ of 23.7% and 6.3%, respectively). The lower comparison base in 2004 should also be taken into consideration, having in mind that one of the exporting metallurgic facilities was closed in the first half of 2004. The intensified export of oil derivatives in 2005 (by 2.1 times annually) is caused by the larger exported quantities and the increase in the factual price (annual increase of 53.2% and 47.1%, respectively). Among other groups of products, growth was registered in the export of fruit and vegetables (of 37.8%), tobacco (of 43.2%) and metal ore (of 3.2 times). Incremented export of metal ore (mainly copper ore and concentrates) is due to the intensified activity of a significant mining facility after its restartation at the beginning of the second half of 2005.

89. Classified according to the Standard International Trade Classification (SITC).

90. Source: www.worldbank.org; commodity price index; NBRM calculations. The average price of nickel in 2005 equals US Dollar 14,744 per metric ton, which is an increment of 6.7% on annual basis (analyzing since 1990, the historically highest price of nickel of US Dollar 16,932 per metric ton was registered in May 2005); The average price of iron in 2005 amounts to 65 cents per metric ton unit, which is a rise of 71.5% compared to 2004; The average price of the hot-rolled and cold-rolled steel products surged by 20.8% and 26% and they amounted to US Dollar 733.3 and US Dollar 633.3 per metric ton, respectively. In 2005, the average price of tin of 738 cents per kilo registered a decrease of 13.3%, compared to 2004 (851.3 cents per kilo).

Table 23

Contribution to the total increase in the export of goods by groups of products according to SITC

groups of products	change in absolute amount		
	2004	2005	
	in millions of Euros		
Total export of goods	1,345.9	1,643.5	297.6
Food products	101.4	135.0	33.6
of which: fruit and vegetables	51.2	70.6	19.4
<i>Beverages and tobacco</i>	101.3	131.3	30.0
of which: tobacco and tobacco products	57.3	82.1	24.8
<i>Raw materials except fuel</i>	35.5	55.0	19.5
of which: metal ore and metal waste	8.3	26.9	18.5
<i>Mineral fuels, lubricants etc.</i>	62.7	132.6	69.9
of which: oil and oil products	60.4	128.2	67.8
<i>Products classified by materials</i>	438.8	546.7	107.8
of which: iron and steel	325.4	427.6	102.2
<i>Various finished products</i>	459.3	475.3	16.0
of which: clothing	394.4	401.0	6.6
	share in the total export		contribution to the total increase
	(in %)		(in %)
Fruit and vegetables	3.8	4.3	6.5
Tobacco and tobacco products	4.3	5.0	8.3
Metal ore and metal waste	0.6	1.6	6.2
Oil and oil products	4.5	7.8	22.8
Iron and steel	24.2	26.0	34.4
Clothing	29.3	24.4	2.2
Total	66.7	69.1	80.4

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

Such a dynamics with separate groups of export products in 2005 led to structural movements in the total export towards higher share of iron and steel and oil derivatives (by 1.8 percentage points and 3.3 percentage points, respectively) and lower share of clothing (by 4.9 percentage points). However, in 2005 the export of clothing went up by 1.7% on annual basis. Such a dynamics of export of clothing proves that the increased competitiveness from China in the placement of these products on the international markets had insignificant negative effect on the export of clothing from the Republic of Macedonia only in the first quarter of 2005 (decrease of 9% annually, mainly on the USA markets), while the export registered a growth in the other quarters of the year (annual increase in the second and the third quarter of identical 2.5%, while a growth of significant 11.2% was evidenced in the fourth quarter).

The large dependence of the Macedonian economy on the import and the lower customs burdening of the import since the beginning of the year (in accordance with the Agreement with the WTO and the SAA with the EU)⁹¹ and the rise in the price of oil on the international stock exchanges, are the main factors which acted

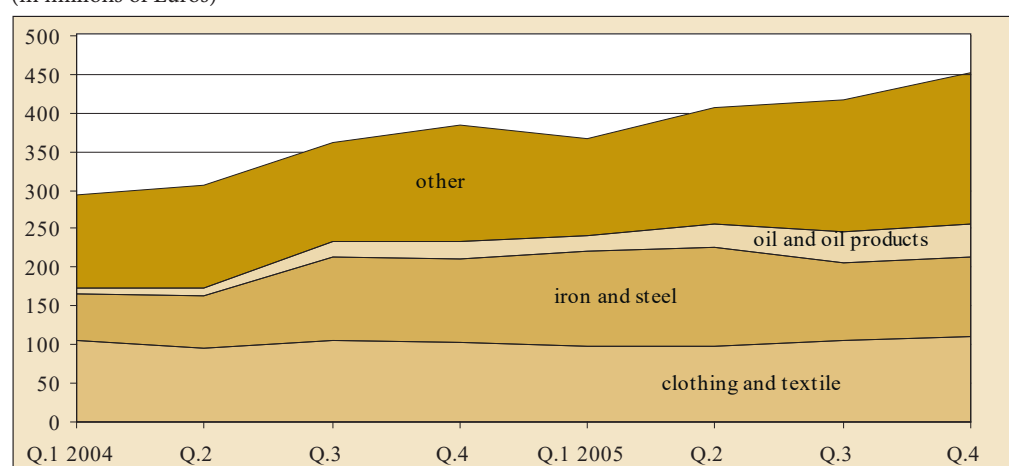
91. In accordance with the admission of the Republic of Macedonia to the WTO, the duties on individual products decreased since January 01, 2005, with the average customs rate being reduced from 11.23% in 2004 to 10.12% in 2005. The average customs rate on agricultural and industrial products of 19.88% and 8.59%, respectively in 2004, reduced to 18.15% and 7.68%, respectively in 2005.

towards the increase in the *import of goods* of 10.5% in 2005. Simultaneously, the high comparison base registered in 2004, especially in the last quarter of 2004, when higher import of iron and steel for the needs of the metallurgic facility that was restarted in May was realized, as well as high import of vehicles due to the announcements of the Macedonian Government for re-introduction of excise from the beginning of 2005⁹² should also be taken into consideration. Analyzed by products, such a dynamics of the import is mainly caused by the intensified import of oil and oil derivatives and electricity, the contribution of which in the increase in the import equals 58% and 9.7%, respectively.

Figure 58

Export dynamics by groups of products

(in millions of Euros)



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

In 2005, the import of energy registered an annual increase of 56.1%, with its share in the total import of goods being augmented by 5.6 percentage points and it reached 19.2%. Within the separate types of energy sources, the highest increase is registered in the import of electricity (of 75.4%), which in terms of small increase in the actual price is primarily due to the larger imported quantities for satisfying the higher needs of industrial output and mining (mainly from Switzerland and Serbia and Montenegro). Simultaneously, the import of crude oil augmented by 66.7% on an annual basis, which is a combined effect of higher prices and quantities (annual increase of 47.7% and 12.9%, respectively), while the import of oil derivatives went up by 31%, which is completely a price effect⁹³ in terms of reduced imported quantities.

92. Vehicles in the amount of Euro 150.3 million and 131.6 million, respectively were imported in 2004 and 2005.

93. In order to quantify the effect of the increase in the price of oil and oil derivatives on the trade deficit of the Republic of Macedonia in 2005 a simulation was made presuming that the current quantities in 2005 are realized at the average prices registered in 2004. However, the estimated effect regarding the import of goods would have been lower import by Euro 119.2 million. If the same simulation in the export of goods is made (the value of the exported quantities of oil derivatives in 2005 presented at average prices registered in 2004), the export would have been smaller by 40.6 million. Consequently, the estimated net effect of the increase in the prices of oil and oil derivatives on the foreign trade balance in 2005 is bigger trade deficit by Euro 78.6 million.

Table 24

Import of oil, oil derivatives and electricity

	2004	2005	2005-2004	2005/2004	2004	2005	2005
	Amount		change in absolute amount in millions of Euros	rates of change (in %)	structure (in %)		contribution to the increase in the import (in %)
1. Import of goods in the Republic of Macedonia	2,354.0	2,601.0	247.0	10.5			
2. Import of energy	319.9	499.2	179.3	56.1	13.6	19.2	72.6
Oil and oil derivatives	240.8	384.1	143.3	59.5	10.2	14.8	58.0
crude oil (in mil. of Euros)	192.2	320.4	128.2	66.7	8.2	12.3	51.9
quantity in tons	842,197.9	950,741.6	108,543.6	12.9			
actual price per 1 kg.	0.23	0.34	0.11	47.7			
lubricants obtained from oil (in mil. of Euros)	48.6	63.6	15.1	31.0	2.1	2.4	6.1
quantity in tons	141,125.4	139,132.7	-1,992.7	-1.4			
actual price per 1 kg.	0.34	0.46	0.11	32.9			
Electricity (in mil. of Euros)	31.7	55.7	23.9	75.4	1.3	2.1	9.7

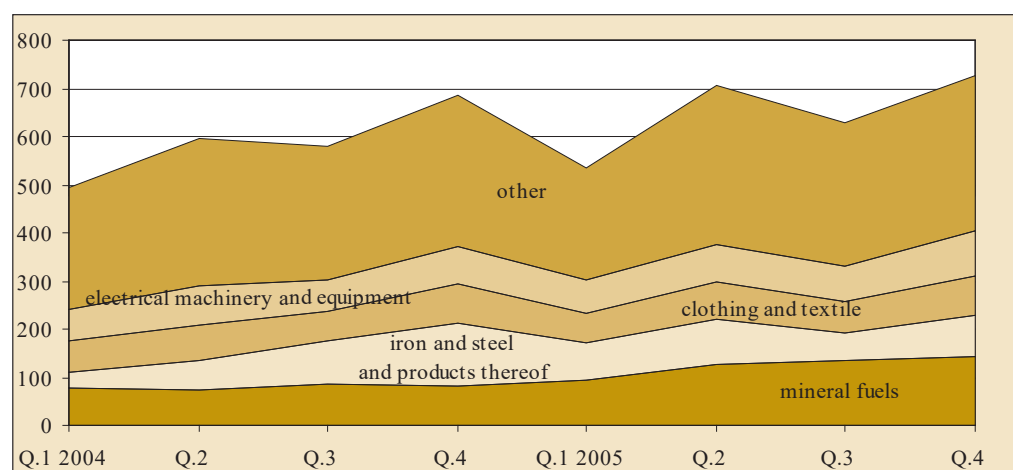
Source: State Statistical Office of the Republic of Macedonia; NBRM calculations in Euros

On the other hand, the high dependence of the Macedonia export activity on the imports, primarily in metallurgy and textile industry (69% in 2005) causes the import of iron and steel and product thereof, and clothing and textile to equal Euro 311 million and Euro 285.7 million, respectively in 2005, which is the same level as registered in the previous year (Euro 311.6 million⁹⁴ and Euro 287.2 million, respectively). However, their share in the total import in 2005 equals 12% and 11%, respectively. The large orientation of the Macedonian economy to import of equipment and electrical machinery⁹⁵ (with their share in the total import in 2005 being equal to 12.1%) led to larger import of these products by Euro 26.8 million, thus reaching Euro 315.3 million.

Figure 59

Import dynamics by groups of products

(in millions of Euros)



Source: State Statistical Office of the Republic of Macedonia, and NBRM calculations in Euros.

94. High import of iron and steel by the restarted metallurgical facility in the fourth quarter of 2004 was registered.

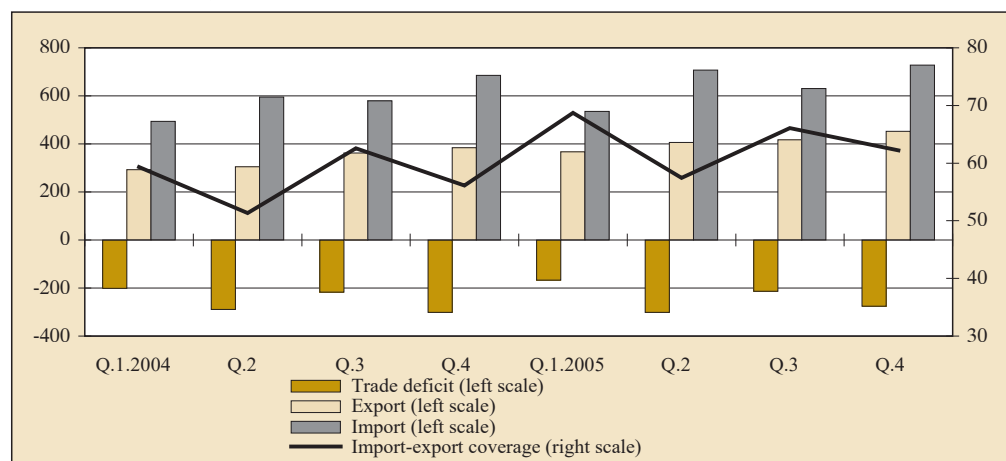
95. It pertains to the tariff numbers 84 and 85.

The analysis of the quarterly dynamics of individual foreign trade components indicates more stable movements in the export, especially starting from the third quarter of 2004, which is due to the intensified production and export activity of the restarted metallurgical facility, while cyclical quarterly movements are registered in the import, with significantly higher import being registered in the second and in the fourth quarter, in comparison with the first and the third quarter of the year.

Figure 60

Foreign trade dynamics by quarters

(in millions of Euros)



Source: State Statistical Office of the Republic of Macedonia, and NBRM calculations in Euros.

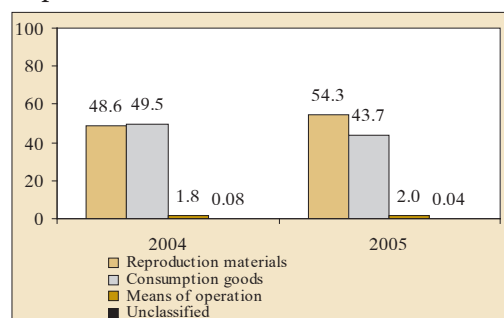
In 2005, the analysis of the foreign trade by the economic use of products indicates that the production materials dominate in both export and import structure by 54.3% and 64.9%, respectively. The analysis from the aspect of the dynamics shows that changes towards bigger participation of the production materials and lower share of consumption goods in comparison with the previous year are registered (annually by 5.7 percentage points and 5.8 percentage points, respectively).

Figure 61

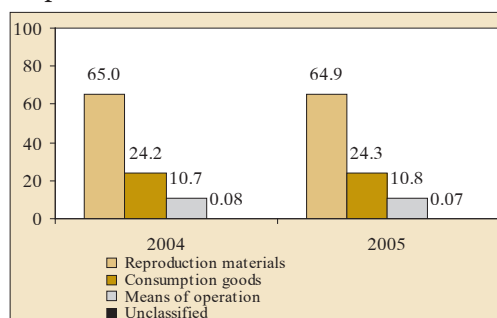
Foreign trade of the Republic of Macedonia by economic use of products

(in %)

Export



Import



Source: State Statistical Office of the Republic of Macedonia and NBRM calculations in Euros.

The analysis of the products depending on the degree of processing shows that the largest share of the export and the import registered in 2005 accounts for the highly

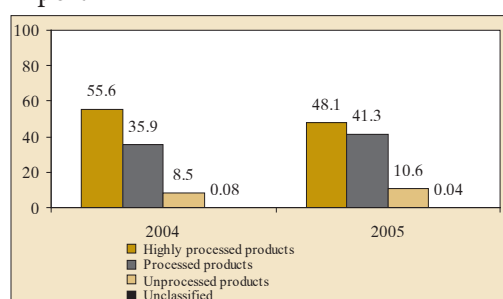
processed products (48.1% and 53.9%, respectively). Also, regarding the export, the share of processed products is high (41.3%), while the level of unprocessed products equals 10.6%. Simultaneously, regarding the import, 28.2% of the total import account for the processed products and 17.8% for the unprocessed products. The analysis from the aspect of the dynamics of the export shows higher presence of the processed products (by 5.4 percentage points, mainly due to the higher import of iron and steel and oil derivatives), whereas smaller presence of the highly processed products (by 7.5 percentage points), while regarding the import, higher share of unprocessed products was registered (by 4.2 percentage points, due to the higher import of energy), given simultaneous decrease in the share of the highly processed products (by 5.1 percentage points).

Figure 62

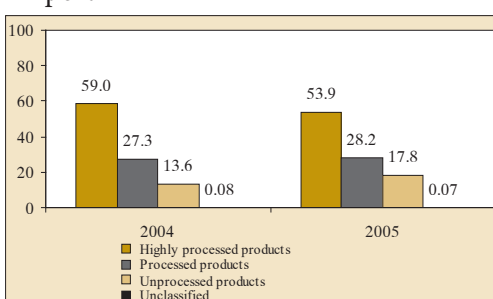
Foreign trade of the Republic of Macedonia according to the degree of processing of the products in 2005

(in %)

Export



Import



Source: State Statistical Office of the Republic of Macedonia and NBRM calculations in Euros.

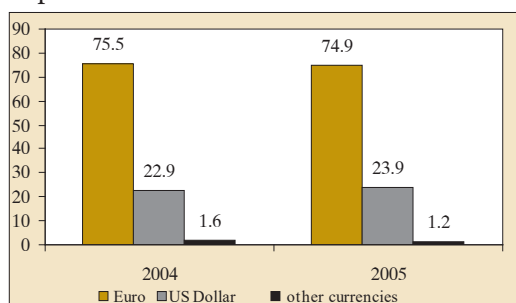
The analysis of the foreign trade by the currency structure in 2005 indicates lower share of the Euro (by 2.8 percentage points in comparison with 2004), and increased share of the US Dollar (by 3.2 percentage points), which is closely related to the risen import of oil and oil derivatives, mainly paid in US Dollars. The Euro dominates in both export and import of goods (by 74.9% and 70.5%, respectively), which is lower compared to 2004 (by 0.6 percentage points and 4.2 percentage points, respectively). On the other hand, in 2005 the share of the US Dollar in the export and the import of goods incremented by 1 percentage point and 4.5 percentage points, respectively.

Figure 63

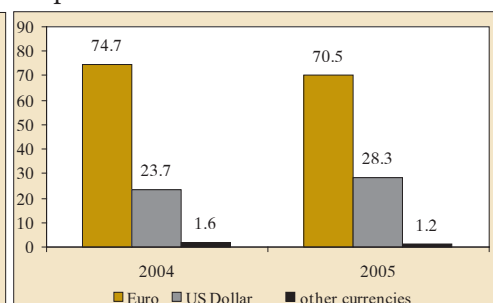
Currency structure of the foreign trade of the Republic of Macedonia

(in %)

Export



Import



Source: State Statistical Office of the Republic of Macedonia and NBRM calculations in Euros.

Analyzed by geographic distribution of the foreign trade in 2005, high orientation of the Macedonian economy to the European Union is evidenced, the share of which in the total foreign trade of 48.4% is the dominant one. Observed from the aspect of the trade components, this group of countries participates in the total export and import of goods with 53% and 45.5%, respectively. Large dependence of the Macedonian economy on raw materials resources (oil and other raw materials, mainly iron and steel) causes intensive trade with the Central and Eastern European countries, the participation of which in the total trade in 2005 equals 18.2% (17% in 2004). The Republic of Macedonia realizes intensive foreign trade with the countries of the former SFRY, the share of which in 2005 went up by 0.9 percentage points and it equals 18.1%.

Table 25

Geographic distribution of the foreign trade of the Republic of Macedonia

	Export	Import	Total trade	Trade balance	Export - import coverage	Export	Import	Total trade	Trade balance	Export - import coverage
	in millions of Euros					in millions of Euros				
	2004					2005				
European Union	768.2	1,173.4	1,941.6	-405.2	65.5	870.7	1,183.5	2,054.2	-312.9	73.6
Germany	254.3	295.5	549.7	-41.2	86.1	291.9	270.1	562.1	21.8	108.1
Greece	184.0	227.5	411.5	-43.6	80.9	251.9	239.2	491.1	12.6	105.3
Italy	107.9	135.8	243.7	-27.8	79.5	136.4	156.4	292.8	-19.9	87.2
Other	222.0	514.6	736.6	-292.6	43.1	190.5	517.8	708.3	-327.3	36.8
Central and Eastern European countries and former countries of USSR	80.4	544.0	624.4	-463.7	14.8	108.9	664.8	773.7	-556.0	16.4
Russia	15.8	217.2	233.0	-201.3	7.3	17.3	343.6	360.8	-326.3	5.0
Bulgaria	41.3	169.0	210.2	-127.7	24.4	61.7	188.3	250.0	-126.6	32.8
Romania	1.5	89.8	91.2	-88.3	1.6	3.4	51.5	54.9	-48.1	6.6
Other	21.8	68.1	89.9	-46.3	32.0	26.5	81.5	108.0	-55.0	32.5
Former countries of SFRY	370.7	262.2	632.9	108.4	141.3	477.9	292.3	770.3	185.6	163.5
Serbia and Montenegro	279.3	196.2	475.5	83.2	142.4	371.9	212.5	584.4	159.4	175.0
Other	91.3	66.1	157.4	25.2	138.2	106.0	79.8	185.9	26.2	132.8
Other countries	126.7	352.9	479.6	-226.3	35.9	186.1	460.3	646.3	-274.2	40.4
China	1.0	65.9	67.0	-64.9	1.6	7.6	92.6	100.3	-85.0	8.3
Other	125.6	287.0	412.6	-161.4	43.8	178.4	367.7	546.1	-189.2	48.5
TOTAL	1,345.9	2,354.0	3,699.9	-1,008.0	57.2	1,643.5	2,601.0	4,244.5	-957.4	63.2

Source: State Statistical Office of the Republic of Macedonia and NBRM calculations in Euros.

The analysis of the ten most important trade partners shows that also in 2005 the largest part of the foreign trade of the Republic of Macedonia accounts for its traditional trade partners: Germany, Serbia and Montenegro and Greece, the total share of which in the foreign trade remained unchanged compared to the previous year and it equals 38.6%. The import - export coverage of the three most important foreign trade partners in 2005 increased on an annual basis (by 32.6, 22 and 24.4 percentage points, respectively), indicating larger presence of the Macedonian products on the markets of these countries.

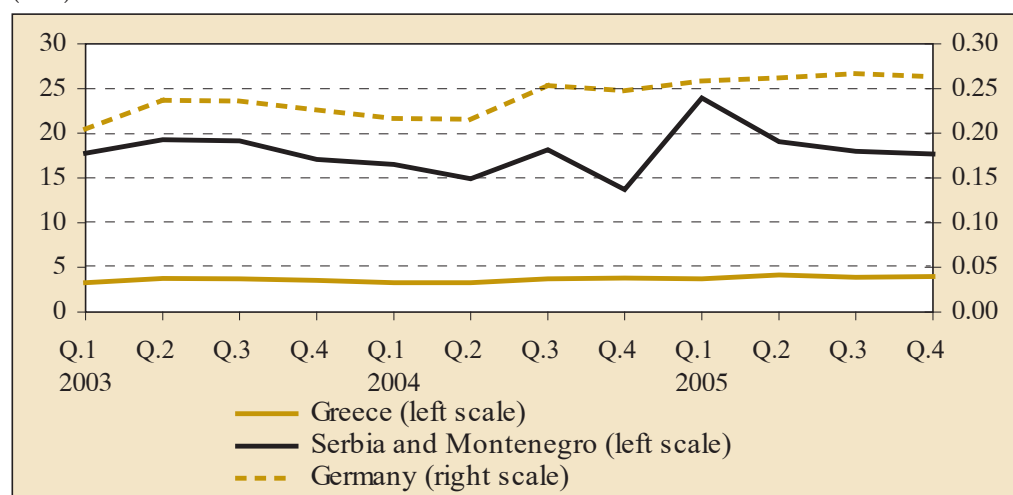
From the aspect of individual countries, the highest surplus of the Republic of Macedonia in the amount of Euro 159.4 million was registered in the trade with Serbia and Montenegro (the highest one since the independence, mainly due to the increased export of oil derivatives), thus registering the highest export - import coverage of 175%, while the highest deficit of Euro 326.3 million was registered in the trade with Russia, and as a result, the lowest export - import coverage of 5% (as a result of the high import of oil). In 2005, one of the ten the most important partner-states is China, the share of which in the total foreign trade of the Republic of Macedonia increased

by 0.6 percentage points and it equals 2.4%, which is due to the intensified import of goods from China (annual growth of 40.5%).

Figure 64

Share of the export of the Republic of Macedonia in the import of the three most important trade partners

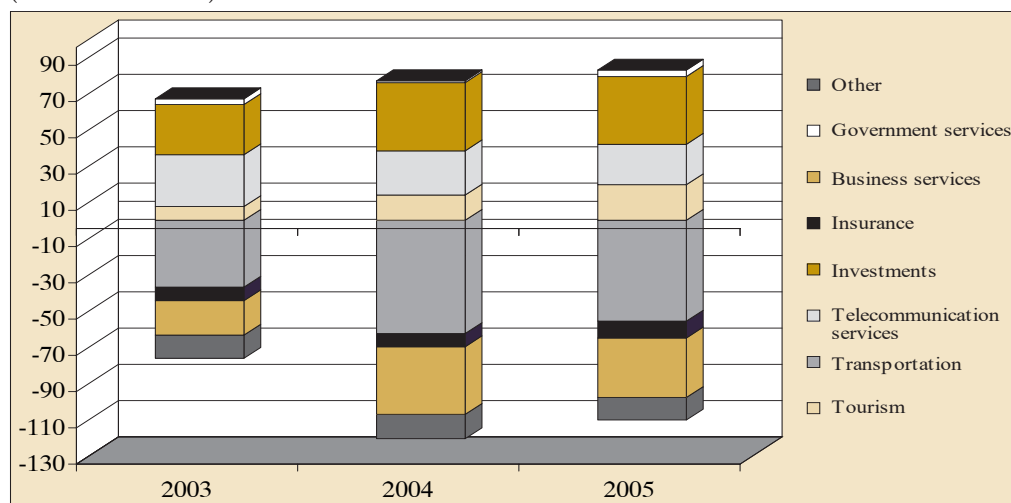
(in %)



Source: State Statistical Office of the Republic of Macedonia and NBRM calculations in Euros.

The favorable movements in the foreign trade led to lower deficit in the trade of *services*. Thus in terms of faster growth dynamics in the inflows compared to the increase in the outflows of services (of 16.1% and 9.9%, respectively), lower deficit in 2005 was recorded (by Euro 16.2 million annually), amounting to Euro 27.2 million. In 2005, services in the amount of Euro 380.6 million were provided (annual increase of Euro 52.9 million). The largest contribution to the higher inflows of services in 2005 accounts for the higher inflows originating from realized transport and business services (by Euro 17.1 million and Euro 15.2 million, respectively), primarily due to the intensified export activity. Simultaneously, higher inflows based on tourism were registered (by Euro 17.8 million and by Euro 9.9 million in comparison with 2003 and 2004, respectively) pointing to improved attractiveness of the Republic of Macedonia for the foreign tourists. In 2005, services in the amount of Euro 407.9 million were provided by non-residents (annual increase of Euro 36.7 million). The highest increase is registered in the business and transport services (of Euro 10.7 million and Euro 10.3 million, respectively), due to the increase in the import of goods. Lower net inflows (by Euro 2.1 million and Euro 0.2 million, respectively) in the telecommunication and investment services were registered in 2005 (which usually register positive balance), and they amount to Euro 22.3 million and Euro 37.4 million, respectively.

Figure 65
Balance of certain categories of services
(in millions of Euros)

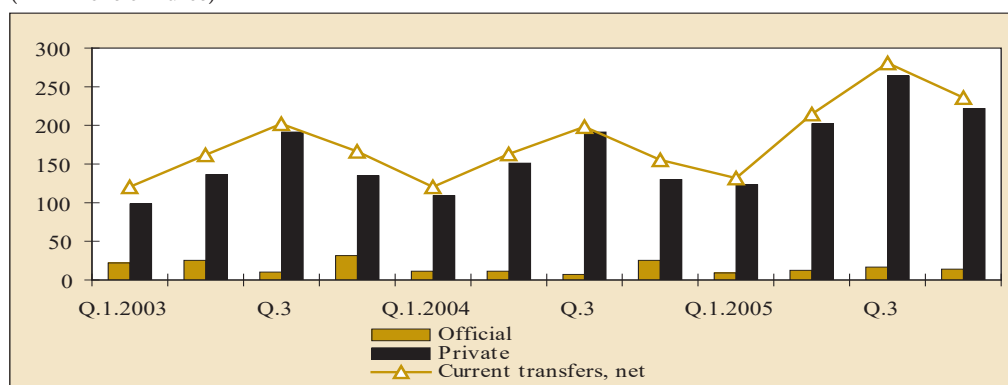


Source: National Bank of the Republic of Macedonia

Increase in the deficit of Euro 11.2 million was registered in the *income sub-balance* in 2005, mainly due to the augmented foreign currency outflows on the basis of payment of dividends to non-residents. Also, higher foreign currency inflows on the basis of compensation of resident employees (by Euro 4.6 million) were registered in 2005, which neutralizes the profit repatriation effect with the foreign direct investors to certain extent (higher by Euro 14.9 million). Net outflows of foreign assets based on interest in the amount of Euro 20.7 million were registered, which are at the level registered in the previous year. Higher inflows originating from interest on the official foreign reserves and the foreign currency deposits of commercial banks abroad are realized (by Euro 7.6 million), neutralized by the higher amount of paid interest to the foreign creditors for the utilization of long-term and short-term credits (by Euro 7.1 million).

The decrease in the deficit in the balance of payments' current account in 2005 was significantly contributed by the augmented net inflows originating from *current transfers*.

Figure 66
Current transfers, net
(in millions of Euros)



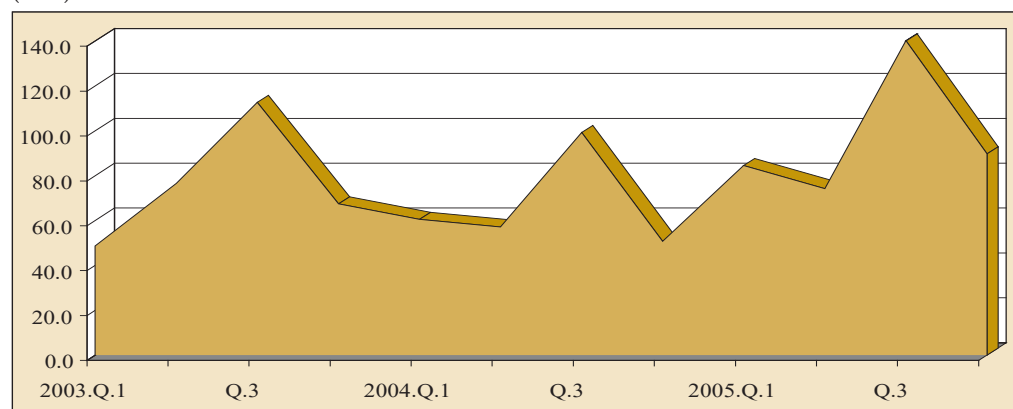
Source: National Bank of the Republic of Macedonia

In terms of reduced foreign currency inflows from official transfers (by Euro 3 million), the higher net foreign currency inflows based on current transfers (by Euro 226.2 million) completely originate from the increased private transfers. Thus net inflows of foreign assets based on private transfers in the amount of Euro 810.7 million went up by Euro 229.2 million, mainly as a result of the higher net inflows based on currency exchange operations (by Euro 198.6 million), while the increase in other net private transfers (mainly pensions, rents and disability allowances) and net remittances equals Euro 23.2 million and Euro 7.4 million, respectively. Such a dynamics of individual private transfer components determines changes in the private transfers' structure, with the share of the net inflows from currency exchange operations in 2005 being higher by 7.2 percentage points reaching 68.4%. The incremented net inflows of private transfers in 2005 covered 95% of the trade deficit (compared to 74.8% in 2003 and 65.1% in 2004), pointing to the growing importance of the private transfers for financing the current account deficit.

Figure 67

Coverage of the trade deficit with private transfers

(in %)



Source: National Bank of the Republic of Macedonia

In 2005, the inflow of funds based on official transfers preserved the level registered in the previous year and they equal Euro 59.9 million (Euro 31.8 million in funds and Euro 28.2 million in goods). Within the financial donations, Euro 13.3 million (41.8% of the total financial donations) originate from the Netherlands⁹⁶ aimed at macrofinancial support. The total outflows based of donations of the Republic of Macedonia to other countries in 2005 amount to Euro 7.5 million, i.e. increase of Euro 2.8 million on annual basis (mainly due to the in-kind donations aimed for the tsunami stricken Asian countries in February 2005).

5.1.2. Capital and financial account

The capital and the financial transactions in 2005 resulted in an increase in the net foreign currency inflows (of Euro 77.1 million compared to 2004), mainly as a result of the significant increase in the net inflows based on foreign direct and portfolio investments and loans (of Euro 137.6 million and Euro 77.1 million, respectively). Their share in the total net financial inflows is dominant and it equals 62.2% and 28.3%, respectively).

96. In July and December 2005, Euro 6.3 million and Euro 7 million, respectively were received.

Table 26

Capital and financial account of the balance of payments¹⁾

(in millions of Euros)

	2003	2004	2005
Capital account	-5.8	-3.8	-1.7
Financial account	205.9	346.5	421.6
Direct investments, net	81.1	126.2	77.1
Portfolio investments, net*	3.0	11.3	198.0
Trade credits, net	68.9	136.4	21.1
Loans, net	35.0	47.9	125.0
Currencies and deposits, net	5.5	-2.3	-20.7
Other, net**	12.5	26.9	21.1
Capital and financial account	200.1	342.7	419.8

1) Preliminary data

*In 2005 together with the inflows based on Eurobonds

**Overdue claims

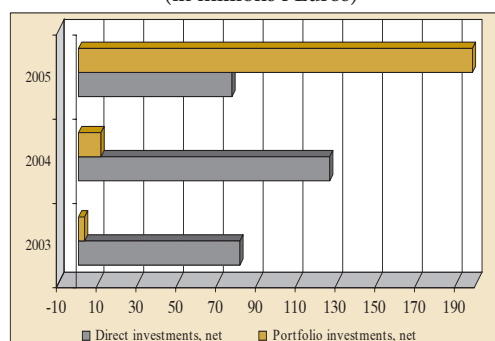
Source: National Bank of the Republic of Macedonia

In 2005, the net inflows based on foreign direct and portfolio investments reached Euro 275.1 million, representing significant source of financing of the deficit in the current foreign transactions. The analysis from the aspect of the structural correlation between individual components shows increased share of portfolio investments, which in 2005 went up by Euro 186.7 million on net basis. The fact that Euro 149.2 million out of these inflows account for the portfolio investments based on debt securities issue - Eurobonds in December 2005, should also be taken into consideration, with the inflow being intended for total repayment of the liabilities of the Republic of Macedonia to the London Club of Creditors. The portfolio investments without Eurobonds equal Euro 48.8 million⁹⁷, which is an annual increase of 4.3 times, pointing to the higher share of the foreign investors on the domestic securities market, in terms of their liberalization.

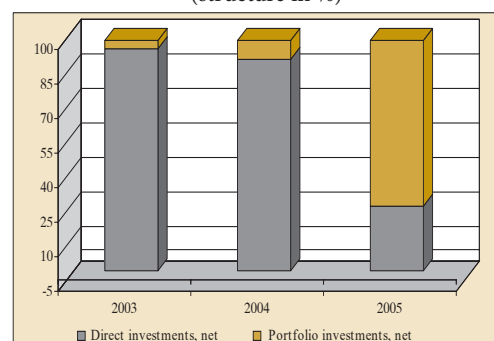
Figure 68

Direct and portfolio investments, net

(in millions f Euros)



(structure in %)



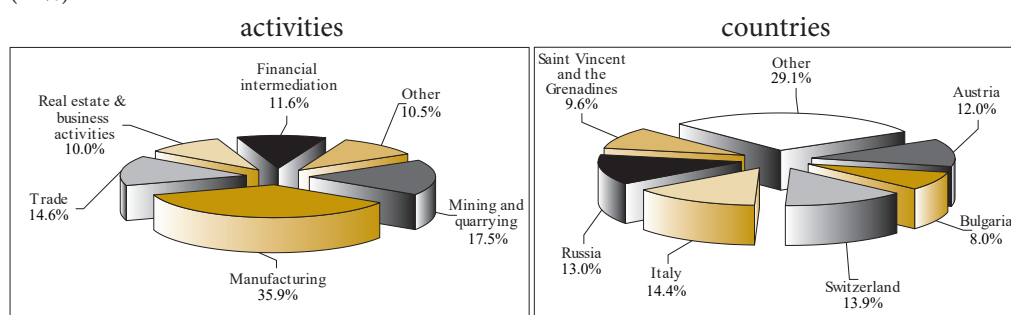
Source: National Bank of the Republic of Macedonia.

97. Euro 11.8 million out of this amount, are inflows from the European Bank for Reconstruction and Development intended for pre-privatization of the electric power company ESM.

In 2005, the inflows based on foreign direct investments in the country amounted to Euro 89.7 million (Euro 131.8 million in 2004). The analysis from the aspect of the allocation by activities indicates that the largest portion of the foreign direct investments in 2005 accounts for manufacturing (35.9%). The analysis of the structural share of individual activities points to the growing interest of the foreign investors in investments in both mining and manufacturing (by 13.9 percentage points and 3 percentage points, respectively) compared to 2004. In 2005, total of Euro 32.2 million were invested in production activity, which are primarily directed towards both production of chemicals and chemical products and production of metal products (Euro 9.5 million and Euro 8 million, respectively). From the aspect of the countries, the largest share of the investments originates from Italy, Switzerland and Russia (in the amount of Euro 12.9 million, Euro 12.4 million and Euro 11.7 million, respectively).

Figure 69

Foreign direct investments in the Republic of Macedonia in 2005
(in %)



Source: National Bank of the Republic of Macedonia

In 2005, direct foreign investments of the Republic of Macedonia to other countries in the amount of Euro 3.4 million were realized, which is by 2.4 times more compared to 2004. The most attractive activities of the domestic investors to invest in are both manufacturing and mining (64.5% and 28.1%, respectively). Analyzed by countries, the largest share of the domestic investments is realized in Albania and China (in the amount of Euro 2.1 million and Euro 1 million, respectively).

In 2005, larger net annual inflow of foreign assets based on middle-term and long-term loans and credits (by Euro 77.1 million) was registered, mainly due to the higher amount of used new long-term and middle-term loans and credits, in terms of reduced repayments based on principal and interest based on long-term and middle-term funds withdrawn from foreign creditors.

After the high increase in the trade credits in 2004 initiated by the intensified foreign trade activity, as well as the high advance import of manufacturing supplies by a significant metallurgical facility, remarkable decrease in the trade credits (of Euro 115.3 million) was registered in 2005. Such a dynamics is mainly caused by the large payments, especially in the first quarter of 2005, aimed at the import of goods realized in the last quarter of 2004, with the trade net outflows in the first quarter being equal to Euro 45.7 million, compared to net inflows of Euro 22.4 million registered in the same period of 2004. The lower advance import of manufacturing supplies for metallurgy in the third quarter of 2005 also acted in the same direction, with net outflows of Euro

32,1 million being realized, in comparison with Euro 6.8 million registered in the same period of 2004.

In 2005, increase of Euro 20.7 million in the category "currencies and deposits" on net basis was registered, which is mainly due to the increase in the households' cash foreign assets, which is a result of the withdrawn funds based on fast money transfer to a great extent (in the amount of Euro 56.9 million), while the net foreign assets of the commercial banks registered a decrease (of Euro 22.4 million). In 2005, arrears in the balance of payments in the amount of Euro 21.1 million were registered, which totally refer to the private sector⁹⁸.

The favorable movements of certain current and capital and financial transactions in 2005 were the reason for the significant increase in the gross official reserves of Euro 347.9 million⁹⁹.

5.2. Denar exchange rate

In conformity with the applied strategy of Denar exchange rate targeting against the Euro, in 2005, the nominal Denar exchange rate against the Euro on the foreign exchange market remained stable. Thus as of December 31, 2005, Denar 61.17 per one Euro were traded, which is slight appreciation of the Denar of 0.2% compared to the end of the previous year. Namely, in terms of increased foreign exchange inflows from the currency exchange market, high amount of used foreign credits and loans and intensified export activity, the supply of foreign assets by the bank exceeded the demand for foreign exchange during the whole year (except in January). The higher supply of foreign exchange on the foreign exchange market, and consequently pressures for appreciation of the domestic currency were especially characteristic for the third quarter, because of the high foreign exchange inflows from currency exchange operations. However, the NBRM contributed for maintaining stable nominal Denar exchange rate against the Euro through the transactions on the foreign exchange market (high net purchase of foreign exchange) and the monetary policy instruments layout. Namely, in 2005, the average Denar exchange rate against the Euro equaled Denar 61.30 per one Euro, compared to Denar 61.34 per one Euro in 2004.

The Denar exchange rate relative to the Euro on the currency exchange market followed the movements of the Denar exchange rate relative to the Euro on the foreign exchange market. Namely, in terms of constantly higher supply of than demand for foreign currency, small appreciations of the Denar against the Euro in 2005 were registered. Thus Denar 61.65 per one Euro were averagely traded in January, while Denar 61.42 per one Euro were traded in November and December. However, in 2005

98. Part of the arrears originates from the improperly submitted documentation by the private sector to the NBRM.

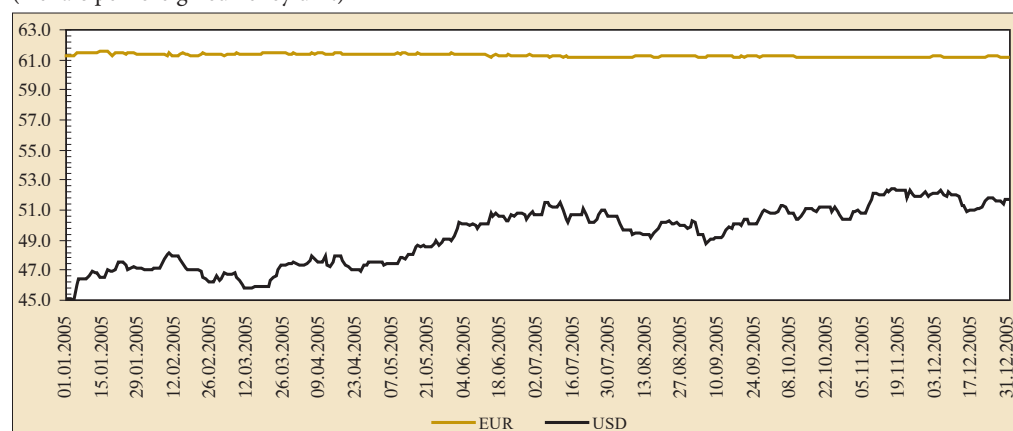
99. The datum on the gross official reserves presented in the balance of payments differs from the datum on the gross foreign reserves, due to which the exchange rate differentials and the monetary gold are excluded from the balance of payments statistics.

the average annual foreign exchange rate of the Denar relative to the Euro remained almost unchanged and Denar 61.53 per one Euro were traded (Denar 61.54 per one Euro in 2004).

Figure 70

Nominal Denar exchange rate against the Euro and the US Dollar on the foreign exchange market

(Denars per foreign currency unit)



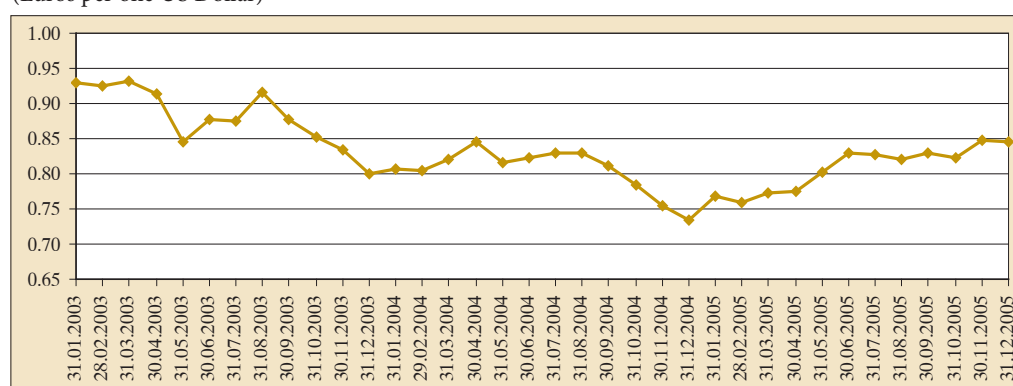
Source: National Bank of the Republic of Macedonia

The Denar exchange rate relative to other foreign currencies depends on their parity with the Euro on the international foreign exchange markets. Compared to the previous year, in 2005 the value of the US Dollar relative to the Euro started to increase (primarily as a result of the multiply increase in the reference interest rate in the USA), especially in the first half of 2005. At the beginning of 2005, relatively stable movements were recorded, while further strengthening of the US Dollar at the end of the year was registered, with the highest value of the US Dollar against the Euro¹⁰⁰ since the beginning of 2005 being recorded in November.

Figure 71

Nominal Euro/US Dollar exchange rate

(Euros per one US Dollar)



Source: the National Bank of the Republic of Macedonia

100. According to the data of the European Central Bank, on November 15, 2005 the US Dollar/Euro correlation equaled US Dollar 1,1667 per one Euro, which is the lowest correlation registered in 2005.

The Denar exchange rate relative to the US Dollar on the foreign exchange market followed up such movements with the value of the Denar registering a significant decrease in the first half of 2005 (Denar depreciation of 12.8% on June 30, 2005 compared to December 31, 2004), while in the second half the Denar depreciation continued, although with slower pace. On December 31, 2005, the Denar exchange rate relative to the US Dollar on the foreign exchange market equaled Denar 51.73 per one US Dollar, which is annual depreciation of the Denar of 14.8%. The average Denar exchange rate relative to the US Dollar in 2005 equaled Denar 49.29 per one US Dollar, and it appreciated by 0.2% on an annual basis (in 2004, Denar 49.41 per one US Dollar, on average were traded).

Similar movements of the Denar/US Dollar exchange rate on the currency exchange market to those evidenced on the foreign exchange market were registered. Namely, in December 2005, the average Denar exchange rate against the US Dollar equaled Denar 51.60 per one US Dollar, which is a depreciation of 11.8% compared to December 2004. On the other hand, the average annual exchange rate of the Denar against the US Dollar appreciated on an annual basis by 0.5%, with Denar 49.24 per one US Dollar being traded (Denar 49.51 per one US Dollar in 2004).

The real effective exchange rate (REER) is one of the indicators for the competitiveness of the economy. Calculated as a correlation between the nominal effective exchange rate index (NEER)¹⁰¹ and the relative price index¹⁰², the REER shows the changes in the price competitiveness of the national economy compared to the economies of the most significant foreign trade partners. In December 2005, the Denar REER index calculated according to the consumer price index and price index of the producers of industrial products registered a depreciation compared to December 2004, which means improved price and export performances of the domestic products on the international markets. Namely, in terms of appreciation of NEER of 0.8%, the appreciation of the REER of the Denar calculated according to the consumer price index of 3% is primarily due to more intensive annual increase in the foreign consumer prices¹⁰³ compared to domestic ones (increase of 5.3% and 1.3%, respectively¹⁰⁴). According to the price index of the producers of industrial products, the real effective exchange rate depreciated by 0.5% on annual basis, given more intensive increase in the foreign prices of the industrial producers¹⁰⁵ relative to the domestic ones (increase of 5% and 3.7%, respectively¹⁰⁶).

101. 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).

102. Correlation between foreign and domestic prices.

103. Preliminary data pertaining to December 2005.

104. Changes in prices with a basis of 1995=100.

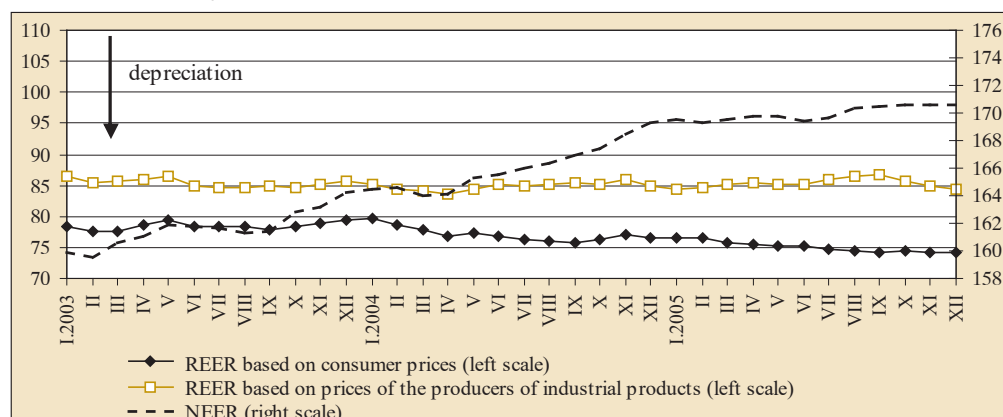
105. Preliminary data for November and December 2005, while the data pertaining for Greece and Turkey refer to the January - December 2005 period.

106. Changes in prices with a basis of 1995=100.

Figure 72

REER and NEER indices of the Denar

(basis 1995=100, weights HTP 2003)



Source: National Bank of the Republic of Macedonia

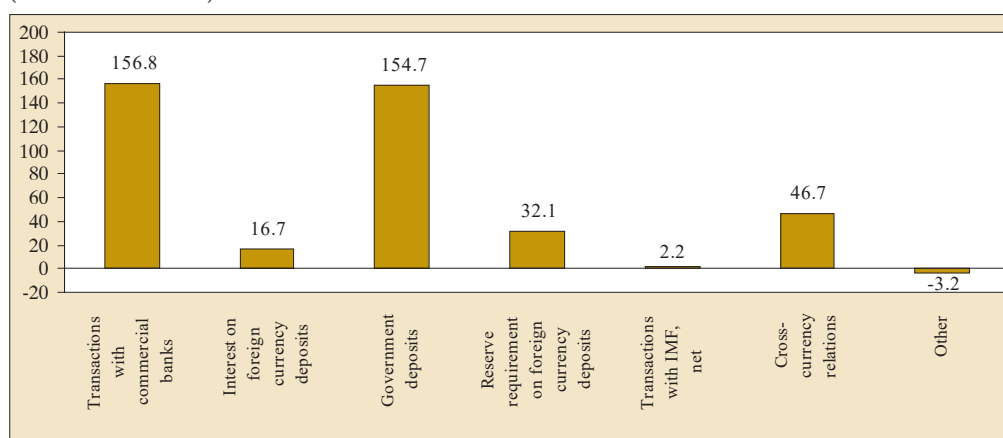
5.3. Foreign reserves

In conformity with the favorable movements registered on the foreign exchange market, in 2005, the gross foreign reserves of the NBRM went up by Euro 406 million, and reached Euro 1,122.9 million. Having in mind that Euro 149.2 million out of the registered increase refer to the inflows based on Eurobonds (issued in December 2005) aimed at repayment of the debt to the London Club of Creditors (in January 2006), if this inflow is excluded due to the short-term effect, the increase in the gross foreign reserves in 2005 will equal Euro 256.8 million.

Figure 73

Factors of change in the gross foreign reserves in 2005

(in millions of Euros)



Source: National Bank of the Republic of Macedonia

The increase in the gross foreign reserves is primarily generated from the realized net purchase of foreign exchange by the NBRM on the foreign exchange market and from the realized net inflows of government deposits in the amount of Euro 156.8 million and Euro 154.7 million, the contribution of which in the increase in the gross foreign reserves equals 38.6% and 38.1%, respectively. The gross foreign reserves growth was also influenced by the allocated funds on the basis of the banks' reserve requirement on the foreign currency deposits and inflows originating from interest on foreign currency deposits with foreign banks in the amount of Euro 32.1 million and Euro 16.7 million, respectively. In terms of appreciation of the US Dollar relative to the Euro, and in accordance with the currency structure of the gross foreign reserves, positive exchange rate differentials in the amount of Euro 46.7 million were realized, determining 11.5% of the increase in the gross foreign reserves in 2005.

The analysis of the quarterly dynamics of the changes of the gross foreign reserves shows *continuous increase in the gross foreign reserves during the whole year*. Thus in the first quarter of 2005, the gross foreign reserves augmented by Euro 20.1 million, primarily as a result of the allocated funds based on the banks' reserve requirement on foreign currency deposits (especially apparent in January 2005, when the increased rate became effective), the realized net purchase of foreign exchange on the foreign exchange market and the positive exchange rate differentials (41.3%, 35.4%, 18.4%, respectively, of the transactions that created increase in the gross foreign reserves in the first quarter of 2005). On the other hand, the net outflows with the government deposits acted towards decrease in the gross foreign reserves in the first quarter of 2005, mainly as a result of the regular servicing of the liabilities¹⁰⁷. The increase in the gross foreign reserves in the second quarter of 2005 in the amount of Euro 41 million is caused by the positive changes registered with all components (except to the transactions with the IMF), with the highest contribution for the gross foreign reserves growth accounting for the realized purchase on the foreign exchange market and positive exchange rate differentials (43.1% and 36.9% of the transactions that created increase in the gross foreign reserves in the second quarter of 2005). In the second quarter of 2005, the net inflows of the government deposits amounted to Euro 3.8 million, including the foreign assets extended by the International Bank for Reconstruction and Development based on Public Sector Management Adjustment Loan - PSMAL II, which were received in June 2005 in the amount of Euro 16.5 million.

107. The largest share accounts for the paid liabilities on the basis of the first annual installment to both London and Paris Club of Creditors, as a result of the rescheduled debt (realized in January 2005).

Table 27

Amount and changes in the gross foreign reserves of the Republic of Macedonia

(in millions of Euros)

	31.12.2004	Q.1	Q.2	Q.3	Q.4	01.01- 31.12.2005
Amount of the foreign reserves of the Republic of Macedonia	716.9	737.0	778.0	876.6	1,122.9	
Net increase in the foreign reserves		20.1	41.0	98.6	246.4	406.0
1. Transactions with commercial banks		18.9	19.8	76.7	41.4	156.8
Purchase and sale		12.3	15.7	73.7	33.1	134.8
Securities		6.6	4.1	3.0	8.4	22.1
2. Interest on the foreign currency deposits		2.6	3.1	4.2	6.7	16.7
3. Government deposits		-29.9	3.8	-6.1	186.9	154.7
4. Reserve requirement on foreign currency deposits		22.0	2.2	6.0	1.8	32.1
5. Transactions with IMF, net		-0.3	-5.0	11.4	-3.9	2.2
6. Cross-currency relations		9.8	17.0	6.5	13.4	46.7
7. Other		-3.1	0.1	-0.1	-0.1	-3.2

Source: National Bank of the Republic of Macedonia

In the second half of 2005, intensified dynamics of the increase in the gross foreign reserves is registered, which is caused to a great extent by the higher net purchase of foreign assets on the foreign exchange market. Thus in the third quarter of 2005, the gross foreign reserves surged by Euro 98.6 million, given high seasonal supply of foreign currency on the currency exchange market, which resulted in higher net purchase of foreign currency on the foreign exchange market by the NBRM in the amount of Euro 76.7 million (73.2% from the transactions creating increase in the gross foreign reserves in the third quarter of 2005). One of the reasons for the increase in the gross foreign reserves was the net inflow from the IMF in the amount of Euro 11.4 million (Euro 12.4 million of which are withdrawn on the basis of the Stand-By Arrangement with the IMF¹⁰⁸ in September 2005), as well as the positive exchange rate differentials, the reserve requirement of foreign currency deposits and inflows based on interest. Net outflows were registered only with the government deposits¹⁰⁹, despite the received donation from the Netherlands in July 2005 and the funds of the European Bank for Reconstruction and Development aimed at pre-privatization of the Macedonian electric power company ESM in August 2005, in the amount of Euro 6.3 million and Euro 6.8 million, respectively. In the fourth quarter of 2005, an extremely high increase in the gross foreign reserves of Euro 246 million was registered, mainly due to the inflow from the Eurobonds in the amount of Euro 149.2 million. Also in December 2005, within the category government deposits, the anticipated donation from the Netherlands was received (Euro 7 million), as well as funds from the International Bank for Reconstruction and Development on the basis of the Programmatic Development Policy Loan - PDPL I (Euro 24.3 million) and the European Bank for Reconstruction and Development aimed at the pre-privatization of the Macedonian electric power company ESM (Euro 4.5 million). In the fourth quarter of 2005, foreign assets and monetary gold in the amount of Euro 12 million were received on the basis of the succession of the financial assets of former SFRY¹¹⁰. However, in the fourth quarter of 2005, the total net inflows of government deposits reached Euro 186.9 million (74.6% of the transactions that created increase in the gross

108. On August 31, 2005, the Board of Directors of the IMF extended three-year "cautious" Stand-By Arrangement (in total value in original currency of SDR 51.7 million).

109. The largest portion of the outflow is paid liabilities on the basis of the second annual installment to both London and Paris Club of Creditors on the basis of rescheduled debt (realized in July 2005).

110. The total inflows in 2005 amounted to Euro 12.4 million.

foreign reserves in the fourth quarter of 2005). The realized net purchase of foreign currency on the foreign exchange market, the positive exchange rate differentials, the interest income and the reserve requirement on foreign currency deposits, also acted towards rise in the gross foreign reserves in the fourth quarter of 2005.

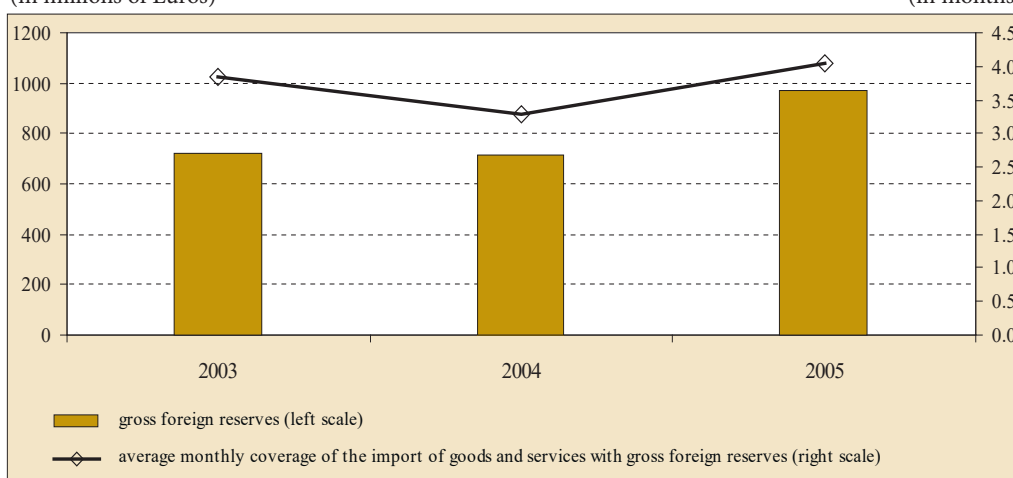
The continuous growth dynamics in the gross foreign reserves during the whole year resulted in higher average monthly coverage of the import of goods and services. Thus at the end of 2005, the gross foreign reserves (without the inflows based on Eurobonds) provide four-month coverage of the import of goods and services in 2005, compared to 3.3 month average coverage in 2004.

Figure 74

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

(in millions of Euros)

(in months)



Source: National Bank of the Republic of Macedonia

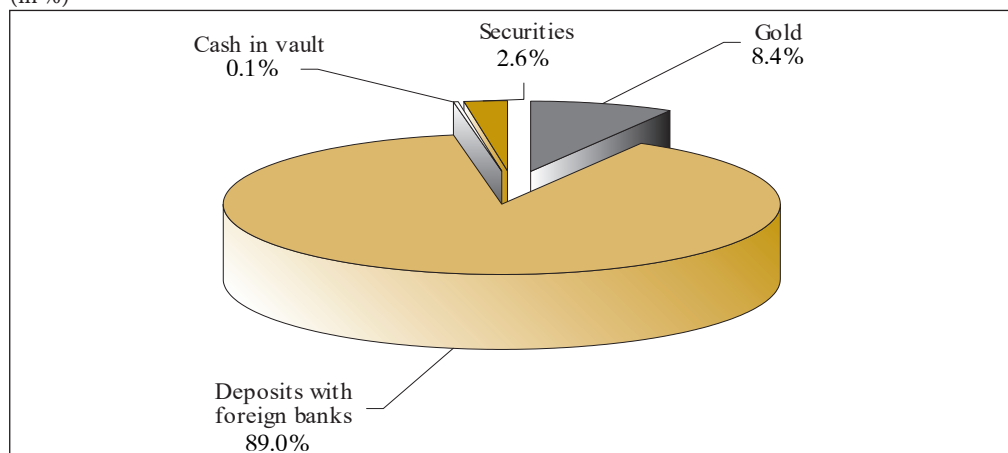
At the end of 2005, the total foreign assets of the National Bank of the Republic of Macedonia¹¹¹ equaled Euro 1,136.1 million, which is an increase of Euro 407.3 million compared to the end of 2004. The funds used as collateral with foreign banks amounted to Euro 12.5 million at the end of 2005 (compared to Euro 11.3 million at the end of 2004). The increase is completely caused by exchange rate differentials. The analysis of the total foreign assets observed from the structural aspect shows that the share of the foreign currency deposits with foreign banks dominates and it equals 89% (rise of 0.7 percentage points compared to the end of 2004). On the other hand, the share of the cash in vault and the monetary gold dropped by identical 0.4 percentage points compared to the end of the previous year.

111. The total foreign assets differ from the gross foreign reserves for the amount of the foreign assets pledged as collateral in foreign banks, which has been included in the total foreign assets, but not in the gross foreign reserves.

Figure 75

Structure of the total foreign assets on December 31, 2005

(in %)



Source: National Bank of the Republic of Macedonia

The liabilities of the Republic of Macedonia towards the International Monetary Fund compared to the end of December 2004 rose by Euro 6.7 million, and on December 31, 2005 they equaled Euro 52.7 million. Such a dynamics is mainly a result of the increase in the net liabilities of Euro 3.7 million (in terms of higher amount of withdrawn funds compared to the paid liabilities based on principal by Euro 12.4 million and Euro 8.7 million, respectively), as well as the exchange rate differentials in the amount of Euro 3 million. The net foreign assets of the Republic of Macedonia (difference between the total foreign assets and liabilities towards the IMF) reached Euro 1,083.4 million, i.e. increase of Euro 400.6 million compared to the end of 2004.

5.4. External debt of the Republic of Macedonia¹¹²

At the end of 2005, the total external debt of the Republic of Macedonia (short-term and long-term debt) equaled Euro 1,928.3 million, Euro 1849.1 million (or 95.9%) of which refer to the long-term liabilities, while Euro 79.2 million (or 4.1%) account for the short-term loans. In comparison with the end of the previous year, the total external debt registered an increase of Euro 399.8 million, or 26.2%, generated mainly from the higher amount of used funds than paid liabilities, as well as from the indebtedness of the public sector based on issued Eurobonds in December 2005.

The total external debt, not including the Eurobonds, equals Euro 1,778.3 million, which is an annual increase of Euro 249.8 million, or 16.3%.

112. Preliminary data of the NBRM.

Table 28
External debt of the Republic of Macedonia

		As of 31.12.2005		Structure	Changes compared to 31.12.2004	
		in millions of Euros	(in %)	(in %)	in millions of Euros	(in %)
Long-term credits and loans		1,849.1	100.0	95.9	373.4	25.3
	Principal	1,826.5	98.8		367.0	25.1
	Interest	22.6	1.2		6.4	39.6
Short-term credits		79.2	100.0	4.1	26.4	49.9
	Principal	72.3	91.3		25.1	53.2
	Interest	6.9	8.7		1.3	22.3
Total debt		1,928.3		100.0	399.8	26.2

Source: National Bank of the Republic of Macedonia

Despite the increase in the total external debt, the indicators for the level of indebtedness for 2005¹¹³ remained within the zone of indebtedness registered in the previous year. 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. According to the indicator total external debt relative to the average GDP in the last three years, the Republic of Macedonia is moderately indebted country.

Table 29
Indicators for the level of indebtedness of the Republic of Macedonia

Indicators	31.12.2001	31.12.2002	31.12.2003	31.12.2004	31.12.2005
Total external debt/GDP (criterion: moderate indebtedness 30-50%)	45.50%	40.25%	36.99%	36.89%	44.28%
Total external debt/export (criterion: low er indebtedness 0-165%)	107.77%	98.75%	98.25%	99.59%	111.47%
Debt servicing/ export of goods and services (criterion: low er indebtedness 0-18%)	14.69%	15.66%	14.86%	12.99%	10.99%
Repayment of interest/export of goods and services (criterion: low er indebtedness 0-12%)	4.43%	3.55%	3.19%	2.53%	2.65%

Source: National Bank of the Republic of Macedonia

5.4.1. Debt structure

At the end of 2005, the long-term external debt (liabilities of residents towards non-residents based on credits and loans with maturity exceeding one year) amounted to Euro 1,849.1 million, the largest share of which, i.e. 98.8% are liabilities based on principal, while 1.2% account for the liabilities based on overdue interest and estimated late interest.

Analyzed by individual creditors, the structure of the long-term external debt is further dominated by the official creditors with their share being equal to 57.6% (lower by 7.8 percentage points compared to the previous year). Thus the share of the multilateral creditors equals 48.2%, while the share of the bilateral ones equals 9.4% (annual decrease of 4.7 and 3.2 percentage points, respectively). The share of the external debt to the private creditors in the total long-term debt equals 42.2%.

113. Calculation made by the NBRM according to the World Bank methodology.

Table 30

Structure of the long-term debt by individual creditors

(in millions of Euros)

	Amount of the debt		Annual changes		Structural share	
	31.12.2004	31.12.2005	Amount	In %	31.12.2004	31.12.2005
Official creditors	965.8	1,065.7	99.9	10.3	65.5	57.6
of which:						
Multilateral creditors	780.3	891.7	111.4	14.3	52.9	48.2
IMF	46.0	52.7	6.7	14.5	3.1	2.8
IBRD	164.2	210.4	46.2	28.1	11.1	11.4
IFC	6.8	5.1	-1.7	-24.9	0.5	0.3
IDA	285.3	307.1	21.9	7.7	19.3	16.6
EIB	108.8	118.4	9.5	8.8	7.4	6.4
ERFC	6.1	6.1	0.0	-0.2	0.4	0.3
Council of Europe Development Bank	16.9	16.8	-0.1	-0.8	1.1	0.9
EBRD	47.9	74.2	26.3	54.9	3.2	4.0
EU	90.0	90.0	0.0	0.0	6.1	4.9
IFAD	7.9	11.0	3.1	38.8	0.5	0.6
EAR	0.4	0.0	-0.4	-100.0	0.0	0.0
Bilateral	185.5	174.0	-11.5	-6.2	12.6	9.4
Paris Club (reschedule 1995)	111.8	102.3	-9.5	-8.5	7.6	5.5
Non-rescheduled debt	6.6	6.6	0.0	0.0	0.4	0.4
Paris Club (reschedule 2000)	7.0	0.0	-7.0	-100.0	0.5	0.0
Newly concluded credits	60.1	65.1	4.9	8.2	4.1	3.5
Private creditors	509.8	783.3	273.5	53.6	34.5	42.4
of which:						
London Club	171.2	188.5	17.3	10.1	11.6	10.2
Eurobond	0.0	150.0	150.0			8.1
Other private creditors	338.7	444.8	106.1	31.3	23.0	24.1
Banks and financial institutions	175.0	224.8	49.8	28.4	11.9	12.2
Non-financial private sector	163.6	220.0	56.4	34.4	11.1	11.9
TOTAL	1,475.7	1,849.1	373.4	25.3	100.0	100.0

Source: National Bank of the Republic of Macedonia

The debt structure to the multilateral creditors indicates that the International Development Association is the larger individual creditor of the Republic of Macedonia, the share of which in the total long-term debt equals 16.6%, followed by the International Bank for Reconstruction and Development with a share of 11.4%, European Investment Bank with 6.4% and European Union with 4.9%.

From the aspect of the bilateral credits, the rescheduled debt to the Paris Club of Creditors (since 1995 and 2000) preserved its dominant structural share, which in 2005 equals 5.9%, while the newly concluded credits on bilateral basis in the total long-term debt participated with 3.5% at the end of 2005.

The group of private creditors registers higher share by 7.8 percentage points, due to the Eurobonds issue in December 2005. Within their frames, the debt to the London Club of Creditors participated with 10.2% on December 31, 2005, while the share of the debt originating from the issued Eurobonds in the amount of Euro 150 million in the total long-term debt equaled 8.1%. The debt to the remaining private creditors comprised 24.1% of the total debt, 12.2% of which account for the banks, and 11.9% for the non-bank private sector.

Attachment 5

Issue of the first Macedonian Eurobonds

The Eurobonds issue is practiced by many countries in the world, which provide additional financial capital by issuing securities on the international market. This trend is also present in the countries in transition for the last several years, which faced with lack of domestic accumulation (low rate of domestic saving) and moderate inflows of foreign investments, use the Eurobond issue as a relatively easy and inexpensive way for accumulating new foreign capital.

The empirical examples show that the investors from developed countries are interested in purchasing bonds of the economies in transition. Thus with the first issue in 1997, Croatia and Romania registered inflow of US Dollar 300 million and Deutsche Mark 600 million, respectively, while in 2001 Bulgaria registered an inflow of Euro 250 million on this basis.

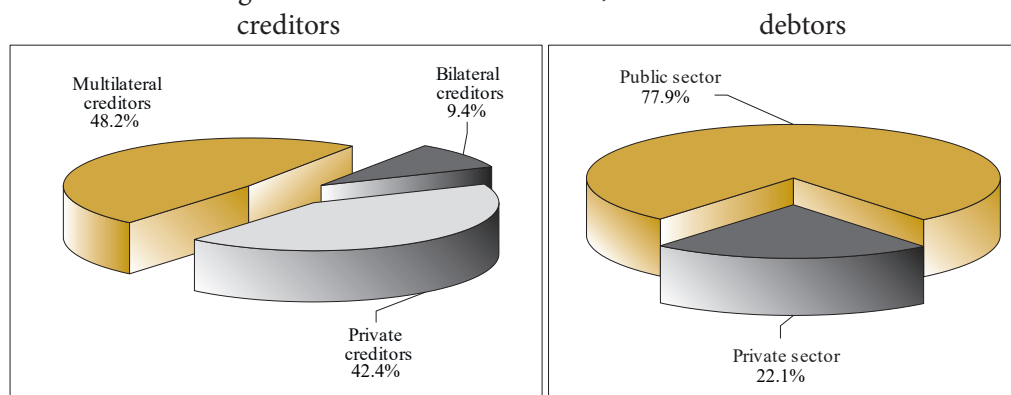
The interest of the foreign investors for the countries in transition was proven also in the case of the Republic of Macedonia, which acquired all formal and essential conditions for participation on the international capital market after obtaining credit rating by two internationally renowned agencies¹¹⁴. Thus after the successfully completed promotion of the Eurobonds by the Ministry of Finance and NBRM team, on December 02, 2005, first Macedonian Eurobonds in the amount of Euro 150 million were issued on the London Stock Exchange, which were with maturity of ten years and coupon interest rate of 4.625%. In comparison with the ten-year bonds issued by the countries in the region, Macedonia registered a relatively favorable interest rate. The demand for the Eurobonds reached Euro 593 million, exceeding the supplied amount by four times, pointing to large interest of the investors in this financial instrument issued by the Republic of Macedonia. The issue is placed with a total of 56 institutional investors as follows: 33% with British investors, 31% with German investors, 22.5% investors from other European countries (France, Italy, Switzerland, Greece, Slovenia, Cyprus), 12% are American investors and 1.5% are investors from Asia. The main investors are investment banks, investment funds and asset management companies.

The fact that Eurobonds and the debt towards the London Club of Creditors are included in the debt structure in December 2005 should also be mentioned. However, in May 2006, the registered inflows from the Eurobonds will be used for repayment of the current debt to the London Club of Creditors.

114. In 2005, Standard & Poors increased the long-term credit rating of the Republic of Macedonia in domestic and in foreign currency from BB to BB+, and in November 2005, the Republic of Macedonia obtained favorable rating by the Fitch agency (BB).

Figure 76

Structure of the long-term debt as of December 31, 2005



Source: National Bank of the Republic of Macedonia

Analyzed from the aspect of the debtors, 77.9% of the long-term external debt accounts for the external debt of the public sector (or Euro 1,441.2 million), while the share of the private sector equals 22.1% (or Euro 407.9 million). Within the public sector, the debt of the central Government amounts to Euro 1,245.4 million, the dominant portion of which refers to the multilateral creditors (a share of 40.7% in the total long-term debt). The liabilities of the public enterprises participate with Euro 143.2 million, with the largest share of the debt (Euro 87.3 million) pertaining to the foreign private creditors. The indebtedness of the NBRM within the public sector is the lowest (Euro 52.7 million) and it pertains completely to the liabilities to the IMF. The largest portion of the private sector's debt refers to the private creditors (Euro 360.9 million), while the debt to the official creditors equals Euro 47 million. Within the private sector, the indebtedness of the non-banking private sector and the banking sector amounts to Euro 308.2 million and Euro 99.9 million, respectively.

The total currency structure of the long-term debt shows that the largest portion of the debt, i.e. 50.4% is denominated in Euros (increase on annual basis of 6.5 percentage points). A significant share, i.e. 27.1% is debt in US Dollars, while 20.3% of the debt is presented in SDR (decline of 3.6 and 2.9 percentage points, respectively, compared to the previous year).

At the end of 2005, the external short-term debt of the Republic of Macedonia (credits with maturity of up to one year, extended to residents by non-residents) equaled Euro 79.2 million, 91.3% of which are liabilities based on principal, while the remaining share accounts for overdue interest and estimated late interest. From the aspect of the debtors, the short-term debt is completely a debt to the private sector, i.e. of private banks and enterprises. The analysis of the short-term sector by types of credits shows dominance of the financial loans (98.5%), while the share of the commercial loans equals 1.5%.

5.4.2. Registered movements in 2005

The total external debt of the Republic of Macedonia in 2005 registered annual increase of Euro 399.8 million, or 26.2%. The long-term external debt went up by Euro

373.4 million, or 25.3%, given the simultaneous increase in the short-term liabilities of Euro 26.4 million, or 49.9%.

In 2005, the withdrawn funds on the basis of both short-term and long-term credits and loans amount to Euro 491.6 million, which are by Euro 208.1 million more relative to 2004. However, amount of Euro 67.2 million was withdrawn on the basis of short-term credits (Euro 36.4 million in 2004), solely by the private sector.

In 2005, funds in the amount of Euro 424.4 million on the basis of long-term credits and loans were withdrawn (an annual increase of Euro 177.3 million). Within the official creditors, Euro 120.3 million were withdrawn from the official creditors (by Euro 12.6 million more than in 2004).

Within the multilateral creditors, the largest amount of Euro 45 million was withdrawn from the International Bank for Reconstruction and Development, primarily on the basis of the Programmatic Development Policy Loan - PDPL I (Euro 24.4 million), the Public Sector Management Adjustment Loan - PSMAL II (Euro 16.5 million) and the Irrigation Rehabilitation and Restructuring Project (Euro 2 million).

Amount of Euro 37 million was used from the European Bank for Reconstruction and Development, the largest portion of which, i.e. Euro 24.8 million was debt of the private sector, followed by the withdrawals aimed at the Road Project II, the Municipal Environmental Action Project (MEAP), the Civil Aviation Project and the Power Transmission Project.

In 2005, funds in the amount of Euro 16.8 million from the European Investment Bank on the basis of global finance loans, road projects and ESM Substation Project were used.

In September 2005, Euro 12.6 million from the International Monetary Fund on the basis of the three-year cautious Stand-By Arrangement concluded in August 2003 were withdrawn.

Funds in the amount of Euro 6.4 million from the International Development Agency were used, aimed at the Trade and Transport Facilitation in Southeast Europe Project, Community Development Project, Community Development and Culture Project, Children and Youth Development Project.

In 2005, Euro 9.2 million extended by bilateral creditors were used (completely originating from the newly concluded credits). The largest share, or Euro 8.6 million accounts for the private sector crediting, with funds being withdrawn for the purpose of the Zletovica Basin Water Utilization Improvement Project from the Italian credit line aimed at import of equipment, the Ministry of Defense, the Lisice Project and the reconstruction of the irrigation system.

In 2005, funds in the amount of Euro 294.8 million were withdrawn from the private creditors, which is an annual increase of Euro 169.2 million. The largest share of the funds originates from the inflow based on Eurobonds (Euro 150 million), as well as from other private creditors (Euro 144.8 million). Such a tendency of higher

indebtedness of the private sector is effect of the capital transactions liberalization, pointing to positive perceptions of the private creditors for the Macedonian economy.

Table 31

Withdrawn funds and paid liabilities in 2005

(in millions of Euros)

	W ithdraw n funds	Paid liabilities		
		Total	Principal	Interest
LONG-TERM CREDITS AND LOANS	424.4	188.6	144.4	44.1
<i>OFFICIAL CREDITORS</i>	129.6	98.1	73.3	24.9
MULTILATERAL CREDITORS	120.3	58.9	40.3	18.6
International Monetary Fund	12.6	9.7	8.7	1.1
International Bank for Reconstruction and Development	45.0	14.5	8.9	5.6
International Financial Corporation	0.0	2.5	2.2	0.3
International Development Agency	6.4	4.2	1.9	2.3
European Investment Bank	16.8	11.3	7.3	4.1
European Railw ay Funding Company	0.0	0.3	0.0	0.3
Council of Europe Development Bank	0.0	0.6	0.1	0.5
European Bank for Reconstruction and Development	37.0	13.2	10.8	2.4
European Union	0.0	2.0	0.0	2.0
International Fund for Agriculture Development	2.5	0.1	0.0	0.1
European Reconstruction Agency	0.0	0.4	0.4	0.0
BILATERAL CREDITORS	9.2	39.3	33.0	6.3
Paris Club (total)	0.0	29.7	25.2	4.5
New ly concluded credits	9.2	9.6	7.8	1.7
PRIVATE CREDITORS	294.8	90.4	71.2	19.3
London Club	0.0	14.3	8.4	5.9
Eurobond	150.0	0.0	0.0	0.0
Other private creditors	144.8	76.1	62.8	13.3
Banks and financial institutions	75.9	49.0	39.8	9.2
Non-financial private sector	68.9	27.1	23.0	4.2
SHORT-TERM CREDITS	67.2	22.0	20.4	1.6
Commercial credits	0.9	0.1	0.1	0.0
Financial credits	66.3	21.9	20.3	1.6
Short-term bank credit lines	0.0	0.0	0.0	0.0
TOTAL	491.6	210.6	164.8	45.8

Source: National Bank of the Republic of Macedonia

In 2005, the total amount of serviced liabilities to foreign creditors based on used long-term credits and loans and short-term credits equals Euro 210.6 million (Euro 212 million in 2004), Euro 188.6 million of which account for the long-term debt, while Euro 22 million refer to the repayment of liabilities on the basis of used short-term credits.

In 2005, the total amount of serviced liabilities to foreign creditors based on used long-term credits equals Euro 188.6 million (Euro 198.8 million in 2004). Euro 144.4 million of this amount refer to the serviced principle, while Euro 44.1 million account for the serviced interest. The analysis by individual creditors indicates that Euro 58.9 million were repaid to the multilateral creditors, while Euro 39.3 million to the bilateral ones. Within the multilateral creditors, the largest amount was repaid to the International Bank for Reconstruction and Development (Euro 14.5 million) and the European Bank for Reconstruction and Development (Euro 13.2 million), while among bilateral creditors, the largest amount was paid to the Paris Club of Creditors (Euro 29.7 million).

During 2005, liabilities in the amount of Euro 90.4 million were repaid to the private creditors (in 2004, Euro 93 million), with the repayments based on principal and interest being equal to Euro 71.2 million and Euro 19.3 million, respectively. The largest share of the total repayments to the private creditors accounts for payments to liabilities to banks and financial institutions (Euro 49 million), while the remaining share accounts for the non-financial private sector (Euro 27.1 million) and the London Club of Creditors (Euro 14.3 million).

In 2005, compared to the previous year, the paid liabilities based on short-term credits surged by Euro 8.9 million. Funds in the amount of Euro 20.4 million were paid on the basis of principal and Euro 1.6 million were interest.

In 2005, the amount of the newly concluded credits and loans equaled Euro 490.7 million, which is an increase of Euro 277.9 million compared to the previous year. The annual increase in the newly concluded credits is mainly due to the Eurobonds issue (Euro 150 million), intended for repayment to the London Club of Creditors in January 2006, as well as to the larger share of the newly concluded credits by the private sector. The concluded loans and credits referred to the following creditors and projects:

- The International Monetary Fund extended balance of payments support credit in the amount of Euro 62.6 million¹¹⁵.
- The International Bank for Reconstruction and Development extended credits in the amount of Euro 43.5 million, Euro 24.4 million of which are aimed at the Programmatic Development Policy Loan (PDPL I), Euro 10.3 million aimed at Real Estate Cadastre & Registration Project and Euro 8.8 million for the Business Environment and Institutional Strengthening Project (BERIS);
- The European Bank for Reconstruction and Development extended credits to private banks in the amount of Euro 4 million, intended for the Small-Size and Medium-Size Enterprise Sector Finance Project.

115. On August 31, 2006, the Board of Directors of IMF extended three-year cautious Stand-By Arrangement (in total value in original currency of SDR 51.7 million). In 2005, one tranche was withdrawn (Euro 12.6 million), with no withdrawals being envisaged for the following years, in accordance with the expected inflows from privatization.



Starter (gold), issued during the reign
of the Macedonian king Philip II (359 - 336 BC).
Private collection.



Other activities of NBRM

VI. Other activities of NBRM

6.1. Payment system in the Republic of Macedonia

The payment system in the Republic of Macedonia continued to operate and develop successfully also in 2005. 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 2005, the National Payment Systems Council of the Republic of Macedonia held three sessions, the operating focus of which was improved efficiency of the payment system in the Republic of Macedonia.

6.1.1. *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.

a) Operational function

Within its operational function, the NBRM manages the settlement system - MIPS. In 2005, the MIPS operated in real time during all 253 working days with accessibility of 99.88%, i.e. it was not accessible only for 170 minutes out of the projected time for the whole year. The average dynamics of the system was 11,140 orders per day, while the maximal number of processed orders equaled 21,434.

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

Aside from that, in 2005, within its operational function, the NBRM received and processed 1,384 decisions on forced collection, 1,093 of which were realized completely, while the remaining were partially or completely unexecuted due to debtors' insolvency, deferred decisions by the body that adopted them, or incomplete decisions returned to the courts for revision and completion through the Legal and Human Resources Department.

In 2005, 167,290 out of the total 2,818,345 settled transactions were queuing, which is 5.94% of the total number of settled transactions in MIPS, or 661.2 transactions

per day, on average. The average queuing time is 14.19 minutes. The increase in the average queuing time compared to 2004, which equaled 8.02 minutes, is mainly due to the additional authorization of part of the transactions in the MIPS for the purpose of accomplishing the supervisory function of the NBRM. A detailed analysis of the queuing in MIPS for 2005 is prepared.

b) Regulatory function

In 2005, the NBRM performed its regulatory function within the payment systems area through amendments to decisions and instructions within its competence. Hence, the following regulations were adopted:

1. Decision on amendments to the Decision on determining the criteria on issuing license for conducting payment operations in the country;
2. Instructions for amendments to the Instructions for submitting data on the payment operations by the entities conducting payment operations.

The Decision on amendments to the Decision on determining the criteria on issuing license for conducting payment operations in the country defines precisely the actions of the entity responsible for conducting payment operations the license of which for conducting payment operations in the country is revoked, with regard to the decisions on execution the execution proceeding of which is underway. This Decision defines also the actions of the entities responsible for conducting payment operations regarding the decisions submitted for execution, which were previously in execution proceeding with an entity responsible for conducting payment operations, the license for conducting payment operations of which was revoked.

The Instructions for amendments to the Instructions for submitting data on the payment operations by the entities conducting payment operations were amended in order to obtain more quality data from the entities responsible for conducting payment operations within the payment cards area.

c) Oversight function

As part of the oversight function of the payment systems, in 2005 the NBRM was conducting a constant direct and indirect oversight over the operations of the banks and the Clearing House. The payment system was monitored regularly through the implemented information system developed on the basis of the Instructions for internal and external clearing, according to which the data on the payment operations of the banks are submitted electronically on a daily basis. Also, indirect oversight of the blocked accounts on a daily basis is performed, through comparison analysis of the reports on blocked accounts submitted by the bank and the reports on blocked accounts by banks, obtained from the data the NBRM undertakes from the Clearing House. On the other hand, the operations of the entities responsible for conducting payment operations were subjected to immediate inspections, with recommendations for lawful, efficient and transparent execution of the activities being given. In 2005, total of ten immediate oversights were conducted.

In 2005, the NBRM initiative for introducing the International Bank Account Number, the so-called IBAN, was realized, representing a significant step toward increasing the automation level of the payment instruction completion process (STR - straight through processing).

In addition, in 2005 the National Bank of the Republic of Macedonia continued collecting and distributing payment operations data on a monthly basis, in line with the Decision on submitting and distributing data on the payment operations. These data were used as a foundation for the preparation of the Information on using the payment instruments, the number of accounts, payment cards and machines they are used on in the Republic of Macedonia for 2005. The following statements aroused from this Information:

- credit transfers, i.e. transactions executed on the burden of the accounts on the basis of submitted payment instruments by order of the account holder, dominate the structure of the total number and the value of the non-cash transactions;

- payment instruments - checks in the payment operations, take larger percentage share in the total number of non-cash transactions, and lower in the value of the non-cash transactions, which is due to the larger use of checks based on current account of the citizens;

- percentage share of the direct indebtedness in the number of non-cash transactions is lower, whereas their percentage share in the value of the non-cash transactions which is higher; and

- payments based on credit/debit cards register the lowest percentage share in the structure of the total number and value of the non-cash transactions. However, the data on the number of the payment cards in the circulation indicate that besides the lowest percentage share in the structure of the non-cash transactions, the use of the payment cards, as a mean of payment, by the clients beings to increase gradually during the year.

In 2005, the oversight function of the NBRM within the payment systems area was also carried out through the functioning of the National Payment Systems Council. For that purpose, the National Payment Systems Council of the Republic of Macedonia established a work group. The work group consisted of two representatives by each institution, the NBRM, the Ministry of Finance and the Banking and Insurance Association within the Economic Chamber of the Republic of Macedonia, as its permanent members. Whenever proposals related to introduction of one stop-shop system, the pension reform and proposals pertaining to Clearing House operating, representatives of the Central Registry of the Republic of Macedonia, Pension and Disability Insurance Fund and Clearing House also participated in the work group activities. The work group of the National Payment System Council prepared draft amendments to the Law on Payment Operations, draft amendments to the Instructions for the form and the contents of the payment instruments for conducting payment operations in the country, and the new Instructions for the manner and the procedure for opening and closing of accounts. The amendments to the regulations were directed towards accomplishment of the undertaken obligations according to the concluded

IMF Arrangement, which are in line with the recommendations given by FSAP and the Technical Mission of the IMF.

The amendments to the Law on Payment Operations were enforced at the beginning of 2006, while the aforementioned instructions were introduced at the end of 2005.

6.1.2. Indicators for the operating of the payment system in the Republic of Macedonia

a) Opened accounts

In 2005, total of 42,607 new accounts were registered, while 7,927 accounts were closed in the Single Registry of Account Holders with the Entities Responsible for Conducting Payment Operations, with the total number of opened accounts with the Single Registry of Account Holders reaching 145,802 at the end of the year. Owners of these accounts are 111,986 different entities (individuals and legal entities), 81.02% of which have only one account, while on average, there are about 1.3 accounts per entity.

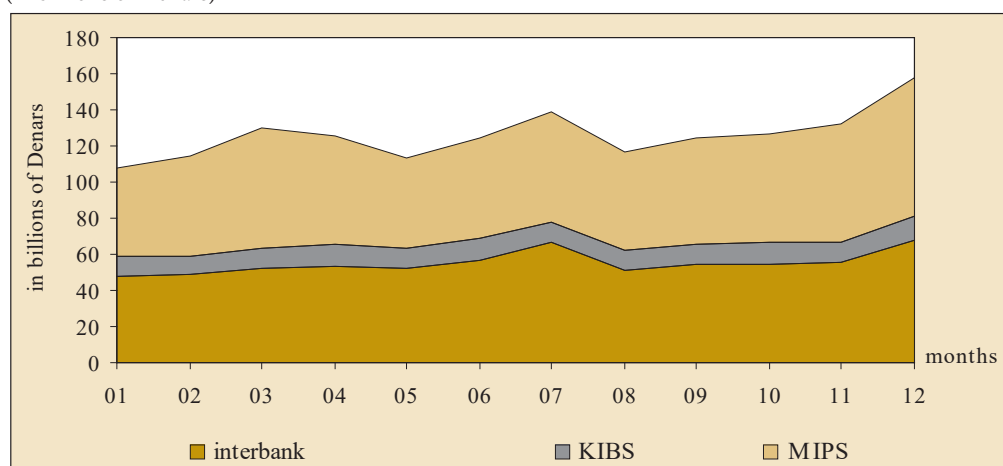
Since the implementation of the new payment system until the end of 2005, total of 9,131 accounts were blocked. In 2005, 17,368 blockades were initiated, 8,911 of which were closed (unblocked accounts), which is 51.31% of the total number of initiated blockades.

b) Total payment operations in the Republic of Macedonia

In 2005, the total value of the performed payment operations equaled Denar 1,510.74 billion. The total payment operations do not encompass the transactions for settlement of the net balance of the Clearing House KIBS. However, 43.8% of the total amount are interbank operations (among accounts within the same bank), 47.21% refer to the interbank payment operations through MIPS, and 8.99% account for the interbank operations through KIBS.

Figure 77

Total domestic payment operations in 2005 by months
(in billions of Denars)



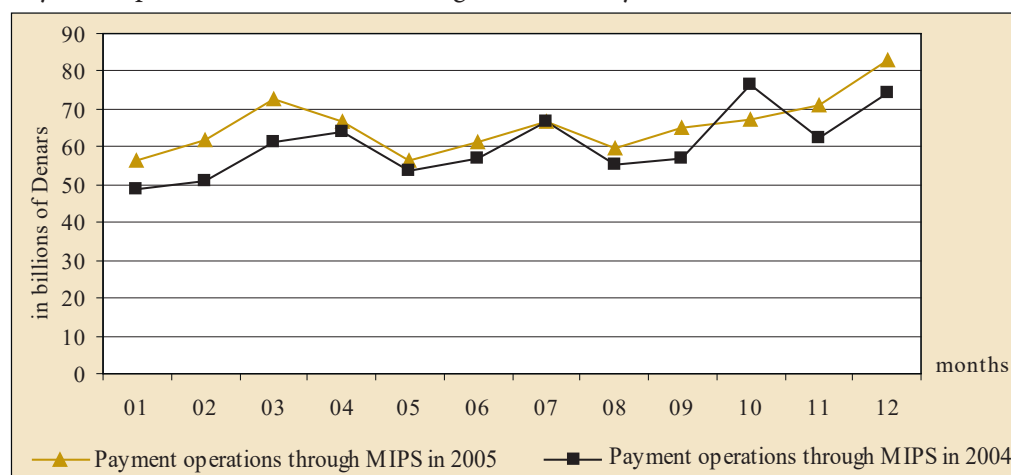
The total number of executed transactions in the domestic payment operations in 2005 equals 21,317,712, 13.2% of which are executed through the MIPS, 43.74% through the KIBS, and 43.06% are transactions executed through the internal clearing.

c) Payment operations and number of transactions executed through MIPS in 2005

In 2005, total turnover in the amount of Denar 787.72 billion was carried out through the MIPS of the NBRM, with total number of 2,818,345 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 2005 increased by 8.23% in comparison with the previous year. 53.56% 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 46.44% are turnover initiated by Government institutions (the National Bank of the Republic of Macedonia, the Treasury System, etc).

Figure 78

Payment operations carried out through the MIPS by months



In 2005, the number of executed transactions compared to the previous year increased by 40.08%. 73.48% of the total number of transactions executed through MIPS are interbank transactions initiated by the other entities responsible for conducting payment operations, while 26.52% are transactions initiated by the Government institutions (the National Bank of the Republic of Macedonia, the Treasury System etc.).

d) Interbank payment operations in 2005

The analysis of the conducted payment operations among the accounts of depositors opened in the system of same entity responsible for conducting payment operations in 2005 indicates an annual decrease in the value of the interbank payment operations of 3.75%. The realized turnover amounts to Denar 661.75 billion, while the number of executed transactions equals 9,180,551, which is an increment of 9.22% compared to the previous year.

6.2. Vault operations

6.2.1. Currency in circulation

In conformity with the legal framework, the NBRM is responsible for issuance of banknotes and coins as legal tender.

The analysis of the structure of the currency in circulation shows that the share of the banknotes and coins in the total value of the currency in circulation equals 99.06% and 0.4%, respectively. Regarding the quantity, the share of the banknotes equals 32.3%, while the share of the coins is 67.7%. At the end of 2005, the number of banknotes in circulation amounted to 49.6 million, which is by 5.8% more compared to the end of 2004, while an increase of 2.5% is registered with regard to their value.

Table 32

Structure of the currency in circulation

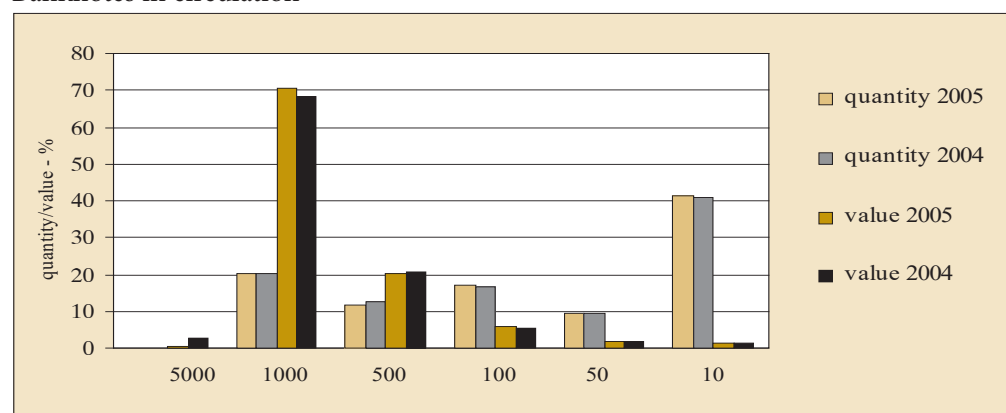
	Banknotes in circulation		Coins	
	in millions of Denars	quantity in millions	in millions of Denars	quantity in millions
1999	8,052	30.6	116.1	60.2
2000	9,424	36.0	135.2	68.7
2001	14,141	44.9	145.9	74.2
2002	13,945	44.4	160.9	80.9
2003	14,004	45.4	175.2	87.8
2004	14,049	46.9	192.6	96.2
2005	14,401	49.6	211.2	104.1

Source: Cash Management Department
As of December 31.

The largest share of the banknotes in circulation accounts for the banknotes in denomination of Denar 1,000 and Denar 500. The share of the banknote in denomination of Denar 1,000 equals 70.4% (68.2% at the end of 2004), while the banknote in denomination of Denar 500 participates with 20.1% (20.2% at the end of 2004). Only 9.5% of the total value of the banknotes in circulation account for the banknotes in the remaining denominations, which is by 2.1 percentage points less than at the end of 2004.

Figure 79

Banknotes in circulation



Source: Cash Management Department

6.2.2. Supply of cash to banks

In 2005, payments of cash to banks in the amount of Denar 27.3 billion were made through the central vault of the NBRM and the nine dispersed vaults (70.1 million of banknotes and 12 million of coins were issued), which is less by 8.7% compared to 2004. Simultaneously, cash in the amount of Denar 26.6 million was received from banks (67.4 million of banknotes and 4.2 million of coins), which is a decrease of 8.5% compared to 2004.

Figure 80
Issued banknotes

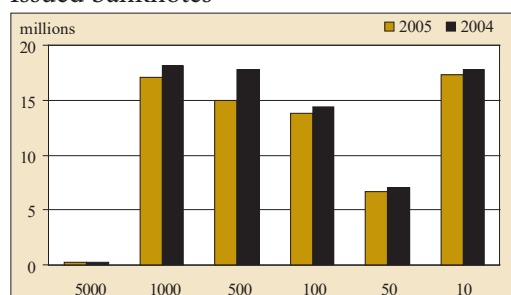
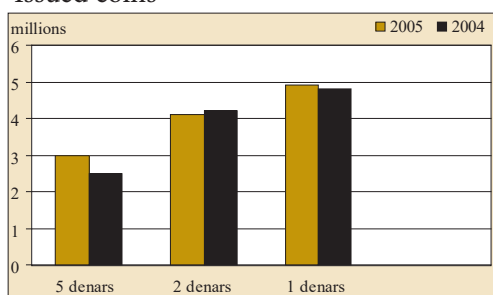


Figure 81
Issued coins

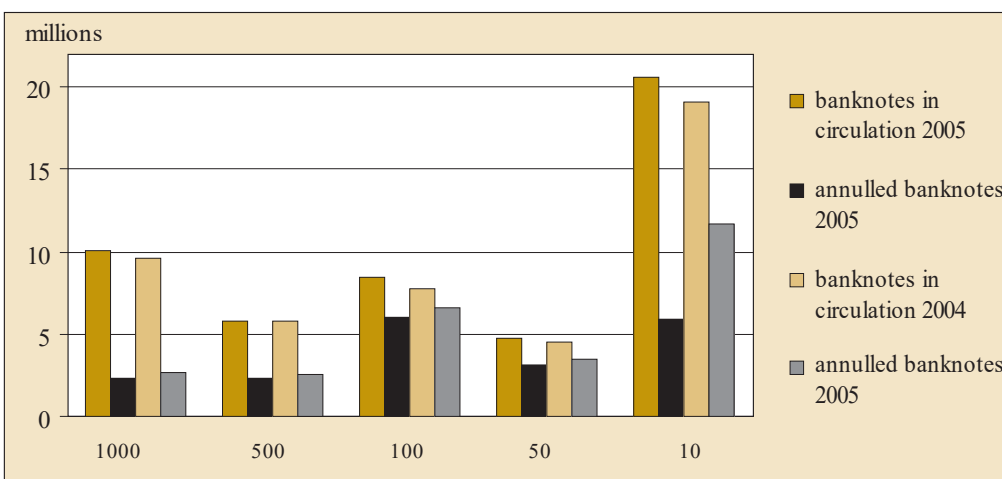


Source: Cash Management Department

6.2.3. Processing and withdrawal of banknotes

In 2005, total of 40.6 million banknotes were processed in the banknote processing machine (41.7 million in 2004), while the total amount of annulled banknotes due to their wear out and damage equaled 19.6 million (27.1 million banknotes in 2004).

Figure 82
Banknotes in circulation and annulled banknotes

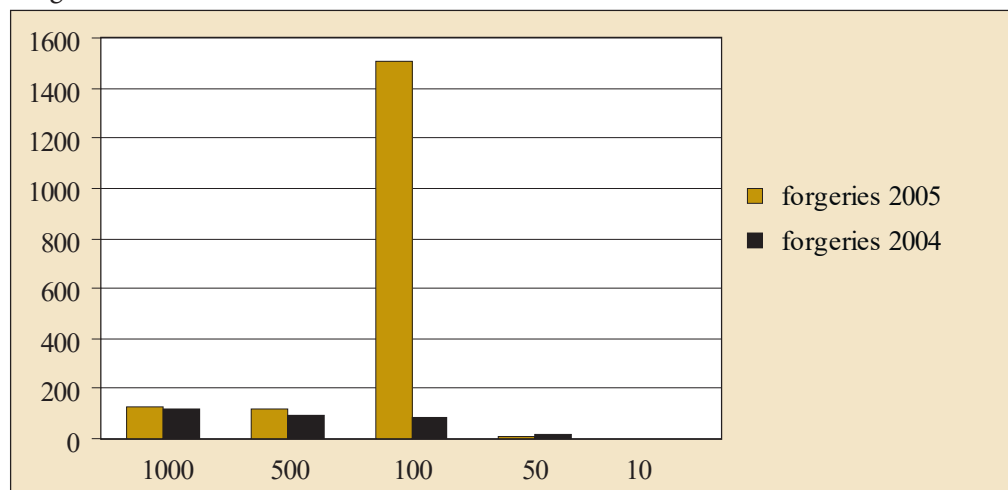


6.2.4. Expertise of doubtful - forged banknotes

An expertise was carried out in 2005, with 1756 forgeries of Denar banknotes detected and confiscated in the Republic of Macedonia by the Interior Ministry being stated, which is by 5.6 times more compared to the forgeries stated in 2004.

Figure 83

Forged Denar banknotes



Source: Cash Management Department

The increase in the number of forgeries is mainly due to the higher number of copied banknotes in denomination of Denar 100, the total number of which is 1503. Total of 131 banknotes in denomination of Denar 1000 (increase of 11%) and 115 banknotes in denomination of Denar 500 (increase of 16%) were forged. However, the value of the forged Denars (Denar 339.110) is insignificant compared to the value of the cash currency in circulation. The disclosed forgeries were mainly made by using computer (scanning and printing), or color regular paper copies without security elements. In 2005, the NBRM required expertise from the Interior Ministry for 53 forged Euro banknotes and seven forged US Dollar banknotes which were reported by individuals.

6.2.5. Printing banknotes and other valuables

In order to supplement the stock of banknotes, ten million pieces of banknotes in denomination of Denar 100 were printed in 2005. Administrative stamps in denomination of Denar 50 and 10 in the total quantity of 15 million pieces, as well as court government stamps in quantity of 5 million pieces were printed for the account of the Ministry of Finance.

6.2.6. Other vault operations

In 2005, control stamps for alcohol and cigarettes were stored in and issued from the vault for the account of the Public Revenues Office. Total of 191 transactions for issuing control stamps for cigarettes, as well as 57 transactions for accepted stamps in the vault were performed, which is approximately at the same level as in 2004. Also,

397 transactions for issuing control stamps for alcohol were executed, which is by 35% more compared to 2004. Administrative stamps and court government stamps in the total quantity of 12.1 million pieces were sold for the account of the Ministry of Finance (11.8 million in 2004), as well as bills of exchange in all denominations in the total amount of 135.400 (151.500 in 2004).

On the basis of the Rehabilitation and Reconstruction of a Bank Bonds, 6884 interest coupons are cut and submitted on a regular monthly basis, as well as 6884 coupons of principal annually, which are submitted for payment to the Ministry of Finance.

On the basis of depositing temporarily confiscated foreign currency in the NBRM vault by the competent bodies, total of 52 transactions in 2005 were executed (46 in 2004). Simultaneously, total of 112 payments as a result of court decisions were made (44 in 2004).

As a result of the regular foreign currency vault operations, 2170 payments of cash foreign currency to government bodies (1680 in 2004) and 288 receipts of cash foreign currency (277 in 2004) were made.

On the basis of the previously minted jubilee coins made in gold and silver, total of 276 pieces were sold in 2005 (515 in 2004).

6.3. Internal Audit

In 2005, the internal audit was implemented in accordance with the Audit Program for Internal Audit Operating in 2005. The main objective of the internal audit pertains to identification of risks the NBRM is exposed to in performing its functions, establishment of appropriate internal control system, as well as its efficient application. The main objectives that should be reached in conducting the working processes in the NBRM are credibility and integrity of the financial and other information, harmonization of the operating with the legal acts and by-laws, internal policies and operating procedures, safeguard and protection of assets, as well as economic and efficient use of resources.

The adequacy of the established internal control system was estimated through conducting regular audits on the operating processes of the NBRM, on which the management of the NBRM was regularly informed. In case of weaknesses, recommendations on their elimination were given, with fulfillment of the given recommendations being also monitored, presented in the audit reports from the previous year. The planning of the performed audits was made from the aspect of the estimation of the risk level, as well as according to the meaning of the functions performed, the period from the last completed audit and the changes performed in the processes themselves.

The internal audit was engaged in other activities as well, that were in direction of promotion of the operating through informing and implementation of the international internal audit standards, and consequently, the revision of the current internal operating procedures.

In 2005, thirteen regular and two extraordinary audits were carried out, while the recommendations given in the audit report of the previous year were monitored in fourteen cases. The findings from the completed audits point to compliance with the given recommendations and their realization within the given deadlines. The audits carried out in 2005 resulted in 53 recommendations for improvement in the internal control systems. Generally, the level of established internal controls in the departments the operating processes of which were audited in 2005 is satisfactory, although there is possibility for their further development and improvement.

6.4. Improvement of the institutionalized capacity of the NBRM

- After the successful launching of the primary market of Treasury bills at the beginning of 2004, in 2005 the NBRM was directed towards establishing regulatory and infrastructure framework for trading with Treasury bills on secondary market. Namely, the market infrastructure for trading with securities in the Republic of Macedonia was upgraded by establishing over the counter markets the main objective of which is financial markets development support, thus enabling more efficient implementation of the monetary policy.

Initial step for commencing the Treasury bills trade on the over the counter market was adoption of the *Rules for the manner and the procedure for trading and settlement of transactions with securities on the over the counter market* during the second quarter of 2005. According to the rules, purchase and sale transactions with short-term securities are concluded on the over the counter market, outside the stock exchange, in direct buyer/seller relationship (without mediators), thus avoiding high transaction expenses. Simultaneously, the OTC markets enable settlement in real time during the same day, which acts in direction of creating environment for more efficient liquidity management, not only with banks and other financial institutions, but with the non-financial sector entities, as well.

Simultaneously, for the purpose of increasing the transparency in the trading on the OTC market, Quotation System was established, through which the banks may quote purchasing and selling prices of Treasury bills on Internet site of the NBRM. In addition, the establishment of interbank securities trade e-system is in its final stage, enabling faster and more efficient conclusion of transactions with Treasury bills on the over the counter markets.

Also, for the purpose of further stimulation of the secondary market development and increase in the liquidity of short-term securities, the NBRM promoted

the introduction of repo transactions. For smooth implementation of the repo transactions the NBRM prepared *General Repo Agreement* as a legal framework for concluding repo transactions in the Republic of Macedonia. The collateralized credit operations (allowed overdrafts and Lombard credit) the NBRM carries out with the banks were replaced with repo transactions in the second half of 2005.

Besides undertaking activities in direction of development support of the securities market, in 2005, the NBRM performed a large number of activities in order to increase the trading on the interbank foreign currency market. Namely, within the efforts for providing more efficient intervention policy by the NBRM and for the purpose of interbank foreign exchange market promotion, an *e-platform* for quoting and trade with foreign exchange among banks was introduced. This e-platform enables the banks to monitor the information on the exchange rate movements in real time, as well as direct electronic trading with foreign currency. In this manner, higher transparency on the market, easier matching of the supply and demand of foreign currency and establishing the exchange rate on the basis of the information on the situation on the market in real time is provided. Also, to stimulate the trading between banks and to reduce the own presence at the market in terms of supply and demand equilibrium, the NBRM introduced banks supporters of the foreign exchange market. These banks, which are basically the core of the foreign exchange market, are exclusively entitled to trade with the NBRM, with also being obliged for continuous quoting of the bid and ask rates within certain limits in order to meet the interbank foreign currency needs.

- In 2005, Banking Supervision Development Plan in coordination with the World Bank was prepared. This Plan, in accordance with the IMF arrangement and the PDPL arrangement concluded with the World Bank, the NBRM adopted in the first quarter of 2006.

The transition towards risks oriented supervision was imposed as a need from several reasons: 1) rationalization and efficient allocation of resources; 2) focusing according to the risk, i.e. allocation of the focus of the operating areas having the largest influence on the banks risk.; 3) more adequate determining of the banks' risk profile and formulating adequate supervisory strategies; and 4) on the basis of defined supervisory strategies, undertaking of efficient corrective actions in order to correct the identified weaknesses with the banks.

In 2006, in coordination with consultant that would be engaged by the IMF, detailed plans for enforcing and implementation of the activities and measures prescribed in the Plan will be prepared, specifying the realization deadlines in the 2006 - 2009 period.

In direction of strengthening of the banking supervision capacity of the NBRM, within the technical assistance of the Financial Sector Voluntaries Corps, a seminary for market risk management was organized at the beginning of 2005. The market risk characteristics, models for its measurement and monitoring, as well as the basics elements of the regulations pertaining to the inclusion of the market risk in the capital adequacy ratio management were discussed on this seminary.

Also in 2005, a seminary for controlling the money laundering prevention systems of banks, savings houses, exchange offices and fast money transfers providers was organized. The seminary was organized by representatives of the Central Bank of the Netherlands, which conveyed their experience in the implementation of this type of controls, as a significant segment in the overall supervisory process.

- In October 2005, the National Bank of the Republic of Macedonia, in cooperation with the International Monetary Fund, held a seminary the topic of which was "Macroeconomic forecasting Eviews". On the seminary, except representatives of the NBRM and the Ministry of Finance, representatives of the central banks in the region (Albania, Bulgaria, Bosnia and Herzegovina, Montenegro, Serbia, Croatia and Turkey) were also present.

The lecturer on the seminary was John Cuddington, professor at the Georgetown University and expert in practical training of economists for operating with econometrics software - Eviews. The seminary was organized as follows: 1) informing the participants on the econometric software Eviews; 2) meeting with modern techniques of econometric forecasting through examples; and 3) use of these methods for analysis in time series when assessing the macroeconomic relations.

The seminars in the area of econometrics and forecasting are of special significance for the central banks and for the other institutions engaged in researching activities, not only in Macedonia but in the whole region, as well. The improvement in the knowledge in this forecasting area is part of the process for further approach of the NBRM and the remaining central banks in the region to the modern central banks operating, which apply sophisticated econometric techniques during the analysis, models and projections.

- In 2005, the cooperation of the National Bank of the Republic of Macedonia with the Central Bank of the Netherlands in the technical assistance area continued. The implementation of the technical assistance project of the Central Bank of the Netherlands aimed at the NBRM, which commenced in 2000 continued successfully also in 2005. The project covered almost all basic functions and activities of the National Bank of the Republic of Macedonia. In addition, in 2005, the National Bank actively cooperated with the IMF in the area of technical assistance, as well as with other foreign agencies and organizations (USAID, FSVC).

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA

**Financial Statements prepared in accordance
with International Financial Reporting Standards**

For the year ended 31 December 2005

Content

	Page
Report of independent auditors	1
Income statement	2
Balance sheet	3-4
Statement of changes in equity	5
Cash flow statement	6
Notes to the financial statements	7-44

GENERAL INFORMATION

Members of the Council

Petar Gosev, Governor
Emilija Naceska, Vice Governor
Fadil Bajrami, Vice Governor
Slobodan Kosev
Marina Kavrakova
Liman Kurtisi
Risto Gogovski
Ljubomir Kekenovski
Drage Janev

Registered office

Kompleks banki bb
1000, Skopje

PricewaterhouseCoopers dooel
ul. Marshal Tito 12,
"Palata Makedonija" IV floor
1000 Skopje
Republic of Macedonia
Telephone+389 (02) 3116 638
+389 (02) 3111 012
+389 (02) 3110 623
Facsimile +389 (02) 3116 525
www.pwc.com/mk

Report of Independent auditors

To the Council of National Bank of the Republic of Macedonia

We have audited the accompanying balance sheet of the National Bank of the Republic of Macedonia ("the NBRM") as of 31 December 2005 and the related statements of income, changes in equity and cash flows for the year then ended. These financial statements set out on pages 2 to 44 are the responsibility of the NBRM's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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.

As disclosed in Note 42 to the accompanying financial statements, on 28 April 2006, the NBRM enacted a decision for provisioning the total net amount of the unreconciled contra accounts of MKD 171,452,000. These unreconciled contra accounts relate to the past periods and the provision should have been fully recognised already in the periods before 1 January 2004 and therefore has no impact on the result for 2005.

In our opinion, except for the effect on the financial position of the matter referred to in the preceding paragraph, the financial statements present fairly in all material respects the financial position of the NBRM as of 31 December 2005 and the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers dooel

Skopje,

22 May 2006

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA
Financial statements for the year ended 31 December 2005

(All amounts in MKD thousands unless otherwise stated)

Income statement

		Year ended 31 December	
		2005	2004
Interest income	5	1,205,669	907,215
Interest expense	6	(751,332)	(539,053)
Net interest income		454,337	368,162
Net unrealized exchange rate and fair value differences		2,539,493	(512,591)
Fee income	7	204,348	132,268
Fee expense	8	(10,925)	(42,908)
Other operating income	9	38,117	145,162
Operating income		231,540	234,522
Staff expenses		(286,443)	(293,592)
Depreciation		(64,169)	(64,947)
Other expenses	10	(145,664)	(204,778)
Operating expenses		(496,276)	(563,317)
Provisions and write offs	11	(148,699)	(449,479)
Profit/(Loss) for the year		2,580,395	(922,703)

The notes on pages 7 to 44 are an integral part of these financial statements

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA
Financial statements for the year ended 31 December 2005

(All amounts in MKD thousands unless otherwise stated)

Balance sheet

ASSETS	Note	At 31 December	
		2005	2004
Gold	12	5,816,277	3,896,865
Foreign currency deposits	13	61,499,563	39,088,839
Foreign currencies	14	47,909	204,322
Foreign securities	15	1,810,586	1,132,445
Special Drawing Rights - holdings	16	40,671	33,981
Foreign assets		69,215,006	44,356,452
Receivable from Government related to IMF	17	620,630	586,427
Government securities	18	2,929,085	2,501,383
Receivable from Government		3,549,715	3,087,810
IMF Membership	19	4,970,211	5,186,805
Loans to banks	20	31,247	37,100
Other receivables	21	-	-
Receivables from banks		31,247	37,100
Property and equipment	22	938,693	979,440
Inventories	23	76,119	96,184
Receivables	24	21,676	16,273
Other assets	25	24,456	46,821
Other assets		1,060,944	1,138,718
Total assets		78,827,123	53,806,885

The notes on pages 7 to 44 are an integral part of these financial statements

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA
Financial statements for the year ended 31 December 2005

(All amounts in MKD thousands unless otherwise stated)

Balance Sheet (continued)

LIABILITIES AND EQUITY	Note	At 31 December	
		2005	2004
Currency in circulation	26	15,813,022	15,071,504
Bank deposits	27	4,973,550	2,668,636
Reserve requirement of banks and savings houses	28	5,333,913	3,371,477
NBRM bills issued	29	8,945,039	4,565,838
Government Denar deposits	30	8,932,142	6,450,882
Government foreign currency deposits	31	15,625,341	6,604,440
Government deposits		24,557,483	13,055,322
Restricted deposits	32	411,198	219,481
Special Drawing Rights Allocation		620,630	586,426
Borrowing from IMF	33	3,221,857	2,818,696
Payables based on membership and deposits		4,970,211	5,186,805
Payables to IMF		8,812,698	8,591,927
Other deposits	34	1,594,898	1,574,330
Other payables	35	166,931	167,554
Other liabilities	36	209,219	298,181
Other liabilities		376,150	465,735
Capital	37	1,289,789	1,289,789
General reserves	38	502,110	-
Revaluation reserves	39	6,217,273	3,677,780
Accumulated loss		-	(744,934)
Capital and reserves		8,009,172	4,222,635
Total liabilities and equity		78,827,123	53,806,885

The notes on page 7 to 44 are an integral part of these financial statements

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA
Financial statements for the year ended 31 December 2005

(All amounts in MKD thousands unless otherwise stated)

Statement on changes in equity

	Note	Capital	General reserves	Revaluation reserves	Investment securities available for sale	Accumulated (losses) /earnings	Total capital and reserves
At 1 January 2004		1,289,789	853,564	4,190,371	(75,706)	(1,102,993)	5,155,025
Reclassification resulting from changes in accounting policy for investments in foreign debt securities	2A	-	-	-	75,706	(75,706)	-
Adjusted balance at 1 January 2004		1,289,789	853,564	4,190,371	-	(1,178,699)	5,155,025
Loss for the year		-	-	-	-	(922,703)	(922,703)
Total recognized (Loss) for 2004		-	-	-	-	(922,703)	(922,703)
Transfer of Unrealized FX gains less losses to revaluation reserve		-	-	(512,591)	-	512,591	-
Covering of losses		-	(855,990)	-	-	855,990	-
Appropriation to general reserves		-	2,426	-	-	(2,426)	-
Appropriation to Budget		-	-	-	-	(9,687)	(9,687)
At December 2004 /1 January 2005		1,289,789	-	3,677,780	-	(744,934)	4,222,635
Loss coverage by government bonds	18	-	-	-	-	714,581	714,581
Profit for the year		-	-	-	-	2,580,395	2,580,395
Total recognized income for 2005		-	-	-	-	2,580,395	2,580,395
Transfer of Unrealized FX gains less losses to revaluation reserve		-	-	2,539,493	-	(2,539,493)	-
Appropriation to general reserves		-	2,110	-	-	(2,110)	-
Appropriation to budget	35	-	-	-	-	(8,439)	(8,439)
Capitalization of general reserves by the government	38	-	500,000	-	-	-	500,000
At December 2005		1,289,789	502,110	6,217,273	-	-	8,009,172

The notes on pages 7 to 44 are an integral part of these financial statements

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA
Financial statements for the year ended 31 December 2005

(All amounts in MKD thousands unless otherwise stated)

Cash flow statement

	Note	Year ended 31 December	
		2005	2004
Net gain/(loss) before allocation		2,580,395	(922,703)
Adjusted for:			
Interest income		(1,205,669)	(907,215)
Interest expenses		751,333	539,053
Depreciation		64,169	64,947
Net gain/(loss) before changes in assets and liabilities		2,190,228	(1,225,918)
Gold		(1,919,412)	(2,078,284)
Foreign securities		(677,468)	3,208,306
Term deposits over 90 days		(4,603,155)	-
Restricted deposits		(40,030)	23,338
Receivables from Government		286,678	366,639
Receivables from banks		5,853	25,807
Other assets		36,756	182,751
Currency in circulation		741,518	60,222
Bank deposits		2,303,449	(568,672)
Reserve requirement of banks and savings houses		1,962,436	595,056
Government deposits including restricted and other deposits		11,727,841	94,556
Borrowings from IMF		403,161	(533,846)
Other liabilities		(105,573)	219,838
Interest received		1,206,889	1,007,342
Interest paid		(747,069)	(540,228)
Net cash flows from operating activities		12,772,102	836,907
Fixed assets additions, net of write offs		(23,422)	(56,468)
Net cash flows used in investing activities		(23,422)	(56,468)
NBRM bills issued		4,369,136	172,639
Net cash flows from financing activities		4,369,136	172,639
Unrealized effects		500,000	-
Net increase in cash and cash equivalents		17,617,816	953,078
Cash and cash equivalents at the beginning of the year		38,860,350	37,907,272
Cash and cash equivalents at the end of the year		56,478,166	38,860,350

The notes on pages 7 to 44 are an integral part of these financial statements

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA
Financial statements for the year ended 31 December 2005

(All amounts in MKD thousands unless otherwise stated)

1 General Information

The National Bank of the Republic of Macedonia (hereinafter referred to as: "NBRM") is the central bank of the Republic of Macedonia and the sole issuing institution in the country. The organization and the operating of the NBRM are regulated by the Law on the National Bank of the Republic of Macedonia, ("NBRM Law"), dated January 22, 2002, and the amendments to the Law on the National Bank of the Republic of Macedonia of July 31 and December 31, 2003, July 21, 2004 and July 21, 2005. According to the Law, NBRM is a legal entity fully owned by the state, with financial and administrative independence. NBRM was established in 1946, while it was constituted as a central bank of issue in 1992.

Pursuant to the NBRM Law, the main objective of the NBRM is maintaining the price stability. The NBRM is supporting the economic policy of the country, observing the financial stability, without jeopardizing the accomplishment of its main objective. The achievement of these objectives takes priority over the profit.

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

Net income of NBRM is appropriated so that firstly revaluation reserves are allocated in the amount of the net calculated revaluation income, then 20% are allocated to the general reserves (until the level of core capital is reached), the core capital of the NBRM is increased (on the basis of prior approval of the Government of the Republic of Macedonia), and the rest is regarded as revenue of the Budget of the Republic of Macedonia. The loss is covered from the general reserves of the NBRM, and when there is a shortage of funds, it shall be covered from the Budget of the Republic of Macedonia, or by issuing Government securities. In the case when the general reserves are completely used for covering the loss of the NBRM, the Republic of Macedonia provides funds for supplementing the general reserves up to 40% of the amount of the core capital.

The bodies of NBRM are the Council and the Governor.

The total number of employees as of 31 December 2005 was 412 (December 31, 2004: 394).

The financial statements are adopted by the National Bank of the Republic of Macedonia Council. and signed by the president of the NBRM Council on its behalf:

Governor

Petar Goshev, M.Sc.

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA
Financial statements for the year ended 31 December 2005

(All amounts in MKD thousands unless otherwise stated)

2 Summary of significant accounting policies

The principal accounting policies adopted in the preparation of these financial statements are set out below:

A Basis of presentation

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 and gold.

During 2005 the accounting policy for available-for-sale investments has been changed. Under the previous treatment the changes in the fair value have been recognised in reserves, while under the new treatment as trading securities the changes in the fair value are recognised in the profit and loss accounts.

The change in the accounting policy has been accounted retrospectively. The effect of the change is presented below:

In 2004 the NBRM recognised reserves as a result of changes in fair value in amount of MKD 63,261,000. The restated figures shown increase in other operating income and the restated amount is MKD 145,162,000 (previously MKD 81,901,000) and restated net loss for 2004 is MKD 922,703,000.

Adoption of new and revised standards.

In 2005 the NBRM adopted the following IFRSs, which are relevant to its operations. The 2004 accounts have been amended as required, in accordance with the relevant requirements.

IAS 1 (revised 2003)	Presentation of Financial Statements
IAS 8 (revised 2003)	Accounting Policies, Changes in Accounting Estimates and Errors
IAS 10 (revised 2003)	Events after the Balance Sheet Date
IAS 16 (revised 2003)	Property, Plant and Equipment
IAS 17 (revised 2003)	Leases
IAS 21 (revised 2003)	The Effects of Changes in Foreign Exchange Rates
IAS 24 (revised 2003)	Related Party Disclosures
IAS 32 (revised 2003)	Financial Instruments: Disclosure and Presentation
IAS 39 (revised 2003)	Financial Instruments: Recognition and Measurement
IAS 36 (revised 2004)	Impairment of Assets
IAS 38 (revised 2004)	Intangible Assets

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA
Financial statements for the year ended 31 December 2005

(All amounts in MKD thousands unless otherwise stated)

The adoption of the revised IAS 1, 8, 10, 16, 17, 21, 24, 32, and 39 (all revised 2003) and IAS 36 and 38 (all revised 2004) resulted in certain additional disclosures, but did not result in material changes to the NBRM's accounting policies and accounting treatment of transactions.

Standards, interpretations and amendments to published standards that are not yet effective

Certain new standards, amendments and interpretations to existing standards have been published that are mandatory for the Bank's accounting periods beginning on or after 1 January 2006 or later periods but which the Bank has not early adopted.

IFRS 7, Financial Instruments: Disclosures, and a complementary Amendment to IAS 1, Presentation of Financial Statements - Capital Disclosures (effective from 1 January 2007). IFRS 7 introduces new disclosures to improve the information about financial instruments. It requires the disclosure of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk, including sensitivity analysis to market risk. It replaces IAS 30, Disclosures in the Financial Statements of Banks and Similar Financial Institutions, and disclosure requirements in IAS 32, Financial Instruments: Disclosure and Presentation. It is applicable to all entities that report under IFRS. The amendment to IAS 1 introduces disclosures about the level of an entity's capital and how it manages capital. The Bank assessed the impact of IFRS 7 and the amendment to IAS 1 and concluded that the main additional disclosures will be the sensitivity analysis to market risk and the capital disclosures required by the amendment of IAS 1. The Bank will apply IFRS 7 and the amendment to IAS 1 from annual periods beginning 1 January 2007.

IAS 39 and IFRS 4 (Amendment), Financial Guarantee Contracts (effective from 1 January 2006). This amendment requires issued financial guarantees, other than those previously asserted by the entity to be insurance contracts, to be initially recognised at their fair value, and subsequently measured at the higher of (a) the unamortized balance of the related fees received and deferred, and (b) the expenditure required to settle the commitment at the balance sheet date.

There are a number of other new standards or amendments to existing ones but the management concluded they are not relevant to the Bank's operations. These amendments and standards include:

- IAS 19 (Amendment), Employee Benefits (effective from 1 January 2006)
- IAS 39 (Amendment), Cash Flow Hedge Accounting of Forecast Intragroup Transactions (effective from 1 January 2006)
- IAS 39 (Amendment), The Fair Value Option (effective from 1 January 2006)
- IFRS 1 (Amendment), First-time Adoption of International Financial Reporting Standards and IFRS 6 (Amendment), Exploration for and Evaluation of Mineral Resources (effective from 1 January 2006)
- IFRS 6, Exploration for and Evaluation of Mineral Resources (effective from 1 January 2006)
- IFRIC 4, Determining whether an Arrangement contains a Lease (effective from 1 January 2006)

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA
Financial statements for the year ended 31 December 2005

(All amounts in MKD thousands unless otherwise stated)

-IFRIC 5, Rights to Interests arising from Decommissioning Restoration and Environmental Rehabilitation Funds (effective from 1 January 2006)

-IFRIC 6, Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment (effective from 1 December 2005)

Further information is disclosed in accounting policies and related notes to the financial statements.

B Foreign currency translation

Assets and liabilities denominated in foreign currency are translated into MKD at exchange rates ruling at the balance sheet date. Transactions denominated in foreign currency are translated into MKD at the exchange rates valid at the date of the transactions. Gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

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.

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 (securities)

Securities at the balance sheet date are classified as securities held to maturity, trade securities and securities available for sale.

All investments are initially recognized at their fair value including the 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.

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA
Financial statements for the year ended 31 December 2005

(All amounts in MKD thousands unless otherwise stated)

Trading securities

The trading securities, i.e. the investments in debt securities having market value, are valued on a daily basis at fair value, with the price changes being included in the income statement.

Available for sale

After initial recognition, investments, which are classified as "available for sale" are remeasured at fair value, except unquoted equities 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 value

The fair value of financial instruments traded on organized financial markets is determined according to quoted market prices.

The fair value of unquoted equity investments is determined by reference to the market prices of similar investments and the fair value of unquoted debt securities is based on the expected discounted cash flows.

H Impairment and uncollectibility of the financial assets

Assets carried at amortized cost

The NBRM assesses at each balance sheet date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

When a loan is uncollectible, it is written off against the related provision for loan impairment.

Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of the provision for loan impairment in the income statement.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized (such as an improvement in the debtor's credit rating), the previously recognized impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognized in the income statement.

Any accrued interest on impaired loans is immediately subject to impairment allowance recognized in the income statement (as part of carrying value of the loan measured at amortized cost).

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA
Financial statements for the year ended 31 December 2005

(All amounts in MKD thousands unless otherwise stated)

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 Property and equipment

All property and equipment is stated at cost or valuation less accumulated depreciation.

Assets in course of construction are reported at their cost of construction including costs charged by third parties. No depreciation is charged on assets during construction. Upon completion, all accumulated costs of the asset are transferred to the relevant tangible property and equipment category and subsequently subject to the applicable depreciation rates.

Gains and losses on disposal of property and equipment are recognised in the income statement.

Depreciation is provided on all assets except assets in the course of construction on a straight line basis so as to write off the cost of the assets over their estimated useful lives at the following annual rates:

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

Land and works of art are not depreciated.

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 the 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.

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA
Financial statements for the year ended 31 December 2005

(All amounts in MKD thousands unless otherwise stated)

Revenue from sale of jubilee coins is recognized when it is probable that future economic benefits will flow to the NBRM and these benefits can be measured reliably.

M Currency in circulation

Banknotes and coins in circulation issued by NBRM are presented in the balance sheet as a liability in favor of the holder, at face value. When coins and notes are withdrawn from circulation the relevant demand deposits liabilities are increased, while the liability in favor of the holders is reduced.

N Short-term securities

Short-term securities (CB 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 over the period to maturity.

O Deposits

Demand deposits are carried at their face value less amounts repaid, whereas term deposits are carried at amortised costs.

P Revenue recognition

Interest income and expense

Interest income and expense are recognized in the income statement for all interest bearing instruments on an accrual basis using the effective interest method. When loans become doubtful of collection, they are written down to their recoverable amounts and interest income is thereafter recognised based on the rate of interest that was used to discount the future cash flows for the purpose of measuring the recoverable amount.

Fee and other income

Fees and commissions are generally recognized on an accrual basis when the service has been provided. Loan disbursement fee that are likely to be drawn down are deferred and recognized as an adjustment to the effective interest rate on the loan.

Q Taxation

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

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA
Financial statements for the year ended 31 December 2005

(All amounts in MKD thousands unless otherwise stated)

3 Financial risk management

A 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.

B Credit risk

Credit risk is the risk of reducing the value of the foreign assets due to a change in the financial position of the contractual financial institution or commercial bank where the foreign reserves are kept, or of the issuer of the instrument in which 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. The table below shows main concentrations of credit risk by counter-party:

	Deposits	Securities	Total 2005	2004
BIS Basel	15,574,495	271,430	15,845,925	12,792,445
Federal Reserve Bank of New York	8,317,600	259,185	8,576,785	9,509,493
Banque de France	14,703,083	63,943	14,767,026	11,424,335
Bank of England	12,254,972	-	12,254,972	12,303,429

The main instrument for managing credit risk is by due assessment of the creditworthiness of the counterparty – commercial bank or issuer of a security. The assessment of a financial institution is performed by monitoring several criteria, which are approved by the NBRM Council.

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA
Financial statements for the year ended 31 December 2005

(All amounts in MKD thousands unless otherwise stated)

C Currency 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.

NBRM 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 of 31 December 2005:

ASSETS

	EUR	USD	SDR	Other	MKD	Total
Foreign assets	52,530,870	16,573,850	80,484	399,075	(369,273)	69,215,006
Receivable from the government	-	-	620,630	-	2,929,085	3,549,715
Membership with the IMF	-	-	-	-	4,970,211	4,970,211
Receivable from banks	-	-	-	-	31,247	31,247
Other assets	-	-	-	-	1,060,944	1,060,944
Total assets	52,530,870	16,573,850	701,114	399,075	8,622,214	78,827,123

LIABILITIES

Currency in circulation	-	-	-	-	15,813,022	15,813,022
Deposits of banks	-	-	-	-	4,973,550	4,973,550
Reserve requirements	5,323,066	-	-	-	10,847	5,333,913
NBRM Bills	-	-	-	-	8,945,039	8,945,039
Deposits of the government	15,396,267	221,351	-	7,813	8,932,052	24,557,483
Restricted deposits	81,723	294,688	-	34,787	-	411,198
Borrowings from IMF	-	-	3,842,487	-	4,970,211	8,812,698
Other deposits	-	-	-	-	1,594,898	1,594,898
Other liabilities	134,519	5,405	-	7,868	228,358	376,150
Capital and reserves	-	-	-	-	8,009,172	8,009,172
Total liabilities	20,935,575	521,444	3,842,487	50,468	53,477,149	78,827,123
Gap analysis	31,595,295	16,052,406	(3,141,373)	348,607	(44,854,935)	-

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA
Financial statements for the year ended 31 December 2005

(All amounts in MKD thousands unless otherwise stated)

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

ASSETS	EUR	USD	SDR	Other	MKD	Total
Foreign assets	30,270,926	13,959,903	71,600	400,348	(346,325)	44,356,452
Receivable from the government	-	-	586,427	-	2,501,383	3,087,810
Membership with the IMF	-	-	-	-	5,186,805	5,186,805
Receivable from banks	-	935,581	-	-	(898,481)	37,100
Other assets	-	-	-	-	1,138,718	1,138,718
Total assets	30,270,926	14,895,484	658,027	400,348	7,582,100	53,806,885
LIABILITIES						
Currency in circulation	-	-	-	-	15,071,504	15,071,504
Deposits of banks	-	-	-	-	2,668,636	2,668,636
Reserve requirements	3,363,332	-	-	-	8,145	3,371,477
NBRM Bills	-	-	-	-	4,565,838	4,565,838
Deposits of the government	5,627,761	974,924	-	1,755	6,450,882	13,055,322
Restricted deposits	41,926	177,555	-	-	-	219,481
Borrowings from IMF	-	-	3,405,123	-	5,186,804	8,591,927
Other deposits	-	-	-	-	1,574,330	1,574,330
Other liabilities	325,697	4,578	-	7,942	127,518	465,735
Capital and reserves	-	-	-	-	4,222,635	4,222,635
Total liabilities	9,358,716	1,157,057	3,405,123	9,697	39,876,292	53,806,885
Gap analysis						
Gap per individual band	20,912,210	13,738,427	(2,747,096)	390,651	(32,294,192)	-

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA
Financial statements for the year ended 31 December 2005

(All amounts in MKD thousands unless otherwise stated)

D Interest rate risk

NBRM is exposed to interest rate risk as a result of mismatches of interest rate re-pricing of assets and liabilities.

The NBRM's interest sensitivity position based on contractual re-pricing arrangements as of 31 December 2005 was as follows:

	Interest-bearing items					Non-interest bearing items	Total
	Up to 1 month or at variable rate	1 to 3 months	3 months to 1 year	1 to 5 years	over 5 years		
ASSETS							
Foreign assets	50,400,599	7,736,832	4,743,919	6,079,492	-	254,164	69,215,006
Receivable from the government	-	-	307,013	1,944,054	669,786	628,862	3,549,715
Membership with the IMF	-	-	-	-	-	4,970,211	4,970,211
Receivable from banks	-	-	5,837	5,836	19,574	-	31,247
Other assets	-	-	-	-	-	1,060,944	1,060,944
Total assets	50,400,599	7,736,832	5,056,769	8,029,382	689,360	6,914,181	78,827,123
LIABILITIES							
Currency in circulation	-	-	-	-	-	15,813,022	15,813,022
Deposits of banks	4,969,300	-	-	-	-	4,250	4,973,550
Reserve requirements	5,333,913	-	-	-	-	-	5,333,913
NBRM Bills	8,920,990	-	-	-	-	24,049	8,945,039
Deposits of the government	22,808,969	-	-	-	-	1,748,514	24,557,483
Restricted deposits	-	-	-	-	-	411,198	411,198
Borrowings from IMF	2,906,597	-	404,169	531,721	-	4,970,211	8,812,698
Other deposits	1,556,117	-	-	-	-	38,781	1,594,898
Other liabilities	-	-	-	-	-	376,150	376,150
Capital and reserves	-	-	-	-	-	8,009,172	8,009,172
Total liabilities	46,495,886	-	404,169	531,721	-	31,395,347	78,827,123
GAP ANALYSIS							
Gap per individual band	3,904,713	7,736,832	4,652,600	7,497,661	689,360	(24,481,166)	-
Cumulative gap	3,904,713	11,641,545	16,294,145	23,791,806	24,481,166	-	-

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA
Financial statements for the year ended 31 December 2005

(All amounts in MKD thousands unless otherwise stated)

The NBRM's interest sensitivity position based on contractual re-pricing arrangements as of 31 December 2004 was as follows:

	Interest-bearing items					Non-interest bearing items	Total
	Up to 1 month or at variable rate	1 to 3 months	3 months to 1 year	1 to 5 years	over 5 years		
ASSETS							
Foreign assets	39,644,263	66,590	-	485,550	-	4,160,049	44,356,452
Receivable from the government	-	-	307,013	1,228,054	956,464	596,279	3,087,810
Membership with the IMF	-	-	-	-	-	5,186,805	5,186,805
Receivable from banks	-	-	11,921	5,605	19,574	-	37,100
Other assets	-	-	-	-	-	1,138,718	1,138,718
Total assets	39,644,263	66,590	318,934	1,719,209	976,038	11,081,851	53,806,885
LIABILITIES							
Currency in circulation	-	-	-	-	-	15,071,504	15,071,504
Deposits of banks	2,665,851	-	-	-	-	2,785	2,668,636
Reserve requirements	3,371,477	-	-	-	-	-	3,371,477
NBRM Bills	4,565,838	-	-	-	-	-	4,565,838
Deposits of the government	-	-	-	-	-	13,055,322	13,055,322
Restricted deposits	3,549	-	-	-	-	215,932	219,481
Borrowings from IMF	2,138,929	-	381,895	884,299	-	5,186,804	8,591,927
Other deposits	1,549,738	-	-	-	-	24,592	1,574,330
Other liabilities	-	-	-	-	-	465,735	465,735
Capital and reserves	-	-	-	-	-	4,222,635	4,222,635
Total liabilities	14,295,382	-	381,895	884,299	-	38,245,309	53,806,885
GAP ANALYSIS							
Gap per individual band	25,348,881	66,590	(62,961)	834,910	976,038	(27,163,458)	-
Cumulative gap	25,348,881	25,415,471	25,352,510	26,187,420	27,163,458	-	-

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA
Financial statements for the year ended 31 December 2005

(All amounts in MKD thousands unless otherwise stated)

E Liquidity risk

Liquidity risk is the risk that insufficient liquid 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 NBRM'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, on 31 December 2005:

	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	over 5 years	Total
ASSETS						
Foreign assets	50,614,951	7,736,832	4,743,919	6,079,492	39,812	69,215,006
Receivable from the government	628,862	-	307,013	1,944,054	669,786	3,549,715
Membership with the IMF	4,970,211	-	-	-	-	4,970,211
Receivable from banks	-	-	5,837	5,836	19,574	31,247
Other assets	49,189	-	-	-	1,011,755	1,060,944
Total assets	56,263,213	7,736,832	5,056,769	8,029,382	1,740,927	78,827,123
LIABILITIES						
Currency in circulation	15,813,022	-	-	-	-	15,813,022
Deposits of banks	4,973,550	-	-	-	-	4,973,550
Reserve requirements	5,333,913	-	-	-	-	5,333,913
NBRM Bills	8,945,039	-	-	-	-	8,945,039
Deposits of the government	24,557,483	-	-	-	-	24,557,483
Restricted deposits	129,426	18,713	263,059	-	-	411,198
Borrowings from IMF	5,590,841	-	448,313	2,773,544	-	8,812,698
Other deposits	1,594,898	-	-	-	-	1,594,898
Other liabilities	535,680	8,439	753	2,730	(171,452)	376,150
Capital and reserves	-	-	-	-	8,009,172	8,009,172
Total liabilities	67,473,852	27,152	712,125	2,776,274	7,837,720	78,827,123
GAP ANALYSIS						
Gap per individual band	(11,210,639)	7,709,680	4,344,644	5,253,108	(6,096,793)	-
Cumulative gap	(11,210,639)	(3,500,959)	843,685	6,096,793	-	-

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA
Financial statements for the year ended 31 December 2005

(All amounts in MKD thousands unless otherwise stated)

The maturity profile of the assets and liabilities on 31 December 2004 was as follows:

	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	over 5 years	Total
ASSETS						
Foreign assets	43,766,692	66,590	-	485,550	37,620	44,356,452
Receivable from the government	596,279	-	307,013	1,228,054	956,464	3,087,810
Membership with the IMF	5,186,805	-	-	-	-	5,186,805
Receivable from banks	-	-	11,921	5,605	19,574	37,100
Other assets	63,095	-	-	-	1,075,623	1,138,718
Total assets	49,612,871	66,590	318,934	1,719,209	2,089,281	53,806,885
LIABILITIES						
Currency in circulation	15,071,504	-	-	-	-	15,071,504
Deposits of banks	2,668,636	-	-	-	-	2,668,636
Reserve requirements	3,371,477	-	-	-	-	3,371,477
NBRM Bills	4,565,838	-	-	-	-	4,565,838
Deposits of the government	13,055,322	-	-	-	-	13,055,322
Restricted deposits	1,734	48,182	169,565	-	-	219,481
Borrowings from IMF	5,773,232	-	467,614	2,337,687	13,394	8,591,927
Other deposits	1,574,330	-	-	-	-	1,574,330
Other liabilities	731,763	9,691	3,479	1,622	(280,820)	465,735
Capital and reserves	-	-	-	-	4,222,635	4,222,635
Total liabilities	46,813,836	57,873	640,658	2,339,309	3,955,209	53,806,885
GAP ANALYSIS						
Gap per individual band	2,799,035	8,717	(321,724)	(620,100)	(1,865,928)	-
Cumulative gap	2,799,035	2,807,752	2,486,028	1,865,928	-	-

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA
Financial statements for the year ended 31 December 2005

(All amounts in MKD thousands unless otherwise stated)

F Fair value

The differences between the carrying value and the fair value of the securities held to maturity, are as follows:

	31 December 2005			31 December 2004		
	Carrying value	Fair value	Difference	Carrying value	Fair value	Difference
Financial assets						
Investments held to maturity (note 15)	514,372	515,562	1,190	485,550	488,468	2,981

The non-interest earning government bond (Note 18) which is held to maturity is initially recognised at fair value of the assets by which it was acquired, and subsequently it is amortized to its maturity.

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.

As explained in Note 15, included in available-for-sale investments are BIS shares with a value of MKD 39,814,000 (2004: MKD 37,620,000), 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.

(All amounts in MKD thousands unless otherwise stated)

4 Critical accounting estimates, and judgments in applying accounting policies

The NBRM makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

(a) Impairment of available for sale equity investments

The NBRM determines that available for sale equity investments are impaired when there has been a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires judgment. In making this judgment, the NBRM evaluates among other factors, the normal volatility in share price. In addition, impairment may be appropriate when there is evidence of deterioration in the financial health of the investee industry and sector performance, changes in technology, and operational and financing cash flows.

(b) Held-to-maturity investments

The NBRM follows the guidance of IAS 39 on classifying non-derivative financial assets with fixed or determinable payments and fixed maturity as held-to-maturity. This classification requires significant judgment. In making this judgment, the NBRM evaluates its intention and ability to hold such investments to maturity. If the NBRM fails to keep these investments to maturity other than for the specific circumstances – for example, selling an insignificant amount close to maturity – it will be required to reclassify the entire class as available-for-sale. The investments would therefore be measured at fair value not amortized cost.

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA
Financial statements for the year ended 31 December 2005

(All amounts in MKD thousands unless otherwise stated)

5 Interest income

	Loans granted	Deposits	Securities	Total 2005	Total 2004
Government	-	-	122,040	122,040	140,949
Domestic banks	2,728	-	-	2,728	1,288
Foreign entities	-	1,029,255	51,646	1,080,901	764,978
Total for 2005	2,728	1,029,255	173,686	1,205,669	907,215
Total for 2004	1,389	711,963	193,963	907,215	

6 Interest expenses

	Loans received	Deposits received	Securities issued	Total 2005	Total 2004
Government	-	67,100	-	67,100	19,119
Domestic banks	-	82,494	527,427	609,921	473,216
Foreign entities	74,311	-	-	74,311	46,718
Total for 2005	74,311	149,594	527,427	751,332	539,053
Total for 2004	46,718	140,895	351,440	539,053	

7 Fee income

	2005	2004
Fees from providing cash to banks	54,604	59,772
Fees based on settlement of payments (RTGS)	40,466	35,065
Fees from domestic banks for maintaining account based on debt turnover on account	27,092	-
Fees from sale of administrative and court government stamps	14,908	14,472
Fees from foreign exchange operating	8,913	4,567
Fees from issued guarantees	-	3,142
Other fees	58,365	15,250
Total	204,348	132,268

The revenues based on fees from providing cash to banks and settlement of the payments through RTGS, relate to services that the NBRM provides to domestic banks and other account holders in RTGS. At the beginning of January 2005, the NBRM introduced fee for debt turnover on the account related to the services in the domestic payment operations.

The fees originating from sale of administrative and court government stamps pertain to the registered income from sale of administrative and court government stamps belonging to the NBRM, in accordance with the concluded agreement with the Ministry of Finance regulating the activities for their printing and distribution.

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA
Financial statements for the year ended 31 December 2005

(All amounts in MKD thousands unless otherwise stated)

The fees from foreign exchange operations refer to the registered income from sale of foreign exchange to government bodies and conducting operations for the Government in the international payment operations.

The remaining fees of MKD 58,365,000 include revenue of MKD 33,809,000 on the basis of purchased rights for purchasing foreign exchange from the NBRM for sold securities to non-residents.

The amount of the fees that NBRM charges are regulated in the Decision on the single tariff for compensations for services provided by the NBRM adopted by the NBRM Council, as well as by individual agreements concluded with certain government bodies.

8 Fee expenses

	2005	2004
Fees to foreign banks	10,907	18,995
Fees from swap of gold	-	23,889
Other fees to domestic banks	18	24
Total	10,925	42,908

The fees paid to foreign banks refer to executed transactions with NBRM deposits and other foreign exchange transactions with foreign banks.

9 Other operating income

	2005	2004
Realized positive exchange rate differences, net	3,358	47,032
Fees from administering foreign credit lines	9,000	11,909
Income based on dividend from BIS (note 15)	7,438	7,183
Income based on sale of jubilee coins	1,740	2,071
Realized gain from securities available for sale	-	63,515
Other income	16,581	13,452
Total	38,117	145,162

The realized positive exchange rate differentials, net arise from purchase and sale of foreign exchange with domestic banks, arbitrations with foreign banks, as well as from the spread between middle and ask rate when selling foreign exchange to the government bodies for the purpose of executing international foreign exchange payments.

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA
Financial statements for the year ended 31 December 2005

(All amounts in MKD thousands unless otherwise stated)

10 Other expenses

	2005	2004
Services	49,389	75,310
Costs of production of banknotes and coins	54,059	60,409
Realized losses from securities available for sale sold	-	34,876
Price changes from securities	6,658	-
Tangible expenses	24,896	26,581
Other administrative expenses	2,351	5,113
Other expenses	8,311	2,489
Total	145,664	204,778

The costs of banknote and coin manufacture mainly relate to imported banknotes or imported special banknote printing paper, and materials purchased for minting coins. The banknote printing is made by private domestic or foreign manufacturers, and the coin minting is made by the NBRM. The NBRM applies a policy of differentiating the costs of manufacture of banknotes and coins over the period of their use.

The expenditures arising from price movements of foreign securities are net negative price differences resulting from adjusting of the individual securities to their market value.

11 Provisions and write offs

	2005	2004
Provisions related to the BNT bankruptcy	-	152,646
Write off of irrecoverable balances	-	120,468
Liabilities arising from the non-compliance of the counter items (Note 36)	109,367	-
Expected provisions related to lawsuits	-	87,730
Provisions for interests and fees (Note 36)	16,000	62,864
Provisions for receivables from banks (Note 13)	22,946	-
Provisions for other receivables (Note 21)	-	18,754
Other provisions	386	7,017
Total	148,699	449,479

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA
Financial statements for the year ended 31 December 2005

(All amounts in MKD thousands unless otherwise stated)

12 Gold

	2005	2004
Gold in the NBRM vault	80,867	52,291
Sight gold deposits	5,567	3,844,574
Term gold deposits	5,729,843	-
Total	5,816,277	3,896,865

As of December 31, 2005, the NBRM total gold reserves stand at 218,283.87 ounces (2004: 197,413.69 ounces) at a market value of US Dollar 513 (Denar 26,603) per ounce (31.12.2004: US Dollar 438 or Denar 19,740 per ounce). The increase in the quantity of gold in 2005 is a result of the gold inherited from the succession of the assets of the former SFRY. Up to 2004, the gold deposits, 194,764.685 ounces (MKD 3,844,574,000), were held as non-interest bearing sight deposits in three correspondent banks. In 2005, the gold deposits, of 215,034.95 ounces (MKD 5,720,696,000), with 5-year maturity were deposited in three correspondent banks as interest deposits with an average interest rate of 0.557 % p.a. Term gold deposits include accrued interest of MKD 9,147,000 (2004: MKD -).

13 Foreign Currency Deposits

	2005	2004
Foreign currency sight deposits	19,924,593	11,468,727
Foreign currency term deposits	36,834,266	27,499,647
Provisions	(369,273)	(346,327)
Included in the cash and cash equivalents (Note 40)	56,389,586	38,622,047
Restricted accounts	506,822	466,792
Term deposits over 90 days	4,603,155	-
Total	61,499,563	39,088,839

The time deposits bear an interest at interest rates contingent upon the deposit currency and range from 2.54% to 4.06% p.a. on US Dollar deposits and from 1.97% to 2.42% p.a. on Euro deposits (2004: from 1.03% to 1.83% p.a. on US Dollar deposits and from 1.85% to 2.18% p.a. on Euro deposits). The interest rates on overnight deposits for 2005 range from 1.61% to 4.2% p.a. on US Dollar deposit and from 1.76% to 2.27% p.a. on Euro deposits (2004: from 0.85% to 2.23% p.a. on US Dollar deposits and from 1.61% to 2.46% p.a. on Euro deposits). The time deposits structure by the remaining maturity period is included in note 40. Foreign Currency Deposits include accrued interest of MKD 52,744,000 (2004: MKD 3,798,000).

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA
Financial statements for the year ended 31 December 2005

(All amounts in MKD thousands unless otherwise stated)

Sight deposits include MKD 506,822,000 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 1,099,791,000 in this bank. NBRM has provided MKD 120,989,000 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 72,310,000. NBRM has made a subordinated loan with the same bank of USD 5 million (MKD 259,294,000) maturing in 2002, which is fully provisioned. As the bank is in liquidation, the maturity of this loan did not change its subordinated status.

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

	2005	2004
Balance at 1 January	346,327	1,364,585
Transfer of provision to other accounts receivable (Note 21)	-	(1,018,258)
Additional provision (Note 11)	22,946	-
Balance at 31 December	369,273	346,327

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA
Financial statements for the year ended 31 December 2005

(All amounts in MKD thousands unless otherwise stated)

Foreign currency deposits by type of entity		
	2005	2004
International financial institutions	15,568,927	11,706,981
Central banks	40,648,887	22,496,415
Foreign commercial banks	5,651,022	5,231,770
	61,868,836	39,435,166
Provisions to deposits in foreign commercial banks	(369,273)	(346,327)
Total	61,499,563	39,088,839

Foreign currency deposits by geographic location		
	2005	2004
Europe	53,490,480	30,103,117
America	8,335,335	9,324,334
Other	43,021	7,715
	61,868,836	39,435,166
Provisions to deposits in Europe	(369,273)	(346,327)
Total	61,499,563	39,088,839

14 Cash Foreign Currency

Cash foreign currency is cash foreign currency and checks held in the NBRM vault. Cash foreign currency are included in cash equivalents for the purposes of the cash flow statement (Note 40).

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA
Financial statements for the year ended 31 December 2005

(All amounts in MKD thousands unless otherwise stated)

15 Foreign Securities

The NBRM has investments in foreign debt securities and foreign equity securities. The investments in foreign debt securities are classified as securities held to maturity and trading securities.

	2005	2004
Securities held to maturity		
2.625% semiannual Treasury note denominated in USD maturing November 2006	156,085	135,654
3.5% annual Euro-denominated government note maturing October 2008	91,803	91,770
4.75% semiannual GBP-denominated BIS bond, maturing March 2007	271,430	262,943
Trading securities		
Fixed income foreign government bonds purchased in 2005	640,372	-
Fixed income foreign government bonds (reclassified from available for sale)	611,082	604,458
Securities available for sale		
Fixed income foreign government bonds	-	-
Foreign equity securities	39,814	37,620
Total	1,810,586	1,132,445

Securities intended to be held to maturity bear fixed income and mature between 2006 and 2008.

The trading securities portfolio contains securities purchased in the preceding years classified as available for sale and securities purchased in 2005.

In 2005, the NBRM changed its accounting policy and classified the investments in foreign debt securities, not intended to be held to maturity, which are highly liquid and there is a market value, as trading securities. Previously, these investments were classified as available for-sale investments. The prior year comparatives were restated and the restated amount is MKD 63,261,000. These investments are complied with the market value daily and bear fixed annual and semiannual coupon interests at a rate ranging from 3% and 4.5% p.a.

The equity securities are composed of ordinary BIS shares with a nominal value of 5,000 SDR per share (paid up at 25% of their nominal value).

Securities held to maturity include accrued interest of MKD 4,946,000 (2004: MKD 5,117,000).

Trading securities include accrued interest of MKD 13,171,000 (2004: MKD 12,627,000).

16 Special Drawing Rights (SDR)

The NBRM maintains an SDR-denominated current account with the IMF used for processing and settling transactions with the IMF. This current account bears interest in the amount of the so-called IMF basic rate, obtained weekly, as a weighted average of selected rates of three-month instruments on the money market of the five countries the currency of which constitutes the SDR basket. In 2005, the basic rate ranged from 2.22% and 3.03% p.a. (2004: 1.57% and 2.24% p.a.). Special Drawing Rights are included in cash equivalents for the purposes of the cash flow statement (Note 40).

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA
Financial statements for the year ended 31 December 2005

(All amounts in MKD thousands unless otherwise stated)

17 Receivables from Government related to IMF

	2005	2004
Receivables related to SDR allocation based on liability (Note 33)	620,630	586,427
Total	620,630	586,427

The receivable related to the SDR allocation with the IMF resulting from the correspondent requirement for the Macedonian portion of the liability to the IMF for SDR allocated to, and received by the former SFRY, according to the Law on Legal Inheritance of the Republic of Macedonia of the Membership in the IMF (see Note 33).

18 Government Securities

	2005	2004
Bond for rehabilitation of one commercial bank	669,786	649,451
Other bonds	1,543,299	1,851,932
Government Bonds for covering the NBRM loss	716,000	-
Total	2,929,085	2,501,383

The securities of the Republic of Macedonia held to maturity are securities issued on behalf of and for the account of the Republic of Macedonia, on the basis of the provisions of the 1995 Law on Reconstruction and Rehabilitation of a portion of the banks in the Republic of Macedonia. The bond for rehabilitation and reconstruction of one commercial bank which becomes due for the whole amount in April 2020 is in a nominal amount of MKD 1,039,318,000 and is non-interest bearing. For the purposes of the IFRS, this bond is valued at fair value of the funds it was acquired with and is amortized to the maturity of the bond.

The other bonds issued on behalf of and for the account of the Republic of Macedonia are repayable in equal annual installments of MKD 307,013,000 by April 1, 2010. These bonds bear interest at variable interest rate equal to the NBRM discount rate, which in 2005 equaled 6.5% p.a. (2004: 6.5% p.a.).

The bonds of MKD 716,000,000 were acquired in December 2005 for funding the remaining uncovered loss recognized in 2004, based on the Law on the NBRM. The government bonds mature in 2010 and bear annual interest of 7.45%.

Government Securities include accrued interest of MKD 8,232,000 (2004: MKD 9,852,000).

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA
Financial statements for the year ended 31 December 2005

(All amounts in MKD thousands unless otherwise stated)

19 Membership in the IMF

According to the IMF Statute, ratified by the Parliament of the Republic of Macedonia and the Law on the Legal Inheritance of the Republic of Macedonia of the Membership in the International Monetary Fund, the NBRM acts as a fiscal agent of the Republic of Macedonia and simultaneously behaves as a depositary of the IMF in the Republic of Macedonia. As such, the NBRM keeps records of the quota of the Republic of Macedonia for membership with the IMF and of the account no.1 and the account no.2. The quota of the Republic of Macedonia for membership with the IMF stands at MKD 4,957,639,000 at the end of 2005, the account no. 1 amounts to MKD 12,425,000 and account no.2 is valued at MKD 146,000. (2004: MKD 5,173,685,000, MKD 12,967,000 and MKD 152,000 respectively for the three positions, see note 33). The changes are due to the evaluation of these positions by the SDR exchange rate on April 30, according to the IMF financial year.

20 Loans to banks

	2005	2004
Long-term loans from the conversion of the selective credits:		
1993	11,673	17,511
1996	19,574	19,574
Long-term loans from other conversions	-	15
Total	31,247	37,100

These loans originate from the restructuring of the so called selective credits of the NBRM used for refinancing of mainly agricultural loans of the banks in the former SFRY. The loans converted in 1996 mature on March 31, 2020, while the loans converted in 1993 mature from 2003 to 2008, in ten equal semiannual installments. All selective loans bear annual interest of 1.5%, which becomes due semiannually.

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA
Financial statements for the year ended 31 December 2005

(All amounts in MKD thousands unless otherwise stated)

21 Other receivables

	2005	2004
Receivable from bank under bankruptcy	1,034,569	1,034,569
Due auction deposits	9,268	9,268
	<u>1,043,837</u>	<u>1,043,837</u>
Provision	<u>(1,043,837)</u>	<u>(1,043,837)</u>
Total	<u><u>-</u></u>	<u><u>-</u></u>

In January 2004, the NBRM paid out MKD 1,018,258,000 to foreign banks on the basis of guarantees given for borrowings of one Macedonian bank from foreign banks, in accordance with the Decision on the criteria and the conditions for the use of a portion of the foreign reserves based on guarantees for borrowings of Macedonian banks from foreign banks, which ceased being valid in March 2003. The NBRM created receivable from the domestic bank. Bankruptcy proceeding was initiated against the bank in March 2004. The NBRM has receivables on the basis of guarantees granted by the bank under bankruptcy worth MKD 1,034,569,000. The NBRM receivable was fully disputed by the bankruptcy trustee. Therefore, on December 31, 2003, the NBRM fully provisioned the receivables from the bank under bankruptcy. For the year-end December, 31 2004, the NBRM increased the correction of value for this receivable by MKD 16,311,000, to MKD 1,034,569,000.

The deposit auction is a monetary instrument providing additional liquidity in the banking system by auction sale of short-term deposits and with interest rate set at the respective auction. Overdue receivables from banks are related to auction deposits of one bank not repaid on time. In 1999, a bankruptcy proceeding was initiated against this bank which is still underway. As specified by the Banking Law, the NBRM receivables along with the Republic of Macedonia receivables have a priority in the collection over the receivables of other creditors.

The movement of provision is analyzed as follows:

	2005	2004
Balance at 1 January	1,043,837	6,825
Reclassified from foreign currency deposits (Note 13)	-	1,018,258
Charge for the year (Note 11)	-	18,754
Balance at 31 December	<u><u>1,043,837</u></u>	<u><u>1,043,837</u></u>

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA
Financial statements for the year ended 31 December 2005

(All amounts in MKD thousands unless otherwise stated)

22 Property and Equipment

	Land and buildings	Furniture, equipment and vehicles	Works of art	Software	Investments in progress	Total assets for business purposes	Funds for enterta- inment purposes	Total fixed assets
On January 1, 2004								
Cost	842,995	404,395	25,923	57,898	12,821	1,344,032	34,858	1,378,890
Accumulated depreciation	(100,372)	(254,527)	-	(30,220)	-	(385,119)	(6,066)	(391,185)
Net book amount	742,623	149,868	25,923	27,678	12,821	958,913	28,792	987,705
On January 1, 2004	742,623	149,868	25,923	27,678	12,821	958,913	28,792	987,705
Additions	6,019	31,852	17,775	83	-	55,729	886	56,615
Write offs	-	(38)	-	-	-	(38)	-	(38)
Depreciation for the year	(11,052)	(41,988)	-	(10,156)	-	(63,196)	(1,646)	(64,842)
On December 31, 2004	737,590	139,694	43,698	17,605	12,821	951,408	28,032	979,440
On December 31, 2004								
Cost	849,014	427,145	43,698	57,981	12,821	1,390,659	35,744	1,426,403
Accumulated depreciation	(111,424)	(287,451)	-	(40,376)	-	(439,251)	(7,712)	(446,963)
Net book amount	737,590	139,694	43,698	17,605	12,821	951,408	28,032	979,440

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA
Financial statements for the year ended 31 December 2005

(All amounts in MKD thousands unless otherwise stated)

22 Property and Equipment (continued)

	Land and buildings	Furniture, equipment and vehicles	Works of art	Software	Investments in progress	Total assets for business purposes	Funds for enterta- inment purposes	Total fixed assets
On January 1, 2005								
Cost	849,014	427,145	43,698	57,981	12,821	1,390,659	35,744	1,426,403
Accumulated depreciation	(111,424)	(287,451)	-	(40,376)	-	(439,251)	(7,712)	(446,963)
Net book amount	737,590	139,694	43,698	17,605	12,821	951,408	28,032	979,440
On January 1, 2005, net of accumulated depreciation	737,590	139,694	43,698	17,605	12,821	951,408	28,032	979,440
Additions	3,064	4,994	3,551	11,731	112	23,452	-	23,452
Write offs	-	(30)	-	-	-	(30)	-	(30)
Transfers	-	(12,401)	-	12,401	-	-	-	-
Depreciation for the year	(11,117)	(39,539)	-	(11,741)	-	(62,397)	(1,772)	(64,169)
On December 31, 2005	729,537	92,718	47,249	29,996	12,933	912,433	26,260	938,693
On December 31, 2005								
Cost	852,079	391,241	47,248	82,113	12,933	1,385,614	35,719	1,421,333
Accumulated depreciation	(122,542)	(298,520)	-	(52,117)	-	(473,179)	(9,461)	(482,640)
Net book amount	729,537	92,721	47,248	29,996	12,933	912,435	26,258	938,693

The fixed assets for entertainment purposes include two buildings and other fixed assets within those buildings. As a part of the reforms of the payment system, in 2001, the NBRM took over the function for supplying with cash from the former Payment Operations Bureau (POB), and a part of the buildings, equipment and the furniture of the POB related to such function in ten towns throughout Macedonia. These fixed assets were transferred within NBRM possession and currently are used and maintained by the NBRM. The NBRM made capital improvements shown as investments in progress in the upper table. Since the competent bodies have not yet made a final decision on the POB asset, the NBRM still has not got any legal title of this property. Therefore, no assessment has been made of the value of this property, and hence, they are not recorded in the financial statements of the NBRM.

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA
Financial statements for the year ended 31 December 2005

(All amounts in MKD thousands unless otherwise stated)

23 Inventories

	2005	2004
Jubilee coins	64,292	69,917
Other inventories	11,827	26,267
Total	76,119	96,184

The jubilee coins are gold and silver coins which, as defined by the decision of the Government, were manufactured for the purposes of celebrating jubilees relevant for the country. On December 31, 2005, the NBRM held total of 8,238 gold coins and 420 silver coins (2004: 8,464 gold coins and 470 silver coins). The jubilee coins in the NBRM vault are intended for sale.

The other inventories primarily include office supplies, paper purchased for printing banknotes and other value papers, and other small inventory for the needs of the NBRM.

24 Receivables

Receivables consist of receivables based on compensations and fees for services provided by the NBRM and other receivables mostly including receivables for maintenance of the complex of banks:

	2005	2004
Fees	17,383	12,929
Other receivables	4,293	3,344
Total	21,676	16,273

25 Other Assets

	2005	2004
Prepaid expenses of printing banknotes	17,818	41,071
Other prepaid expenses	1,969	2,790
Other assets	4,669	2,960
Total	24,456	46,821

26 Currency in circulation

	2005	2004
Currency in circulation	15,813,022	15,071,504

27 Bank Deposits

The liabilities based on deposits to banks reflect the balances on the banks' accounts with the NBRM for settling payment transactions. The funds on the banks' accounts are included in the fulfillment of the banks' Denar reserve requirement, to which the NBRM pays remuneration in specified percentage (note 28).

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA
Financial statements for the year ended 31 December 2005

(All amounts in MKD thousands unless otherwise stated)

28 Reserve requirement of banks and savings houses

	2005	2004
Savings houses' Denar reserve requirement	10,847	8,145
Banks' foreign exchange reserve requirement	5,323,066	3,363,332
Total	5,333,913	3,371,477

As specified by the regulations, the banks are obliged to fulfill the reserve requirement in both Denars and in foreign currency.

The banks calculate the Denar reserve requirement at a rate of 10% of the Denar liabilities to residents and non-residents, legal entities and individuals, as defined by the Methodology for calculating the basis for the banks' Denar reserve requirement. The banks fulfill the Denar reserve requirement by funds on the accounts with the NBRM (note 27) and by a portion of the cash in the vault.

NBRM pays reserve requirement remuneration to the average allocated funds on the bank's account in the period of fulfillment. The NBRM does not pay any remuneration for the portion of the reserve requirement fulfilled with cash in vault and the funds allocated over the requirement. The reserve requirement remuneration equaled 2% in 2005 (2004: 4% from January to July, and 2% from August).

The banks calculate the foreign exchange reserve requirement at a rate of 10% of the foreign exchange liabilities to residents and non-residents, legal entities and individuals as defined by the Methodology for calculating the basis for the banks' foreign exchange reserve requirement. The banks fulfill the foreign exchange reserve requirement by depositing funds on the special foreign exchange reserve requirement accounts with the NBRM. Since January 2005, the NBRM does not pay any remuneration for the foreign exchange reserve requirement (2004: the foreign exchange reserve requirement remuneration equaled 1% p.a. - rate equivalent to the interest rate on deposit standing facility of ECB).

As specified by the regulations, the savings houses are obliged to fulfill the Denar reserve requirement. The savings houses calculate the reserve requirement at a rate of 2.5% and fulfill it by funds on the special reserve requirement accounts with the NBRM. The reserve requirement of the savings houses is fulfilled at a fixed level. The NBRM pays reserve requirement remuneration to the savings houses at a reserve requirement remuneration rate in Denars of the banks.

(All amounts in MKD thousands unless otherwise stated)

29 Central Bank Bills issued

The Central Bank (CB) bills auctions are monetary instrument used for liquidity management by sterilizing the excess liquidity from the banking system. The maturity of the CB bills is standardized and equals 28 days. Depending on the monetary policy objectives, the maturity of the CB bills could be shorter. The CB bills are sold to banks through an auctioning process, by applying an interest rate tender (banks auction for amounts they want to purchase and the interest rate) or volume tender (the banks auction only with the amounts they want to purchase, while the interest rate is fixed, determined by the NBRM).

In 2005, the CB bills maturity was 7 days (by March 4, 2005) and 28 days. Two types of tender were applied at the auctions: volume tender - unlimited amount and interest rate tender, starting from October 26, 2005. As a result of the application of the volume tender until October, the interest rates on the CB bills auctions equaled 10%, and the introduction of the interest rate tender led to reduction in the lowest interest rate of 8.37%, achieved at the auction on December 30, 2005, (2004: the maturity of CB bills was 7 and 28 days. The interest rates were at lowest level the lowest in January, with the monthly weighted interest rate equaling 6.75%, while the highest level of interest rates was registered in December when the monthly weighted interest rate equaled 8.95%). Central Bank Bills issued include accrued interest of MKD 24,049,000 (2004: MKD 13,984,000).

30 Government Denar Deposits

The NBRM performs deposit operations for the government and the government administration bodies, as defined by the Law on the NBRM. It maintains the single treasury account of the government and the accounts of the compensation funds from foreign donations.

	2005	2004
Single Treasury account	6,566,799	4,324,703
Other Denar deposits	2,365,343	2,126,179
Total	8,932,142	6,450,882

In 2005, the interest paid by the NBRM on these deposits was calculated at an interest rate of 0.7% p.a. (2004 only for the October - December 2004 period, at an interest rate of 1% p.a.).

(All amounts in MKD thousands unless otherwise stated)

31 Government foreign currency deposits

As specified by the Law on the National Bank of the Republic of Macedonia and the Foreign Exchange Operations Law, the NBRM is an agent of the government for performing international payment operations. The Central Government bodies and part of the public funds deposit their foreign currency inflows on foreign exchange accounts with the NBRM, only if the opening of such account is formally approved by the Ministry of Finance. In 2005, the NBRM paid an interest on the government foreign currency deposits at an interest rate of 0.5% p.a. (2004: 0.5% p.a. only for the October - December 2004 period).

The foreign currency deposits include government deposits based on principal and interest from the commercial banks participants in the credit lines administered through the Apex Unit established at the NBRM. As of December 31, 2005 these deposits are valued at MKD 564,994,000 and are mostly funds based on repaid principal, primarily from the two private sector development loans approved by the World Bank (2004: MKD 317,423,000).

32 Restricted Deposits

The restricted deposits primarily include foreign assets of depositors (government) pending the completion of wire transfers abroad and funds of depositors (government) which represent 100% cover of letter of credit issued by the NBRM for their account. The NBRM does not pay interest on these deposits.

33 Borrowing from IMF

Borrowing from IMF comprises the liabilities on the basis of net cumulative allocation, borrowings and liabilities on the basis of membership and IMF deposits.

Liabilities on the basis of net cumulative allocation

By a decision of the IMF's Executive Board of December 14, 1992, and following the written approval by all successors - countries in the process of allocation of the IMF quota of Former Yugoslavia, Macedonia took over 5.4% of the liability on the basis of the net SDR allocation from former Yugoslavia of SDR 8,378,694. This amount represents the share of the Republic of Macedonia in the liabilities of Former Yugoslavia to the IMF, for the amount of SDRs which were previously allocated and applied by former Yugoslavia.

According to the IMF Statute, the liability for the SDR allocation falls due for collection only in the case and in the amount of the cancelled previous SDR allocation, which requires a decision of the Council of IMF Governors, with 85% majority of votes, or in case of canceling the participation in the SDR Department within the framework of the IMF, or closing of the SDR Department within the framework of the IMF.

NBRM pays interest to the existing share of the liability on the basis of the SDR allocation, at the basic interest rate of the IMF, and starting from 2005, it is being refunded from the Budget of the Republic of Macedonia.

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA
Financial statements for the year ended 31 December 2005

(All amounts in MKD thousands unless otherwise stated)

Liabilities on the basis of borrowings from IMF

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

	2005	2004
Systemic Transformation Facility - Part 2 (STF-2)	-	72,324
Enhanced Structural Adjustment Facility (ESAF)	808,300	1,145,636
Poverty Reduction and Growth Facility (PRGF)	127,590	120,558
Extended Fund Facility (EFF)	63,795	80,372
Stand-by	1,444,412	1,399,806
Stand-by	777,760	-
Total	3,221,857	2,818,696

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

STF-2 was repaid during 2005.

In September 2005, a new Stand-by Arrangement was concluded.

ESAF and PRGF arrangements are repayable over a period of ten years, including a grace period of five years and six months. These borrowings are payable in semi-annual installments and should be settled fully between 2002 and 2010, depending on the arrangement type. The Stand-by loans are for a period of four to 4.3 years, including a grace period of 2.3 to three years, with quarterly payments maturing between 2005 and 2009. EFF arrangement is repayable over a period of eight years and six months, including a grace period of four years and six months. ESAF and PRGF arrangements incur interest at fixed rates of 0.5% per annum. Other borrowing arrangements incur interest determined according to the basic rate of IMF (see Note 16) and additional charges.

Liabilities on the basis of membership in the IMF (see Note 19):

	2005	2004
Liabilities on the basis of issued promissory note for membership in the IMF	4,957,639	5,173,685
Liabilities on the basis of account 1	12,425	12,967
Liabilities on the basis of account 2	146	152
Total	4,970,210	5,186,804

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA
Financial statements for the year ended 31 December 2005

(All amounts in MKD thousands unless otherwise stated)

34 Other deposits

Other deposits comprise of deposits of brokerage houses client accounts, the Central Depository of Securities account, the Deposit Insurance Fund account and the liabilities on the basis of the Denar deposits to the international financial institutions.

	2005	2004
Liabilities on the basis of Denar deposits to other domestic entities	1,575,227	1,568,659
Liabilities on the basis of Denar deposits to international financial institutions	19,671	5,671
Total	1,594,898	1,574,330

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. NBRM pays interest to the Deposit Insurance Fund of 0.7% per annum (2004: 1% per annum).

The accounts of the international financial institutions are deposited with the NBRM. NBRM pays no interest on these deposits.

35 Other payables

	2005	2004
Payables from appropriation of net income	8,439	9,691
Liabilities from BNT bankruptcy	154,195	157,747
Payables arising from annuities received from sale of socially-owned flats	2,049	-
VAT	2,199	116
Other payables	49	-
Total	166,931	167,554

Payables from appropriation of net income relate to appropriation of net income, which is due to the Budget of the Republic of Macedonia, 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 of MKD 292,442,000 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 of MKD 24,761,000. Cumulatively, until the end of 2004, the NBRM paid MKD 120,233,000 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 152,646,000 in relation to this liability (see Note 11).

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA
Financial statements for the year ended 31 December 2005

(All amounts in MKD thousands unless otherwise stated)

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.

36 Other liabilities

	2005	2004
Contra accounts	(171,452)	(280,820)
Bank deposits related to swap operations	-	147,144
Temporarily confiscated foreign currencies	145,502	145,183
Expected litigation outlays	154,272	161,662
Jubilee coins counterpart	53,022	58,312
Deferred income	4,094	2,297
Equity payments pending operational license	-	42,917
Deferred expenses IMF	16,643	10,432
Liabilities to suppliers	6,838	8,742
Other liabilities	300	2,312
Total	209,219	298,181

Contra accounts of MKD 171,452,000 (2004: MKD 280,820,000) represent a suspense balance of asset and liability items from previous years, on which the assets and the liabilities related to monetary transactions. In 2005 the NBRM identified that the balance has been there in the NBRM's balance sheet since 2001, but it originates from previous years. For an amount of MKD 109,367,000, for which the origin was identified, NBRM allocated provisions, which was reflected in the income statement for 2005.

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 through the MIPS system). During 2005 they were closed.

Temporarily confiscated foreign currencies represent foreign currency holdings of individuals that are confiscated by the competent government bodies as a mandatory measure. The competent government bodies pressed charges against those individuals, with the competent courts. Depending on the court decision, these foreign currencies are either returned to the original holder or conferred to the Budget of the Republic of Macedonia. NBRM also maintains temporary deposited foreign currencies that are recorded on memo accounts.

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA
Financial statements for the year ended 31 December 2005

(All amounts in MKD thousands unless otherwise stated)

Those foreign currencies recorded off-balance sheet amount to MKD 169,057,000 as of 31 December 2005 (2004: MKD 150,843,000). 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 and they were closed during 2005.

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 gyro 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).

In February 2005, on the basis of court decision, NBRM settled liabilities against an insurance company, based on litigation, but in December 2005, on the basis of a verdict of the Supreme Court of the Republic of Macedonia, the case was returned to the court for repeated trial. Therefore, no additional provisions for penalty interest for the litigations with the insurance companies were paid. In the course of 2005, the status of the litigations with commercial banks has not significantly changed. For 2005, the potential liabilities on this basis increased by MKD 16,000 as 50% of the estimated penalty interest for 2005, which is recognized as expenditure in the income statement for 2005 (see Note 11). Jubilee coins counterpart arises as a result of the accounting policy for jubilee coins (Note 2L).

37 Capital

The NBRM capital is defined in the Law on the NBRM and as of December 31, 2005, it amounted to MKD 1,289,789,000 (2004: MKD 1,289,789,000).

38 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 were fully utilized to cover the negative financial results from 2004. During 2005, on the basis of the amendments to the NBRM Law, the Republic of Macedonia replenished the general reserves of MKD 500,000,000.

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA
Financial statements for the year ended 31 December 2005

(All amounts in MKD thousands unless otherwise stated)

39 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.

	2005	2004
Revaluation reserves from foreign exchange gains	4,350,048	3,230,161
Revaluation reserves from price and exchange rate changes of gold	1,866,868	447,619
Revaluation reserves from price changes of securities for trading	357	-
Total	6,217,273	3,677,780

On the basis of the allocation of the net unrealized foreign exchange gains from monetary assets and liabilities, of MKD 1,119,887,000 is allocated to the Revaluation reserves from foreign exchange gains (see Statement on changes in equity).

Revaluation reserves from price and exchange rate changes of gold for 2005 increased by MKD 1,419,249,000 on the basis of allocation of the net unrealized price and exchange rate changes of gold.

Revaluation reserves from price changes of securities for trading is established on the basis of allocation of the net unrealized price changes of securities for trading according to the security-by-security principle.

40 Cash and cash equivalents

	2005	2004
Foreign currency deposits (Note 13)	56,389,586	38,622,047
Foreign currencies in vault (Note 14)	47,909	204,322
SDR holdings, net (Note 16)	40,671	33,981
Total	56,478,166	38,860,350

41 Commitments and contingencies

a) Litigation

NBRM is a defendant in several legal proceedings arising from its operations. NBRM contests these claims and based on legal advice considers that no other material liabilities will be incurred, except for the amounts already provided for (see Notes 11 and Note 36).

b) Derivatives

NBRM had no derivatives as of 31 December 2005 and 2004.

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA
Financial statements for the year ended 31 December 2005

(All amounts in MKD thousands unless otherwise stated)

42 Events after balance sheet date

On 28 April 2006, NBRM enacted a decision for provisioning of the unreconciled contra accounts, originate from previous years, in the amount of MKD 171,452,000 until they are finally reconciled (see Note 36)

MANAGING BODIES OF THE NATIONAL BANK OF THE REPUBLIC OF MACEDONIA

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Members

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Governor of the National Bank of the Republic of Macedonia

Petar Goshev, M.A.

Vice Governors

Emilija Nacevska

Fadil Bajrami

Vancho Kargov

Organizational Chart of the National Bank of the Republic of Macedonia

