

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA



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Honorable,

After the difficult security and economic crisis in 2001, in 2002 the Republic of Macedonia was making efforts to consolidate the economy, to improve the macroeconomic performances and to continue the structural reforms. The Macedonian economy was facing numerous challenges. The recovery of the capacities, the renewal of the relations with the foreign partners, the implementation of the ongoing projects, as well as the return of the confidence of the domestic and the foreign investors, were considered to be the key prerequisites for re-acceleration of the economic growth and achievement of satisfactory growth rates. However, the macroeconomic indicators for 2002 confirm the necessity of a longer period of recovery from the effects of the crisis and more dynamic functioning of the overall economy. Thus, in 2002, the Macedonian economy registered a real GDP growth of 0.7%, with a fall being registered in the activity of the industrial sector. Despite the difficulties and the relatively slow recovery, several facts reaffirmed the clear determination of the Government and the support of the international community for integration of the Macedonian economy in the global economic flows:

- *although the arrangement with the International Monetary Fund (IMF) in 2001 was terminated due to the security crisis and the impossibility to implement the agreed policies, the cooperation of the Republic of Macedonia with the IMF in the first half of 2002 continued through the so-called Staff Monitored Program. Such an approach was a signal to the international investors for the transitory character of the problems in the country and the possibility to be promptly overcome. Additionally, the negotiations for concluding a new Stand by arrangement with the IMF (approved at the end of April 2003) were announced at the end of 2002, and successfully completed at the beginning of 2003);*
- *the donor conference for the Republic of Macedonia was held in March 2002, at which the donors announced financial support of Euro 307 million, which was above the expectations. These funds were primarily intended for supporting the balance of payments, reconstruction of the regions affected by the conflict, implementation of the Framework Agreement and therefore represent an important support to the Republic of Macedonia in its endeavors to cope with the economic and security problems. The largest portion of the announced financial funds from the donors was contingent upon the conclusion of the arrangement with the IMF. After the fulfillment of this prerequisite, larger inflows could be expected in 2003, which along with the positive direct effects, increases the importance of the arrangement with the IMF;*
- *the involvement of the Republic of Macedonia in the global trade flows continued in 2002. In October 2002, the Republic of Macedonia officially became 145th member state of the World Trade Organization (WTO), after the General Council of the WTO verified the Membership Agreement. The Macedonian economy accepted the obligation for further opening towards the foreign markets and promoting the competitiveness, as a necessary precondition for regular conduct of the international commodity trade.*

In 2002, the National Bank of the Republic of Macedonia (NBRM) was focused on achieving the legally defined primary goal – maintenance of the price stability by conducting flexible monetary policy based on the Denar exchange rate targeting strategy (against the Euro starting from this year). Thus, in 2002, the achieved average inflation rate equaled 1.8%. Such inflation performances are within the framework of the medium-term inflation goal of the European Central Bank, which is of a great importance, taking into consideration the long-term orientation of the Republic of Macedonia towards the European integration.

The actual implementation of the monetary policy was conducted in the environment of clear need for coordinated action with the other macroeconomic policies, aimed at providing consistent macroeconomic framework. This was particularly evident in the third quarter of the year, i.e. in the period prior to the parliamentary elections, when the high public consumption, typical for the pre-election period, created excess liquidity in the banking system, and increased the level of currency in circulation. In such environment, the NBRM managed to absorb the excess liquidity through the basic monetary regulation instrument, the CB bills auctions, acting towards defense of the exchange rate stability. In this year, the monetary policy instruments were permanently adjusted to the developments in the Macedonian economy.

In accordance with the accepted monetary strategy, in 2002 the NBRM took an active role on the foreign exchange market, where the supply of and the demand for foreign exchange mostly reflected the unfavorable developments in the foreign trade. The difficulties regarding the renewal of the lost markets and canceled contracts with the foreign partners due to the crisis in 2001, as well as the environment of high demand on the domestic market made the export of goods drop by 3.9%. Taking into account the dependence of the Macedonian economy on the imports (and the additional measures aimed at creating favorable conditions for import of used vehicles), the imports picked up by 15.9%, resulting in higher demand for foreign exchange for servicing the foreign liabilities. In such circumstances, the NBRM managed to close the gap between the supply and the demand for foreign exchange and to preserve the exchange rate stability by a net sale of foreign exchange. Nevertheless, at the end of 2002, the NBRM gross foreign exchange reserves remained at a satisfactory level of US Dollar 735 million, covering 4.5-months of import. It was achieved with the liabilities towards the foreign creditors being regularly serviced, where total of US Dollar 300 million were paid off in 2002. However, in 2002, the deficit in the current account of the balance of payments of the Republic of Macedonia increased and reached US Dollar 324.5 million. The realization of a portion of the donations from the donor conference and the private transfers enabled partial financing of the trade deficit. In this context, it is essential to mention the enforcement of the new Law on Foreign Exchange Operations (October 2002) which allows high degree of liberalization of the capital transactions, thus bringing the Republic of Macedonia closer to the contemporary market economies. However, with regard to the liberalization, the potential adverse effects from the liberalization of the portfolio investments (because of their short-term character) and the international credit relations (in both directions) are of a great concern, due to which the NBRM undertook proper preventive measures.

The outcome of the efforts for reforming, modernizing and restructuring of the banking system, made throughout many years, became particularly evident in 2002, in the time of the transfer of the payment operations to the banks and the Euro conversion. The reform of the payment system is regarded as one of the most successful reforms in the Macedonian economy. The NBRM plays the leading role in the new payment system, by settling the large-value payments between the banks through the RTGS system. In 2002, the NBRM also provided technical assistance for reforming the payment systems of other central banks worldwide, which is a proof of the excellent concept and efficiency of the reform. The new payment system operates on the basis of the principle of real time gross settlement and it is compatible with the payment systems in the developed economies. From the aspect of the banks, the reformed payment system provided enhanced capacity for liquidity monitoring and management, and introduced a new type of services the banks offer to the clients. The smooth conduct of the payment operations in 2002 indicated the excellent staff and technical equipment and willingness of the banks and other participants to undertake such a venture.

The Euro-conversion was an exceptional opportunity for mobilizing the households' foreign exchange savings in the banking system. However, after the substantial foreign

exchange inflows in the banks in the last quarter of 2001, an uncertainty could have been felt regarding the volume and the dynamics of withdrawal of these funds, and particularly regarding the successfulness of such credibility test for the banking system. However, the withdrawal of the foreign exchange deposits was moderate and it was registered only in the first quarter of 2002, immediately followed by the trend of further depositing of foreign exchange savings, alongside the increase in the savings in domestic currency. It should be underlined that the Republic of Macedonia is among the top countries in transition according to the amount of funds that remained in the banks after the conversion. Such situation confirms the strengthened confidence in the banking system and emphasizes the significance of the interest income as a source of income for the households. Hence, the annual drop in the total deposits of 16.6% was primarily due to the high comparison base at the end of 2001, as a period when the funds depositing was the most intensive due to the Euro-conversion.

In 2002, the currency in circulation was preserved at a high level, under the influence of the Euro-conversion and the reform of the payment operations early this year, the enforcement of the temporary financial transactions tax, as well as the effect of the high budget spending. Taking into consideration the high level of currency in circulation and the increase in the transaction deposits, in 2002, the monetary aggregate M1 registered annual increment of 4.3%. Simultaneously, in 2002, the money supply M2 – Denar component increased by 7.9%. The change in the broadest money supply M4 in December was negative (9.8%), indicating the high comparison base due to the conversion of the “in-currencies” into Euro.

In 2002, the banks’ credit policy showed certain responsiveness to the stabilization of the situation, the lower country risk and consequently, to the lower credit risk of the clients. Thus the total amount of credits extended at the end of 2002 compared to the end of the previous year was by 7.8% higher. The fact that the placements in domestic currency are generator of the increase in the banks’ placements just confirms the perceptions for the lower risk. Thus the Denar placements registered annual growth rate of 10.1%, whereas the foreign exchange placements fell by 1.5%. The lower amount of overdue claims of the banks indicates higher efficiency in the credit portfolio management, improved selection and higher financial reliability of the clients. In 2002, the banking system played an important role in the process of supplementing the households’ financial potential, by more intensive extension of consumer and long-term housing credits. This increases the role of the banks in inducing the joint consumption and the investments, as factors of the economic development.

In 2002, when the NBRM interest rate policy was flexibly adjusting to the changes in the overall economic flows, and when the interest rates on the Money Market were following the monetary impulses, the banks’ interest rates were relatively stable, remaining, however, insufficiently responsive. At the end of 2002, the average weighted lending Denar interest rates of the banks equaled 17.7%, reducing by 1.4 percentage points on annual basis, whereas the deposit Denar interest rates registered more moderate increase of 0.9 percentage points and equaled 9.2%. Thus, the interest rate margins remain high indicating the high financial intermediation costs.

The activities for creating sound and modern legal basis for the financial system functioning continued in 2002. Thus, the new Law on the National Bank of the Republic of Macedonia entered into force in January 2002, with the NBRM operations being largely harmonized with the modern central banks in the developed economies. Thus, the price stability is legally defined as a primary goal of the monetary policy. Additionally, the Law emphasizes the independence of the NBRM, which is one of the major preconditions for consistent and effective conduct of the monetary policy. The amendments to the Banking Law are also aimed at more secure and efficient functioning of the banking system. Also, the amendments to the Law on Deposit Insurance Fund, i.e. the increase in the amount of

indemnification of the households' deposits, were aimed at supporting and strengthening the confidence in the banks.

The implemented reforms of the financial system and the maintenance of the price stability, as the most favorable environment for sustainable economic growth, are only some of the elements necessary for more dynamic and successful functioning of the Macedonian economy. The need for implementation of the structural reforms, the strengthening of the production capacity of the economy, the expansion of the markets, as well as the renewal of the export demand by increasing the competitiveness of the domestic exporters remains. Only by such radical changes, the Macedonian economy will acquire the capacity to absorb the labor force and solve one of the largest problems – the high rate of unemployment.

Eventually, it should be noted that the year 2002 was of an exceptional importance for the NBRM as a monetary authority of the Republic of Macedonia. In April 2002, we celebrated the tenth anniversary of the monetary independence of the Republic of Macedonia, meaning ten-year of existence of the national currency unit and the Central Bank. Throughout this period, the NBRM has developed into a modern institution with proved capacity for achieving the set goals. Therefore, the maintained price stability and the Denar exchange rate stability, the increase in the foreign exchange reserves up to the level of optimum import coverage, as well as the gradual strengthening of the supervisory function and the stability of the banking system should be stressed as the most significant accomplishments of the NBRM in the past decade of monetary independence. In this context, it should be underlined that the Republic of Macedonia is one of the rare countries in transition that avoided the systemic banking crisis, in spite of the numerous unfavorable circumstances. On the eve of the new challenges, the NBRM permanently improves its operations, and through the flexible conduct of the monetary policy and the clear determination to preserve the stability in the economy, it will act towards supporting the positive trends and accelerating the economic growth.

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May 2003, Skopje

*Governor and President of the
NBRM Council*

I. Economic Developments in the World

In 2002, the world economic growth rate equaled 2.8%¹, and although it increased by 0.6 percentage points compared to 2001, however it is below the long-term upward trend. Such performances were significantly affected by the uncertain environment in which the global economy functioned, the difficulties for maintaining the economic growth in the EU and the USA, as well as the stagnation facing Japan. With respect to dynamics, in the first quarter of 2002, the economic conjuncture in global framework was unexpectedly favorable. Notwithstanding the expectations for considerable undermining of the confidence of the consumers and the investors after the terrorist attacks on September 11, 2001, at the beginning of 2002, the world trade and the industrial output registered an increase. However, given the considerable disturbance of the financial markets, supplemented with the depreciation in the US Dollar, as well as the deterioration of the terms of financing of the developing countries (particularly South America and Turkey), after the first quarter of 2002, the performances of the world economy deteriorated. From the aspect of the groups of countries, the lowest growth rate was registered in the group of developed economies (1.7%), while the developing countries registered an increase of 4.2%. These two groups registered acceleration of the economic activity, contrary to the countries in transition, where the economic growth rate equals 3.9% in 2002, which is a slowdown of 1.1 percentage point compared to the previous year.

Notwithstanding the moderate recovery of the economic activity, the world trade registered a growth of 2.1%, which is substantially lower than the average for the 1984 – 2001 period (6.4%). The oil price registered moderate increase (0.5%), with more intensive increase being reached in the prices of the primary and industrial products (4.2% and 2.6%, respectively). Due to such movements of the prices on the international markets, combined with the dynamics of the economic activity, the inflation rate in the developed countries, the developing countries and the countries in transition equaled 1.4%, 5.6% and 11.3%, respectively.

Table 1
Selected indicators for the world economy

	1998	1999	2000	2001	2002
			(in %)		
Real GDP growth rate	2.8	3.6	4.7	2.2	2.8
Growth in the world trade	4.3	5.5	12.6	-0.1	2.1
Inflation rate					
Developed countries	1.5	1.4	2.3	2.2	1.4
Developing countries	10.5	6.9	6.1	5.7	5.6
Transition countries	22.1	44.1	20.2	15.9	11.3
Prices					
Oil	-32.1	37.5	57.0	-14.0	0.5
Primary products	-14.7	-7.0	1.8	-5.4	4.2
Industrial products	-1.8	-2.0	-5.2	-2.3	2.6
			(% of GDP)		
Saving rate	23.2	23.2	24.1	23.1	22.8
Investment	23.5	23.2	23.6	22.8	22.5

Source: IMF World Economic Outlook, September 2002.

¹ Estimation, WEO, September 2002.

1.1. Developed countries

The real growth rate of the gross domestic product in the group of developed countries equaled 1.7% in 2002, which is an annual acceleration of the dynamics of the economic activity of 0.9 percentage points. The total domestic demand registered an increase of 1.8%, primarily as a result of the strengthened private and public consumption, with a decline being registered in the investment activity (evident through investments in fixed and permanent working assets). Thus, in Japan, the low domestic demand, the appreciation of the Japanese yen and the structural problems (the need of restructuring of the banking and the corporate sector) further contribute to achieving negative economic growth rates (0.5% in 2002). Therewith, in 2002 Japan is the only country that registered negative economic growth rate within the framework of this group of countries. Besides the acceleration of the economic activity, taking into account the increase in the labor productivity of 2.4% (annual increase of 1.8 percentage points) and the moderate increase in the unit labor costs of 0.9% (lower by 1 percentage point compared to 2001), in 2002, the inflation rate in the developed countries equaled 1.4%, relative to 2.2% in 2001. Given the permanent procyclic adaptation of the macroeconomic policies, the low inflation rate partially reflects the high credibility in maintaining low and stable inflation rates. Given the modest economic growth and the substantial deterioration of the stock exchange indicators, the unemployment rate registered an increase of 0.5 percentage points, thus reaching 6.4%. The deficit in the current account remained at the level of the preceding year, that is 0.8% of the GDP and equals US Dollar 210.3 billion.

Table 2
Selected economic indicators for the developed countries

	GDP (real growth rate in %)			Inflation (retail prices increase in %)			Unemployment (in %)			Current Account Balance in the Balance of Payments (in US Dollar billion)		
	2000	2001	2002	2000	2001	2002	2000	2001	2002	2000	2001	2002
Developed countries	3.8	0.8	1.7	2.3	2.2	1.4	5.9	5.9	6.4	-227.1	-188.4	-210.3
European Union	3.5	1.6	1.1	2.3	2.6	2.1	8.2	7.4	7.7	-35.1	3.2	50.7
Germany	2.9	0.6	0.5	2.1	2.4	1.4	7.8	7.8	8.3	-20.9	2.4	38.7
France	4.2	1.8	1.2	1.8	1.8	1.8	9.5	8.6	9.0	19.4	24.0	26.6
Italy	2.9	1.8	0.7	2.6	2.7	2.4	10.6	9.5	9.3	-5.7	1.6	2.8
USA	3.8	0.3	2.2	3.4	2.8	1.5	4.0	4.8	5.9	-410.3	-393.4	-479.6
Japan	2.4	-0.3	-0.5	-0.8	-0.7	-1.0	4.7	5.0	5.5	119.6	87.8	119.3

Source: IMF World Economic Outlook, September 2002.

In 2002, the European Union (EU) (group of countries being the major trading partner of the Republic of Macedonia) registered a real growth rate of the GDP of 1.1% (half of the respective growth rate in the USA). Such dynamics of economic growth was achieved in environment of simultaneous slowdown in the growth of the external demand and the domestic aggregate demand. The inflation performances of the EU are favorable. Thus, the inflation rate in 2002 equaled 2.1% (which inconsiderably diverges from the inflation rate (2.0%) which is a goal of the ECB on a medium run). The gradual increase in the wages causes concern regarding the price stability, which given the slower dynamics of the growth in the labor productivity (0.9% in 2002, relative to 2.2% in the previous year), resulted in an increase in the unit labor costs of 2.3%. Nevertheless, the Euro appreciation, as well as the depletion of the effects of the transitory shocks (Euro conversion, oil prices, etc.) are expected to contribute to further maintenance of the price stability.

Given the registered decrease in the private consumption, the almost unchanged level of public consumption and the permanent negative growth rates of the total investments, the

domestic demand in Germany (as the most important trading partner of the Republic of Macedonia in 2002) dropped by 1.1%. Such movements, given the strengthened external demand, contributed to achieving modest real growth of the GDP of 0.5%. Thus the analysis shows insignificant effect of the floods in 2002 on the economic activity, expecting stimulating effects of the growing expenses for assistance and reconstruction. The inflation rate in Germany is maintained at low level of 1.4%, with increase being registered in the labor productivity of 3.2% and lower unit labor costs of 0.2%. In 2002, the unemployment rate in Germany equals 8.3%, which is an increase of 0.5 percentage points compared to the preceding year.

After the considerable slowdown in the economic growth rate in the previous year, in 2002, the USA registered a real growth rate of the GDP of 2.2%, which is the second highest growth rate in the Group 7, after Canada. Additionally, the most intensive dynamics was registered in the first quarter of the year due to: a. the timely and adequate reaction of the institutions responsible for the economic policy of the recession tendencies in the previous year; b. the strengthened credibility of the monetary policy; c. the intensive growth in the productivity, which offset the growth in the real wages and enabled prevention from profit decline. Also, the strengthened joint consumption contributed to acceleration of the economic dynamics, which was a sign of prompt improvement of the confidence and stabilization of the expectations after the terrorist attacks on September 11, 2001. In the remaining period of 2002, the increase in the GDP in the USA was substantially more modest, primarily as a result of the acceleration of the import activities and the lower level of consumption. At the same time, since March 2002, the Stock Exchange Index S&P500 has been registering permanent decrease reflecting the higher uncertainty regarding the growth sustainability, the non-confidence in the corporate sector following the numerous accounting and auditing manipulations and revised projections for lower profit of the corporations in the forthcoming period. Given the substantial increase in the labor productivity (4.4%) and the decline in the unit labor costs (0.3%), the inflation rate in the USA in 2002 equals 1.5% (decrease of 1.3 percentage points compared to the preceding year). The balance on the current account in the balance of payments in 2002 is negative and amounts to US Dollar 479.6 billion, or 4.6% of the GDP.

1.2. Developing countries

In 2002, the economic growth rate in the developing countries equaled 4.2%, showing the strengthened dynamics of the economic activity compared to the previous year. Analyzed by regions, the negative economic growth rate is registered only in the region of the West Hemisphere² (real fall of the GDP of 0.6%), whereas the other regions registered acceleration of the economic activity. Thus, the regions of Africa, developing Asia³, Middle East and Turkey⁴ registered real growth in the GDP of 3.1%, 6.1% and 3.6%, respectively.

Although the crisis in Argentina had direct transferable effects on the countries in the region, it is a signal of the investors for the problems latently present in these countries. Furthermore, the inaccessibility to the financial markets for Brazil (as the largest user of external sources of financing), alongside the high level of public debt and the weak banking sector, additionally increases the economic and the financial uncertainty in the region.

In the region of developing Asia (that registers the highest economic growth rate in this group of countries), the economic performances are primarily caused by the exports demand and hence, by the economic situation in the USA and Europe. Additionally, these

² Countries of Latin America.

³ China, India, Indonesia, Malaysia, Philippines and Thailand.

⁴ Including Malta.

countries show high sensitivity to the movements of the oil price. Thus the global economic movements and the positive performances of the information technology in the first quarter of 2002 ensured achieving intensive dynamics of the economic activity in these countries. The inverse trend in the remaining period of the year, with the simultaneous growth in the oil price on the international markets (caused by the undermined security in the Middle East) led to slowdown in the economic growth rate in this region.

Table 3
Selected economic indicators for the developing countries

Annual changes	1998	1999	2000	2001	2002
	(in %)				
Real GDP	3.5	4.0	5.7	3.9	4.2
Exports	-7.8	9.7	25.2	-3.2	3.2
Imports	-5.3	0.7	19.2	-1.0	4.6
	(US Dollar billion)				
Current account of the Balance of Payments	-85.1	-10.2	66.7	39.6	18.9

Source: IMF World Economic Outlook, September 2002.

The inflation performances of the developing countries are satisfactory. Thus the average inflation rate in 2002 equaled 5.6%, which is almost the same as the level in the previous year. The lowest inflation rate was registered in the region of the developing Asia (2.1%), whereas the group of Middle East and Turkey continues registering the highest inflation rate (17.1%). The current account balance in the balance of payments in 2002 is positive and equals US Dollar 18.9 billion, due to the surplus of the regions of developing Asia and Middle East and Turkey.

1.3. Countries in transition⁵

The high degree of integration of the countries in transition in the global trade and financial flows prevents these countries from isolating themselves completely from the developments in the leading economies. However, in 2002, notwithstanding the global economic problems, the comprehensive reforms in the countries in transition created prerequisites for solid macroeconomic performances, sustainable growth and macroeconomic stability. Major challenge in the next period for the countries of the Central and Eastern Europe and the Baltic countries (CEB) is to achieve balance between the high fiscal outlays (necessary for convergence towards the EU) and to meet the fiscal Maastricht criteria, having in mind that their exports are primarily oriented towards the EU and they have a set date for accession to the Union (most of them). The countries of South-Eastern Europe (SEE) are facing with problems regarding the rehabilitation of the post-conflict consequences, as well as with the challenge for creating favorable environment for domestic and foreign investments, with their membership in the Stability Pact being the most considerable contribution. Development of the infrastructure, proper external debt management and strengthened regional cooperation (by removing the artificial barriers of the trade and the financial flows) continue to be an imperative for the Commonwealth of Independent States (CIS).

⁵ Central and Eastern Europe and the Baltic countries, South-Eastern Europe and the Commonwealth of Independent States.

Table 4

Selected economic indicators for the countries in transition

	GDP			Inflation			Current account of the Balance of Payments			Foreign direct investment		
	(real growth rate in %)			(in %)			(% of GDP)			(in US Dollar billion)		
	2000	2001	2002	2000	2001	2002	2000	2001	2002	2000	2001	2002
Countries in transition*	6.6	5.0	3.9	20.2	15.9	11.3	-4.5	-6.0	-6.2	7.8	8.1	10.3
Central and Eastern Europe	4.0	2.5	2.3	6.5	5.5	3.2	-4.7	-4.9	-4.7	18.6	17.5	22.0
Czech Republic	3.3	3.3	2.5	3.9	4.7	2.3	-5.3	-4.7	-3.6	4.9	4.8	8.0
Estonia	7.1	5.0	4.0	4.0	4.0	6.1	-5.7	-6.2	-6.7	0.3	0.3	0.3
Croatia	2.9	3.8	3.5	4.0	5.8	3.8	-2.3	-3.3	-3.5	1.1	1.3	1.0
Latvia	6.8	7.7	4.0	2.6	2.5	2.3	-6.9	-9.7	-8.5	0.4	0.2	0.3
Lithuania	3.8	5.9	5.2	1.0	1.3	0.9	-6.0	-4.8	-5.8	0.4	0.4	0.4
Poland	4.0	1.0	1.0	10.1	5.5	2.1	-6.3	-3.9	-3.8	8.2	6.5	5.0
Slovak Republic	2.2	3.3	3.5	12.0	7.3	3.1	-3.7	-8.8	-9.1	2.1	1.5	4.0
Slovenia	4.6	3.0	2.7	8.9	8.4	7.4	-3.4	-0.4	1.2	0.1	0.3	0.6
Hungary	5.2	3.8	4.0	9.8	9.2	4.9	-2.8	-2.1	-2.4	1.1	2.1	2.6
South and Eastern Europe	3.6	4.5	3.6	24.5	28.3	11.8	-8.0	-10.4	-10.0	2.5	2.7	2.7
Albania	7.8	6.5	6.0	0.1	3.1	5.3	-6.9	-6.3	-6.0	0.1	0.2	0.2
Bosnia and Herzegovina	4.5	2.3	3.0				-21.4	-23.1	-20.3	0.2	0.1	0.2
Bulgaria	5.4	4.0	4.0	9.9	7.4	6.1	-5.6	-6.5	-5.9	1.0	0.6	0.8
SR Yugoslavia	5.0	5.5	3.0	60.4	91.3	21.5	-7.4	-10.7	-12.9	0.0	0.2	0.3
Macedonia ¹	4.5	-4.5	0.7	5.8	5.5	1.8	-1.9	-6.3	-8.8	0.2	0.4	0.1
Romania	1.8	5.3	3.5	45.7	34.5	22.7	-3.7	-6.1	-5.0	2.5	4.0	n.a.
Community of Independent States	7.9	5.9	4.4	29.0	17.0	11.0	-0.8	-2.6	-3.9	2.2	4.2	6.2

Source: Transition Report, EBRD, 2002

*IMF World Economic Outlook, September 2002.

1/ The respective official institutions are source of the data on the Republic of Macedonia.

In 2002, the real growth rate of the GDP in the countries in transition equaled 3.9% (a slowdown of 1.1 percentage point compared to the previous year). Thus, the three-year trend of achieving positive economic growth rate in this group of countries continued. The most intensive growth was registered in the CIS (4.4%), with divergent movements being registered within the framework of the countries. Russia is considered a generator of the positive economic dynamics, that after the crisis in 1998, continuously registers positive economic growth rates. The countries rich in natural resources extensively contribute to the growth in 2002, taking into account the rise in the oil price and the primary products on the international markets. In the SEE countries, the growth rate equaled 3.6% (decline of 0.9 percentage points) indicating the positive effects of the economic and political restructuring, as well as the intensification of the regional cooperation, by various regional initiatives for trade and investments promotion. The lowest economic growth rate (2.3%, or slowdown of 0.2 percentage points) is registered in the CEB. The performances within the group are largely divergent. Thus, the growth rate of Poland (1.0%) is of a great concern, taking into account the extremely poor domestic demand and unsuitable coordination between the monetary and the fiscal policy. On the other hand, the Baltic countries are the major generators of growth in this group. Simultaneously, the low inflation and the attractiveness of these countries for the foreign direct investments enhanced their developing potential.

From the aspect of the inflation movements, the countries in transition continue registering higher inflation rates relative to those of both the developed and the developing countries. Thus in 2002, the inflation rate equaled 11.3%, which is a slowdown of 4.6 percentage points compared to the previous year. The highest inflation rate was registered in the SEE countries, due to the two-digit inflation rates in Romania and FR Yugoslavia.

Nevertheless, in spite of the high inflation rates, the inflation performances of these two countries significantly improved compared to the preceding year. In this group of countries, the lowest inflation rates were registered in the Republic of Macedonia. In the CIS, the inflation rate equaled 11.0%, with four countries registering two-digit rates of inflation (Russia, Belarus, Tajikistan and Uzbekistan). The most favorable levels of inflation were registered in the countries of CEB (3.2%), gradually converging towards the medium-term inflation goal of the EU (2.0%).

The movements in the external sector in the group of countries in transition, observed from the aspect of the current account balance in 2002 are divergent. Thus, the deficit in the current account of the countries in transition in 2002 equaled 6.2% of the GDP (increase of 0.2 percentage points relative to the previous year). In the CEB group, the deficit in the current account equaled 4.7% of the GDP (improvement of 0.2 percentage points relative to the preceding year), although the external demand from their major export market (EU) registered a decrease. The SEE countries registered deficit in the current account of 10.0% (decline of 0.4 percentage points compared to the previous year). Excluding Romania (the deficit of which in the current account equaled 5.0% of the GDP), all countries of this group registered a deficit over the criteria for sustainability of the current account set on the basis of experience (5.0%)⁶. The most favorable performances in this area were registered in the CIS, the deficit of which in the current account in 2002 equaled 3.9% of the GDP. It was primarily due to the accelerated interregional cooperation, as well as the surplus on the current account of the countries that export oil and primary products.

The efforts of the countries in transition are directed towards creating an environment for attracting long-term capital for financing the deficit in the current account. The foreign direct investments (FDI) are considered to be the most favorable type of capital inflow with numerous quantitative and qualitative effects (effect on the balance of payments, the employment, the introduction of modern technological processes and knowledge, etc.). In 2002, the total FDI in the countries in transition equaled US Dollar 31 billion (annual increment of 27.0%). The SEE group registered the lowest inflow of FDI (US Dollar 2.7 billion), while in the CIS it equaled US Dollar 6.2 billion. The CEB countries continue to register the highest inflow of FDI (US Dollar 22 billion, in 2002).

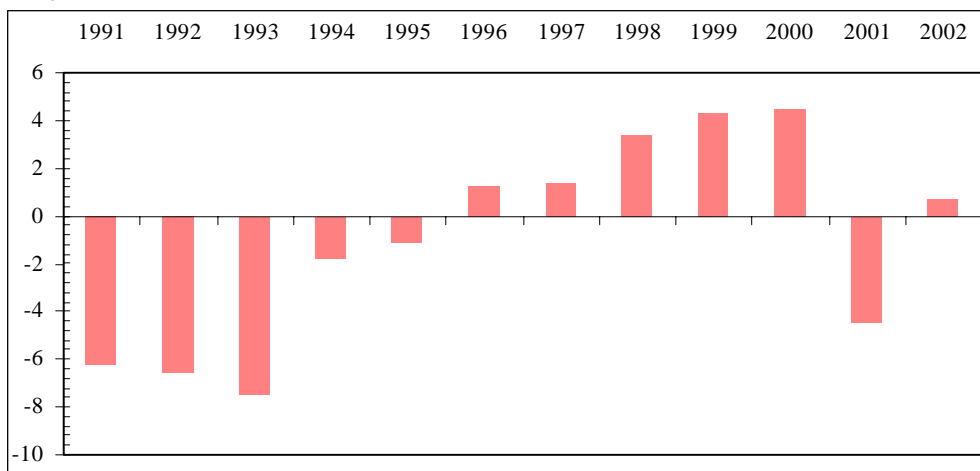
⁶ According to the IMF.

II. Economic Developments in the Republic of Macedonia

2.1. Gross domestic product⁷

The macroeconomic performances of the Macedonian economy in 2002 were severely influenced by the security crisis evidenced during the previous year, which was a serious shock with long lasting consequences. Namely, the results registered in the economic and the foreign trade activity in 2002 prove that for complete rehabilitation from such a shock, a longer period of time is needed. Thus, despite the recovery of the economic activity recorded in the last months of 2002, no significant revitalization of the economy was registered, due to which in 2002, compared to 2001, the increase in the gross domestic product in real terms equaled only 0.7%. In addition, the registered growth rate is significantly below the upward trend of the Macedonian economy registered before the security crisis.

Chart 1
Gross domestic product of the Republic of Macedonia
(real growth rates)



In 2002, the movements of the gross domestic product analyzed by quarters, point to a gradual and continuing improvement of the situation compared to the previous year. Thus, in the first quarter of 2002, the gross domestic product registered a decrease of 2.2%. The decrease in the second quarter of the year was lower and equaled 0.6%, while in the third quarter it increased by 1%. Such developments correspond to the gradual consolidation of the economy, which was more obvious in the second half of the year. Consequently, in the last quarter of 2002, high increase of 4.3% in real terms was registered.

The analysis of the gross domestic product based on production structure indicates that in 2002, the largest real decrease of 5.1% was registered in the value added in the industrial sector, the share of which is largest in the gross domestic product (23%). In addition, the value added in the construction activities (a share of 5%) decreased by 3.7%. On the other hand, more obvious real increase was registered in the activities "transport, storage and communications", and "trade" (of 9.4% and 6.5%, respectively), jointly comprising 21% of the gross domestic product, the increase of which they were responsible for.

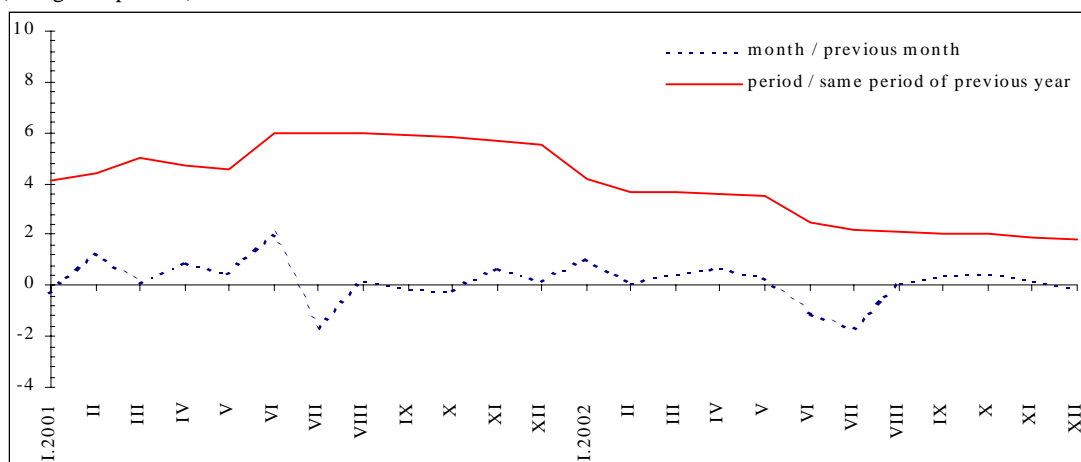
⁷ Source: State Statistical Office of the Republic of Macedonia. Estimated data for 2002. The quarterly GDP data is given in constant prices, in Denar denomination from 1997. The structure is according to the National Classification of Economic Activities (NCEA).

Observed from the aspect of the expenditure structure of the gross domestic product, in 2002 compared to the previous year, Government consumption registered a nominal decline of 5.6%, given the significantly lower expenditures of the Central Government for the security needs. Investments in machinery and equipment registered high nominal increase of 16.4%, taking into consideration the low comparison base registered in the previous year. The foreign trade of the Republic of Macedonia in 2002 registered an increase, although it is characterized by unfavorable structure. Thus, the export of goods and services registered a significant nominal decrease of 7.5%, while the import of goods and services nominally increased by 5.6%.

2.2. Inflation

Despite the unfavorable movements in the real sector, the Macedonian economy in 2002 registered satisfactory results in the maintenance of the price stability. Given the high liquidity in the economy caused by the Euro conversion, the payment system reform and the increased budget expenditures, the National Bank of the Republic of Macedonia succeeded in achieving the main objective of the monetary policy - preserving the price stability, through its firm determination to maintain stable exchange rate of the Denar against the Euro. Thus, in 2002, a one digit average rate of inflation of 1.8% was registered. In addition, the registered rate of inflation was below the projection for 2002, being also significantly lower than the average rate of inflation in 2001 (5.5%). Simultaneously, the annual rate of inflation (December 2002 / December 2001) equaled 1.1%.

Chart 2
Costs of living
(changes in percent)



The modest average rate of inflation in the Republic of Macedonia in 2002, measured through the costs of living index, was caused by several factors:

- High increase in the prices of the postal and telecommunication services (the prices of the impulses and the subscription for fixed telephony in May 2002) and the increase in the prices of housing and public utility services (in October 2002), causing higher increase in the costs for services;
- Higher prices of the agricultural products, mainly of the vegetables (due to the increase registered in January, March, April and September 2002), which reflected in the increased costs in the "food" category. The late production of the early vegetables, lower domestic supply given the necessity of exporting the largest part of the domestic production, the

dominance of the imported agricultural products and higher customs for the import of vegetables, also contributed for such a situation;

- Increase in the prices of oil derivatives in accordance with the movements in the price of the crude oil on the international stock exchanges (in accordance with the Government decisions adopted in March, April and September 2002), and increased costs of insurance for the registration of motor vehicles due to the abolition of the benefits of 25% (in November 2002). Such changes reflected in the increase in the costs of transportation and communication services.

Consequently, in 2002 compared to the previous year, the costs of services registered more intensive increase (5.0%), in comparison with the increase in the costs of goods (1.2%). Observed from the aspect of categories with more significant share in the total index of the costs of living, the highest increase was registered in the costs of the means of transportation and services (of 2.1%), food (of 1.8%) and housing (of 1.7%).

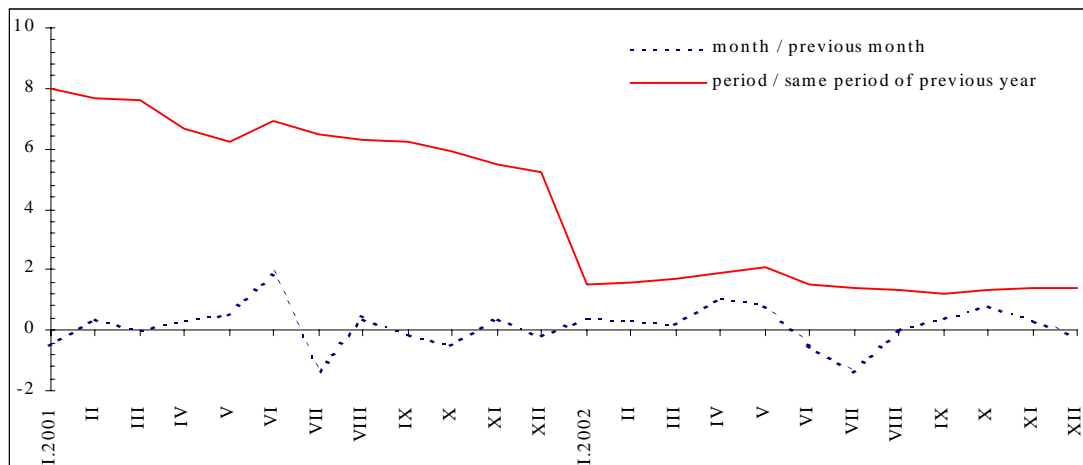
From the aspect of the monthly dynamics, in 2002 the monthly rates of increase in the costs of living were mostly registered. Monthly deflation was registered in June and July (seasonal decrease in the prices of the agricultural products, i.e. the vegetables), while in February, August and December, the level of the costs of living remained almost unchanged. The most remarkable increase in the costs of living was registered in January (1.1%) and April (0.7%). The increase registered in January is due to the higher prices of the agricultural products given the decreased supply on the domestic market, which resulted in an increase in the costs of food. The increase in the costs of living in April is caused by the higher prices of the agricultural products and oil derivatives.

Regarding the correlation between the retail prices and the costs of living, the changes registered in the retail prices in 2002 were similar to the changes in the costs of living, having in mind the influence of elaborated factors. Thus, in 2002 compared to the previous year, the retail prices registered an average increase of 1.4%, while their annual rate of increase (December 2002 / December 2001) equaled 2.2%.⁸

The structural changes in the retail prices correspond to the changes in the costs of living. Thus, the prices of services registered higher monthly increase (3.7%) compared to the increase in the prices of goods (0.3%). The highest increase was registered in the prices of beverages (3.4%) and the prices of agricultural products (3.1%). However, the effect of the increase in these categories was partially neutralized by the decline in the prices in the category "non-food products" (0.6%). Observed on a monthly basis, more significant monthly increase was registered in April (1.1%), May (0.8%) and October (0.8%), with the increase in all three months originating from the changes in the prices of the agricultural products and oil derivatives.

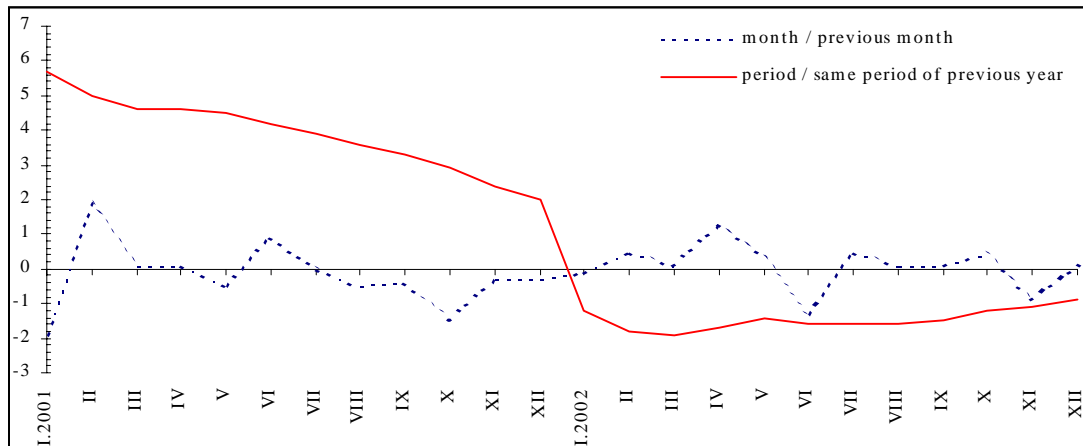
⁸ If the price index of the food products and the price index of energy (oil and oil derivatives, gas, electricity, etc) are excluded from the total retail price index, a basic rate of increase of the retail prices shall be obtained, which in December 2002 equaled 2.8% on annual basis. This core inflation is calculated on the basis of the retail prices, with the average for 2001 being taken as a base. Source: State Statistical Office of the Republic of Macedonia.

Chart 3
Retail prices
(changes in percent)



The average value of the consumer's basket for food and beverages⁹ in 2002 equaled Denar 10,336, which is an increase of 3.5% compared to 2001. Annually observed, the value of the consumer's basket in December 2002 remained almost unchanged relative to the same month of the previous year (a minimal decrease of 0.1%). This is due to the divergent changes in the value in the categories "raw and processed vegetables" (decrease of 7.6%) and "raw and processed fruits" (increase of 7.5%).

Chart 4
Prices of producers of industrial products
(changes in percent)



The prices of the producers of industrial products in 2002 registered an average decrease of 0.9% compared to the previous year, caused by the movements in the prices of crude oil on the international stock exchanges. Taking into consideration the fact that generally, in 2002 the world prices of oil were lower relative to 2001¹⁰, the prices of the producers of oil derivatives in the Republic of Macedonia decreased by 9.4% on average,

⁹ All products in "food and beverages" category, which compose the basket, are taken as average monthly needs of a four-member non-agricultural household, and that list of products is constant (same products - same quantities) during one year period.

¹⁰ The high increase in the world prices of oil at the end of the last month of 2002, did not reflect immediately on the level of the prices of oil derivatives in the country, given the time lag for their adjustment to the prices of oil on the international stock exchanges.

which contributed to the decrease in the prices of the producers of energy by 3.4%¹¹. However, 12 out of 22 observed branches registered a decrease in the prices of the producers of industrial products. Analyzing the dynamics of changes, monthly decrease in the prices of the producers of industrial products was registered in June (of 1.3%) and November (of 0.9%).

2.3. Domestic output¹²

In 2002, the volume of the industrial output registered an average decline of 5.3%, which is continuation of the unfavorable movements registered in the previous year. Observed from 1996 until present days, 2002 is the third year, during which the industrial output decreased (in 1999 due to the Kosovo crisis, and in 2001 due to the security crisis in the Republic of Macedonia). These shocks significantly slowed down the increase in the industrial output, as a main driving force of the Macedonian economy. Consequently, the estimated economic growth of 0.7% in 2002, contrary to the practice so far, does not originate from the movements in the industry, but from the increase in the other sectors of the economy.

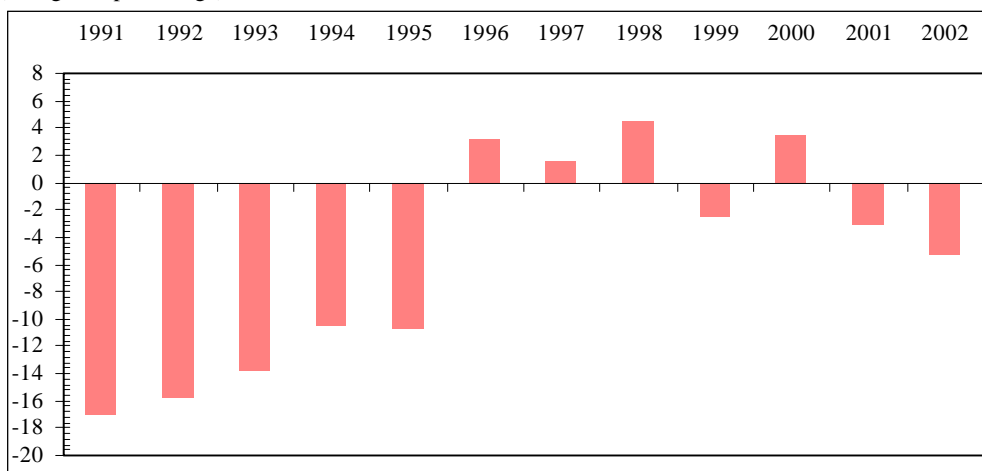
The decline in the industrial output in 2002 is primarily due to the low starting base of the output at the beginning of the year, the weakened industrial sector the restructuring of which has not been completed yet, and its slow revitalization from the consequences of the security crises evidenced in the previous year. This was supplemented with the fact that the contracts with the foreign partners were not renewed, with the unfavorable weather conditions and the recession in the steel industry in global terms. However, the gradual consolidation of the economy and the improved performances given the revitalization of the economic activity in the second half of 2002, and especially in the last quarter, were not sufficient for the economy to return to the level it was before the war crisis, and even less to register more dynamic growth. Generally, the decrease in the industrial output in 2002 mainly reflects the continued influence of the last year crisis, which in combination with the other aforementioned factors, led to intensification of the decrease in the output relative to the year in which the security crisis de facto existed (the decrease in the industrial output in 2001 equaled 3.1%)¹³.

¹¹ Starting from January 2002, the State Statistical Office of the Republic of Macedonia announces the price index of the producers of industrial products according to the new National Classification of Economic Activities (NCEA), applying the National Nomenclature of Industrial Products (NNIP).

¹² Source: State Statistical Office of the Republic of Macedonia.

¹³ According to the National Classification of Economic Activities, National Nomenclature of Industrial Products and the new weighting system of the State Statistical Office of the Republic of Macedonia.

Chart 5
Industrial output
 (changes in percentage)



Analyzed from the structural aspect¹⁴, in 2002, all main industrial groups¹⁵ registered a decrease, except the production of capital goods, where an increase of 53.3% was recorded. However, the increase in this industrial group had no significant effect on the movement of the total industrial output, due to its relatively low share in the total output, contrary to the share of the production of energy and the production of non-durable consumption goods, where an average decline of 16.8% and 2.4%, respectively, was registered.

Analyzed by sectors, the output declined in all three sectors (mining and quarrying, manufacturing industry and electricity, gas and water supply). In addition, the output in the manufacturing industry, as a sector with the highest share in the total industrial output (89.9%), registered an average decrease of 4.7%.

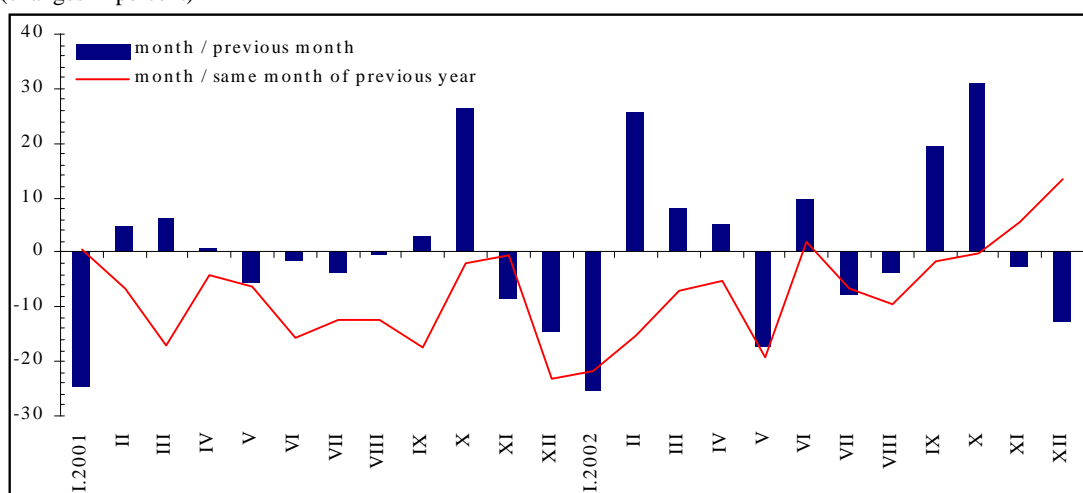
Thirteen out of 24 analyzed industrial branches, the participation of which in the total industrial output equals 73.2%, registered a reduced production. The production of food products and beverages, as a branch with the highest share in the industrial output (24.9%), dropped by 8.0% compared to 2001. The decrease in this branch is due to the lower production in the agriculture, as a basis of raw materials for this industry, which was a result of the unfavorable weather conditions. The production of basic metals, as the second most important branch (participating with 16.4%), registered a decline of 18.6%. The decrease is caused by the insufficient source of raw materials for this branch (due to the reduced extraction of metal ores), as well as to the global recession in the steel industry. Simultaneously, the production of oil derivatives (7.0% of the total industrial output) registered significant decrease of 31.9%. Namely, the production of oil derivatives in the country was minimized on several occasions, and one of the reasons for that was the suspended operations of the refinery, due to the activities related to the construction of the oil pipeline to Kosovo. The textile industry also registered a significant decline (decrease of 12.4% in the branch "production of wearing apparel; dressing and dyeing of fur", in which the largest part of the tolling manufacturing is included). This industrial branch was mostly affected by the fact that the contracts with the foreign partners were not renewed, as well as by the lower demand for domestic textile products on the international market.

¹⁴ The structural analysis of the movement of the industrial output in 2002 differs from that in the previous years, due to the different structuring of the activities in accordance with the new National Classification of Economic Activities and the calculations according to the new weighting system.

¹⁵ According to the National Classification of Economic Activities, the industrial output is divided into five main industrial groups: energy, intermediary products (except energy), capital goods, durable consumption goods and non-durable consumption goods.

The analysis of the monthly dynamic of the industrial output points to the dominance of the common seasonal movements, although in certain cases, uncommon intensity in the changes was registered. Such are the decreases registered in January, May and November, and the increases in February and October. Namely, in January 2002, an uncommonly high seasonal decrease in the industrial output on monthly basis (25.5%) was registered, conditioned by the still present unfavorable influence of the economic crisis, as a supplementation to the seasonal factor (smaller number of working days in the month). Consequently, an extraordinary and unusually high monthly increase in February (25.5%) was registered, partially due to the extremely low comparison base, and partially to the initiated process of normalization of the economic conditions. In addition, the decline registered in May (17.4%) was uncommonly high mainly due to the reduced production in the steel and chemical industry and in the supply of electricity, as well as to the high comparison base in the previous month (namely, as a result of the gradual recovery of the economy, in April, an uncommon increase in the industrial output of 5.2% was registered). The increase registered in October this year (31.1%) was intensified due to the increased production of electricity (the heating season started earlier) and basic metals. However, despite the high comparison base, the decrease in November was relatively low (2.6%), primarily due to the intensified increase in the production of oil derivatives during this month.

Chart 6
Industrial output
(changes in percent)



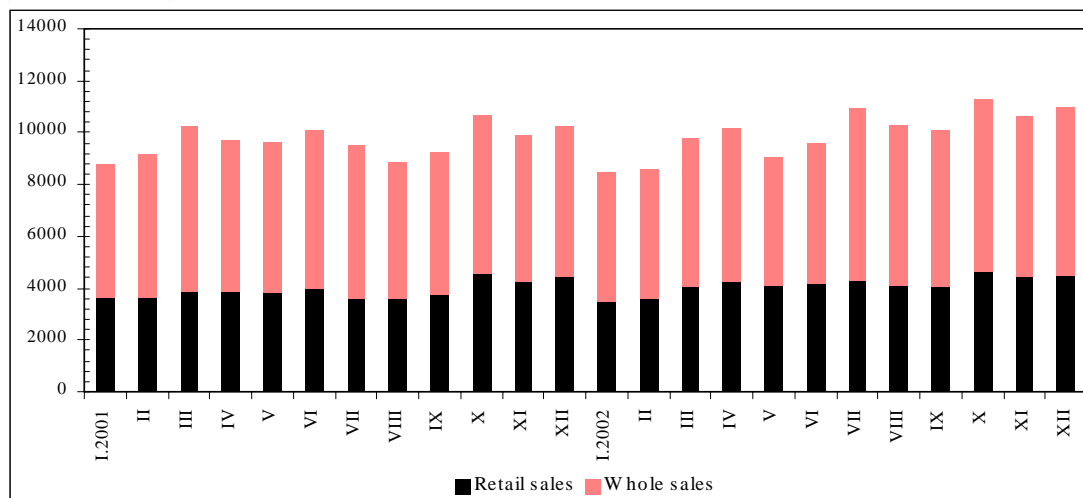
In 2002 compared to the previous year, the total production of the agricultural products in the Republic of Macedonia registered a decrease of 5.2%¹⁶. The decrease is mostly due to the reduced production in the viticulture (a decrease of 49.3%), the unfavorable weather conditions (freezing of the vine plantation as a result of the low temperatures at the beginning of the year). The production also decreased in the cattle breeding (by 1.8%), with the most remarkable decline being registered in the sheep raising (11.0%). The decrease recorded in these branches was partially compensated with the increased production in the fruit growing and farming (of 44.6% and 3.9%, respectively). The high increase in the fruit growing is a result of the low comparison base registered in the previous year, when this agricultural branch was severely affected by the drought period.

¹⁶ Estimated data of the State Statistical Office of the Republic of Macedonia.

2.4. Trade turnover and construction¹⁷

In 2002, moderate intensification in the trade and construction activities in the Republic of Macedonia was recorded. Namely, in 2002 compared to 2001, the total trade turnover¹⁸ increased by 3.3%, and reached Denar 119,712 million. The analysis of the movements on quarterly basis shows that the registered increase in the trade turnover in 2002 is a result of the intensified trading activity in the last two quarters of the year. Namely, in the first quarter of 2002, compared to the same period of the previous year, the total trade turnover decreased by 4.9%, while the fall in the second quarter was more moderate and equaled 2.3%. The registered decrease is caused by the continuing influence of the crisis evidenced in the previous year and the slow revitalization of the economic activity and consumption. During the third quarter, in line with the gradual recovery of the economy, the total trade turnover registered high increase of 13.5%. However, the low comparison base should also be taken into consideration, since the security crisis culminated in the third quarter of the previous year, due to which the trade turnover in that quarter registered its lowest level. The favorable movements also continued in the last quarter, so an increase of 7.1% was recorded. Observed from the aspect of the monthly dynamic, the highest monthly rates of increase in the total trade turnover were registered in March (13.4%), July 14.1%) and October (11.8%).

Chart 7
Total trade turnover
(in Denar million)

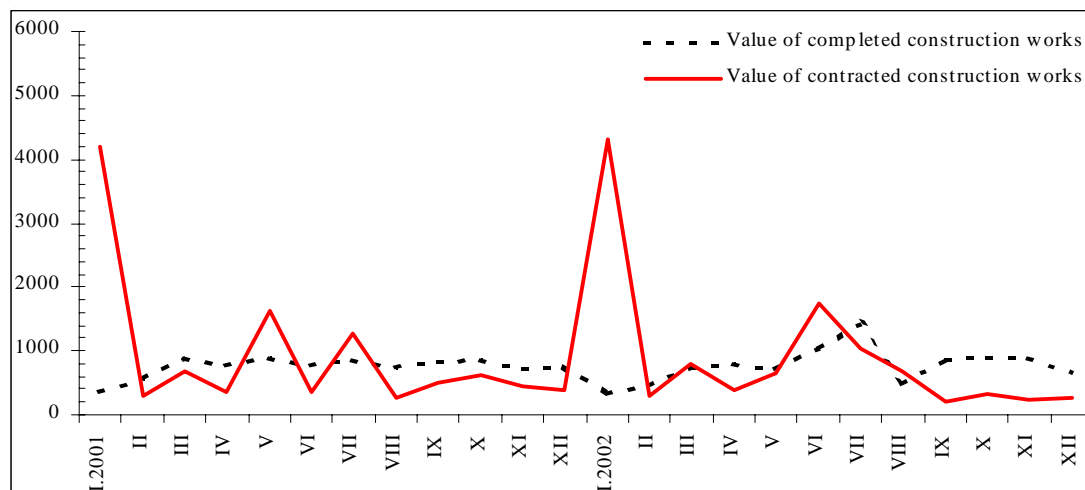


Analyzed by structure, the increased total trade turnover in 2002 is a result of the increase in the retail sales and the wholesales. Thus, in 2002 compared to the previous year, the retail sales turnover increased by 7.5% and reached Denar 49,444 million, while the wholesales turnover increased by 0.5%, and equaled Denar 70,268 million.

¹⁷ Source: State Statistical Office of the Republic of Macedonia

¹⁸ Estimated data.

Chart 8
Contracted and completed construction works
(in Denar million)



In 2002, an increase in the realization of the construction works was registered, contrary to the value of the concluded construction works. Namely, the value of the completed construction works in 2002, compared to the previous year, increased by 2%, thus reaching Denar 9,193 million. However, construction works in the amount of Denar 10,924 million were contracted, which is by 0.6% less relative to 2001. From the aspect of the monthly dynamics, the highest monthly increase in the value of the completed construction works was registered in September (of 85.3%), which corresponds to the initiation of two important investment projects (construction of the oil pipeline to Kosovo, and the reconstruction of a section of the highway).

2.5. Labor market¹⁹

According to the Labor Force Survey, the rate of unemployment in the Republic of Macedonia in 2002, calculated as a share of the number of the unemployed persons in the total labor force²⁰ given in percentages, equals 31.9%, which is an increase of 1.4 percentage points compared to the previous year. Such a situation on the labor market in 2002 was expected and represents a reversible process, since the positive changes registered in the previous year (significant decrease in the rate of unemployment) were of a short duration, i.e. they were a result of the extraordinary circumstances in which the Republic of Macedonia was involved. Due to this, they did not contribute in resolving the problem with the existing structural unemployment in the country on a longer term. Thus, having in mind the minimal increase in the total number of unemployed persons in 2002 (by 287 persons, or 0.1%), the increase in the rate of unemployment is due to the decrease in the total labor force, i.e. to the smaller number of active population (contrary to the increased inactive population). Namely, in 2002, the active population consists of 824,824 persons, which is by 37,680 persons, or by 4.4% less compared to the previous year. The decline in the active population originates from the significantly lower number of employed persons (by 37,967 persons, or by 6.3%). Consequently, the rate of employment (the share of the employed persons in the total population older than 15 years of age) registered a decline of 2.8 percentage points, and

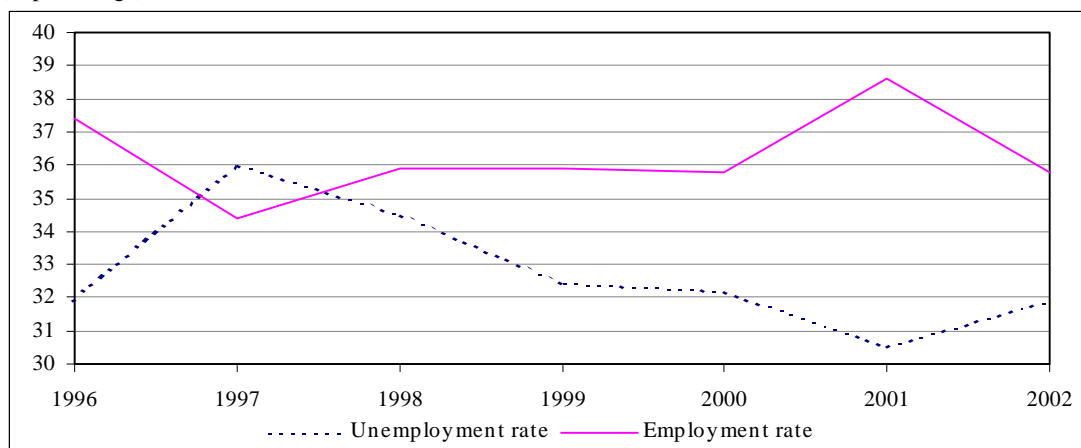
¹⁹ According to the Labor Force Survey (April 2002). The survey was conducted by the State Statistical Office of the Republic of Macedonia, on the basis of a sample of 7,200 households on the whole territory of the country and is in accordance with the methodological recommendations of the International Labor Organization (ILO) and the European Statistical Bureau (EUROSTAT).

²⁰ The total labor force (economically active persons) encompasses the employed and unemployed persons from 15 to 80 years of age.

reduced to 35.8%, i.e. to the level it recorded in 2000. The additional factor which contributed to the decrease in the number of employed persons in 2002, is the accelerated process of resolving the problem of the loss making companies, which emphasizes the need for implementing more intensified structural reforms in the economy, as a precondition to overcome the problem of high unemployment.

When analyzing, the higher comparison base should also be taken into consideration, due to the time incommpliance in the period of conducting the research on the labor market relative to the previous year. Namely, in 2001, due to the deteriorated security, the Survey was conducted in October, instead of the usual term in April, with which certain seasonal effects in the movement of the labor force were encompassed (for an example, increased employment in the agriculture).

Chart 9
Rates of employment and unemployment
(in percentage)



Analyzed by gender, 159,144 persons, i.e. 60.4% of the total number of unemployed persons are men, while the remaining 104,339 are women. The male and female population registers almost identical rates of unemployment (31.7% and 32.3%, respectively). The analysis of the rates of unemployment according to the age structure, indicates that the highest rate of unemployment is still registered among the population aged between 15 and 19 (60.2%), 20 and 24 (57.8%), and between 25 and 29 (48.0%). The highest increase in the rate of unemployment is registered among the population aged between 25 and 29 (by 3.9 percentage points compared to the previous year), as a consequence of dismissing the largest part of the reserve security forces of the Republic of Macedonia due to the stabilized situation in the country.

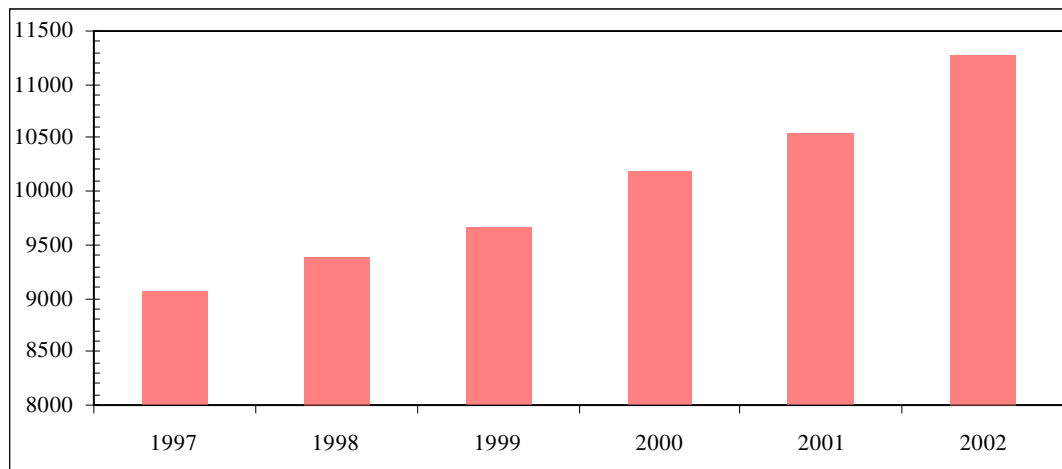
The largest number of the total employed persons (61.1%) are men, who simultaneously register higher rate of employment (43.5%) in comparison with the female population (28.1%). From the aspect of the age structure, the highest rate of employment was registered among the population between 40 to 44 (62.3%) and 45 and 49 (60.2%) years of age.

2.6. Wage policy

The upward trend of the average net paid wage in the Republic of Macedonia also continued in 2002, as a parallel process with continuous increase in the level of privatization of the economy and increasing share of the private sector, where a liberalized setting of wages is present. The nominal increase in the wages did not have an inflation effect, so the inflation

in 2002 remained low and stable, which resulted in a simultaneous increase in the wages in real terms. The increase in the wages in the public administration (in June 2002), in compliance with the still valid Law on Wages that controls the increase in the wages in the government sector, significantly contributed to the increase in the average wage in 2002.

Chart 10
Nominal average net paid wage per worker
(in Denar)



The nominal average net paid wage per worker in the Republic of Macedonia in 2002 increased by 6.9% compared to the previous year and equaled Denar 11,279. Observed from the structural aspect, nominal increase in the wages was registered in all sectors, except in the sector "fishing". However, the highest increase in the wages was registered in the sectors "mining and quarrying" (of 15.7%), "education" (of 12.6%), "public administration and defense, compulsory social security" (by 10.7%), "transport, storage and communications" (by 9.6%) and "health care and social work" (by 9.0%).

Table 5
Net paid wage per worker in the Republic of Macedonia

	Amount in denars	Nominal growth 2002/2001	Real growth 2002/2001*
	2002	(vo %)	
Average monthly wage, total	11,279	6.9	5.0
<i>Selected sectors / activities:</i>			
<i>Mining and quarrying</i>	12,840	15.7	13.9
<i>Transport, storage and communications</i>	14,305	9.6	7.8
<i>Financial intermediation</i>	22,281	5.8	4.0
<i>Public administration and defense, compulsory social security</i>	11,606	10.7	8.9
<i>Education</i>	10,844	12.6	10.8
<i>Health care and social work</i>	11,024	9.0	7.2
<i>Other activities of communal, cultural and personnel services</i>	11,743	6.4	4.6
December wage, total	11,550	9.0	7.8

* Real growth rates are calculated on the basis of the nominal growth rates corrected by the inflation rate.

The lower average rate of inflation (1.8%) compared to the increase in the nominal average net paid wage in 2002, contributed to a high real increase in the average net paid wage of 5.0% relative to the previous year.

In December 2002, the average net paid wage per worker equaled Denar 11,550, which is an increase of 9.0% and 7.8% in nominal and real terms, respectively (with annual rate of inflation of 1.1% being registered in December 2002).

2.7. Fiscal policy²¹

In 2002, the gradual normalization of the situation in the Republic of Macedonia from security and economic aspect, created more favorable environment for the functioning of the fiscal sector. Namely, 2002 is characterized by the significantly lower Government expenditures for the security needs in comparison with the previous year, which conditioned significantly lower increase in the total budget expenditures relative to the increase in the revenues. In addition, the implementation of the tax on financial transactions, which was introduced in order to provide funds for covering the expenditures arising from the security crisis, and which was envisaged to be collected until the end of 2001, continued to be valid in 2002, as well. This tax, together with the value added tax were significant generators of budget revenues in 2002. Hence, despite the more intensive increase in the revenues relative to the budget expenditures, the total expenditures were higher compared to the registered revenues, so in 2002 the budget deficit (central budget and funds) is expected to equal 5.6%²² of the gross domestic product, i.e. by 0.5 percentage points less compared to the deficit recorded in the previous year (6.1%²³ of the GDP). Such a situation in the budget in 2002 is due to the high expenditures for servicing the principal of the domestic debt of the Government, as well as to the increased capital expenditures (expenditures for projects financed with funds obtained from the privatization of Telecom).

In 2002, the total revenues of the budget of the Central Government remained within the projections (97% of the projected revenues) and equaled Denar 70,428²⁴ million. In comparison with 2001, the total budget revenues increased by 11.6%.

In 2002, the primary budget revenues, encompassing tax and non-tax revenues, equaled Denar 56,916 million (an increase of 11.7% compared to 2001), with their share in the structure of the total budget revenues remaining unchanged (80.8%). The registered increase in the primary revenues is a result of the increased tax revenues, while the inflows from the collection of non-tax revenues decreased. Within the tax revenues of greater importance, the highest increase was registered in the revenues from the collection of the tax on financial transactions (twofold increase), which is due to the low comparison base in 2001, when the tax was collected only in the second half of the year. Consequently, in 2002, the revenues from the tax on financial transactions reached 9% of the total budget revenues, which is a twofold increase compared to 2001. Significant increase of 19.8% was registered in the revenues from the value-added tax, which comprise 29.1% of the total budget revenues (an increase of the share of 2 percentage points).

The capital revenues also added more significant inflows in the budget in 2002 (they registered nearly threefold increase), as a result of the high increase in the revenues from the sale of land and non-material investments. The revenues originating from budget financing represented significant revenue item in 2002 (comprising 17.2% of the total revenues) and were by 3.8% higher compared to the previous year.

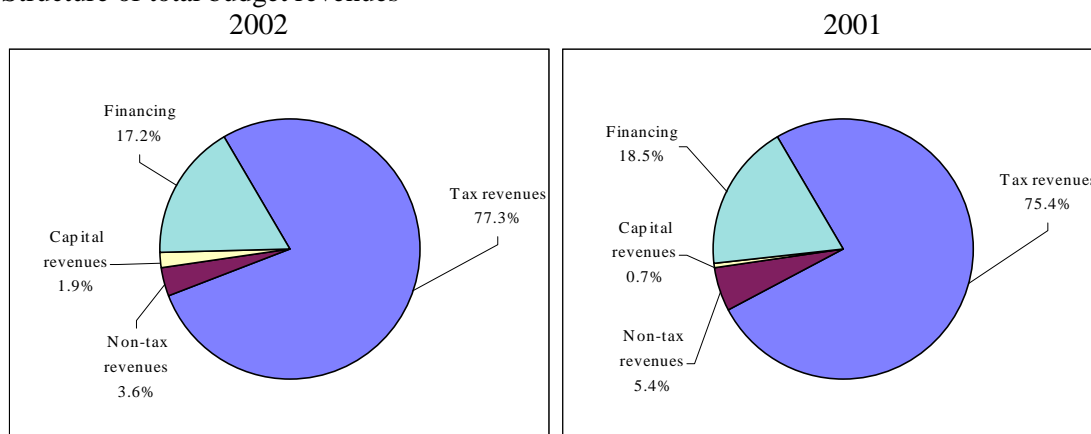
²¹ Source of data: Ministry of Finance.

²² Estimated data.

²³ Preliminary data.

²⁴ The total budget revenues encompass the revenues from financing.

Chart 11
Structure of total budget revenues



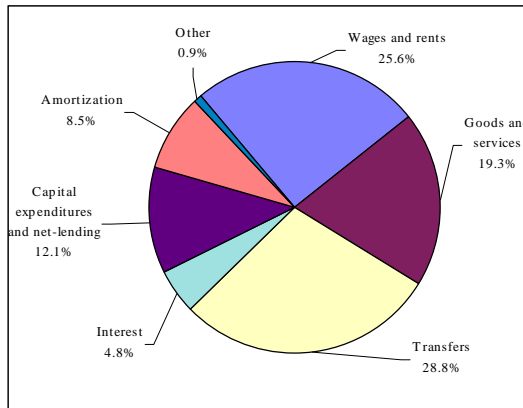
In 2002, the total expenditures of the Central Government budget equaled Denar 71,599²⁵ million, meeting the projection to a large extent (98.7% of the projected expenditures). In addition, the budget expenditures registered a moderate increase of 3.8% relative to the previous year.

In 2002, the current expenditures amounted to Denar 56.686 million, which is a fall of 2%, primarily due to the remarkably lower expenditures for goods and services compared to the previous year (a decrease of 30.4%), as a result of the reduced Government expenditures for security needs. Consequently, the share of the expenditures for goods and services in the total budget expenditures is lower by 9.4 percentage points and equals 19.3%. However, despite such developments, the current expenditures continue to have dominant share in the total budget expenditures of 79.2% (although it decreased by 4.7 percentage points compared to 2001).

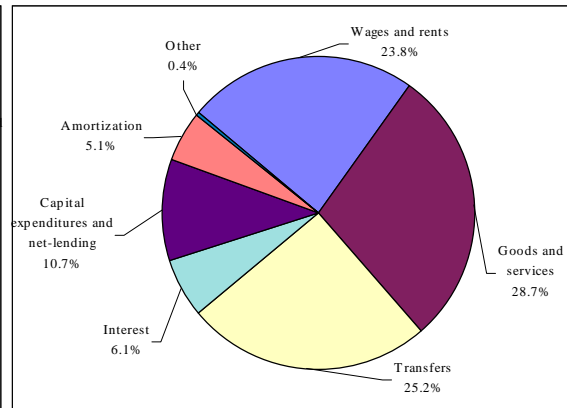
Regarding the reduced current expenditures, the moderate increase in the total budget expenditures in 2002 is due to the higher capital expenditures and the expenditures from financing. In 2002, compared to the previous year, the capital expenditures and net lending registered a significant increase of 17%, reaching 12.1% of the total budget expenditures. This is due to the increased use of a part of the funds provided from the privatization of the Macedonian Telecommunications for public investments (the so-called Telecom projects), as a new expenditure item in the budget for 2002. In 2002 compared to the previous year, the budget expenditures for financing increased by 71.5%, with their share reaching 8.5%. Their increase is due to the increased expenditures for servicing the domestic debt of the Government (among other things, due to the payments based on issued government bonds for the "frozen" foreign currency savings of the households).

²⁵ The total budget expenditures encompass the expenditures of financing.

Chart 12
Structure of the total budget expenditures
2002



2001



In 2002, the revenues and the expenditures of the extrabudgetary funds were balanced and remained within the projections (except the Road Fund, the revenues and expenditures of which were below the projections by 5.3%, i.e. 5.7%, respectively). The total revenues of the social funds (Pension and Disability Insurance Fund, Health Fund, and Employment Fund) equaled Denar 45,384 million, and were almost identical to the total expenditures for these Funds, which amounted to Denar 45,368 million. In comparison with the previous year, the total revenues of the social funds increased by 9.6%, while the total expenditures were higher by 8.9%. The total revenues of the Road Fund equaled Denar 3,434 million, and were minimally higher compared to the expenditures of the Fund (Denar 3,420 million). Besides the fact that they were lower than projected, the revenues and the expenditures of this Fund were also lower in comparison with the previous year (by 14.4% and 14.8%, respectively).

III. Monetary Policy

3.1. Monetary policy goals

The outlining and the conduct of the monetary policy in 2002 were carried out in the environment of gradual consolidation of the Macedonian economy after the security crisis in the previous year. As usual, in 2002, the monetary policy was coordinated with the fiscal policy (in the year of parliamentary elections), thus providing a consistent macroeconomic framework.

The general monetary layout in 2002 was based on the maintenance of the price stability, as an ultimate legally defined goal of the monetary policy. The price stability as a priority is aimed at creating preconditions for sound and sustainable economic development. Thus the basic assumption in the initial projection of the monetary variables for 2002 was the achievement of an average rate of inflation of 2.5%. The projected rate of inflation was based on two major assumptions: a. improvement of the weather conditions for the agricultural output, with a favorable effect being expected on the supply of agricultural products and their prices and b. expected fall in the oil price on the international markets and consequently, decrease in the prices of inputs and the final prices of the products.

Over the past years, the price stability in the Republic of Macedonia has been maintained by applying the monetary strategy of exchange rate targeting. The role of the exchange rate as a nominal anchor in the Macedonian economy results from the great significance of the exchange rate in the small economies, with strong trade and financial linkages with the foreign countries (such as the Macedonian economy). In 2002, the NBRM successfully maintained the stability of the parity of the Denar against the Euro (the exchange rate of the Denar against the Deutsche Mark was targeted by the end of 2001) through the interventions on the foreign exchange market and the coordinated application of the monetary regulation instruments. The focus of the monetary policy on the exchange rate stability, as well as the orientation towards maintaining the price stability emphasized the need for its adjustment to the guidelines of the fiscal policy.

Second basic element of the monetary projection is the growth rate of the real GDP, the initial projection of which for 2002 equaled 4% (opposite to the negative dynamics of the GDP in the previous year). Such considerable acceleration of the economic activity in 2002 was expected to be generated by: 1. the decrease in the total risk of the country, after the stabilization of the security in the country. It was expected to reduce the economic and the financial uncertainty and to strengthen the confidence of the domestic and the external economic agents; b. the implementation of the projects financed by the inflows from the privatization of the Macedonian Telecom was expected to result in multiple effects on the economic activity and c. the funds from the donor conference, announced to be held in March 2002, as an additional generator of the economic growth. The purpose of the conference was to provide micro-financial assistance, as well as financial support for rehabilitation after the security crisis and for implementation of the Framework Agreement. In spite of the terminated arrangement with the IMF, the six-month Staff Monitored Program began in late 2002, the role of which was to send a signal to the investors with respect to the transitory difficulties the country is facing with and the possibility of concluding arrangement with the Fund after their settlement. Generally speaking, the high growth rate of the GDP in 2002 was to be generated by the domestic demand. This is in line with the need for a longer period for recovery of the external demand, by renewing the canceled and concluding new contracts with the foreign partners, given the gradual reduction in the country risk.

In order to provide adequate support of the economic activity, with simultaneous maintenance of stable price level, an annual increase in the money supply M2 – Denar

component of 7.4%, was anticipated within the framework of the initial monetary projection, with increase in the reserve money of 7.8%. In conformity with the active role of the NBRM on the foreign exchange market, so as to preserve the stability of the nominal anchor, a net sale of foreign exchange was anticipated for 2002. The maintenance of the foreign exchange reserves at the level of four-month imports was to be achieved by the announced inflows from the donor conference.

The actual introduction of the new European currency in early 2002 and the need of conversion of the twelve European currencies with the single currency (Euro) was expected to contribute towards considerable expansion of the banks' deposit base. In spite of the expectations for intensive strengthening of the credit potential on this basis, the projected annual increase in the banks' placements to the non-government sector equaled 6.8% and was based on the assumption for prudent credit policy of the banks, taking into account the still present political risk, and hence, the high credit risk. The projection perceived the uncertainty of the banks regarding the dynamics and the amount of the possible withdrawal of funds deposited for Euro conversion. Hence, the increase in the foreign exchange deposit potential of the banks was expected to be primarily directed towards the foreign exchange accounts of the banks abroad and to result in considerable increase in their foreign exchange assets.

The performances of the Macedonian economy in the first quarter of 2002 did not correspond with the anticipated movements. Thus, conversely to the projected acceleration of the economic activity, in conformity with the less risky environment, the industrial output registered permanent slowdown. In addition, the bad weather conditions adversely affected the agricultural output, the recovery of which was an essential element of the initial anticipations for the economic growth in 2002. Another bad circumstance was the uncertainty regarding the promised inflows from the donor conference, taking into account the uncompleted arrangement with the IMF. In line with such movements, in May 2002, the projection of the key macroeconomic variables was revised within the framework of the Staff Monitored Program. The real growth of the GDP was anticipated at the level of 2.5%, while the inflation rate was expected to reach 3.5%.

Revision of the monetary projection was carried out on the basis of the revised projection of the major macroeconomic variables. Thus, the need for offsetting the effects of the expected pre-election acceleration of the public consumption in the third quarter of the year was emphasized in order to defend the stability of the exchange rate. Sterilization of the excess liquidity through the CB bills auctions, as well as the further intervention on the foreign exchange market with a net sale of foreign exchange, were envisaged. An annual decrease in the level of reserve money of 3.2% was projected on the bases of such expectations. In conformity with the projected dynamics of the foreign exchange savings deposited on a short run (expected withdrawal of funds deposited for the Euro conversion), the projected annual rate of the money supply M4 was negative and equaled 13.2%. According to the revised projection, the growth rate of the total banks' placements to the non-government sector equaled 5.4%.

With respect to the monetary regulation instruments, in 2002, further usage of the CB bills auctions as a basic monetary policy instrument was anticipated. Additionally, this instrument was projected to act towards compensating for the liquidity effects from the influence of the autonomous factors, including the effects of the NBRM interventions on the foreign exchange market. From the aspect of the setting of the auctions, their flexible adaptation to the changes in the total economic flows was anticipated for 2002. In line with the expected gradual exhaustion of the adverse effects of the security crisis, reduction of the interest rates, and retransfer towards the "interest rate tender" auctions were envisaged. It confirmed the orientation of the NBRM towards exploitation of the instruments set on market and flexible basis.

3.2. Monetary developments in 2002

In 2002, the NBRM took active participation in the foreign exchange market in order to maintain stable level of the exchange rate of the Denar against the Euro, in line with the applied strategy of exchange rate targeting. The setting of the monetary instruments was in function of regulating the liquidity in the economy and removing the possible pressures on the foreign exchange market. Such monetary policy of the NBRM, with simultaneous efficient coordination with the basic components of the macroeconomic policy resulted in average inflation rate (measured through the costs of living) of 1.8% in 2002, which is below the projected growth. Therewith the NBRM successfully achieved the primary goal of the monetary policy.

Several major factors created the environment in which the monetary policy was conducted in 2002: a. gradual depletion of the negative effects of the security crisis in the previous year, thus enabling gradual recovery of the economy and reduction of the psychological pressures; b. further maintenance of the unfavorable dynamics of the foreign trade; c. favorable movements of the banks' deposit potential after the introduction of the new European currency at the beginning of the year and d. higher intensity of the public consumption in the third quarter prior to the parliamentary elections. The accelerated import activities, with simultaneous further decrease in the imports caused high demand for foreign exchange for servicing the external liabilities. Given the insufficiently high foreign exchange inflow, such movements resulted in pressures for depreciation of the domestic currency. In order to defend the exchange rate, the NBRM took an active role on the foreign exchange market by net sale of foreign exchange (the interventions in January, February and June acted towards net purchase of foreign exchange).

Over the year, CB bills auctions were used as a major monetary regulation instrument. The setting of the CB bills auctions was flexibly adjusted to the changes in the economic environment. After the favorable movements registered on the foreign exchange market in the first two months of the year, in the first half of 2002 the NBRM gradually reduced the interest rates on the CB bills "volume tender" auctions, while the CB bills with maturity of 14 days were abolished. Furthermore, due to the lower demand, the CB bills with 7-day maturity were abolished. In July 2002, as a reaction to the stabilization of the overall economic flows, the "interest rate tender" auctions were reintroduced, which implies auction based, i.e. market based determination of the interest rates. The NBRM successfully offset the effects on the liquidity from the increased pre-election public consumption in the third quarter of the year by withdrawing a portion of the excess liquidity through the CB bills auctions.

In December 2002, the monetary aggregate M2 – Denar component registered an annual increase of 7.9%. The positive annual dynamics of the money supply was a result of the higher amount of funds of the transaction deposits, as a reflection of the depleted psychological pressures from the preceding year, the higher households inflows on the basis of payments from the budget on various basis, as well as to the common accumulation of funds on the enterprises' transaction accounts at the end of the year. In conformity with the lower country risk, the acquired credibility of the banking system, the Denar savings deposited on a short run registered higher level on annual basis. At the end of 2002 compared to the previous year, the currency in circulation remained almost unchanged and consequently, did not contribute to the annual change in the money supply M2 – Denar component. In the course of the year, the currency in circulation remained at permanently high level reflecting the continuous effect of the cash conversion of the in-currencies in the first two months of the year, the reform of the payment operations, the financial transaction tax, as well as the higher budget spending.

In line with the inconsiderable annual change in the level of reserve money (fall of 0.2%), the increase in the money supply was solely due to the strengthened money multiplication. Thus, in December 2002, the money multiplication of the money supply M2 – Denar component equaled 2.06 (1.90 in the same month of the preceding year). In 2002, the average annual growth rate of the reserve money equaled 39.9%, in environment of permanently high level of currency in circulation and high liquidity of the banks (in conformity with the reform of the payment operations and the consistent need of higher liquidity of the banks for executing payment operations). In 2002, the monetary aggregate M2 – Denar component registered positive annual growth rate of 22.0%, with positive annual growth rates continuously achieved throughout the year. The average annual growth rate of the broadest monetary aggregate M4 equaled 37.7%, while on annual basis it was by 9.8% lower (due to the high comparison base).

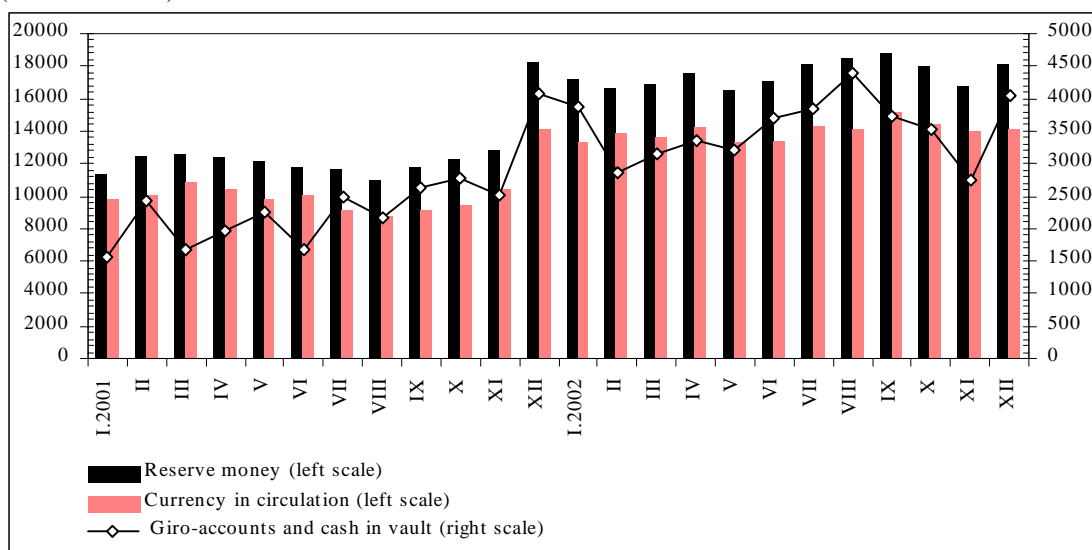
At the end of 2002, the total banks' placements registered annual growth rate of 7.8% directed towards financial support of the real sector and as a proper reaction to the gradual consolidation of the economy, the perceptions for lower country risk and the lower degree of credit risk. The annual increase in the placements (taking into account the transfer of the largest portion of the foreign exchange inflows on the basis of the Euro conversion to the banks' foreign exchange accounts abroad) is due to the high level of Denar placements of 10.1%, whereas the foreign exchange placements fell by 1.5% on annual basis. Unlike the foreign exchange placements, the dynamics of which varied during the year, in the February – September 2002 period, the Denar placements registered continuous increase. In 2002, the banks' interest rate policy was relatively inflexible.

IV. Monetary Developments in the Republic of Macedonia

4.1. Reserve money

At the end of 2002, the reserve money (the currency in circulation and the total liquidity of the banks²⁶) amounted to Denar 18,175 million, thus approximating the level registered at the end of the previous year (minimum decline of Denar 43 million, or 0.2%). In 2002, the reserve money remained at a relatively high level, due to the high level of currency in circulation (in line with the preference to pay in cash) and the relatively high liquidity of the banking sector (permanent increase after the transfer of the payment operations in the banks). In 2002, the structure of the reserve money registered no considerable change, with the currency in circulation continuing to dominate with a share of 77.8%.

Chart 13
Movement of the reserve money and its components
(in Denar million)



Generally speaking, in 2002, the level of reserve money oscillated under the influence of the dynamics of the autonomous factors and the NBRM monetary regulation. Conversely to the slight annual change, the analysis of the dynamics of the reserve money in 2002 indicates substantial oscillations. Thus, in the first quarter of the year, under the influence of the fall in the currency in circulation and the lower liquidity of the banking system, the reserve money registered significant decrease (of 7.5%). The fall in the currency in circulation was caused by the partial exhaustion of the influence of the factors that induced their exceptional increase at the end of the previous year (seasonal factors, reform of the payment operations, the cash conversion of the EMU currencies into the Euro). Simultaneously, the more realistic perception of the needs of the banks for liquidity, after the transfer of the payment operations at the beginning of 2002, and the higher demand for CB bills resulted in relative normalization of the total liquidity at the end of the first quarter of the year. In the second quarter, in spite of the further normalization of the demand for currency in circulation, the total banks' liquidity registered an increase (taking into account the larger budget

²⁶ In February 2002, the banks' giro account and the compulsory reserve account with the NBRM were merged. According to this change, the definition of the reserve money was subjected to certain adjustments. Consequently, the reserve money includes the currency in circulation and the total liquidity of the banks (banks' account with the NBRM and the cash in the vaults). The annual comparisons were made with adequate adjustments, therefore they reflect the actual changes.

spending), rising the reserve money by 1.6%. In the third quarter of 2002, under the influence of the considerably intensified demand for currency in circulation (primarily under the influence of the seasonal factors and the cash payment for indemnification of the savers of the three savings houses²⁷), the reserve money registered a significant increase of 10.3%. As a result of the partial normalization of the demand for currency in circulation, given the increased pressures on the exchange rate and the stronger NBRM interventions on the foreign exchange market, the reserve money reduced by 3.7% in the last quarter of 2002.

Table 6
Reserve money
(in Denar million)

	Balance as of 31.12.2001	Changes by quarters					Balance as of 31.12.2002
		I	II	III	IV	Total	
Reserve money	18,218	-1,372	271	1,757	-699	-43	18,175
- currency in circulation	14,134	-437	-270	1,707	-998	2	14,136
- banks' liquidity	4,084	-935	541	50	299	-45	4,039

From the aspect of the components of the balance sheet of the Central Bank, the slight change in the reserve money in 2002 was due to the convergent movements of the net domestic assets and the net foreign assets of the NBRM. In 2002, the NBRM net domestic assets acted towards reserve money creation. Within the net domestic assets, the largest amount of reserve money was created through the higher budget spending, and partially through the CB bills auctions. In 2002, the Government deposits with the NBRM registered continuous quarterly decline, with the highest intensity being registered in the third quarter, primarily due to the higher budget spending in the pre-election period. On the other hand, the lower NBRM claims on the Government (by 12.1%) mainly realized in the second quarter of the year due to the payment of the government bonds issued in the bank rehabilitation process, acted towards reserve money withdrawal. The credits extended to the banks by the NBRM and the balance on the external account (in spite of the considerable quarterly oscillations) had almost neutral effect on the level of the reserve money in 2002.

Table 7
Flows of reserve money creation and withdrawal¹
(in Denar million)

	Balance as of 31.12.2001	Changes by quarters					Balance as of 31.12.2002
		I	II	III	IV	Total	
Reserve money	18,218	-1,372	271	1,757	-699	-43	18,175
Net foreign assets	50,206	2,169	-2,516	-2,080	-5,805	-8,232	41,974
Net domestic assets	-31,988	-3,541	2,787	3,837	5,106	8,189	-23,799
1. Credits to banks, net	-2,923	-1,918	-872	1,186	1,743	139	-2,784
a) Credits to banks	234	482	-504	0	2	-20	214
- lombard credits	0	500	-500	0	0	0	0
- other credits	234	-18	-4	0	2	-20	214
b) Instruments	-3,157	-2,400	-368	1,186	1,741	159	-2,998
2. Government, net	-17,137	-93	1,150	4,250	1,973	7,280	-9,857
- Claims on Government	4,270	-87	-337	-83	-9	-516	3,754
- Government deposits *	-25,205	471	2,502	2,932	1,884	7,789	-17,416
a) for monetary support	-8,560	0	0	800	1,180	1,980	-6,580
b) giro-account	-3,776	-700	838	1,032	-381	789	-2,987
c) other deposits	-12,869	1,171	1,664	1,100	1,085	5,020	-7,849
- External financing	3,798	-477	-1,015	1,401	98	7	3,805
3. Other items, net	-11,928	-1,530	2,509	-1,599	1,390	770	-11,158

1/ (+) reserve money creation; (-) reserve money withdrawal

*Since these are liabilities presented on the asset side, the figures as of December 31, 2001 and December 31, 2002 are shown with minus (-) as a pre-sign. In the changes by quarters, the change presented with a negative pre-sign denotes an increase in the deposits, and vice versa.

²⁷ According to the adopted Law on Regulating the Claims of the Savers of the Savings Houses "TAT" – Bitola, "Alfa S" – Skopje and "Lavci" – Ohrid, the claims of the savers up to Euro 1,000 were repaid in cash. As for the other higher amounts, convertible certificates were issued.

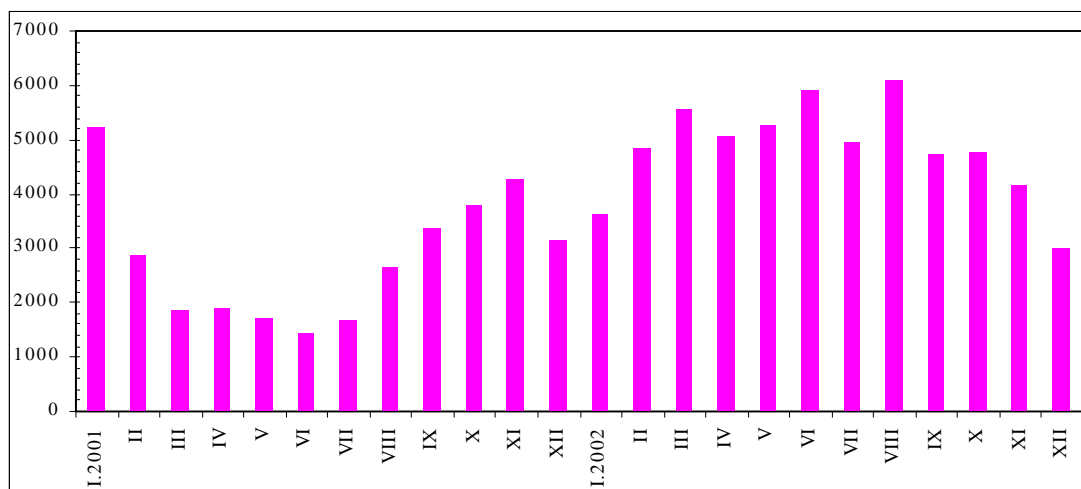
On the other hand, in 2002, the reserve money was mostly withdrawn through the net foreign assets of the NBRM, thus offsetting the increased budget spending. It was primarily due to the need for NBRM intervention on the foreign exchange market by a net sale of foreign exchange aimed at meeting the excess demand for foreign exchange and removing the pressures for depreciation of the exchange rate of the Denar against the Euro, present on the foreign exchange market in the larger period of the year. The higher repayment than the utilization of foreign credits in 2002 was also directed towards decrease in the net foreign assets of the NBRM.

4.1.1. Basic monetary regulation instruments

The activities for permanent reform of the monetary regulation instruments continued in 2002, and were directed towards larger efficiency, flexibility, more clear transmission of the signals of the monetary policy and increased market orientation. The flexible structure ensures successful adjustment of the monetary instruments to the changes in the economic environment and proper response, depending on the actual circumstances. It ensures larger efficiency in the banks' liquidity management, particularly important for providing stable financial system and preventing from larger distortions on the foreign exchange market induced by speculative motives.

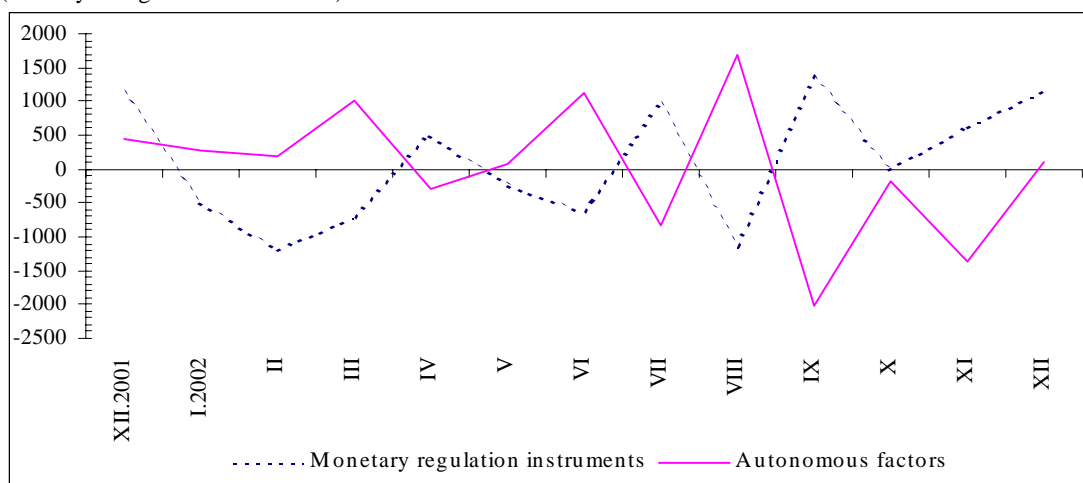
Given the relatively high level of liquidity in the banking system, with the financial market being insufficiently developed and having lack of various financial instruments, the CB bills auctions are the basic and the most important instrument of the monetary policy. By definition, the CB bills auctions act towards reserve money withdrawal and represent the most effective method for sterilization of the excess liquidity, through which, in 2002, the NBRM offset the effects of the movement of the autonomous factors (currency in circulation, foreign exchange transactions, public spending) on the liquidity of the banks. The obligation of the banks to allocate compulsory reserve acts towards sterilization of the excess liquidity, even though with certain restrictions. The compulsory reserve is based on the average allocation system providing an opportunity to use 60% of the allocated amount, thus ensuring larger effectiveness in the banks' liquidity management. In February 2002, the compulsory reserve account was added to the giro account, creating a single account at the banks disposal with the NBRM, and the compulsory reserve has become a component of the reserve money.

Chart 14
CB bills sold at auction
(in Denar million)



The flexible structure of the CB bills auctions is shown through the possibility to be organized in two ways. In the first half of 2002, same as in the second half of 2001, the NBRM continued organizing CB bills “volume tender” auctions, with the CB bills being offered to all interested entities (through the banks). In February 2002, the NBRM sent a clear signal for more relaxed monetary policy layout through the changes in the interest rates on the CB bills auctions (the interest rates on the CB bills with 7-day and 28-day maturity were reduced by 3 percentage points, and 2 percentage points, respectively), in compliance with the gradual normalization of the economic flows and the relative stabilization of the movements on the foreign exchange market and on the Money Market. In January 2002, due to the lower interest, the CB bills with maturity of 14 days were abolished. The stabilization of the economic flows and the gradual recovery from the effects of the crisis, created conditions for abandoning the “volume tender” auctions and reintroduction of the “interest rate tender” auctions (July 17, 2002). At this type of auctions, the banks bid by interest rates with the amount of CB bills being restricted (offered) by the NBRM. Consequently, in the second half of 2002, the interest rates on the CB bills were created on a market basis. Also, in July, the NBRM ceased offering CB bills with maturity of 7 days, with the CB bills with 28-day maturity being the only type used.

Chart 15
 Monetary regulation instruments and autonomous factors of liquidity creation and withdrawal*
 (monthly changes in Denar million)



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

Opposite of their defined function, in 2002, the CB bills auctions acted towards reserve money creation (in the amount of Denar 159 million). At the end of 2002, the total amount of reserve money withdrawn through this instrument amounted to Denar 2,998 million. The dynamics of CB bills sold in this year was determined by the oscillations in the liquidity of the banking system (primarily under the influence of the autonomous factors). Thus, in line with the high liquidity of the banks and the still attractive interest rates, the demand for CB bills increased in the first half of the year. As a result, reserve money in the amount of Denar 2,768 million were withdrawn through the CB bills auctions in this period. In the first quarter, Denar 2,400 million were withdrawn, thus offsetting the effects of the decrease in the currency in circulation and the net purchase on the foreign exchange market on the total liquidity. In the second quarter, the amount of withdrawn reserve money was more moderate (Denar 368 million) indicating the offset of the excess liquidity created through the decrease of the government deposits with the NBRM and the fall in the currency in circulation.

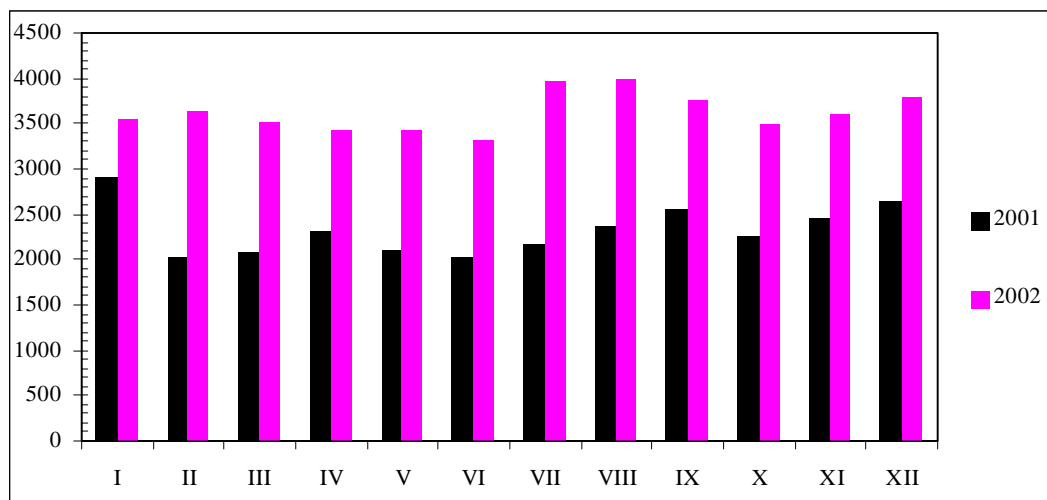
In the second half of 2002, due to the lower interest, the CB bills acted in the opposite direction - reserve money creation (in the amount of Denar 2,927 million). Therewith, the

NBRM compensated for the outflow of liquid funds of the banking system under the influence of the autonomous factors (increase in the currency in circulation, net sale of foreign exchange). In the third quarter of the year, Denar 1,186 million was created through the CB bills auctions, which, besides the lower interest in CB bills, shows the gradual transfer (starting from September) of the funds of the Deposit Insurance Fund generated from the CB bills to the deposit account with the NBRM, according to their maturity. In the last quarter of 2002, the amount of sold CB bills registered further decrease, thus creating additional Denar 1,741 million. The lowest demand for CB bills was registered in December, primarily due to the need of the banks to accumulate liquid funds, in accordance with the expectations for higher outflows at the end of the month (usually prior to the New Year's and the Christmas holidays).

4.2. Liquidity of banks

The transfer of the payment operations to the banking sector in early 2002, in accordance with the reform of the payment system in the Republic of Macedonia, resulted in higher needs of the banks for liquidity (particularly currency in circulation) on a permanent basis. As a result, in 2002, the liquidity of the banking system was permanently preserved at high level. The registered oscillations in the liquidity of the banking sector in 2002 were due to the activity of the autonomous factors (changes in the government deposits with the NBRM, the movements on the foreign exchange market and the demand for currency in circulation).

Chart 16
Average daily liquidity of the banks
(in Denar million)



In 2002, the average daily liquidity of the banks²⁸ equaled Denar 3,619.6 million, which is by Denar 1,294.8 million or by considerable 55.7% over the average level of the preceding year. From the aspect of the dynamics, in the first half of the year, the daily liquidity of the banking sector amounted to Denar 3,473.1 million, on average. In the first three months of 2002, the daily liquidity of the banks was preserved at a relatively higher level (Denar 3,561.4 million on average), as a result of the incapability of the banks to forecast precisely the amount of liquid funds necessary for carrying out the payment

²⁸ According to the new definition of the reserve money in February 2002 (when the giro account of the banks and the compulsory reserve account merged into a single account), the calculation of the amount of the average daily liquidity of the banking sector includes the amount of the compulsory reserve, in spite of the cash in the vaults and the amount on the giro account of the banking system. The annual comparisons were made with adequate adjustments, thus reflecting the actual changes.

operations (immediately after they took them over) and for cash conversion of the “in-currencies” in the first two months of the year. Additional factor was the higher compulsory reserve allocation requirement, in accordance with the expansion of the basis for calculating the requirement for allocation of compulsory reserves on the banks’ Denar deposits. Starting from February 2002, the calculation basis also includes the public sector deposits. In the second quarter of 2002, in conformity with the experience of the banks when determining the liquidity needs for carrying out the payment operations, the level of the daily liquidity of the banking sector dropped and reduced to Denar 3,384.8 million, on average.

In the second half of the year, the daily liquidity of the banking sector was permanently maintained at higher level, primarily under the influence of the higher budget spending, and equaled Denar 3,766.0 million, on average. In the third quarter, due to the considerable decrease in the government deposits with the NBRM (in the election period), notwithstanding the partial depletion of the liquidity through the banking channels by the intensified demand for currency in circulation, the average daily liquidity registered the highest level (Denar 3,906.4 million). In the last quarter of 2002, despite the decrease in the level of currency in circulation and the higher budget spending, the daily liquidity was at a relatively lower level (Denar 3,625.6 million, on average). The decrease was registered in the environment of intensive interventions of the NBRM on the foreign exchange market (net sale of foreign exchange), directed towards maintaining the stability of the Denar exchange rate.

As a result of the high level of liquidity, in 2002, at the end of the calculating period the banks allocated 23.8% over the compulsory reserve requirement, on average. Compared to the previous year, it is a considerable increase of 16.4 percentage points, indicating exceptionally high liquidity of the banking sector in 2002, and irrational liquidity management of some banks. With respect to the dynamics, in the first half of the year, the banks allocated 21,7% over the set compulsory reserve requirement, on average, while in the second half such allocation was higher (the banks allocated 26.0% over the set compulsory requirement, on average). The higher allocation in the second half of 2002 corresponds with the higher level of liquidity in the banking system registered in this period.

The high level of liquidity of the banking sector significantly influenced the developments on the Money Market, with the amount of the supply, the demand and the turnover registering exceptionally high levels in 2002. The permanent maintenance of the demand for liquid funds on the Money Market at a relatively high level, and in the largest part of the year (excluding May and the third quarter) exceeding the supply of liquid funds, indicates that the basic characteristic of the liquidity of the banking sector in 2002 was its uneven dispersion. In 2002, total of 31 Lombard credits were extended for coverage of the occasional shortages of liquid funds of certain banks, mainly in the period of considerable outflows of funds due to the payment of tax liabilities by the consumers. The Lombard credits were used in almost all months of 2002, excluding May, July and August. More frequent usage of Lombard credits was registered in the first half of the year (23), while in the second half, the number of extended Lombard credits was lower (8) due to the higher liquidity.

The CB bills auctions were the basic instrument for withdrawing the excess liquidity (that occurred after the reform of the payment operations, the Euro-conversion and which was due to the relatively higher budget spending), creating pressure for depreciation of the Denar exchange rate on the foreign exchange and the exchange offices market. Also, the foreign exchange transactions of the NBRM acted towards liquidity withdrawal, in line with the unfavorable movements on the foreign exchange market registered in the largest part of 2002.

4.3. Monetary aggregates

In 2002, the movement of the money supply was determined by the NBRM monetary regulation, the total economic activity, the perceptions of the economic entities for the future developments, the continuous effect of the Euro-conversion and the reform of the payment operations, as well as the NBRM interventions on the foreign exchange market, directed towards preserving a stable exchange rate.

At the end of 2002, the monetary aggregate M1 (currency in circulation and demand deposits) amounted to Denar 26.406 million, which is by Denar 1,084 or by 4.3% higher compared to the end of the previous year. Given the considerable decrease in the reserve money, the annual growth in the money supply M1 was a result of the strengthened money multiplication process (in December 2002, the money multiplier of the money supply M1 equaled 1.45, compared to 1.39 in the same month of the previous year, given the almost unchanged demand for currency in circulation and higher level of transaction deposits). In 2002, the average annual growth rate of the money supply M1 was exceptionally high and equaled 23.1%. It was largely due to the maintenance of a high level of currency in circulation, as a component of the money supply M1.

Table 8
Monetary survey
(in Denar million)

	Balance as of 31.12.2001	Changes by quarters					Balance as of 31.12.2002
		I	II	III	IV	Total	
Money Supply M4 (total)	80,380	-12,277	-168	4,441	-446	-8,450	71,930
Money Supply M4 (non-government sector)	77,236	-12,215	-562	5,174	50	-7,553	69,683
Net foreign assets ¹	86,497	-13,180	-5,806	-1,113	-3,825	-23,924	62,573
Net domestic assets ¹	-6,117	903	5,638	5,554	3,379	15,474	9,357
Domestic credits	32,524	829	2,216	6,579	182	9,806	42,330
Deposit money banks	49,661	922	1,066	2,329	-1,791	2,526	52,187
<i>out of which:</i>							
Non-government sector credit ²	41,983	816	1,264	2,150	-2,004	2,226	44,209
- in Denars	34,978	893	1,494	945	-970	2,362	37,340
- in foreign currency	7,005	-77	-230	1,205	-1,034	-136	6,869
Government sector credit	7,678	106	-198	179	213	300	7,978
NBRM claims on Government, net	-17,137	-93	1,150	4,250	1,973	7,280	-9,857
Other items, net	-38,641	74	3,422	-1,025	3,197	5,668	-32,973

1/ (+) money supply (M1) creation; (-) money supply (M1) withdrawal

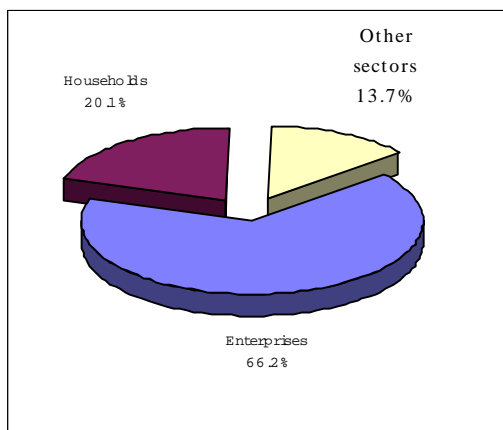
2/ Shows the accounting of the banks' credits extended to the non-government sector.

The analysis of the dynamics shows negative dynamics of the money supply M1 in the first quarter of 2002 (decrease of 2.1%), in conformity with the usual stabilization of the demand for currency in circulation (after the increase induced by the seasonal factors at the end of the year) and the insignificant decrease in the demand deposits. In both the second and the third quarter, the monetary aggregate M1 registered an increase of 0.7% and 10.3%, respectively (the intensive increase in the third quarter was due to the substantially high level of currency in circulation and demand deposits, with high budget spending being registered in the election period). In the last quarter of the year, the money supply M1 was by 4.1% lower, in accordance with the high comparison base of the previous quarter.

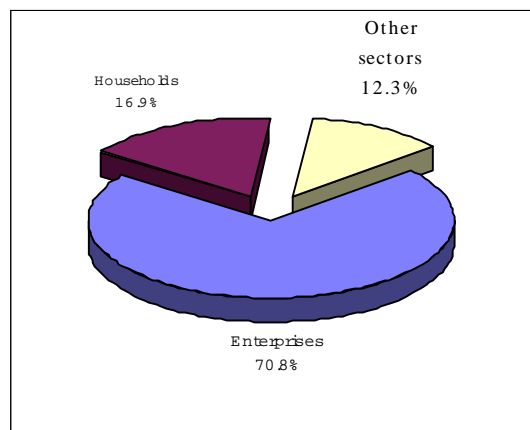
Given the higher level of demand deposits and the almost unchanged demand for currency in circulation, the structure of the money supply M1 registered favorable movements at the end of 2002. Thus, at the end of 2002, the share of the currency in circulation in the money supply M1 equaled 53.5%, which is an annual decline of 2.3 percentage points. Nevertheless, the average monthly share of the currency in circulation in 2002 registered a monthly increase of 5.8 percentage points and reached 54.6% due to the preferences of holding cash and the higher share of cash transactions.

In 2002, the currency in circulation permanently oscillated, thus remaining at a permanently high level, under the influence of the following factors: the cash conversion of the savings in “in-currencies” in the first two months of the year, the reform of the payment system, the temporary financial transactions tax (factors that were also present in a certain period of the previous year) and the higher budget spending in the pre-election period. From the aspect of the quarterly dynamics, in the first quarter of 2002, the currency in circulation was by 3.1% lower, indicating the usual stabilization of the demand for currency in circulation, after the seasonal increase prior to the New Year’s and Christmas holidays. The currency in circulation fell in the second quarter (2.0%), as well, while in the third quarter the demand for currency in circulation again intensified (12.7%). The dynamics of the currency in circulation in the third quarter was a result of the combined activity of: a. the seasonal effect of the higher consumption prior to the beginning of the new school year, and b. the accelerated public consumption in the period of parliamentary elections. In spite of the seasonal effect in December 2002, prior to the holidays, the high comparison base at the end of the third quarter decreased the level of currency in circulation in the last quarter of the year (6.6%). On December 31, 2002, the currency in circulation equaled Denar 14,136 million, thus remaining almost unchanged relative to the end of the preceding year.

Chart 17
Structure of demand deposits by sectors
December 31, 2002

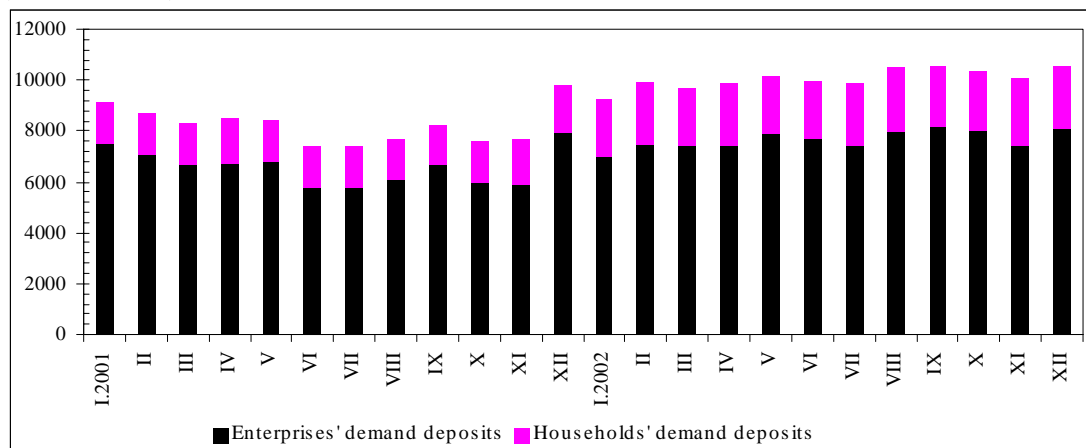


December 31, 2001



At the end of 2002 compared to the level at the end of the last year, the demand deposits (current and giro accounts) were by Denar 1,082 million, or by 9.7% higher. The positive annual dynamics of the demand deposits was due to the simultaneous increase in the demand deposits of both the enterprises and the households. Thus, in December 2002 compared to the same month of the previous year, the enterprises’ demand deposits were by 2.5% higher. In the course of the year, the demand deposits constantly fluctuated due to their transaction character, with their level permanently exceeding the average monthly amount of the funds on the enterprises’ transaction accounts in the previous year. Such movement shows the gradual recovery from the effects of the security crisis, the recovery of the economic activity and the need of higher liquidity for regular conduct of the activities. At the end of 2002, the share of the enterprises’ demand deposits in the structure of the total demand deposits equaled 66.2%, which is a decrease compared to the end of the preceding year of 4.6 percentage points.

Chart 18
Demand deposits of enterprises and households
(in Denar million)



In December 2002, the households' demand deposits registered high annual growth rate of 30.1%, which is due to the low comparison base of the previous year. Conversely to the liquid funds withdrawal from the accounts and their conversion into foreign exchange or Denar cash during the previous year (due to the psychological pressures, taking into account the security crisis), the lower country risk and the stabilized expectations in 2002, as well as the payments from the budget on various bases, resulted in accumulation of funds on the households' transaction accounts. As of December 31, 2002, the share of the enterprises' demand deposits in the structure of the total demand deposits equaled 20.1%, which is by 3.2 percentage points higher compared to the end of the previous year.

Table 9
Monetary aggregates and their components
(in Denar million)

	Balance as of					Changes by quarters				
	31.12.2001	31.03.2002	30.06.2002	30.09.2002	31.12.2002	I	II	III	IV	Total
Currency in circulation	14,134	13,697	13,427	15,134	14,136	-437	-270	1,707	-998	2
Demand deposits	11,188	11,091	11,536	12,399	12,270	-97	445	863	-129	1,082
Money Supply M1	25,322	24,788	24,963	27,533	26,406	-534	175	2,570	-1,127	1,084
Quasi-Denar deposits	9,368	9,060	9,567	11,725	11,019	-308	507	2,158	-706	1,651
Quasi-foreign currency deposits	35,094	24,530	23,448	23,903	26,797	-10,564	-1,082	455	2,894	-8,297
Money Supply M2	69,784	58,378	57,978	63,161	64,222	-11,406	-400	5,183	1,061	-5,562
Non-monetary Denar deposits	3,828	3,792	3,346	3,482	3,965	-36	-446	136	483	137
Non-monetary foreign currency deposits	3,624	2,851	3,135	2,990	1,496	-773	284	-145	-1,494	-2,128
Money Supply M4	77,236	65,021	64,459	69,633	69,683	-12,215	-562	5,174	50	-7,553

Besides the effect of the currency in circulation and the transaction deposits, in 2002 the dynamics of the broader monetary aggregates was under the influence of: a. the expected withdrawal of a portion of the funds deposited on a short run during the Euro-conversion in the first quarter of the year; b. additional depositing of funds, i.e. new savings; c. depreciation of the US Dollar, implying lower Denar value of the US Dollar-denominated deposits. The annual change in the broader monetary aggregates is negative, in conformity with the high comparison base at the end of the preceding year (intensive depositing of foreign exchange savings in Deutsche Marks and other "in-currencies" in the last two months of the preceding year so as to be converted into Euro). Thus, the money supply M2²⁹ (money supply M1, sight deposits and deposits with one-year maturity) was by Denar 5,562 million, or by 8.0% lower, on annual basis, and equaled Denar 64,222 million at the end of 2002. Its Denar component registered an annual increase of Denar 2,735 million, or 7.9%, partially reflecting the strengthened orientation towards saving in domestic currency. In December 2002, the broadest monetary aggregate M4 (money supply M2, restricted deposits and long-term

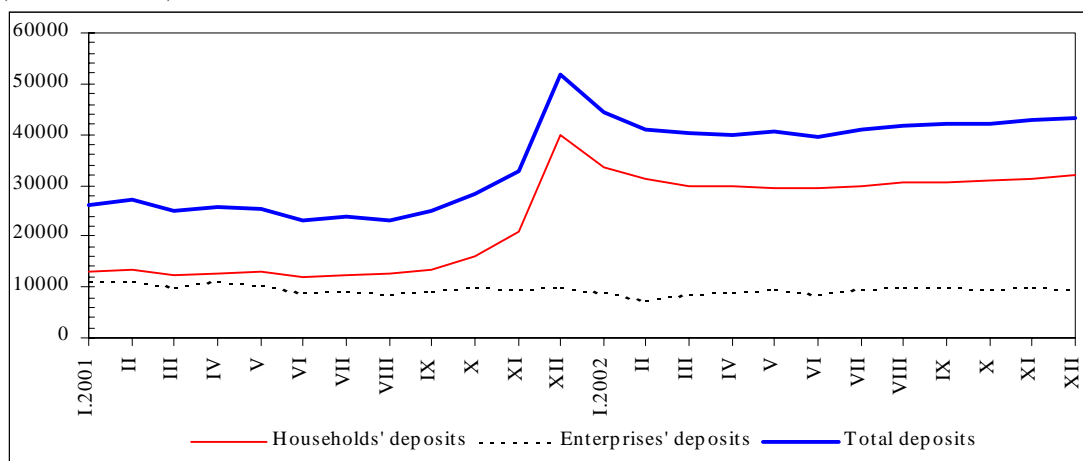
²⁹ All foreign exchange categories are valued according to the current exchange rate.

deposits) amounted to Denar 69,683 million and was by Denar 7,553 million, or by 9.8% lower on annual basis.

4.3.1. Total deposits

The actual introduction of the single European currency at the beginning of 2002 and the need of conversion of the existing twelve European currencies into Euro, resulted in high inflows of foreign assets in the banking system of the Republic of Macedonia, at the end of the previous year. Hence, the high comparison base at the end of 2001 led to a negative annual growth rate of the total deposits of the non-government sector at the end of 2002. Thus in December 2002, compared to the same month of the previous year, the total deposits of the banking system (sight deposits, deposits with maturity up to and over one year) were by Denar 8,637 million, or by 16.6% lower and amounted to Denar 43,277 million. Several features of the dynamics of the deposits in this year indicate the strengthened credibility of the banking system and the resumed orientation of the households to save in banks: a. the expected withdrawal of the foreign exchange savings, deposited on a short run in order to be converted into Euro, was made only in the first quarter of the year, followed by depositing additional savings; b. the annual growth rate of the Denar deposits is positive, reflecting the strengthened orientation towards saving in domestic currency, and c. in the second half of 2002, the total deposits registered a permanent increase.

Chart 19
Total deposits
(in Denar million)



With respect to dynamics, in the first quarter of the year, the total deposits dropped by 22.5%. The negative dynamics of the deposits in this period was primarily due to the withdrawal of a portion of the foreign exchange savings deposited for the Euro conversion (decrease of about one third compared to the level of the foreign exchange deposits at the end of 2001). In the second quarter of 2002, the level of the total deposits was by 1.8% lower, due to a certain accounting reclassification and depreciation of the US Dollar, leading to lower Denar value of the foreign exchange deposits. Distinctive feature of this quarter is the increase in the short-term Denar deposits (5.6%), as an indicator for the higher propensity to save, given good functioning of the banking system and gradual exhaustion of the negative effects of the security crisis in the previous year. Also, more than four fifths of the increase in the total deposits in the third quarter (by 6.6%) was due to the increase in the short-term Denar deposits. Such movements were registered with the banks' interest rate policy being almost unchanged. In the last quarter of 2002, the banks' deposit potential was by 2.8% higher, primarily due to the considerably higher level of short-term foreign exchange savings. The favorable dynamics of the deposits in 2002 is a reflection of: a. the lower political and security risk in the country; b. the strengthened confidence in the banking system, in line with

its successful functioning during the crisis in the previous year; c. the transfer of a portion of the savings into the banking system for their conversion into Euro increased the awareness for the interest yield as a source of income and induced additional new savings, and d. the amendments to the Law on Deposit Insurance Fund in this year, with which the percentage of indemnification of the savings increased to 100% for the deposits up to Euro 10,000 and 90% for the deposits up to Euro 20,000.

Table 10
Total deposits
(in Denar million)

	Balance as of					Changes by quarters				
	31.12.2001	31.03.2002	30.06.2002	30.09.2002	31.12.2002	I	II	III	IV	Total
Total deposits of the non-government sector	51,914	40,233	39,496	42,100	43,277	-11,681	-737	2,604	1,177	-8,637
- Denar	13,196	12,852	12,913	15,207	14,984	-344	61	2,294	-223	1,788
- foreign currency	38,718	27,381	26,583	26,893	28,293	-11,337	-798	310	1,400	-10,425
I. Short-term deposits ¹	44,462	33,590	33,015	35,628	37,816	-10,872	-575	2,613	2,188	-6,646
- Denar	9,368	9,060	9,567	11,725	11,019	-308	507	2,158	-706	1,651
- foreign currency	35,094	24,530	23,448	23,903	26,797	-10,564	-1,082	455	2,894	-8,297
II. Long-term deposits ²	7,452	6,643	6,481	6,472	5,461	-809	-162	-9	-1,011	-1,991
- Denar	3,828	3,792	3,346	3,482	3,965	-36	-446	136	483	137
- foreign currency	3,624	2,851	3,135	2,990	1,496	-773	284	-145	-1,494	-2,128

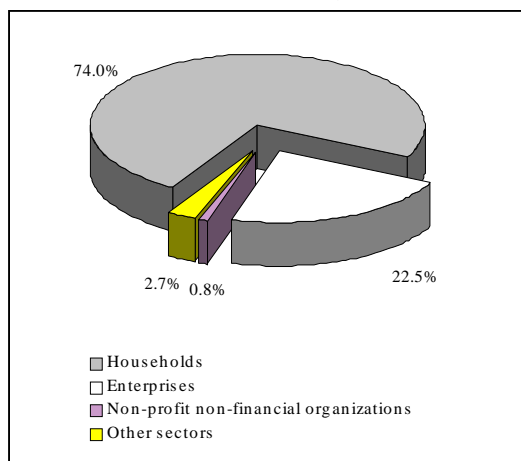
1/ The short-term deposits include sight deposits and deposits with maturity of up to one year.

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

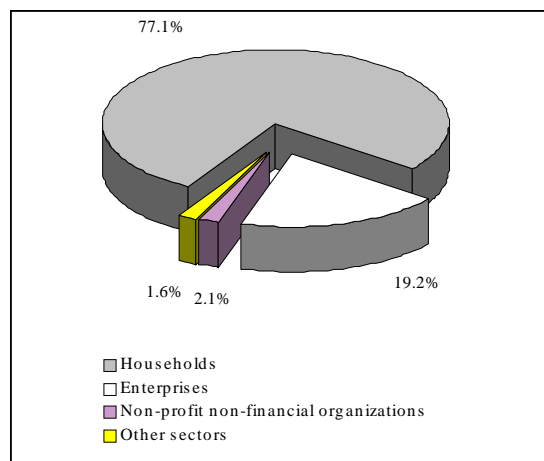
With respect to maturity, the narrowing of the banks' deposit base on annual basis was due to the simultaneous decrease in both the short-term and the long-term deposits. Thus, in December 2002, compared to the same month of the previous year, the short-term deposits were by 14.9% lower, which is solely due to the decrease in the short-term foreign exchange deposits (in line with the high comparison base at the end of 2001, due to the Euro conversion). The annual growth rate of the long-term deposits was negative and equaled 26.7%. Such a decrease was caused by the fall in the restricted foreign exchange deposits, intended for transactions based on the international payment operations instruments (the dynamics of which is changeable and induced by the time schedule of the transactions with the foreign partners), as well as the lower level of foreign exchange savings deposited on a long run.

At the end of 2002, the structure of the deposits with respect to the currency of denomination registered divergent movements. Thus, the increased propensity to save in domestic currency is confirmed with the annual increase in the Denar deposits of 13.5% (given the increase in both the short-term the long-term Denar deposits of 17.6% and 3.6%, respectively). At the end of December 2002, compared to the same month of the previous year, the total foreign exchange deposits were by 26.9% lower, with more intensive decrease being registered in the long-term foreign exchange deposits (by 58.7%, partially due to the lower level of restricted deposits based on the international payment operations instruments; therefore it is not reflecting the propensity to save), while the decrease in the short-term foreign exchange deposits was more moderate (23.6%) and was due to the high comparison base at the end of the preceding year.

Chart 20
Structure of deposits by sectors
December 31, 2002



December 31, 2001



The sector-by-sector analysis indicates that on December 31, 2001, the share of the households' deposits in the total deposits equaled 74.0%, which is a drop of 3.1% compared to the end of the previous year. The share of the enterprises' deposits registered an increase of 3.3%, reaching 22.5% at the end of December 2002.

In December 2002, the total households' deposits were by Denar 7,992 million, or by 20.0% lower, on annual basis. The first quarter registered most intensive decrease (25.4%) given the withdrawal of a portion of the foreign exchange savings deposited for the Euro conversion at the end of the previous year. The decline in the households' deposits in the second quarter was more moderate (1.5%), primarily due to the lower Denar value of the foreign exchange deposits taking into account the depreciation of the US Dollar. In the third and the fourth quarter of 2002, the households' deposits increased by 3.7% and 5.0%, respectively, in accordance with the higher households' propensity to save in both domestic and foreign currency. In December 2002, compared to the same month of the previous year, the enterprises' deposits were by Denar 200 million or by 2.0% lower. In the course of the year, their dynamics was primarily determined by the deposits intended for payments based on the international operations instruments. With respect to the dynamics, the higher level of the enterprises' deposits was registered in both the second and the third quarter (2.7% and 18.1%, respectively), whereas in the first and the fourth quarter of the year, the enterprises' deposits dropped by 15.0% and 4.9%, respectively.

4.4. Banks' placements³⁰

In 2002, the credit activity of the banking sector was directed towards supporting the economic flows. The gradual normalization and stabilization of the political and the economic situation in the country acted towards decreasing the credit risk and creating environment for more expansive credit policy of the banks. Simultaneously, the high liquidity of the banking system and the moderate fluctuations in the banks' deposit base were additional factors that positively affected the credit activity of the banks. In 2002, significant feature of the banks' credit policy was the high degree of prudence and selectivity, with the funds being placed in high quality projects and in financially reliable clients. It indicates the qualitative progress of the banks' business policy in the area of credit portfolio management.

³⁰ The banks' placements are shown according to the actual balance. The actual balance of the Denar placements differs from the accounting balance by the corrections made in the written-off claims and the re-recordings with the banks.

In 2002, the process of credit support to the households (primarily on a long run) intensified by extending consumer, housing and other credits. It made the household lending take an important role in the structure of the banks' Denar placements, simultaneously acting towards stimulating the domestic consumption, as an important segment in the process of acceleration of the economic growth in the country. Such orientation of the banks' credit policy towards the household sector was partially due to the absence of larger number of high quality investment project of the enterprises which is a limiting factor in the process of achieving dynamic and sustainable growth of the Macedonian economy on a long run.

Table 11
Domestic credits of the deposit money banks
(in Denar million)

	Balance as of					Changes by quarters				
	31.12.2001	31.03.2002	30.06.2002	30.09.2002	31.12.2002	I	II	III	IV	Total
Domestic credits ¹	49,661	50,583	51,649	53,978	52,187	922	1,066	2,329	-1,791	2,526
Domestic credits ²	57,536	58,597	60,041	62,792	61,296	1,061	1,444	2,751	-1,496	3,760
1. Credits to the Government	7,678	7,784	7,586	7,765	7,978	106	-198	179	213	300
- Denar credits	831	881	826	907	721	50	-55	81	-186	-110
- Foreign currency credits ³	6,819	6,800	6,671	6,768	7,249	-19	-129	97	481	430
- Overdue interest	28	103	89	90	8	75	-14	1	-82	-20
2. Social and private sector credit ¹	41,983	42,799	44,063	46,213	44,209	816	1,264	2,150	-2,004	2,226
- Denar credits	30,780	31,463	32,946	33,946	33,259	683	1,483	1,000	-687	2,479
- Foreign currency credits ³	7,005	6,928	6,698	7,903	6,869	-77	-230	1,205	-1,034	-136
- Overdue interest	4,198	4,408	4,419	4,364	4,081	210	11	-55	-283	-117
2a. Social and private sector credit ²	45,660	46,405	48,036	50,663	49,237	745	1,631	2,627	-1,426	3,577
- Denar credits	36,840	37,662	39,523	40,945	40,553	822	1,861	1,422	-392	3,713
- Foreign currency credits ³	8,820	8,743	8,513	9,718	8,684	-77	-230	1,205	-1,034	-136

1/ accounting balance

2/ actual balance

3/ the foreign exchange categories are valued by the current rate

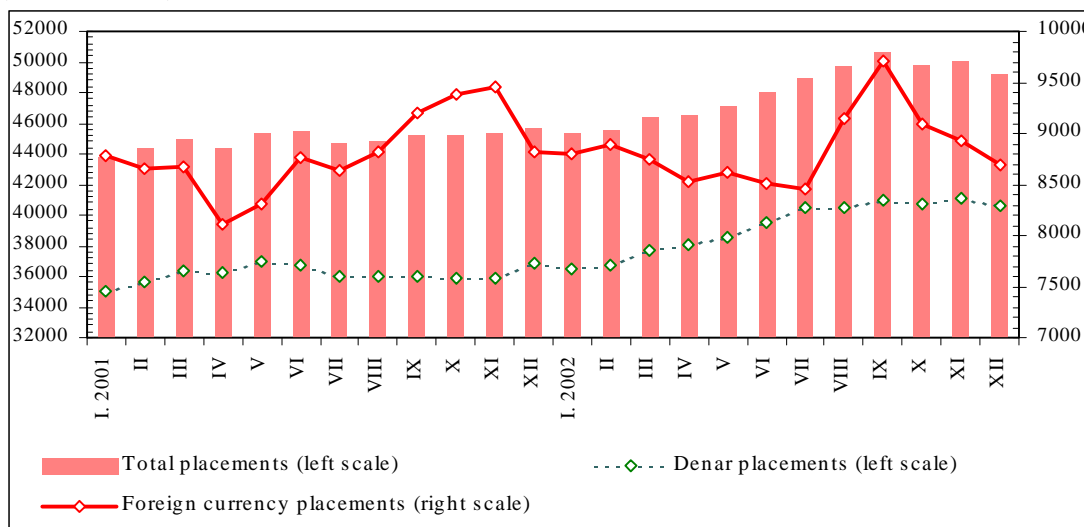
In 2002, the total banks' placements to the non-government sector increased by Denar 3,577 million, or by 7.8% and amounted to Denar 49,237 million on December 31, 2002. With respect to the currency of denomination, the increased credit activity of the banks was due to the higher Denar placements, whereas the foreign exchange placements registered moderate decline.

The largest portion (82.4%) of the total banks' placements is denominated in domestic currency. In 2002, the banks' Denar placements to the non-government sector increased by Denar 3,713 million, or by 10.1% and amounted to Denar 40,553 million on December 31, 2002. One should bear in mind that the increase in the Denar placements was achieved in environment of improved collection of the claims by the banks, evident through the moderate increase (of 3.1%) in the overdue claims based on principal in 2002. The high degree of prudence of the banks' credit policy was also evident in the relatively moderate changes in the movements of the Denar placements in this year, with the average monthly growth rate of the banks' Denar placements equaling 0.8%.

With respect to the dynamics, in the first three quarters of 2002 (excluding January) the banks' Denar placements to the non-government sector registered continuous increase. The monthly fall in the Denar placements in January (of 0.8%) corresponds with the considerably lower economic activity in this period of the year. Due to the fall in January, the increase in the banks' Denar placements in the first quarter of 2002 (2.2%) was almost twice lower compared to their increase in the second quarter (4.9%). In the third quarter, the

increase in the Denar placements equaled 3.6%. The upward trend in the banks' Denar placements to the non-government sector was interrupted in the last quarter of the year, when they dropped by 1.0% (in spite of their rise in November). The contraction of the banks' credit activity in this period of the year causes no restriction of the credit policy of the banks, since it was primarily due to the significant decrease in the banks' overdue claims.

Chart 21
Banks' placements
(in Denar million)

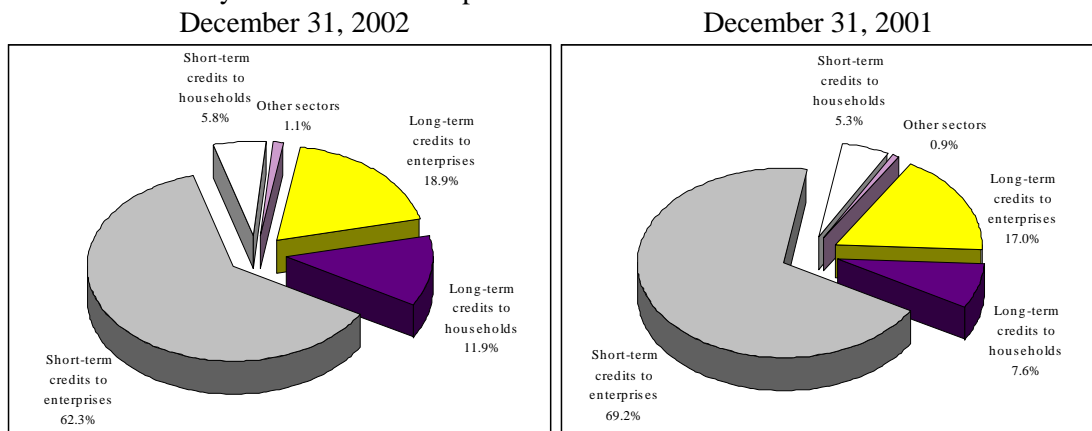


In 2002, the maturity structure³¹ of the banks' Denar placements to the non-government sector registered considerable positive movements. Unlike the previous year, when, according to the depreciated economic flows and the higher risk, the banks were primarily extending short-term credits, in 2002 the banks were oriented towards long-term credit support of the economic agents. Thus, with the long-term placements being significantly increased (by 35.0%) and with the short-term placements being moderately reduced (by 0.7%), the share of the long-term placements registered an increase of 6.1 percentage points and reached 30.7%, approximating the level prior to the beginning of the security crisis in the country (early 2001). Therefore, although the banks continue extending short-term placements (share of 69.3%), there is tendency of increased extension of long-term credits. The gradual increase in the long-term credit support creates prerequisites for more significant investment activity necessary for acceleration of the economic growth. Considering that the long-term credit support of the economic agents rose in the second half of the year, the positive effects on the economic growth should be expected in the following period.

In conformity with the credit support of the households, the sector structure registered an increase in the share of the Denar credits extended to the household sector (by 4.8 percentage points), whereas the share of the placements extended to the enterprises dropped (by 5.0 percentage points). Nevertheless, the credits extended to the enterprises dominate with a share of 81.2%, while the share of the credits extended to the households equaled 17.7% at the end of 2002. The largest portion (67.2%) of the Denar placements is extended to households on a long run, unlike the placements extended to the enterprises (most of them or 76.8% are extended on a short run). However, it should be underlined that in 2002 there was a tendency of increasing the long-term credit support to the enterprises (by 20.0%), taking into account the decline in the short-term placements extended to this sector (by 2.6%).

³¹ In the maturity and the sector-by-sector analysis, the banks' Denar placements are shown according to the accounting balance.

Chart 22
Sector and maturity structure of Denar placements



Taking into consideration the changes in the maturity and the sector structure of the banks' Denar placements, in 2002, the banks' credit policy was characterized with larger orientation towards placing funds on a long run (the share of the long-term credits of both the enterprises and the households in the total Denar placements increased by 1.9 percentage points and by 4.3 percentage points, respectively). Nevertheless, at the end of 2002, the short-term Denar credits extended to enterprises further dominate with a share of 62.3%.

In 2002, the banks' foreign exchange placements to the non-government sector registered a moderate fall of Denar 136 million, or 1.5%, reducing to Denar 8,684 million on December 31, 2002. The decline corresponds with the lower interest of the banks in using foreign credit lines and foreign credits. However, the effect of the depreciation of the US Dollar on the international stock exchanges should be taken into account, considering that the foreign exchange placements in the analysis are presented in Denar, at the current exchange rate.

With respect to the dynamics, due to the restraint of banks from using foreign credit lines, the foreign exchange placements dropped in the first half of the year, with the decrease in the first quarter (0.9%) being more moderate compared to the fall in the second quarter (2.6%). Thus, at the end of June, the foreign exchange placements of the banks to the non-government sector registered negative annual growth rate of 2.9%, for the first time since the beginning of the year. The relatively higher comparison base in the previous year should be taken into consideration, when due to the war crisis the banks preferred to extend foreign exchange credits. The third quarter of the year registered intensive usage of foreign short-term credit lines intended for delivery of projects, as well as increased usage of long-term credits extended by foreign banks, which resulted in substantial increase in the banks' foreign exchange placements of 14.1%. In the last quarter of the year, the banks' foreign exchange placements to the non-government sector dropped by 10.6%. In spite of the restraint from using foreign credit lines and foreign credits, such decrease was due to the collection of the banks' claims on the enterprises based on used foreign credit lines (primarily those extended on a short run).

In 2002, there was a tendency of banks orienting towards using foreign long-term credits and credit lines. It resulted in an increase in the long-term foreign exchange placements of the banks extended to the non-government sector (of 14.5%), with simultaneous decrease being registered in the short-term foreign exchange placements (14.0%). Such movements affected the maturity structure of the foreign exchange placements by increasing the share of the long-term placements (by 7.1 percentage points), which equaled

49.3% at the end of 2002. From the sector aspect, the largest portion of the foreign exchange placements (93.7%) was concentrated in the enterprise sector.

4.5. Net foreign assets of the monetary system

In December 2002, the net foreign assets of the monetary system (covering the transactions of the NBRM and the banks with non-residents) registered a decrease of Denar 23,924 million, or 27.7% on annual basis, reducing to Denar 62,573 million. The decrease in the net foreign assets of the monetary system was due to the simultaneous decrease in both its components: net foreign assets of the NBRM and the net foreign assets of the deposit money banks.

Table 12
Net foreign assets of the monetary system
(in Denar million)

	Balance as of 31.12.2001	Changes by quarters					Total	Balance as of 31.12.2002
		I	II	III	IV			
Net foreign assets of the monetary system	86,497	-13,180	-5,806	-1,113	-3,825	-23,924	62,573	
Net foreign assets of NBRM	50,206	2,169	-2,516	-2,080	-5,805	-8,232	41,974	
Foreign assets	55,103	2,110	-2,962	-2,081	-6,247	-9,180	45,923	
Foreign liabilities	4,897	-59	-446	-1	-442	-948	3,949	
Net foreign assets of the deposit money banks	36,291	-15,349	-3,290	967	1,980	-15,692	20,599	
Foreign assets	49,801	-16,785	-2,747	1,393	1,454	-16,685	33,116	
Foreign liabilities	13,510	-1,436	543	426	-526	-993	12,517	

Given the more intensive decrease in the foreign assets (16.7%) relative to the fall in the foreign liabilities (19.4%), in December 2002, the net foreign assets of the NBRM were by Denar 8,232 million, or by 16.4% lower, on annual basis. The decrease in the NBRM foreign assets was primarily due to the Central Bank interventions on the foreign exchange market by a net sale of foreign exchange (excluding January, February and June, when the NBRM participated on the foreign exchange market by a net purchase of foreign exchange) in order to preserve the stability of the exchange rate of the Denar against the Euro, as well as the sale of foreign exchange for import of oil. Simultaneously, the lower amount of foreign exchange partially reflects the depreciation of the US Dollar. The Government external account contributed to the decrease in the level of the NBRM foreign assets, due to the higher amount of repayment of the foreign liabilities, relative to the amount of the inflows from external sources. Taking into account the inconsiderable amount of executed transactions, the fall in the NBRM foreign liabilities was primarily due to the appreciation of the Denar relative to the US Dollar.

At the end of 2002, compared to the end of the previous year, the net foreign assets of the deposit money banks dropped by Denar 15,692 million, or by 43.2%. The negative annual dynamics of the net foreign assets of the deposit money banks was due to the more intensive fall in the foreign assets (33.5%) compared to the fall in the foreign liabilities (7.4%). From the aspect of the quarterly dynamics, the most intensive fall in the banks' foreign assets was registered in the first quarter, due to the withdrawal of a portion of the foreign exchange savings deposited for the Euro conversion (given the security crisis in the country in the previous year and the uncertainty regarding the dynamics of the possible withdrawal of the foreign exchange deposits, these funds were primarily deposited in accounts abroad, thus increasing the foreign assets at the end of the preceding year). The slump in the foreign assets in the second quarter was more moderate, whereas in the last two quarters, in line with the positive dynamics of the foreign exchange deposits, the banks' foreign assets increased. From the aspect of the foreign liabilities, in the last three quarters of 2002, the short-term relative to the long-term indebtedness of the banks abroad registered a downward trend. It corresponds with the downward trend of the short-term, at the expense of the increase in the long-term placements in the structure of the total foreign exchange placements of the banks. With

respect to the dynamics, in the first and the last quarter of the year, the foreign liabilities of the banks plunged, primarily due to the decrease in the deposits of the non-residents in the domestic banks. The considerable increase in the long-term indebtedness of the banks abroad in the second and the third quarter, resulted in higher level of foreign liabilities in these periods.

V. Interest Rate Policy

In 2002, despite the gradual normalization of the economy and the security in the country and the reduction of the credit risk, the interest rates were maintained at a relatively high level. Furthermore, typical for the interest rates in 2002 was: a. the high degree of interdependence of the movements of the interest rates on the CB bills auctions and on the Money Market; b. insufficient responsiveness of the banks' interest rate policy to the monetary policy stance and inconsistency with their liquidity position and, c. high interest rates margins of the banks.

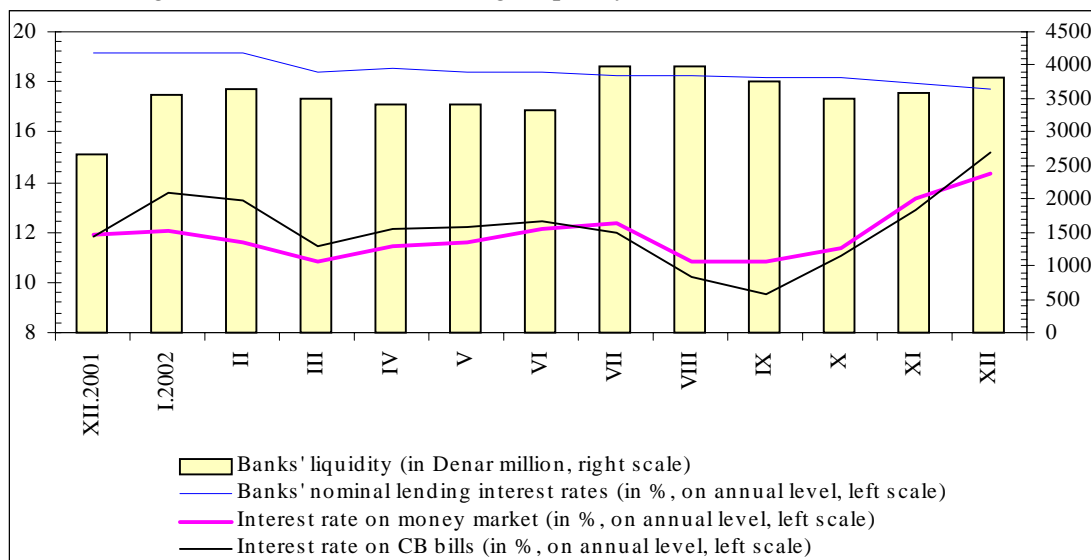
Same as in the previous three years, in 2002, the basic interest rate in the conduct of the monetary policy was the interest rate on the CB bills auctions, established according to the type of tender. Thus, in the first half of 2002, the NBRM was organizing only "volume tender" auctions of CB bills with 7 and 28 days of maturity, three times a week (at the beginning of 2002, the NBRM was offering CB bills with maturity of 14 days, but due to the lower demand they were abolished in January). This type of auctions was applied by the end of May 2001, due to the need for more aggressive action of the NBRM when defending the exchange rate during the last-year crisis and in the post-crisis period. Due to such organization, at the beginning of 2002, the NBRM was offering CB bills with 7 and 28 days of maturity at interest rates of 11.0% and 15.0% p.a., respectively. At the end of February (February 25, 2002), the NBRM reduced the interest rates on the CB bills with 7 and 28 days of maturity to 8.0% and 13.0%, respectively. Such decrease is a continuation of the tendency of gradual reduction of the interest rates on the CB bills that started in the second half of the previous year, due to the gradual normalization of the security situation and the economic conditions. Simultaneously, it was an adequate reaction of the monetary policy to the normalized movements on the foreign exchange market and on the Money Market. The intention was to send positive signal to the banks to make adequate changes in their interest rate policy, aimed at supporting the positive trends in the economy.

After being reduced in February, the interest rates on the CB bills registered no changes by the end of the first half of 2002. The weighted interest rate on the CB bills auctions was continuously maintained at a relatively high level in this period (January – June 2002) and equaled 12.5% p.a., on average. The maintenance of a relatively high level of the average weighted interest rates on the CB bills reflects the considerably higher interest of the banks and the economic agents in CB bills with longer maturity (of 28 days, bringing higher interest).

The gradual stabilization and normalization of the economy created conditions for returning towards a market-oriented method of setting the interest rate on the CB bills. As a result, "interest rate tender" auctions started being used since July 17, 2002, where the banks bid with interest rates for given (restricted) amount of CB bills. At the same time, in July, the NBRM ceased offering CB bills with shorter maturity (7 days), recommending to the banks to meet their short-term liquidity needs on the Money Market. In the second half of 2002, the average weighted interest rate on the CB bills equaled 11.8%. With respect to the dynamics, in the third quarter of 2002, the interest rates registered continuous decrease, with the lowest value being achieved in September (9.5%). The downward tendency of the average interest rate was due to the high liquidity in the banking system, due to which the demand for CB bills was higher compared to the amount supplied by the NBRM. In the last quarter of 2002, divergent movements were registered, with the interest rate on the CB bills registering continuous increase (in December the weighted interest rates on the CB bills auctions reached the highest level of 15.2%). It was primarily due to the continuous supply of higher amount of CB bills by the NBRM relative to the demanded one, in order to keep the signal of conducting

prudent monetary policy in a situation where there were pressures for depreciation of the exchange rate of the Denar against the Euro on the foreign exchange and exchange offices market. Generally speaking, in 2002, the interest rates on the CB bills auctions remained at a relatively high and attractive level, due to the need of withdrawing the excess liquidity from the banking sector (primarily as a result of the large outflows from the budget account).

Chart 23
Nominal weighted interest rates and average liquidity



In 2002, the other NBRM interest rates remained unchanged. Thus, the discount rate of the NBRM (used as a basis for calculating the penalty interest rates) equaled 10.7% in 2002. The interest rate on the Lombard credits also remained at the level of the previous year (23.0%), as a maximum interest rate applied when the banks are not capable of meeting their liquidity needs from other sources. The relatively high level of these interest rates corresponds with the general monetary policy stance, primarily determined by the situation on the foreign exchange and the exchange offices market.

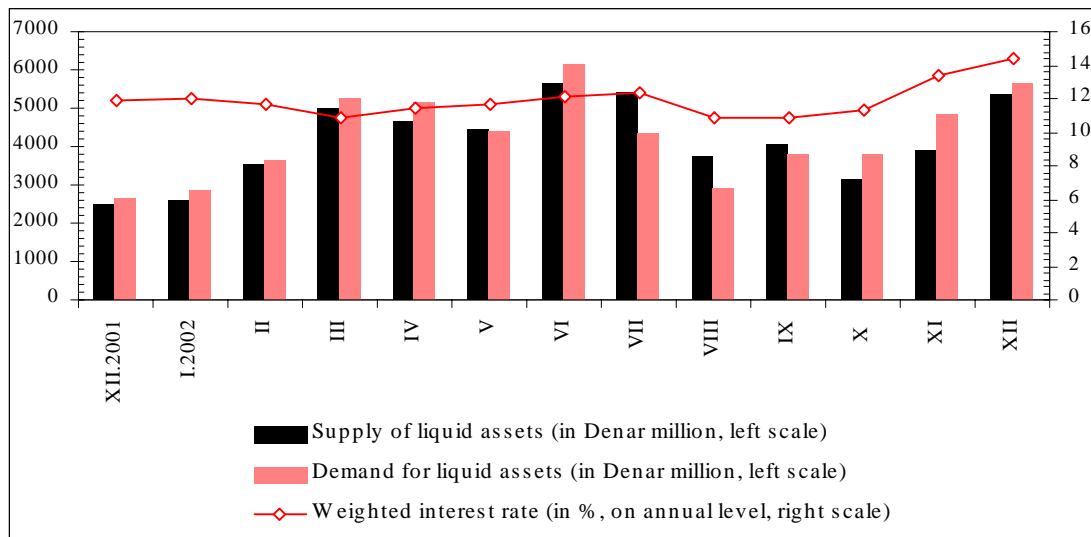
The movement of the interest rates on the Money Market in 2002 was primarily under the influence of the oscillations in the liquidity of the banking system and the monetary policy stance. There was a high degree of correlation in the movement of the interest rates on the Money Market and the CB bills auctions. Basic feature of the interest rates on the Money Market in 2002 was their maintenance at a relatively high level. The average weighted interest rate equaled 11.9%, which is a moderate decrease of 1.1 percentage point compared to the previous year.

With respect to the dynamics, as a continuation of the favorable movements at the end of the preceding year, in the first quarter of 2002, the tendency of reducing the interest rates on the Money Market continued (in March, the average weighted interest rate reduced to 10.8% - the lowest level since May 2001). Such reduction in the interest rates on the Money Market corresponds with the high level of liquidity, as well as with the reduction in the interest rates on the CB bills. In the second quarter of 2002, convergent movements were recorded, with the average weighted interest rate on the Money Market registering continuous increase (in June it was by 1.3 percentage points higher compared to March). The increase was achieved with the demand for liquid funds exceeding the supply on the Money Market in this period (by 5.9%, on average). Considering the high level of total liquidity in the banking system, it indicates unequal dispersion of the liquidity within the banking system.

The exceptionally high level of liquidity in the banking system in the third quarter of 2002 led to constantly higher supply relative to the demand for liquid funds on the Money Market. In such environment, the average weighted interest rate on the Money Market dropped by 1.3 percentage points and for the second time this year was brought down to 10,8% in September. In the last quarter of 2002, the average weighted interest rate on the Money Market considerably increased (by 3.5 percentage points). In the last month of 2002, it reached 14.4%, which is the highest level since the beginning of the year. The increment in the last quarter was achieved both with the demand for liquid funds on the Money Market being constantly higher than the supply (by 17.1%, on average), and with higher interest rates on the CB bills auctions.

Chart 24

Supply, demand and interest rates on the Money Market



In 2002, the banks' interest rates were characterized with inconsistency of their liquidity position and the insufficient responsiveness of the monetary policy stance. Given the high level of liquidity and oscillations in the interest rates on the CB bills and on the Money Market, the banks' interest rates registered a moderate decrease. Thus, the banks' nominal weighted lending³² interest rates in 2002 equaled 18.4%, on average, which is by 1.0 percentage point lower compared to the previous year. Simultaneously, the banks' average nominal weighted deposit³³ interest rates, which in 2002 equaled 9.6% p.a. reduced by 0.3 percentage points. The relatively more intensive fall in the nominal weighted lending interest rates compared to the deposit interest rates, resulted in a moderate decrease of 0.7 percentage points of the average interest rate margins of the deposit money banks, which in 2002 equaled 8.8. percentage points, on average. Given the relatively low monthly inflation rates, in 2002, the real lending and deposit interest rates of the banks registered no considerable divergence from their nominal values, and equaled 17.0% and 8.2%, respectively, on average.

The moderate decrease in the banks' interest rates is a reflection of the lower credit risk, in line with the gradual normalization of the economy and the security in the country. The high level of liquidity of the banking sector, the higher income of the banks generated from the banking services after the transfer of the payment operations in the banks, as well as the satisfactory level of deposit potential of the banks acted towards the same direction.

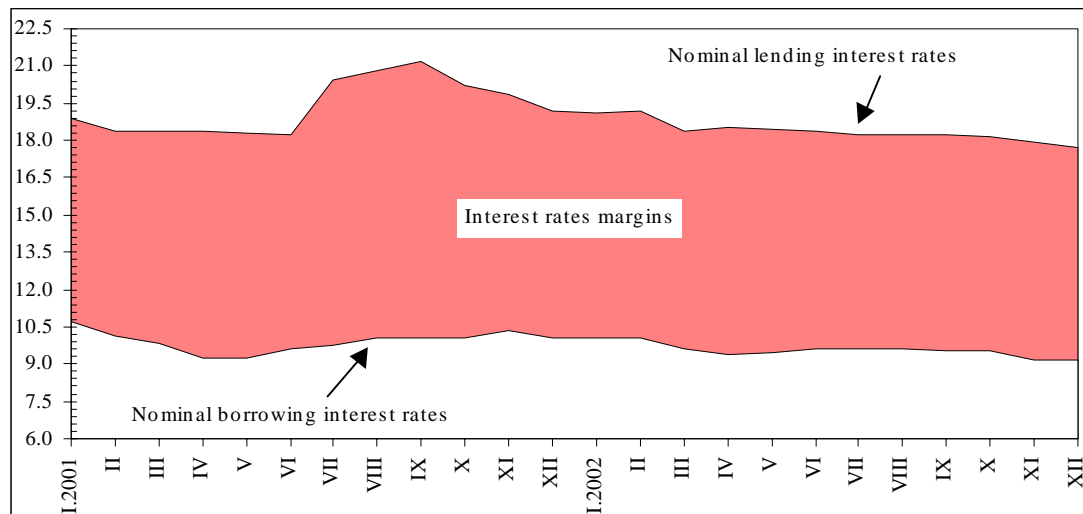
³² Pertaining to Denar short-term credits (up to one year).

³³ Pertaining to three-month Denar deposit.

Chart 25

Nominal lending and deposit interest rates and banks' interest rate margins

(on annual basis)



With respect to the dynamics, in the first half of 2002, the banks' nominal weighted lending interest rates decreased by 0.8 percentage points, while the banks' nominal weighted deposit interest rates fell by 0.5 percentage points. The fall was registered almost solely in March, which is a partial response of the banks' interest rate policy to the monetary policy measures (the decline in the interest rates on the CB bills). Decrease in both lending (by 0.7 percentage points) and deposit (by 0.4 percentage points) banks' interest rates was also registered in the second half of 2002, with the fall being almost solely registered in the last two months of the year, when the banks' interest rate policy became more flexible. In December 2002, the banks' nominal weighted lending and deposit interest rates equaled 17.7% and 9.2% respectively, which is the lowest level ever.

Notwithstanding the moderate decline, the banks' interest rate policy is still characterized with relatively high interest rates. Unlike the stimulating influence of the relatively high banks' deposit interest rates (directed towards favoring the Denar savings), the relatively high banks' lending interest rates increase the costs of financing of the economic agents. Generally speaking, the high level of banks' lending interest rates in the Republic of Macedonia was due to the following factors: a. high amount of overdue claims; b. still high costs in the banks' operations; c. insufficient efficiency and rationality in the operations; d. high demand for banking credits given the insufficient development of alternative sources of funds; e. insufficient "active" competition in the banking sector, etc. The further prudent character of the credit policy of the banks is an additional factor for the high level of the interest rates in 2002. Under the influence of these factors, the banks' interest rate margins still remain at a relatively high level.

The high level of the banks' interest rates and interest rate margins indicate the need for continuing the process of reforming the banking sector. The necessary prerequisites for gradual reduction of the banks' interest rates and the interest rate margins are created through the gradual vanishing of the limiting factors (considering primarily the lower amount of overdue claims of the newly extended credits), the process of concentration and the higher competitiveness in the banking sector. Simultaneously, the increase in the Denar savings and the moderate dynamics of withdrawing the foreign exchange deposits from the banks (after their conversion into Euro) creates prerequisites for enhancing the deposit potential of the banks on a sustainable ground, thus opening perspectives for higher supply of credits, and consequently, lower interest rates. The more relaxed monetary policy, given the stabilized budget spending, the gradual vanishing of the political risk in the country and in the region, as

well as the changes in the foreign exchange system imposed by the new Law on Foreign Exchange Operations should act towards the same direction.

VI. Financial Markets in the Republic of Macedonia

Generally speaking, the overall economic conditions adequately affected the movements on the financial markets. The economic environment in which the financial markets in the Republic of Macedonia operated in 2002 was characterized with: a. continuation of the privatization process taking into account the gradual normalization of the economy after the political and the security crisis in the preceding year; b. the relatively high liquidity of the banking system; c. unfavorable movements in the foreign trade of the Republic of Macedonia and d. changes in the regulation (adoption of the new Law on Foreign Exchange Operations, amendments to the Law on Securities). Also, the parliamentary elections in 2002 affected the dynamics on the financial markets through the higher budget spending and the higher demand for foreign exchange, due to the uncertainty of the election outcome and the future macroeconomic policy. In such environment, excluding the Stock Exchange, the other financial markets (the Money Market and the foreign exchange market) in the Republic of Macedonia registered higher turnover in 2002.

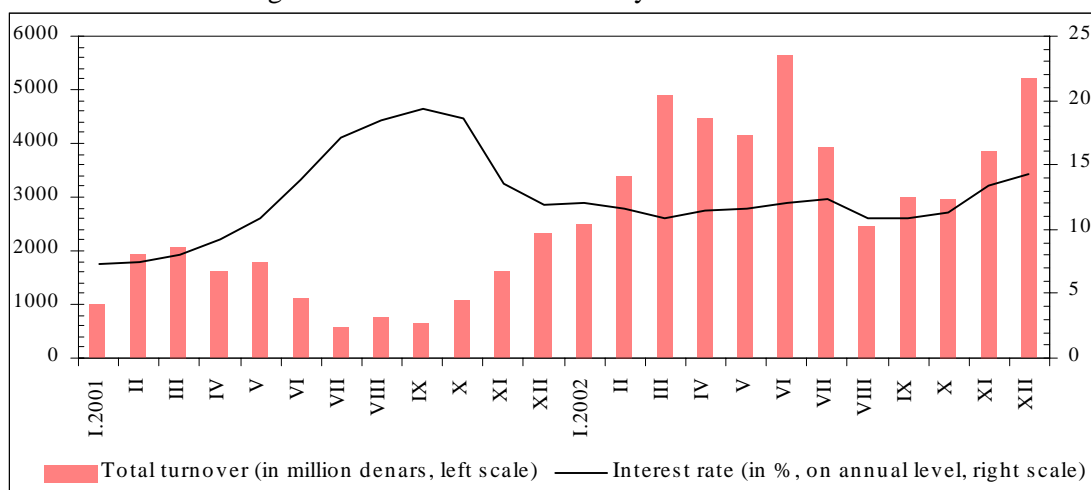
6.1. Money and short-term securities market

In 2002, the Money and short-term securities market registered exceptionally high activity. It was due to the: a. high level of total liquidity of the banking system; b. unequal dispersion of the liquidity within the banking system; c. changes in the monetary instruments (the possibility of purchasing CB bills with shorter maturity was abandoned, resulting in a more frequent presence of the banks on the Money Market for the purpose of meeting the short-term liquidity needs) and, d. gradual normalization of the situation after the security crisis in the previous year. In such environment, the total supply, demand and turnover on the Money Market registered exceptionally high values – the highest since its establishment, whereas the interest rate on the Money Market remained at a relatively high level in 2002.

In 2002, the total supply of liquid funds on the Money Market registered considerable increase of 2.9 times. Simultaneously, significant increase of 2.4 times was registered in the demand for liquid funds. In such environment, the total turnover on the Money Market increased by 2.8 times. It should be considered that the exceptionally high acceleration of the activity on the Money Market in 2002 was partially due to the relatively low comparison base in 2001, when, in an environment of significant oscillations in the liquidity of the banks caused by the deteriorated security, the activity on the Money Market slowed down. Thus, in 2002, the total demand for liquid funds was higher relative to the supply by 2.3%, with 12.0% of the total demand on the Money Market not being met. On the other hand, due to the limits set by the banks – suppliers in order to disperse the risk, 9.9% of the total funds available on this market remained unused. Proof for the exceptionally high activity on the Money Market is the average daily turnover on this market in 2002 (Denar 185.8 million), which is by 2.8 times higher compared to 2001, in larger number of working days in 2002.

Chart 26

Total turnover and weighted interest rate on the Money Market



With respect to dynamics, in 2002, the supply, the demand and the turnover on the Money Market registered exceptionally high monthly amounts. An interesting feature is that, in 2002, the supply, the demand and the turnover act towards the same directions, however, in different intensity of the change. The tendency of their increase in the last quarter of 2001 continued in the first quarter of 2002 (almost identical twofold increase in the supply, the demand and the turnover), corresponding with the stabilization of the political and security situation. In the following months, the activity on the Money Market oscillated in accordance with the dynamics of the liquidity of the banking sector, with the supply, the demand and the turnover registering relatively high amounts. The highest monthly amounts of demand for liquid funds (Denar 6,126.8 million) and supplied liquid funds (Denar 5,646.1 million) on the Money Market were registered in June 2002. Additionally, they are the highest amounts of supply and demand on the Money Market since its establishment.

In 2002 (excluding May and the third quarter) the demand for liquid funds was higher relative to the supply, with the discrepancy being the highest in October (21.3%) and November (24.0%). Consequently, in 2002, the interest rate on the Money Market was maintained at a relatively high level (11.9%, on average), with a tendency of more considerable increase in the last quarter of the year (in December, the average weighted interest rate reached the highest level of 14.4%). On the other hand, its most substantial excess supply over the demand for liquid funds on the Money Market was registered in August (21.7%), which adequately affected the movements of the interest rate, thus reducing it to 10.8%.

6.2. Foreign exchange and exchange offices market

Trading with foreign exchange in the Republic of Macedonia is carried out on the foreign exchange and the exchange offices market. Participants in the foreign exchange market in the Republic of Macedonia are: the National Bank of the Republic of Macedonia, authorized banks and domestic legal entities, while the individuals and the exchange offices participate in the exchange offices market.

In 2002, the movements on the foreign exchange market in the Republic of Macedonia were determined by the unfavorable movements in the foreign trade, the persistent implementation of the accepted monetary concept of targeting the exchange rate of the Denar against the Euro and the application of the new Law on Foreign Exchange Operations. The unfavorable movements in the foreign trade (higher imports, and lower exports) caused

excess demand over supply of foreign exchange in the largest part of the year, and consequently, continuous pressure for depreciation of the Denar against the Euro. In order to meet the excess demand for foreign exchange and maintain the exchange rate of the Denar against the Euro at a stable level, the NBRM intervened on the foreign exchange market with a net sale of foreign exchange (excluding January, February and June). According to the new Law on Foreign Exchange Operations (in force since October 15, 2002) the payment operations were transferred to the banks by abolishing the possibility for independent trade in foreign exchange between enterprises. Consequently, the turnover on the foreign exchange market increased on permanent basis. Additional factor that affected the movements on the foreign exchange market in 2002 was the level of liquidity in the banking system, the changes of which caused adequate conversions between the Denar and the foreign exchange liquidity and consequently, oscillations in both the supply and the demand for foreign exchange on the foreign exchange market.

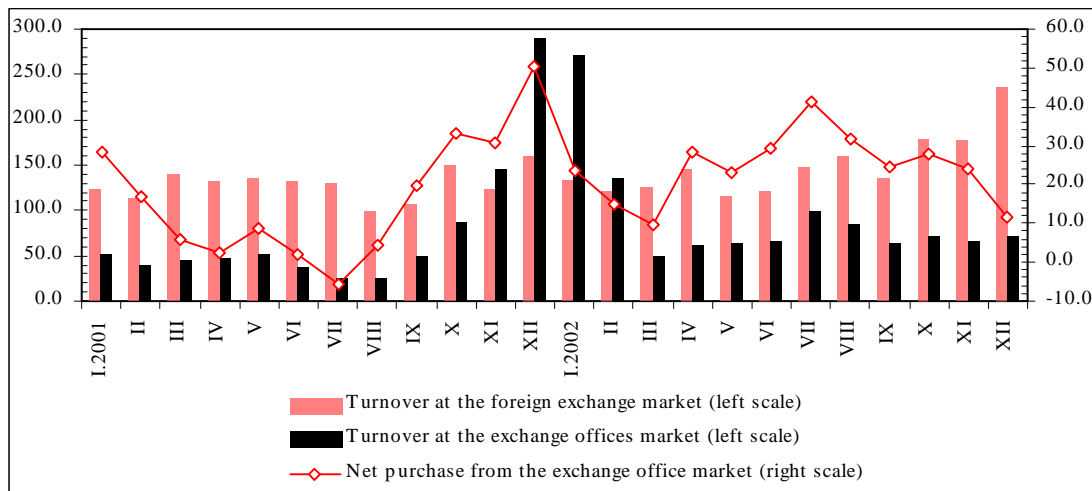
In 2002, the total turnover on the foreign exchange market equaled US Dollar 1,798.8 million, which is by US Dollar 257.9 million, or by 16.7% higher compared to the previous year. At the same time, it is the highest annual amount of turnover on the foreign exchange market since its institutionalization. With respect to the dynamics, in the first half of 2002 relatively lower turnover was registered (the turnover on the foreign exchange market in this period was by US Dollar 8.2 million lower compared to the first half of 2001). It was primarily due to the considerably lower supply of foreign exchange by the enterprises due to the lower export demand for the Macedonian products on the international markets. In the second half of 2002, the turnover on the foreign exchange market substantially increased, with more significant intensity being registered in the last quarter of the year (32.9% of the total turnover on the foreign exchange market in 2002 was carried out in the last quarter). The relatively high turnover in this period was due to the: a. favorable influence of the new Law on Foreign Exchange Operations on the liquidity on the foreign exchange market; b. increased NBRM interventions on the foreign exchange market in order to meet the higher demand for foreign assets, and c. increased need of the banks for Denar liquidity, which was partially met with the conversion of their foreign exchange potential.

In 2002, the increase in the total turnover on the foreign exchange market was primarily due to the increased turnover in the transactions between banks and enterprises (of US Dollar 184.7 million, or by 20.1%), with the sale of foreign assets by the banks registering more considerable increase. Apart from the banks that mostly met the demand for foreign exchange on the foreign exchange market, the NBRM transactions were also essential for balancing the supply and the demand on the foreign exchange market in 2002 (in 2002, the turnover between the NBRM and the other participants on the foreign exchange market increased by US Dollar 47.1 million, or by 13.4%). In 2002, an increment was registered in the turnover in the transactions between the banks (by 34.9%) and between the enterprises (by 6.1%) by the time of the enforcement of the new Law on Foreign Exchange Operations.

In line with such movements, in 2002, the largest portion of the turnover on the foreign exchange market was carried out in the transactions between the banks and the enterprises (61.3%). Out of the total turnover in 2002, 22.2% was carried out in the transactions between the NBRM and the other participants on the foreign exchange market, and 14.0% in the transactions between the enterprises.

Chart 27

Movements of the total turnover on the foreign exchange and the exchange offices markets
(in US Dollar million)



In 2002, the total turnover on the exchange offices market equaled US Dollar 1,103.3 million, which is by US Dollar 209.7 million, or by 23.5% lower compared to the previous year. Thus, US Dollar 696.7 million were purchased from the individuals (supply of foreign exchange), which is by US Dollar 151.3 million more compared to 2001. The amount of foreign exchange sold to individuals (demand for foreign exchange) registered more moderate increase of US Dollar 58.4 million, reaching US Dollar 406.6 million. Such movements of the supply and the demand for foreign assets resulted in net purchase of foreign exchange by the exchange offices market in the amount of US Dollar 290.0 million (by US Dollar 92.8 million more compared to the previous year).

With respect to dynamics, the exceptionally high turnover on the exchange offices market at the end of 2001, caused by the preferences of the economic agents for cash conversion of the foreign exchange savings (primarily in Deutsche Marks) prior to the actual introduction of the Euro, continued in the first two months of 2002. Out of the total turnover on the exchange offices market in 2002, 37% was carried out in this period, due to the possibility for the economic entities to convert their savings in the currencies of the 12 EMU member states into other currencies in the first two months of 2002. After the expiry of the period of cash conversion, the turnover on the exchange offices market normalized in March, while in the second quarter of 2002, its level was characterized with relative stability (average monthly turnover of US Dollar 63.7 million). In the third quarter, the turnover on the exchange offices market was maintained at a relatively high level, caused by the relatively higher level of supply (influenced by seasonal factors) and the demand for foreign exchange (given the relatively high amount of currency in circulation). In the last quarter of 2002, given the normalization of the supply of foreign exchange and the inconsiderable change in the demand for foreign exchange, the turnover on the exchange offices market dropped by US Dollar 35.0 million, compared to the previous quarter.

6.3. Stock exchange

The operation of the Macedonian Stock Exchange in 2002 was influenced by the continuation of the privatization process and the consolidation of the ownership in the Macedonian economy. The Stock Exchange operations in 2002 were characterized with: a. considerably lower turnover; b. larger number of traded securities; c. larger number of executed transactions; d. purchase of large packages of shares and firms through the Stock Exchange, and e. oscillation of the value of the Stock Exchange Index around its initial value.

Table 13

Review of the trade on the Macedonian Stock Exchange in 2002

	Realized turnover (in Denar million)	Number of traded securities	Number of traded Government securities and convertible certificates	Number of transactions	Number of transactions with Government bonds	Days of trading
I-XII.2001	28,800.1	17,397,290	22,341,684	3,527	6,715	136
January	410.9	229,063	2,906,982	280	872	14
February	224.3	169,512	1,068,481	358	837	16
March	219.0	643,722	970,939	416	570	16
April	428.2	538,205	1,130,100	446	722	18
May	418.7	655,948	997,636	415	493	15
June	272.5	1,370,108	2,175,710	515	808	16
July	523.6	997,580	72,942,737	456	427	19
August	671.6	742,131	133,001,495	325	552	16
September	1,050.3	4,391,780	353,886,974	523	927	16
October	417.4	2,203,650	113,704,485	830	793	19
November	317.7	195,368	1,824,354	512	496	16
December	789.2	439,775	5,043,293	643	528	18
I-XII. 2002	5,743.4	12,576,842	689,653,186	5,719	8,025	199

In 2002, compared to the preceding year, the total and the average daily turnover on the Macedonian Stock Exchange registered considerable decrease of 5.0 times and 7.3 times, respectively. The relatively significant fall in the average daily Stock Exchange turnover was due to the larger number of trading days in 2002 (199) compared to 2001 (136), as a result of the electronic trading introduced in April 2002. On the other hand, the number of traded securities and executed transactions on the Stock Exchange in 2002 registered considerable increase, primarily due to the quotation of new government securities.

The substantial fall in the Stock Exchange turnover in 2002, in spite of the unfavorable movements on the Stock Exchange, was due to the exceptionally high comparison base, caused by the execution of the largest Stock Exchange transaction – the sale of the Telecom to a foreign strategic investor (January 2001). However, even if this Stock Exchange transaction is excluded, in 2002 relative to the preceding year, the Stock Exchange turnover is lower by 27.7%³⁴. These comparisons reflect the still inadequate Stock Exchange positioning within the framework of the financial system of the Republic of Macedonia.

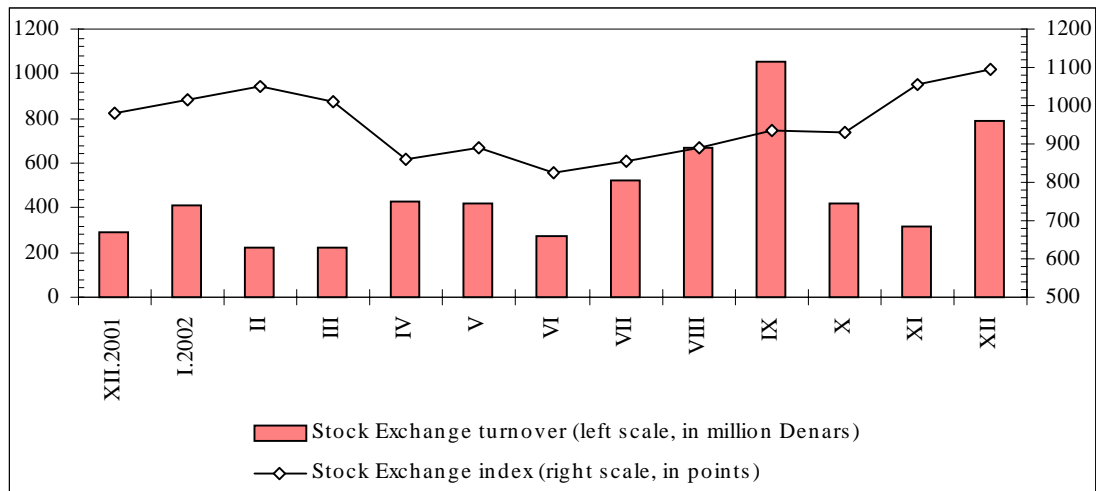
With respect to the dynamics, after the relatively low Stock Exchange turnover in the first two quarters of 2002, in the third quarter the Stock Exchange turnover registered considerable increase, in which the largest portion, or 39.1% of the turnover in 2002 was carried out. The relatively high Stock Exchange turnover in this period was due to: a. the commenced trading in the new government denationalization bonds and the convertible certificates³⁵, and the commenced listing of the government bond for the purchased claims from the privatization of Stopanska Banka a.d. Skopje. At the beginning of their listing on the Stock Exchange, the turnover of these securities registered considerable increase; b. the sale of the residual shares owned by the government intensified, with a possibility to be purchased also with government securities. Starting from June 2002, the packages of residual shares owned by the government, besides with cash payment, might be purchased with the government bonds and the convertible certificates. In 2002, the highest monthly Stock Exchange turnover was registered in September, when the turnover with the convertible certificates registered the significant increase.

³⁴ If the executed block transactions are excluded (Stock Exchange transactions in which at least 10% of the value of the enterprise (basic capital) are traded, or the turnover of which exceeds Denar 5,000,000) the drop in the Stock Exchange turnover in 2002 equals 12.6%.

³⁵ Convertible certificates are securities issued by the Government for regulating the claims of the savers in the savings houses "TAT", "Alfa S" and "Lavci". They can be used only for purchasing or payment of shares, or other property handled by the Privatization Agency of the Republic of Macedonia. Their validity is restricted to 2 years, or by July 9, 2004, after which they cease to be valid.

In the last quarter of 2002, the Stock Exchange turnover registered lower values, primarily due to the significantly lower turnover with the government convertible certificates and the considerably lower sale of government residual shares (in November, only one package was sold, whereas in December, no package of residual shares owned by the government was sold). It should be underlined that larger number of companies are listed on the Official Stock Exchange, in accordance with the amendments to the Law on Securities (May 2002), stipulating compulsory listing (by the end of November 2002) of all companies that meet the criteria to be listed on the Stock Exchange (the nominal value of the capital, the number of shareholders, dispersion of the shares in the public). In spite of the listing of the shares of one firm, the shares of another firm started to be traded in November, while in December, the shares of other 45 joint-stock companies started to be traded.

Chart 28
Stock Exchange turnover and value of the Stock Exchange Index



At the end of 2002, the Stock Exchange Index (MBI), which reflects the total developments on the Stock Exchange, equaled 1,094.7 points, the value of which is by 94.7 points, or by 9.5% higher relative to its initial value (the Stock Exchange Index was introduced in November 2001, and its initial value equaled 1,000 points). Simultaneously, it is the highest value of the Stock Exchange Index since its introduction. With respect to dynamics, in the first three months of 2002, the value of the Stock Exchange Index was continuously maintained over its initial value, whereas in the second quarter it registered lower value, permanently remaining under its initial value. In June, the Stock Exchange Index reduced to 823.3 points – the lowest value since its introduction. In the third quarter, the Stock Exchange Index registered continuous increase, which corresponds with the substantial increase in the Stock Exchange turnover in this period. In the last quarter of 2002, in spite of the decrease in the Stock Exchange turnover, the Stock Exchange Index registered significant increase (by 17.0%), with the increase being solely registered in the last two months of the year.

In 2002, trading activity was registered on all segments of the Stock Exchange, with the Unofficial Market being the most active one, carrying out 58.1% of the total Stock Exchange turnover in 2002. Out of the total Stock Exchange turnover in 2002, 14.8% was registered on the Official Stock Exchange, at which the securities (shares and bonds, among which the government bonds for old foreign exchange savings) listed on the Stock Exchange were traded. The remaining portion of the turnover in 2002 was carried out on the separate segment for trading in securities owned by the government (21.8%) and on the segment for trading in other government securities – convertible certificates (5.3%). The listing of the securities of larger number of companies creates prerequisites for change in the structure

aimed at better positioning on the Official Stock Exchange trading in the structure of the Stock Exchange turnover. It should lead to more appropriate position of the Stock Exchange in the structure of the financial system in the Republic of Macedonia.

VII. External Sector

With the situation in the economy being normalized after the deteriorated security in 2001, in 2002 a relative stabilization of the economic activity and an improvement in the performances of the external sector were expected. However, the consequences from the last year security crisis were still present in the Macedonian economy in 2002, reflecting unfavorably on the movements in the external sector, as well. Namely, in 2002, high deficit in the current account of the balance of payments was registered (the second highest deficit since the independence of the Republic of Macedonia, after that recorded in 1996), mainly caused by the deteriorated deficit in the foreign trade. However, the inflows based on transfers from abroad, as well as the consistent foreign exchange policy shown through the preserved stability of the Denar exchange rate relative to the Euro, and the satisfactory level of covering the import with the foreign exchange reserves, with the liabilities to foreign creditors being regularly serviced, partially mitigated the unfavorable effects caused by the security crisis experienced in the previous year.

7.1. Balance of payments³⁶

In 2002, the deficit registered in the current account of the balance of payments in the Republic of Macedonia equaled US Dollar 324 million, which is an increase of US Dollar 89 million, or by 37.8% compared to 2001. The deficit registered in the current account equaled 8.8% of the GDP³⁷, which is an increase of 1.9 percentage points compared to the previous year. The analysis of the dynamics by quarters points to a continuing deficit, which mainly originates from the deteriorated performances of the foreign trade. Thus, in accordance with the movements in the trade, the highest deficit in the current account was registered in the fourth quarter of 2002, in the amount of US Dollar 124 million, or 38.3% of the total deficit.

In 2002, the deficit in the trade account³⁸ increased, reaching US Dollar 768 million, which is by US Dollar 244 million, or by 46.7% more compared to the previous year. Despite the registered increase in 2002, the foreign trade was characterized by an unfavorable structural character presented through the decreased export and increased import of goods, mainly as a result of the prolonged effects of the last year crisis. Namely, the decreased exports demand, the loss of a part of the markets and unrenewed contracts with the foreign partners, led to a constantly high deficit. This situation was most evident in the fourth quarter of 2002, when it was additionally intensified by the excessive import of used cars, due to which the deficit in the trade account reached its peak on quarterly basis, equaling US Dollar 246 million (32.0% of the total trade deficit).

³⁶ Preliminary data.

³⁷ The amount of the GDP for 2002 is estimated data of the State Statistical Office of the Republic of Macedonia.

³⁸ The deficit in the trade account of the balance of payments differs from the deficit in the foreign trade presented according to the official data, because the imports in the balance of payments are presented on f.o.b. basis, while the official statistics presents the imports on c.i.f. basis.

Table 14
Balance of payments of the Republic of Macedonia
(in US Dollar million)

	2001 ¹					2002 ¹				
	Q1	Q2	Q3	Q4	2001	Q1	Q2	Q3	Q4	2002
1. Current account	-32	-109	-67	-27	-235	-104	-59	-37	-124	-324
1.1. Goods, net	95	-144	-93	-191	-523	-181	-177	-163	-246	-768
Exports, f.o.b.	291	285	295	282	1,153	243	263	305	300	1,110
Imports, f.o.b. ²	-386	-429	-389	-473	-1,677	-424	-440	-468	-546	-1,878
1.2. Services, net	-3	-9	-5	2	-16	-7	-5	-7	-6	-25
1.3. Income, net	-17	-3	-18	-2	-39	-18	-4	-11	2	-31
1.4. Current transfers, net	83	47	49	164	343	101	126	144	127	498
Official	6	10	11	21	49	47	21	14	18	100
Other	76	37	38	143	294	54	105	130	108	398
2. Capital and financial account	19	83	56	20	178	118	76	22	139	354
2.1. Capital account, net	0	0	0	1	1	1	3	2	2	8
Capital transfers, net	0	0	0	4	4	1	3	2	3	10
Official	0	0	0	4	4	3	3	2	3	10
Other	0	0	0	0	0	0	0	0	0	0
Acquisition/disposal of nonprod., nonfinan. assets	0	0	0	-2	-2	-1	0	0	0	-2
2.2. Financial account, net	19	83	56	19	177	117	73	20	136	346
Direct investments, net	372	13	18	40	442	5	16	45	12	77
Portfolio investments, net	0	0	0	0	0	0	0	0	0	1
Other investments, net	-100	-34	-59	4	-189	125	35	-66	44	137
Trade credits, net	-65	-56	-50	46	-125	8	22	-28	64	66
Loans, net	-31	-10	-35	-32	-107	9	-17	12	-31	-26
Foreign currency and f.c. deposits, net ³	-11	29	19	-15	22	100	24	-56	1	69
o/w: Monetary authority, net	3	2	-2	-86	-83	71	-11	1	7	69
Commercial banks, net	8	47	4	-331	-272	161	40	-48	-16	137
Households, net ⁴	-23	-19	17	402	377	-132	-5	-9	10	-136
Other, nets	7	3	8	5	22	7	5	6	10	28
Gross official reserve ⁵	-253	104	97	-25	-77	-13	22	41	81	131
3. Errors and omissions	14	26	11	7	57	-14	-16	15	-15	-29

1/ Preliminary data.

2/ The import is presented on f.o.b. basis in accordance with the V edition of the IMF's Manual for balance of payments. The estimation of the c.i.f - f.o.b. factor as a percentage of the c.i.f. imports in 2001 and 2002 equals 4.20%.

3/ The increase in the assets is denoted with a negative sign.

4/ In 2001 - decrease in the households' foreign assets outside the banking system and their depositing on the banks' accounts due to the conversion into Euro, and in 2002 - withdrawal of the converted foreign assets from the banking system.

5/ Without monetary gold and exchange rate differentials; assets in the amount of US Dollar 23.89 million, originating from the succession of the former SFRY, are not encompassed by the changes of the official reserves for the second quarter of 2001, since they are not a balance of payments transaction.

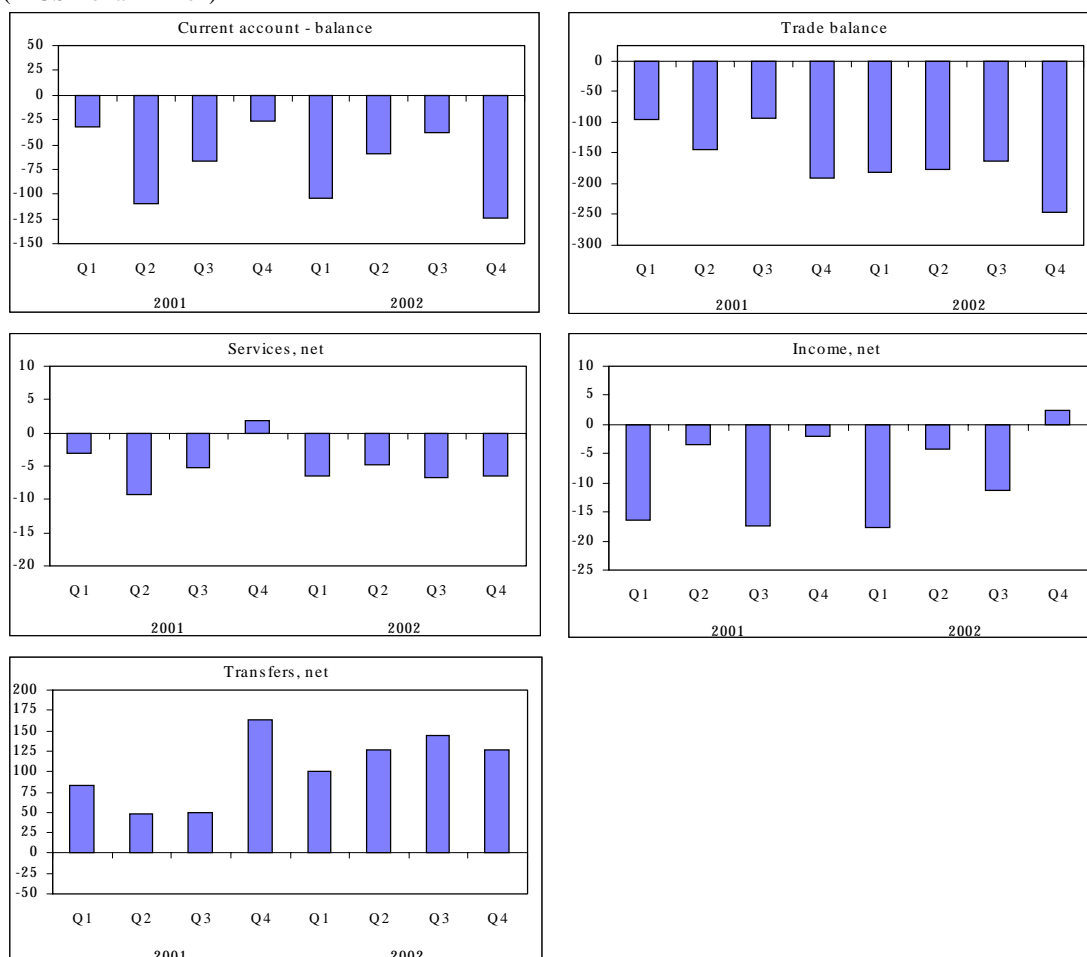
In 2002, the upward trend of the deficit in the item "services, net" continued and reached US Dollar 25 million, which is by US Dollar 9 million, or by 56.0% more compared to the previous year. Despite the annual increase in the inflows, which reached US Dollar 253 million, the main generator of the registered deficit were the increased outflows for serviced external liabilities for services on annual basis, which reached US Dollar 278 million. The annual analysis of the separate categories of services indicates that an annual increase was registered only in tourism services on net basis (by US Dollar 8 million, compared to 2001), while negative changes were registered in transportation services, net and in the other services, net, in the amount of US Dollar 7 million and US Dollar 10 million, respectively.

In 2002, the deficit registered in the item "income, net" equaled US Dollar 31 million, which is a decrease of US Dollar 9 million, or by 22.4% compared to 2001. The decrease in the deficit is a result of the increased inflow of funds based on wages paid to employees, in the amount of US Dollar 13 million, which is by US Dollar 8 million more in comparison with the previous year. In 2002, an outflow of US Dollar 20 million based on net paid interest was registered, contrary to US Dollar 34 million in 2001. The uncertainty and the political and security situation in the region conditioned higher outflow of funds based on profit of foreign investors, which annually increased by US Dollar 13 million and equaled US Dollar 23 million.

Analyzed by transfers, in 2002, a net inflow of US Dollar 498 million on the current account of the balance of payments was registered, which is an increase of US Dollar 155 million, or 45.3% compared to the previous year. The significant increase in the current transfers is due to the increased official and private transfers. Namely, the official transfers reached the amount of US Dollar 100 million, which is an increase of US Dollar 52 million compared to 2001, primarily due to the withdrawn funds from the Donor Conference for the Republic of Macedonia held in March 2002. Significant increase was also recorded in the private transfers (by US Dollar 104 million more relative to 2001), which in 2002 reached the amount of US Dollar 398 million.

Chart 29

Current account of the balance of payments and its components
(in US Dollar million)



In 2002, net inflow of funds in the amount of US Dollar 354 million was registered in the category of capital and financial transactions, representing an increase of US Dollar 176 million compared to 2001. However, the net inflow of funds registered in the capital transactions reached US Dollar 8 million, which is due to the unilateral transfer of funds from the European Union for the purpose of restoring the electricity supply network. Simultaneously, the net financial transactions amounted to US Dollar 346 million (contrary to US Dollar 177 million in 2001), as a result of the net inflows originating from the foreign direct investments and the item "other investments, net".

In 2002, the net direct investments in the Republic of Macedonia equaled US Dollar 77 million, which is a decrease of more than five times in comparison with the previous year,

totally due to the high comparison base registered in the previous year, when the highest level of foreign direct investments since the independence of the Republic of Macedonia was registered (the sale of the Telecom). However, the largest part of the foreign direct investments in 2001 was allocated in the banking sector, which together with the newly invested capital in the insurance companies and other financial holding companies, attracted US Dollar 24 million. The aforementioned investments are followed by the investments in the oil industry (US Dollar 12 million), and the telecommunication services (US Dollar 9 million).

In 2002, the surplus registered in the item "other investments, net" reached US Dollar 137 million, contrary to the deficit in the amount of US Dollar 189 million recorded in 2001. The surplus registered in this category is due to the high amount of trade credits extended for the purpose of import of goods, causing a significant annual increase (of US Dollar 191 million) in the category of net trade credits. On the other hand, a net outflow of funds in the amount of US Dollar 26 million was registered in the item "loans, net" (a significant decrease of US Dollar 81 million, or by 75.5% compared to 2001), mainly as a reflection of several withdrawn credits with the of the liabilities being regularly serviced. In 2002, an outflow of foreign assets in the amount of US Dollar 69 million was registered in the item "currencies and deposits, net", representing an increase of US Dollar 48 million compared to 2001.

In 2002, the gross foreign exchange reserves³⁹ decreased by US Dollar 131 million, while the item "errors and omissions" had a negative sign and amounted to US Dollar 29 million, which points to the further inability to provide a complete identification of the inflows from non-residents.

7.2. Foreign trade

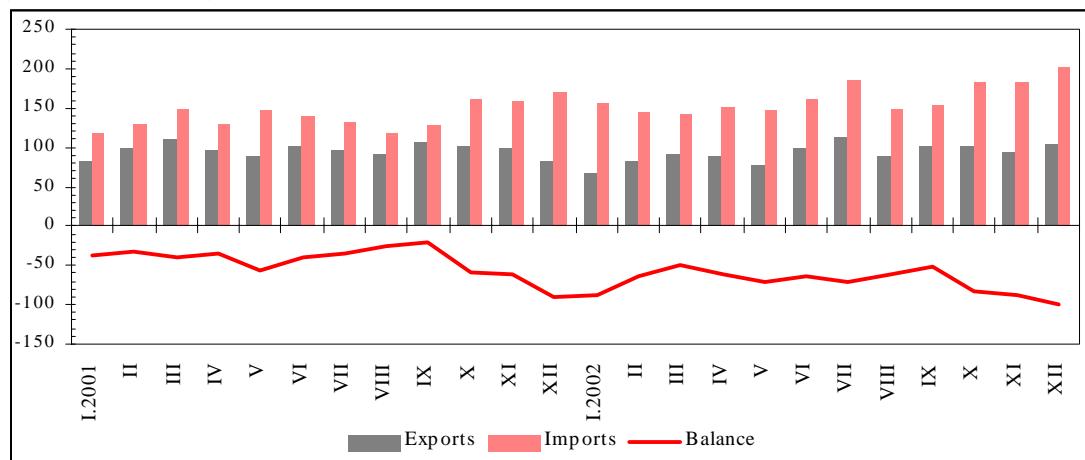
The consequences from the security crisis in 2001 reflected unfavorably on the economic activity during 2002, inevitably producing negative effects on the foreign trade.

Namely, the foreign trade of the Republic of Macedonia in 2002 was characterized by a slow recovery after the last year crisis and the political and economic stabilization. Thus, during the first six months of 2002, despite the low comparison base, the foreign trade increased by only 1.1% compared to the same period of the previous year, with unfavorable structural movement, i.e. increase in the imports of 10.4% and decrease in the exports of 12.1% being registered. In the second half of the year, a slight consolidation of such a trend was recorded, with positive growth rates in the exports during the last two quarters being registered (an annual increase of 2.7% and 6.1%, respectively). In accordance with such developments, the Macedonian economy in 2002 registered an increase in the foreign trade of 7.8%, with an increase in the imports of 15.9% and a decrease in the exports of 3.9% being registered, compared to the previous year.

The dynamics in the imports and exports proves that the economic agents have not completely regained the markets lost during the last year crisis, yet, (especially in the trade with Serbia and Montenegro, and Germany, with which it turned from a net exporter to a net importer).

³⁹ The data on the gross foreign exchange reserves presented in the balance of payments differs from the data on the gross foreign exchange reserves according to the official data, since the balance of payments statistics excludes the exchange rate differentials and the monetary gold.

Chart 30
Foreign trade of the Republic of Macedonia
(in US Dollar million)



In 2002, the total export of the Macedonian products to foreign markets equaled US Dollar 1,113 million, which is by US Dollar 45 million (3.9%) less compared to the previous year. Analyzed by products, the export of iron and steel, comprising 15.2% of the total export, registered a significant decrease of 20.4%. Among other export items of higher importance, the most significant decrease of 42.4% was registered in the export of oil derivatives (mainly intended for the Kosovo market) and the export of zinc of 21.4% (mainly due to the unstable and decreasing price on the stock exchanges). The main reason for such a negative movement is the insufficient use of the production capacity (the production of the basic metals decreased by 18.6%, while the production of oil derivatives in 2002 represents 68.1% of the production registered in the previous year). Among the larger exports categories, only the category "clothes and textile" (the share of which in the total exports in 2002 is 30.8%) registered an increase of 3.9% compared to the previous year.

In 2002, the total imports of the Republic of Macedonia increased by US Dollar 269 million (15.9%) relative to the previous year, thus reaching the amount of US Dollar 1,962 million. The tendency of increase was recorded in all larger import product categories. Simultaneously, the import of vehicles is by two times higher compared to that registered in the previous year, due to the change in the legal framework in February 2002, which allows import of vehicles not older than 10 years. On the other hand, the import of finishings registered a decrease of 2.2%, reducing approximately to 19.2% of the total import (by 3.5 percentage points less compared to the previous year). The import of goods for further processing plays a significant role for the dynamization of the exports, regarding the fact that the export of goods after further processing participates with 47.3% in the total exports. However, the reduced import of goods for further processing is caused by the significant decline in the import of iron and steel for further processing (30.9%), structurally participating with 15.6% in the import of finishings, which points to an unfavorable circumstances in the Macedonian steel industry.

The movements in the exports and the imports in 2002, resulted in a foreign trade deficit of the Republic of Macedonia in the amount of US Dollar 849 million (the highest trade deficit since 1993 until present days). It is, however, an increase of US Dollar 313, or of 58.4% relative to the trade deficit registered in 2001. Consequently, in 2002 the import-export coverage ratio decreased by 11.6 percentage points, and equaled 56.7%.

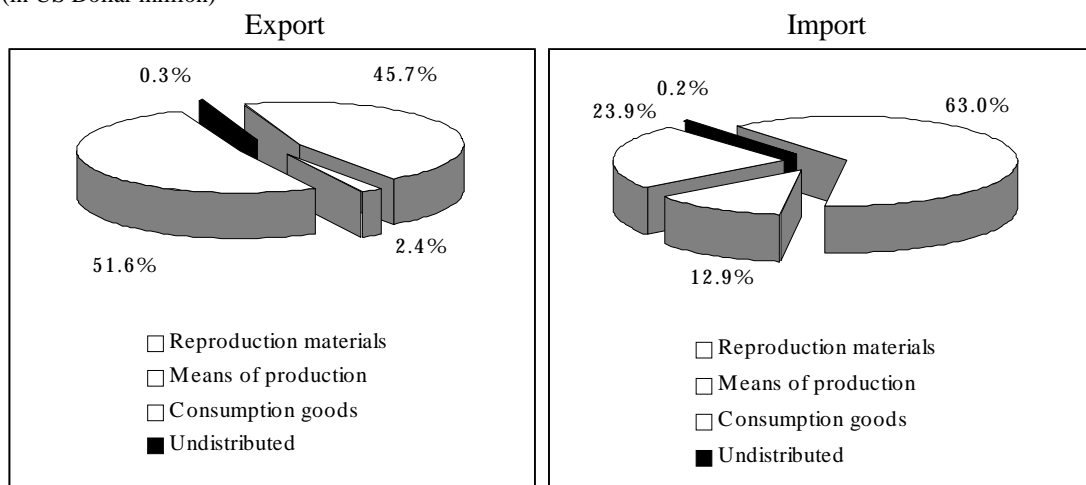
In 2002, observed from the aspect of the economic use of the products, the dominant share in the exports accounts for the consumption goods (51.6% of the total exports), the structural share of which increased by 3.7 percentage points, causing the reproduction

products (with their share of 45.8%) lose their dominance on the export side registered in the previous year, thus representing a positive structural movement toward an export of goods with a higher degree of finalization.

The analysis of the import side indicates that in 2002 the largest share in the imports accounts for the reproduction materials (63.0% of the total import), which is a decrease of 3.4 percentage points compared to the previous year. On the other hand, the share of the consumption goods in the total import increased by 2.9 percentage points, comprising 23.9% of the total imports of the Republic of Macedonia.

Chart 31

Structure of the foreign trade of the Republic of Macedonia in 2002 analyzed by the economic use of the products
(in US Dollar million)



The analysis of the orientation of the foreign trade of the Republic of Macedonia toward separate groups of countries, points to the dominance of the European Union group of countries. Namely, in 2002 the European Union increased its structural share in the total exports of the Republic of Macedonia by 1.9 percentage points and reached 50.8%. Simultaneously, the exports to the countries of Central and Eastern Europe increased by 0.5 percentage points, with their share in the total export being equal to 5.3%. On the other hand, in 2002 the share of the placement of the Macedonian products in the former republics of SFRY in the total exports of the Republic of Macedonia decreased by 0.3 percentage points, reducing to 31.0%. Simultaneously, a decrease was registered also in the export to other developed countries out of the European Union (of 1.5 percentage points), the share of which in the total exports equaled 8.5%.

Table 15

Foreign trade of the Republic of Macedonia with economic groups of countries

(in US Dollar million)

<i>Economic groups of countries</i>	Exports	Structure	Imports	Structure	Foreign trade	Structure
	I - XII.2002					
Republic of Macedonia (total)	1,113	100.0	1,962	100.0	3,075	100.0
1. Developed countries	690	62.0	1,082	55.1	1,771	57.6
out of which:						
EU	565	50.8	888	45.3	1,453	47.3
EFTA	30	2.7	30	1.5	60	2.0
Other developed countries	94	8.5	163	8.3	257	8.4
2. Countries of Central and Eastern Europe and former USSR	59	5.3	382	19.5	441	14.3
3. Undeveloped countries	2	0.1	3	0.1	4	0.1
4. Developing countries	17	1.5	113	5.8	130	4.2
5. Republics of the former SFRY	345	31.0	383	19.5	728	23.7
6. Other countries	0	0.0	0	0.0	0	0.0

The analysis of the structure of the imports relative to separate groups of countries points to an increased share of the European Union (by 2.8 percentage points), which reached 45.3% of the total imports. The imports from the Central and Eastern European countries registered a structural decline of 3.8 percentage points, reducing the share in the total import to 19.5%. This is mainly due to the insufficient use of the production capacities of the iron and steel industry in the Republic of Macedonia, which depends on the import of raw materials from these countries. On the other hand, the imports from the former republics of SFRY comprise 19.5% of the total import in 2002, which means almost the same structural share comparing to the previous year, i.e. increase of 0.2 percentage points.

In 2002, the most significant trading partner of the Republic of Macedonia in the trade with separate countries is Germany, with which goods in the total amount of US Dollar 514 million were traded, which is an increase of 13.3% compared to the previous year. Thus, the share of Germany in the total foreign trade of the Republic of Macedonia increased by 0.8 percentage points and equaled 16.7%, mainly due to the increase in the imports (30.6%) and decrease in the exports to this country (2.3%). In the foreign trade of the Republic of Macedonia with its second most important trading partner - Serbia and Montenegro, in 2002 a reduced export of 7.9% and increased import of 16.7% was registered. However, foreign trade in the amount of US Dollar 430 million was registered, which is an increase of 1.2% compared to 2001, while the share of this country in the total foreign trade of the Republic of Macedonia decreased by 0.9 percentage points, and reduced to 14.0%. In 2002, the foreign trade of the Republic of Macedonia with Greece amounted to US Dollar 353 million, which is an increase of 23.5% compared to the previous year, while its share in the total trade increased by 1.5 percentage points, and reached 11.5% (mainly due to the increased share of imports by 1.2 percentage points).

Table 16

Ten most important trading partners of the Republic of Macedonia

	Foreign trade (in US Dollar million)	Share	Exports (in US Dollar million)	Share	Imports (in US Dollar million)	Share	Import - export coverage ratio
I-XII.2002							
Republic of Macedonia	3,075	100.0	1,113	100.0	1,962	100.0	56.7
<i>out of which:</i>							
Germany	514	16.7	233	21.0	281	14.3	83.1
Serbia and Montenegro	430	14.0	246	22.1	184	9.4	133.4
Greece	353	11.5	116	10.4	237	12.1	49.0
Italy	196	6.4	79	7.1	118	6.0	66.5
Slovenia	151	4.9	22	1.9	129	6.6	16.7
Bulgaria	150	4.9	22	2.0	128	6.5	16.9
USA	135	4.4	77	7.0	58	3.0	133.5
Russia	117	3.8	14	1.3	103	5.2	14.0
Croatia	114	3.7	59	5.3	55	2.8	107.5
Netherlands	96	3.1	45	4.0	51	2.6	86.8
Total (10 largest trading partners)	2,258	73.4	913	82.0	1,345	68.5	67.9

When analyzing the foreign trade with the ten most important trading partners, in 2002 the Republic of Macedonia registered positive trade balance with: Serbia and Montenegro, the USA and Croatia. The highest individual surplus in the amount of US Dollar 62 million was registered in the foreign trade with Serbia and Montenegro, while the largest deficit was recorded in the trade with Greece, which equaled US Dollar 121 million. Until the end of 2002, the Republic of Macedonia concluded Free Trade Agreements with all countries in the region. However, regarding the trade with Bulgaria, Slovenia and Turkey, significantly higher import compared to export was registered, with the trade deficit with these countries in the January - December 2002 period reaching US Dollar 265 million (31.2% of the total deficit). In 2002, compared to the previous month, the trade with Croatia registered an increase of 8.7%, with the Macedonian export - import coverage ratio being equal to 107.5%.

The admission of the Republic of Macedonia to the World Trade Organization - WTO (October 2002), and the practical implementation of the provisions originating from the official admission in April 2003, as well as the changes in the regulation for the foreign exchange operations (the new Law on Foreign Exchange Operations became effective in mid-October 2002), shall act towards an additional liberalization of the trade regime of the Republic of Macedonia. The admission to the WTO provides more stable and more transparent foreign trade policy, with positive implications for the process of the regional integration of the country. However, the evaluation that the domestic contractors need better export strategy adjusted to the economic environment provided by the admission to the WTO, in order to use the benefits this membership provides on a long-term basis, is still present.

7.3. Denar exchange rate

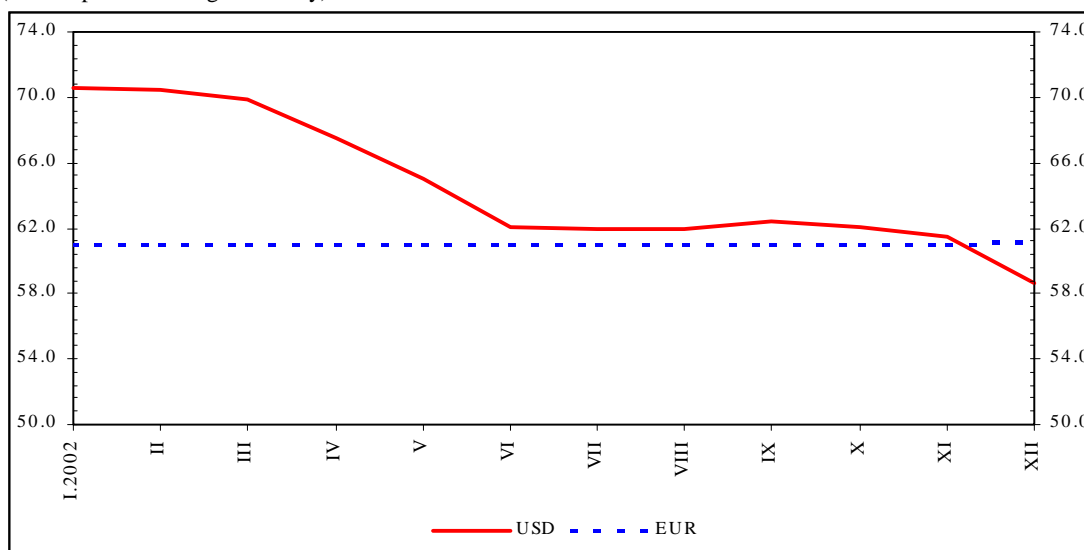
Starting from January 2002, with the actual introduction of the new European currency - the Euro, the National Bank of the Republic of Macedonia changed its strategy of exchange rate targeting of the Denar against the Deutsche Mark to a strategy of exchange rate targeting of the Denar against the Euro. In accordance with the previously set fixed and irrevocable parity of Deutsche Mark 1,95833 per one Euro of the European Central Bank, on January 1, 2002, the initial level of the Denar exchange rate relative to the Euro was set at Denar 60.95 per one Euro.

In 2002, a stable correlation between the Denar and the Euro was registered on the foreign exchange market, despite the unfavorable movements in the foreign trade and the fluctuations in the liquidity during the year. Namely, the foreign trade in 2002 was characterized with constantly high imports and weak export performances of the Macedonian economy, and consequently, the lower inflow of foreign assets from abroad. The high liquidity in the economy, which was especially intensified by the increased budget expenditures during the parliamentary elections period (September 2002), as well as the introduction of the Law on Foreign Exchange Operations in mid-October 2002, which basically allows larger liberalization in the trade also in the other segments of the foreign exchange operations, reflects on the foreign exchange market through continually higher demand relative to the supply of foreign assets. This situation was a reason for pressures for depreciation of the Denar relative to the Euro (especially in the third and the fourth quarter of 2002), which were eliminated through the NBRM interventions on the foreign exchange market with a net sale of foreign assets. Consequently, the Denar exchange rate relative to the Euro remained stable, and on December 31, 2002 Denar 61.07 were traded per one Euro.

Chart 32

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

(Denars per unit foreign currency)



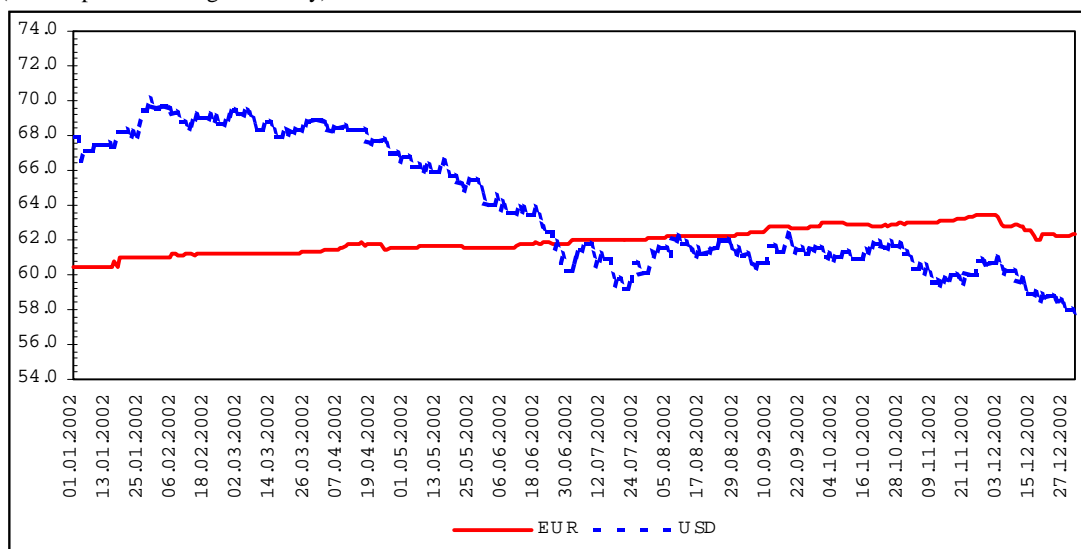
On the exchange offices market, starting from January 2002, when the actual trading in Euros started, until November, a continuous depreciation of the Denar relative to the Euro was registered. Namely, after setting the Denar exchange rate at the level of Denar 61.0 per one Euro at the end of January, its level was continually increasing until the end of November 2002, when Denar 63.5 per one Euro were traded (a depreciation of the Denar of 4.1%). The depreciation of the Denar relative to the Euro is due to the constantly high demand for Euro in 2002. Namely, in the first two months of 2002, this demand was especially intensified due to the conversion of the currencies of the EMU member states in cash, while during the rest of the year, it was stimulated by the high liquidity in the economy and the weak performances of the US Dollar, which resulted in an increased demand for foreign exchange, as well as in the conversion of the US Dollar into the stronger currency - the Euro. Such movements of the Euro relative to the other world currencies eliminated the doubts in the financial area about its successful introduction and application, pointing to the relatively rapid acceptance of the new currency by the population. In the last month of the year, the preference of the economic agents for Denar cash before the Christmas and New Year holidays, led to modest monthly appreciation of the Denar relative to the Euro, of 1.9%. Thus, on December 31, 2002, Denar

62.3 per one Euro were traded, which is a depreciation of 2.1% relative to the level registered on January 31, 2002.

Chart 33

Nominal Denar exchange rate relative to the Euro and the US Dollar on the exchange offices market

(Denars per unit foreign currency)



The strategy of targeting the Denar exchange rate relative to the Euro, implicitly sets the Denar exchange rate relative to other foreign currencies, according to the parities of the Euro and the other foreign currencies announced by the European Central Bank. Consequently, the movement of the Denar exchange rate relative to the US Dollar on the foreign exchange market in 2002, is in accordance with the registered movements of the Euro and the US Dollar. Namely, the gradual recovery of the American economy after the terrorist attack on September 11, 2001, which was additionally impeded by the financial affairs in some of the largest American companies, caused almost continuous depreciation of the US Dollar relative to the Euro, and thus relative to the Denar, during 2002. The depreciation movements of the US Dollar started in January, when US Dollar 0.86 per one Euro were traded, and were additionally intensified in the second quarter of 2002 (at the end of June, US Dollar 0.98 per one Euro were traded). In the third quarter, moderate stabilization of the exchange rate of the US Dollar relative to the Euro was registered, while in September 2002, moderate monthly appreciation of 0.7% was recorded. However, the unfavorable combination of economic and political factors (the rumors about the war in Iraq) which influenced the American economy, led to even larger decrease in the US Dollar exchange rate relative to the Euro in the fourth quarter of 2002. Namely, at the end of December, US Dollar 1.04 per one Euro were traded. Hence, on December 31, 2002 Denar 58.6 per one US Dollar were traded on the foreign exchange market, which is an appreciation of the Denar of 15.3% compared to December 31, 2001.

Identical movements were registered on the exchange offices market, although the US Dollar lost its attractiveness with the domestic entities relatively more rapidly, thus causing lower demand for the US Dollar, so the parity between the Euro and the US Dollar was already achieved in June 2002. The tendency of maintaining the lower exchange rate of the US Dollar relative to the Euro continued also in the second half of the year. On December 31, 2002, Denar 57.79 per one US Dollar were traded on the exchange offices market (an identical annual appreciation of the Denar of 15.3%).

The real effective exchange rate is a generally accepted indicator for the price competitiveness of an economy. At the end of 2002⁴⁰ compared to the end of 2001, the real effective Denar exchange rate⁴¹ estimated by the two indicators - index of the movements in the prices of the producers of industrial products and the index of the movements in the retail sales prices, appreciated by identical 1.6%. The appreciation of the real effective exchange rate is due to the higher increase in the nominal effective Denar exchange rate, which eliminated the improved price competitiveness in both price indicators.

7.4. Foreign reserves of the Republic of Macedonia

The total foreign exchange potential of the Republic of Macedonia consists of the total foreign assets of NBRM and the foreign assets of the banks authorized for conducting international payment and credit operations. At the end of December 2002, the total foreign exchange potential equaled US Dollar 1,355 million, which is by US Dollar 131 million, or by 8.8% less compared to December 31, 2001. This decline is due to the decrease in both components, and especially to the reduced foreign assets of banks authorized for conducting international operations, as a result of the high comparison base registered at the end of the previous year, when, due to the Euro-conversion, the population started to deposit its foreign exchange savings with the banks to a large extent just before the introduction of the Euro.

In comparison with the end of 2001, the total foreign assets of the NBRM decreased by US Dollar 13 million, reducing to US Dollar 784 million at the end of 2002. On December 31, 2002, the gross foreign reserves of the NBRM⁴² equaled US Dollar 735 million, which compared to the end of 2001, is a drop of US Dollar 40 million, or of 5.2%. However, despite the registered decrease in the gross foreign exchange reserves of the NBRM and the significant import of goods (annual increase of 16.3%), the coverage of the imports with the foreign exchange reserves is satisfactory, providing coverage of 4,5 months of import.

Table 17

Inflows and outflows in the gross foreign exchange reserves of the NBRM
(in US Dollar million, end of period)

	31.12.2001	IQ	IIQ	IIIQ	IVQ	01.01.2002- 31.12.2002
Foreign exchange reserves	775	793	865	831	735	
Increase in foreign exchange reserves, net		18	72	-34	-96	-40
Realized change in foreign exchange reserves, on net basis						
Purchase and sale		14	-25	-42	-70	-122
Gold		0	1	1	0	1
External account		7	12	-24	-3	-8
Interest recived on foreign currency deposits		6	3	7	5	20
IMF credits		0	-1	0	-5	-6
Government deposits		-13	4	17	-13	-5
Exchange rate differentials		3	79	-10	36	108
Other		0	0	16	-44	-28

In 2002, the net sale of foreign exchange on the foreign exchange market acted towards a decrease in the foreign exchange reserves of the NBRM. Namely, for the purpose of meeting the increased demand, in 2002 the NBRM realized a net sale of foreign exchange in the amount of US Dollar 122 million. The situation of having relatively lower amount of

⁴⁰ Preliminary data used for December 2002.

⁴¹ Estimations of NBRM.

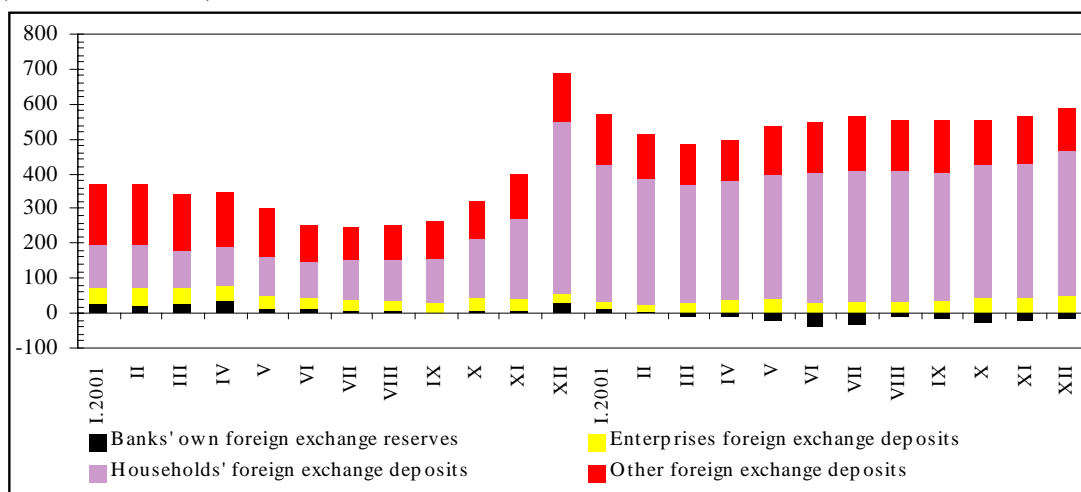
⁴² The gross foreign reserves of the NBRM are estimated as a differential between the total foreign assets of the NBRM and the collateral (collateral in foreign banks).

withdrawn funds given the regular repayment of the liabilities to foreign creditors, triggered a net outflow from the external account in the amount of US Dollar 8 million, while the repayment of the liabilities to the International Monetary Fund (IMF) reduced the reserves by US Dollar 6 million. In 2002, the registered net outflows based on the Government foreign exchange deposits in the amount of US Dollar 5 million, acted in the same direction.

On the other hand, the net inflows of the foreign assets registered from the exchange rate differentials acted towards an increase in the gross foreign exchange reserves of the NBRM. In 2002, the continuing appreciation of the Euro relative to the US Dollar, given the dominant share of the Euro in the currency structure of the foreign reserves of the NBRM, led to a net inflow of foreign assets of US Dollar 108 million. In this regard, the collected interest from the deposited foreign assets abroad also acted in this direction, together with the purchased monetary gold, which in 2002, increased the gross foreign exchange reserves by US Dollar 20 million and US Dollar 1 million, respectively.

In 2002, having in mind the decrease in the gross foreign exchange reserves of the NBRM, the failure to sign the arrangement with the IMF and the regular servicing of the liabilities to this organization, the net foreign exchange reserves of the NBRM, calculated as a differential between the gross foreign exchange reserves and the liabilities to the IMF, decreased by US Dollar 37 million in comparison with the end of the previous year. Hence, at the end of December 2002, the net foreign exchange reserves of the NBRM equaled US Dollar 667 million, while the liabilities to the IMF reduced to US Dollar 67 million.

Chart 34
Structure of the foreign assets with banks
(in US Dollar million)



On December 31, 2002, the total foreign assets of the banks authorized for conducting international operations amounted to US Dollar 571 million, which is a decrease of US Dollar 118 million, or 17.1% compared to the previous year. The registered decrease is a result of the decline in both components: the banks' own foreign assets (by US Dollar 44 million), and the foreign exchange deposits of the economic agents with banks (by US Dollar 74 million). However, the registered decrease in the foreign exchange deposits of the economic agents with banks is a result of the high comparison base at the end of 2001, when before the introduction of the Euro, the foreign exchange deposits with banks (especially the households' deposits) increased by several times, which was followed by their moderate withdrawal.

Although the decrease in the households' foreign exchange deposits (of US Dollar 84 million compared to the end of 2001) was the main cause for the decrease in the foreign

exchange deposits with banks, the analysis of the dynamics points to positive movements in the banking sector. Namely, after the decline registered in the first quarter, when an amount of US Dollar 156 million was withdrawn by the economic agents, in the second quarter of the year, the households' foreign exchange deposits increased again, now by 9.9% compared to the first quarter. In the third quarter of 2002, modest decrease in the households' deposits was recorded (of 1.2% compared to the previous quarter), which is primarily due to the summer vacations, as well as to the uncertainty caused by the parliamentary elections. At the end of the fourth quarter, the households' foreign exchange deposits reached US Dollar 412 million, which is also the highest increase of 11.5% registered on a quarterly basis. These developments point to a strengthened confidence of the depositors in the banking system, which is also stimulated by the changes made in the area of deposit insurance, as well as the continuous process of modernization and improvement of the banking system. Positive developments were also registered in the enterprises' deposits, which were constantly increasing comparing to the end of 2001 (a decrease was recorded only in January and February 2002), thus reaching US Dollar 52 million at the end of December 2002. Hence, the enterprises' deposits increased by US Dollar 25 million compared to December 31, 2001.

7.5. External debt of the Republic of Macedonia⁴³

On December 31, 2002, the external debt of the Republic of Macedonia (based on short-term and long-term credits) equaled US Dollar 1,613 million. From the aspect of maturity, the liabilities based on used short-term credits equaled US Dollar 64 million, or 3.9%, while US Dollar 1,549 million, or 96.1% of the total external debt account for the long-term liabilities. The largest share of the total long-term debt accounts for the liabilities based on principle (98.2%), while the remaining share accounts for the liabilities originating from the overdue interest and estimated late interest (1.8%).

At the end of 2002, in comparison with the end of 2001 (US Dollar 1,506 million⁴⁴), the total external debt increased by 7.1%. The increased indebtedness originates from the larger amount of withdrawn assets based on long-term credits in the amount of US Dollar 175 million, or by 38.0% more compared to the previous year (given the low comparison base in 2001, when the amount of used long-term credits significantly decreased due to the security crisis), as well as from the high amount of exchange rate differentials.

Analyzed by the indicators for the level of indebtedness in 2002⁴⁵, the Republic of Macedonia belongs to the group of less indebted countries with medium income. This statement is based on the following three indicators: correlation between the total debt and the average export of goods and services for the previous three years (118.1%), the correlation between the debt servicing and the average export of goods and services for the previous three years (17.2%), and the repayments of the interest relative to the average export of goods for the previous three years (3.9%). According to the total external debt to the average of the GDP in the last three years ratio (45.2%), the Macedonian economy belongs to the group of moderately indebted countries.

7.5.1. Debt structure

The short-term debt includes all credits with maturity up to one year, extended to residents by the non-residents. On December 31, 2002, the short-term external debt of the Republic of Macedonia equaled US Dollar 64 million (an increase of 1.6% compared to 2001), 95.7% of which are liabilities based on principle. Observed from the aspect of the type

⁴³ Preliminary data of the NBRM.

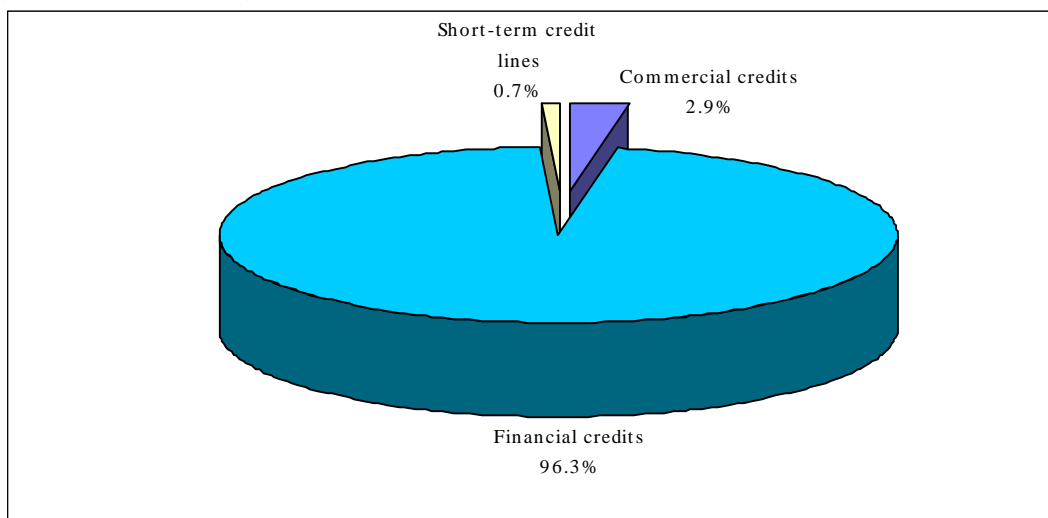
⁴⁴ Revised data.

⁴⁵ According to the methodology of the World Bank.

of the short-term credits, the dominant share in the short-term debt accounts for the financial credits with participation of 96.3%, the share of the commercial credits equaled 2.9%, while the share of the bank credit lines equaled 0.7%. In addition, 60.9% of the financial credits are used for financing in the country, 27.2% for the investments abroad, while the remaining share is intended for the import of equipment, raw materials and intermediate goods, the import of consumption goods, investments, repayment of previously used credits, etc.

Chart 35

Structure of the short-term debt based on types of external credits
(as of December 31, 2002)



The external long-term debt encompasses the liabilities of the residents to non-residents, with a maturity exceeding one year. Within the long-term debt of the Republic of Macedonia at the end of 2002 (US Dollar 1,549 million), the liabilities based on principle in the amount of US Dollar 1,521 million (98.2% of the total long-term debt), the overdue interest of US Dollar 16 million (1.1%) and the estimated late interest of US Dollar 12 million (0.7%) are also included, with their share in these liabilities in the structure of the long-term debt remaining almost unchanged relative to 2001.

Table 18

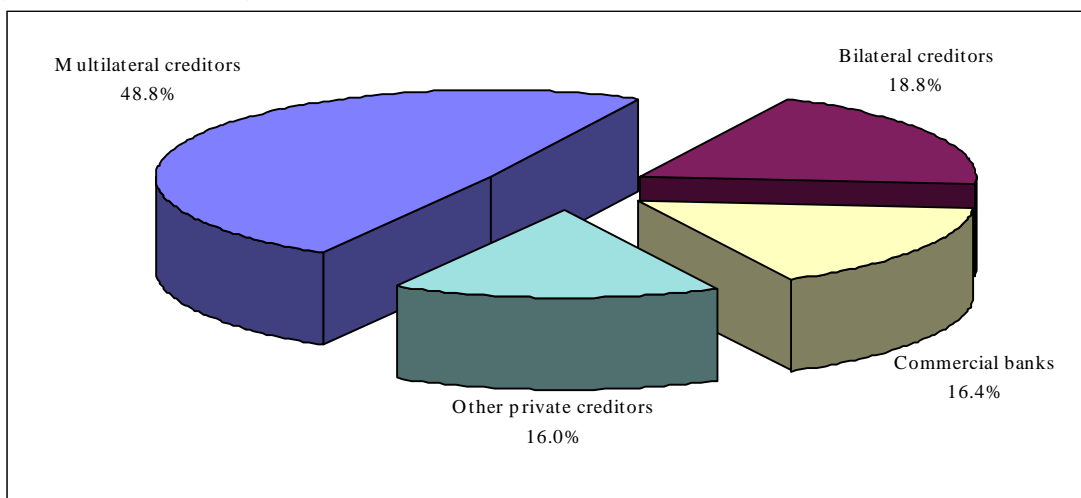
External debt of the Republic of Macedonia in 2002

	Balance as of 31.12.2002		Structure (in %)	Changes relative to 31.12.2001	
	(in USD million)	(in %)		(in USD million)	(in %)
Long-term loans and credits	1,549	100.0	96.1	105	7.3
Principal	1,521	98.2			
Interest ¹	28	1.8			
Short-term credits	64	100.0	3.9	1	1.6
Principal	61	95.3			
Interest ¹	3	4.7			
Total debt	1,613		100.0	106	7.0

^{1/} Liabilities based on overdue interest and interest accrued (late).?

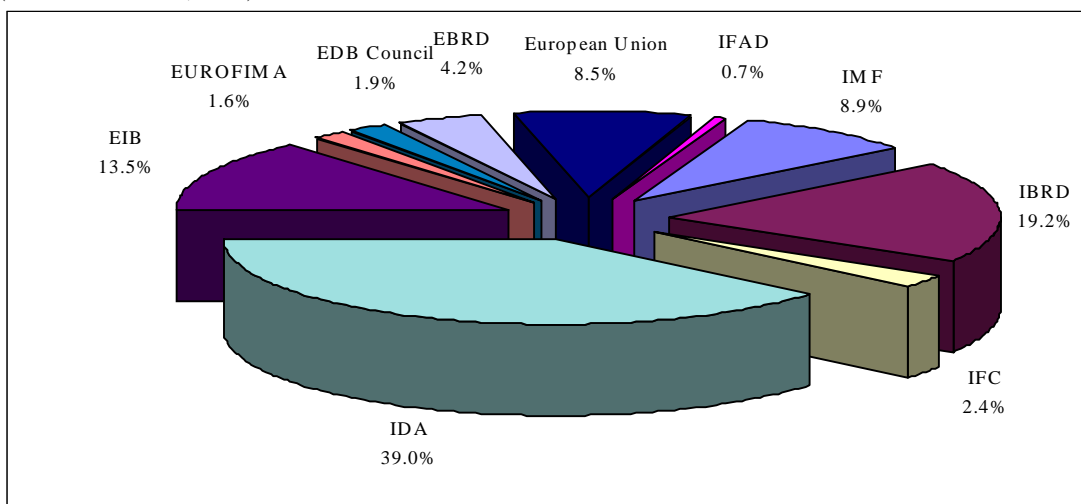
The structure of the long-term external debt of the Republic of Macedonia by individual foreign creditors in 2002 registered no significant changes. Namely, the official creditors (multilateral and the bilateral ones) still dominate with their share being equal to US Dollar 1,048 million, or 67.6% (67.9% in 2002). Within this group of creditors, the multilateral creditors participate with US Dollar 756 million, or 48.8% (47.7% in 2001), while US Dollar 292 million, or 18.8% (20.2% in 2001) account for the bilateral creditors.

Chart 36
 Structure of the long-term debt by types of foreign creditors
 (as of December 31, 2002)



In 2002, the largest individual creditor of the Republic of Macedonia among the multilateral creditors is the International Development Agency (IDA) with its share in the total debt of the Republic of Macedonia being equal to 19.1% (an increase of 1.4 percentage points compared to December 31, 2001). IDA is followed by the International Bank for Reconstruction and Development (IBRD) with 9.4% and the European Investment Bank (EIB) with 6.6%, which increased their share within this group of creditors by 0.8 and 1.4 percentage points, respectively.

Chart 37
 Structure of the long-term debt to multilateral creditors
 (as of December 31, 2002)



From the aspect of the indebtedness of the Republic of Macedonia to bilateral creditors, the dominant structural share of 78.1% in the total debt to bilateral creditors accounts for the Paris Club of Creditors (US Dollar 228 million). Simultaneously, the indebtedness based on the newly concluded credits on bilateral bases equaled US Dollar 64 million, contributing their share in the total liabilities to the bilateral creditors to reach 21.9%.

At the end of 2002, the debt of the Republic of Macedonia to the private creditors equaled US Dollar 501 million, with its share being increased by only 0.2 percentage points

compared to December 31, 2001, reaching 32.4% of the total liabilities based on used long-term credits. In addition, it is the first time since the independence of the Republic of Macedonia to record more intensive credit relations of the residents with private creditors, in the framework of the total withdrawals. Thus, US Dollar 90 million out of the total withdrawn long-term credits in 2002 are extended by private creditors (primarily by foreign banks and financial institutions), while US Dollar 85 million account for the official creditors. Such a situation is in line with the restored security and macroeconomic stabilization in the country. Observed from the aspect of separate private creditors, a dominant share of the debt accounts for the debt to the London Club of Creditors (50.6% of the liabilities to this group of creditors).

At the end of 2002, the debt to the other private creditors equaled US Dollar 247 million, i.e. 49.4% of the total debt to the private creditors. US 181 million, or 36.2% of this amount account for the debt to banks and financial institutions while US Dollar 66 million, or 13.2% of the total debt to the private creditors account for the debt to foreign enterprises.

7.5.2. Registered movements in 2002

On December 31, 2002, compared to the end of 2001, the foreign debt of the Republic of Macedonia increased by US Dollar 106 million, or by 7.1%. In addition, the long-term external debt of the Republic of Macedonia, which represents the largest share of the external debt, increased by US Dollar 105 million, or by 7.3%, given the almost unchanged short-term liabilities (increase of US Dollar 1 million, or of 1.6%).

In 2002, the total withdrawn funds based on short-term and long-term loans and credits reached US Dollar 255 million, which is by US Dollar 69 million more compared to 2001. The significantly higher amount of withdrawn funds during 2002 is due to the low comparison base (the restrain of the foreign creditors from granting new credits in 2001 due to the deteriorated political and security situation in the country).

Additionally, observed from the aspect of maturity, an amount of US Dollar 80 million based on short-term credits from foreign sources of financing was withdrawn in 2002, which is by US Dollar 21 million more compared to the previous year. The largest share of the new short-term credits (93.8%) accounts for the granted financial credits, which reached US Dollar 75 million at the end of 2002. Analyzed by the dynamics of the withdrawal of funds, the highest amount of withdrawn funds was registered in September 2002 (US Dollar 22 million), when the largest part of the financial credits was withdrawn.

In 2002, total amount of US Dollar 175 million was withdrawn from the granted long-term credits, which is an increase of US Dollar 48 million compared to the previous year. Funds in the amount of US Dollar 75 million were withdrawn from the multilateral creditors, which is an increase of US Dollar 12 million compared to the previous year. Simultaneously, US Dollar 10 million and US Dollar 90 million were withdrawn from bilateral and private creditors, respectively. In comparison with 2001, the amount of funds withdrawn from bilateral and private creditors in 2002 increased by US Dollar 2 million and US Dollar 34 million, respectively.

With regard to the multilateral creditors, the largest share of the funds, i.e. US Dollar 18 million were withdrawn from the International Development Agency (IDA), especially from the Emergency Economic Recovery Credit II (US Dollar 12 million), for the purposes of the Health Sector Project (US Dollar 2 million) and the Reconstruction of the Irrigation System Project (US Dollar 1 million). The remaining withdrawn funds refer to the projects aimed at facilitating the trade and the transport in the South Eastern Europe, the Private Farmer Support Project, etc. In 2002, funds in the total amount of US Dollar 16 million were

withdrawn from the European Investment Bank (EIB) on the basis of roads construction projects.

During 2002, an amount of US Dollar 15 was withdrawn from the International Bank for Reconstruction and Development (IBRD) for the purposes of the following projects: Power System Improvement Project (US Dollar 8 million), Private Sector Development Project (PSDL II) (US Dollar 4 million), Transport Sector Project (US Dollar 3 million), and the Reconstruction of the Irrigation System Project (US Dollar 0.3 million).

In 2002, funds in the amount of US Dollar 10 million were withdrawn from the European Union, i.e. the second tranche of the credit aimed at the Structural Adjustment Project. Simultaneously, US Dollar 5 million were withdrawn from the Council of Europe Development Bank (CEDB) aimed at the Project for Construction of apartments at concessional terms intended for persons with insufficient financial support, as well as the third and the fourth tranche of the credit aimed at the Employment Project in the total amount of US Dollar 3 million.

Within the structure of funds withdrawn from bilateral creditors in the total amount of US Dollar 10 million, the largest share (US Dollar 7 million) accounts for the Small-size and Medium-size Enterprises Project (KFW). Funds in the amount of US Dollar 1 million were withdrawn from the Italian credit line aimed at the import of equipment, while the remaining part are funds withdrawn for the Project for Improvement of Micro, Small-size and Medium-size Enterprises (KFW) and funds from the credit extended by the Government of the Republic of Germany.

Within the group of private creditors, in 2002 funds in the amount of US Dollar 90 million were withdrawn, which is an increase of US Dollar 34 million compared to the previous year. US Dollar 79 million of this amount originate from foreign banks and other private financial institutions, while the remaining share refers to the withdrawn funds from foreign private enterprises.

Table 19

Withdrawn funds and serviced liabilities breakdown by creditors in 2002

(in US Dollar million)

	Withdrawn assets	Paid liabilities		
		Total	Principal	Interest
LONG-TERM LOANS AND CREDITS	175	231.7	181.1	51
MULTILATERAL CREDITORS	75	105.0	82.4	23
International Monetary Fund	-	10.0	8.8	1
World Bank	15	13.0	5.8	7
International Financial Corporation	3	22.1	20.4	2
International Development Agency	18	2.0	-	2
European Investment Bank	16	6.8	3.0	4
European Railway Funding Company	-	4.9	4.4	1
European Development Bank Council	8	1.3	1.0	0
European Bank for Reconstruction and Development	4	42.0	38.1	4
European Union	10	1.9	-	2
International Fund for Agriculture Development	1	0.0	-	0
European Agency for Reconstruction	-	0.8	0.8	-
BILATERAL CREDITORS	10	47.1	33.9	13
Paris club (total)		39.8	28.6	11
New credits		7.3	5.3	2
PRIVATE CREDITORS	90	79.6	64.8	15
London club	0	17.8	7.8	10
Other private creditors	90	61.8	56.9	5
Banks and private financial institutions	79	51.6	47.4	4
Foreign enterprises	10	10.2	9.5	1
SHORT-TERM CREDITS	80	68.0	65.9	2
Commercial credits	3	3.1	3.1	0
Financial credits	75	58.2	56.7	1
Short-term credit lines	2	7.0	6.2	1
TOTAL	255	299.7	247.0	53

At the end of 2002, the total amount of serviced liabilities to foreign creditors based on used short-term and long-term credits reached US Dollar 300 million (in 2001, US Dollar 245 million), US Dollar 247 million of which are serviced principle, while the remaining US Dollar 53 million refer to the serviced liabilities based on interest.

In 2002, the total amount of serviced liabilities based on short-term credits in 2002 equaled US Dollar 68 million (in 2001 it equaled US Dollar 40 million), with the largest share referring to the repayment of financial credits (US Dollar 58 million). US Dollar 66 million and US Dollar 2 million out of this amount of serviced short-term liabilities account for the serviced principle and interest, respectively.

At the end of 2002, the total amount of serviced liabilities to foreign creditors originating from the used long-term credits reached US Dollar 232 million (in 2001, US Dollar 205 million). US Dollar 181 million of this amount refer to the serviced principle, while US Dollar 51 million account for the serviced interest. The analysis by individual creditors indicates that the largest share of the funds, or US Dollar 152 million, was repaid to the official creditors, i.e. the amount of US Dollar 105 million was paid to the multilateral creditors, and US Dollar 47 million to the bilateral ones. Within the multilateral creditors, the largest amount was repaid to the European Bank for Reconstruction and Development (EBRD) (US Dollar 42 million) and the International Financial Corporation (IFC) (US Dollar 22 million). Simultaneously, among the group of bilateral creditors, the largest amount, (US Dollar 40 million), was paid to the Paris Club of Creditors.

During 2002, liabilities to the private creditors in the total amount of US Dollar 80 million were serviced (in 2001, US Dollar 50 million), US Dollar 65 million of which were principle and US Dollar 15 million were interest. The largest share of this amount, i.e. US Dollar 52 million are liabilities serviced to foreign banks and private financial institutions. In 2002, US Dollar 10 million were serviced to the London Club of Creditors based on interest and US Dollar 8 million based on principle, with a minimum amount of funds being withdrawn, which contributed the liabilities to this group of private creditors to decrease by US Dollar 8 million compared to the end of the previous year.

During 2002, new loan and credit arrangements were concluded with the following creditors:

- Credit arrangements in the total amount of US Dollar 8 million were concluded with the International Development Agency (IDA), out of which US Dollar 5 million refer to the Culture and Communities Development Project, and US Dollar 3 million account for the Children and Youth Development Project;
- The European Bank for Reconstruction and Development (EBRD) approved a credit in the amount of US Dollar 12 million aimed at the Reconstruction of the Ohrid Airport Project;
- The Government of the Republic of Italy approved a credit in the amount of US Dollar 8 million for the purposes of the Hydroelectric Power Plant "Strezevo" Project.

VIII. Supervision of Banks and Savings Houses

8.1. Activities of the banking supervision in 2002

8.1.1. Changes and improvements to the regulatory framework of the banking supervision

In 2002, the National Bank of the Republic of Macedonia continued its activities directed towards further improvement and strengthening of the regulatory framework for prudent banking operations. Activities for further compliance with and implementation of the international supervisory standards, as well as the incorporation of certain legal solutions originating from the specific conditions and environment in which the Macedonian banks function, were undertaken in that respect.

At the beginning of 2002, changes and amendments to the Banking Law were made. The most significant changes and amendments to the Law refer to the authorization of the National Bank of the Republic of Macedonia to check the source of funds for each payment of capital and each change in the ownership structure of the bank's shares. This change was made within the overall activities in the economy aimed at combating against the possible forms of money laundering. In addition, this change was intended for overcoming the constant problems in the implementation of the provision of Article 11 of the Banking Law, according to which the National Bank of the Republic of Macedonia evaluates the integrity of each individual potential entity, on the basis of which it reviews the request for issuing an approval only in the case of gradual or one-time acquisition of shares, the total cumulative, nominal amount of which equals 10%, 20%, 33%, 50% and 75% of the total number of shares with managing right.

Other important changes and amendments to the Banking Law refer to the possibility of transforming the savings house into bank; prescribing standards for preparing and implementing security measures of the information system, according to which the adequacy of the banks' information systems is evaluated, etc.

In addition, in March 2002, the Supervisory Circular No.5 - Identification, Measurement, Monitoring and Control of the Country Risk was adopted, by which the National Bank of the Republic of Macedonia continue its practice of preparing supervisory circulars, which give a direction for more efficient fulfillment of the stipulated supervisory standards, i.e. fulfillment of the stipulated legal obligations. This Circular represents a guideline with regard to the evaluation of the country risk by the bank, defining of the bank's exposure to a separate country, setting monitoring and controlling systems of the exposure to separate countries, determining the potential losses originating from the exposure to an individual client - foreign entity, and defining the basic elements of the country risk management policy.

8.1.2. Supervisory function of the National Bank of the Republic of Macedonia

The supervisory function of the National Bank of the Republic of Macedonia is based on the Law on the National Bank of the Republic of Macedonia, the Banking Law, as well as on other by-laws. This function is achieved through the following:

- licensing, i.e. issuance of licenses for founding and approvals for conducting operations;
- supervision, i.e. controlling the operations of the banks and the savings houses;
- undertaking corrective measures.

8.1.2.1. Licensing function

In 2002, no requests for issuing founding and operating licenses for new banks and savings houses, or requests for issuing of licenses for changes in the status on any ground, were submitted to the National Bank of the Republic of Macedonia.

8.1.2.2. Examination on the banks and savings houses operations

In 2002, the National Bank of the Republic of Macedonia conducted a total number of 50 on-site examinations, 21 of which were full-scope, and 29 targeted examinations. Full-scope on-site examinations were conducted in 13 banks and 8 savings houses. The full-scope on-site examination is carried out according to the CAMELS rating system, consisting of analysis and evaluation of the capital adequacy, assets quality, management, profitability, liquidity and market risk involved in the banks operations. Also, 28 targeted examinations of the banks operations, as well as a targeted examination on the operations of one savings house were performed. The targeted examinations were for the purpose of checking the manner in which the corrective actions imposed by the National Bank of the Republic of Macedonia are fulfilled, verification of certain findings stated by the off-site supervision of the banks and the savings houses operations, as well as checking of certain segments of the banks and savings houses operations, as the credit portfolio and the shareholders structure.

The on-site examinations conducted in 2002, as well as the permanent off-site surveillance of the banks and savings houses operations, confirm the identified problems in the operations of the banks and the savings houses during the previous period. Further more, the credit risk is the dominant one in the spectrum of risks the banks and the savings houses are exposed to in their operations. This risk is manifested through the relatively high percentage of placements with higher level of risk; credit concentrations, i.e. high credit exposure of the banks to individual entities; high percentages of non-interest bearing assets due to the accumulated bad placements in the balance sheets of the banks, as well as to the assumption of mortgages by the banks, which can not be appropriately materialized on the real estate market in the Republic of Macedonia.

Besides the credit risk, the performances of the banks and the savings houses are also significantly influenced by other risks, most of all the liquidity and the operational risks, while specific problem is also the insufficient transparency of the shareholders structure of some of the banks in the Republic of Macedonia. These risks are reflection of the weak systems of corporate management identified with some of the banks, inadequate systems of internal control, improper functioning of the internal audit departments, inadequate written policies and procedures for risk management involved in the banks and savings houses operations, as well as their improper implementation. Such situations are also influenced by unfavorable external factors, first of all the political and the security environment characteristic for the last several years, the uncompleted reforms in the real sector, as well as the problems in the collection of claims of the banks, due to inefficiency of the judicial system.

Simultaneously with the supervision on banks and savings houses, the National Bank of the Republic of Macedonia also inspects the application of the regulations within foreign exchange and Denar operations. Thus, in 2002, a total number of 63 on-site examinations were conducted, 11 of which covered the overall foreign exchange operations of the banks, 8 examinations covered certain segments of the foreign exchange operations of the banks, while 41 examinations referred to the exchange offices operations.

8.2. The banking system of the Republic of Macedonia in 2002

8.2.1. Structure of the banking system of the Republic of Macedonia

In 2002, no changes in the number of banking institutions belonging to the both main segments of the banking system of the Republic of Macedonia were registered:

1. Banks of universal type;
2. Savings houses.

Thus on December 31, 2002, 21 banks operated on the territory of the Republic of Macedonia, 18 of which were licensed for conducting financial activities pursuant to Articles 45 and 46 of the Banking Law, while the remaining 3 banks were licensed for conducting financial activities stipulated in Article 45 of the Banking Law which refer to the activities of the banks the founding capital of which equaled Euro 3,500,000⁴⁶.

The number of savings houses at the end of 2002, as well as at the end of the previous year, equaled 17, with their share in the total assets of the banking system being equal to 0.97%. As for the attracted households' deposits, as one of the main functions of the savings houses, their structural share at the level of the banking system equaled 0.6%, i.e. 2.2% if only the Denar savings deposits are taken into consideration.

The main structural characteristics of the banking system of the Republic of Macedonia are analyzed from several aspects:

1. The size of the banks;
2. The ownership structure;
3. The regional structure.

The analysis of the size of the banks is made according to five criteria:

- a) Total assets, i.e. total financial potential;
- b) The scope of activities or market share;
- c) Capital strength, i.e. the total amount of banks' own funds disposable;
- d) Credit activity; and
- e) Deposit activity.

In accordance with the stated criteria, the two largest banks have the dominant share in the banking system of the Republic of Macedonia. Thus as of December 31, 2002 the two largest banks in the Republic of Macedonia participated with 54.1% in the total net assets. With respect to the market share, i.e. the total volume of the on-balance sheet and off-balance sheet activities of the banks, on December 31, 2002, the participation of the both largest banks equaled 52.8%. If a comparison is made on the basis of banks' capital, on December 31, 2002, the first two largest banks participate with 34.5% in the total banking system. If the credit activity of the banks is taken into consideration, the share of the two largest banks in the credit activity of all of the banks equaled 46.9% on December 31, 2002. The most remarkable concentration with both largest banks was identified during the analysis of the deposit activity of the banks. Namely, as of December 31, 2002, both largest banks attracted 64.8% of the total deposits.

⁴⁶ On November 11, 2002 Export-Import Banka a.d. Skopje was subjected to a pre-rehabilitation procedure and receiver was appointed. On January 8, 2003, the pre-rehabilitation procedure was replaced with temporary governance in line with the efforts for rehabilitation of this bank. With this, at the end of 2002, the bank was de facto excluded from the regular courses of the banking system of the Republic of Macedonia. In order to obtain real indicators for the structure, the activities and the performances of the banking system of the Republic of Macedonia, Export-Import Banka a.d. Skopje is excluded from the future analysis within this part of the report.

The ownership structure of the banks in the Republic of Macedonia has been analyzed from two aspects:

- a) The level of privatization of the banks; and
 - b) The share of foreign capital.
-
- a) The level of privatization of the banking capital in the Republic of Macedonia as of December 31, 2002 equaled 85.9%, i.e. 90.3% if the Macedonian Bank for Development Promotion AD Skopje is excluded from the analysis, since it is completely state-owned. Analyzed by separate banks, the level of privatization in 7 banks ranged from 66.7% to 100%. Compared to December 31, 2002, the level of privatization increased by 1.6 percentage points.
 - b) As of December 31, 2002, the share of the foreign capital in the total banking capital in the Republic of Macedonia equaled 44.4%, or by 4.3 percentage points more compared to end of December 2001. The analysis by separate banks indicates that foreign capital exists in 16 banks, with the percentage share ranging from 0.2% to 100%.

The structural characteristics of the banking system of the Republic of Macedonia observed from the regional aspect, confirm the already recognized asymmetry and concentration of the supply of financial services in the capital of the Republic of Macedonia. Namely, as of December 31, 2002, only 4 out of the total number of banks are located outside Skopje, 3 of which are licensed for conducting financial activities stipulated in Article 46 of the Banking law, which also includes conducting international payment and credit operations abroad. The financial potential of these 4 banks participates with 11.2% in the total financial potential of the banking system of the Republic of Macedonia. On the other hand, there is a relatively wide network of subsidiaries, branch offices, counters and operational units.

8.2.2. Performances of the banks in the Republic of Macedonia

8.2.2.1. Capital adequacy / Insolvency risk

At the end of 2002, the banks' own assets equaled Denar 19,279 million (Euro 316 million), which is an increase of Denar 120 million, or of insignificant 0.6% compared to the end of 2001.

The decrease of 11.8% registered in the banks' net assets in 2002 relative to 2001 on the one hand, and the insignificant increase in the capital of 0.6% during the same period, on the other, caused the rate of capitalization to equal 20.7% on December 31, 2002, which is an increase of 2.5 percentage points in comparison with the end of 2001.

On December 31, 2002, the average capital adequacy ratio of the banks in the Republic of Macedonia equaled 28.1%, as a result of the movement of the guarantee capital and the risk weighted on-balance sheet and off-balance sheet assets, which is a decrease of 6.2 percentage points compared to the end of the previous year. This situation is primarily due to the inclusion of the aggregate open foreign exchange position in the methodology for calculating this ratio.

8.2.2.2. Credit risk

The changes in the by-laws, which were adopted in 2001 and the implementation of which started on March 31, 2002 are incorporated in the analysis of the asset quality, i.e. the credit risk undertaken by the banks in the Republic of Macedonia in 2002.

The analysis of the main indicators of the quality of the banks' credit portfolio on December 31, 2002 shows significant improvement in comparison with the end of 2001. However, if the effect from the changes in the methodology for defining and calculating the total credit exposure of the banks is not taken into consideration regard, then moderate improvement in the quality of the credit portfolio in 2002 is registered. Such a view about the changes in the quality of the credit portfolio for 2002 is supported also by the comparison of the indicators in the June - December 2002 period, where there is a consistency in the calculation in accordance with the new methodology. Namely, the total claims of the banks classified in the risk categories C, D and E on December 31, 2002 equaled 15.9% (excluding the claims classified in the risk category E for more than two quarters, which are transferred to the off-balance sheet record) which is a decrease of 1.5 percentage points compared to June 30, 2002.

At the end of 2002, the total credit exposure in the risk categories C, D and E equaled Denar 14,860 million, which is 77.7% of the guarantee capital of the Macedonian banks. As of December 31, 2001, the credit exposure in the risk categories C, D and E equaled Denar 17,892 million, or 95.7% of the guarantee capital of the banks in the Republic of Macedonia, indicating to the improvement in the indicator by 18 percentage points.

However, in order to perceive the trend of change in the quality of the credit portfolio of the banks in 2002 more realistically, the total amount of the claims classified in the risk category E for more than two quarters, which are transferred to the off-balance sheet record during the year should be taken into consideration. Thus together with this amount which in 2002 equaled Denar 5,346 million, on December 2002, the total credit exposure of the banks in the risk categories C, D and E equaled Denar 20,206 million. Thus the share of the credit exposure classified in the risk categories C, D and E in the total credit portfolio of the banks on December 31, 2002 equaled 20.5%. In comparison with December 31, 2001, this ratio declined by 17.7 percentage points. However, if the guarantee capital is taken as comparison basis, the indicator of the total credit exposure in the C, D and E / Guarantee capital equals 105.7%. The improvement in the indicator by 10.5 percentage points compared to 2001 is a result of the decreased amount of placements in the C, D and E by Denar 1,521 million, and the increased guarantee capital by Denar 423 million.

If the allocated provisions for the credit exposure classified in the risk categories C, D and E are analyzed, the uncovered part of this segment from the banks' risk exposure equaled Denar 7,950 million on December 31, 2002, which is 8.5% of the total credit portfolio, i.e. 41.6% of the guarantee capital of the Macedonian banks on December 31, 2002.

In 2002, the rate of risk of the credit portfolio, which shows the correlation between the calculated potential losses and the total credit exposure, equaled 8.8% (13.7% with the included claims transferred to the off-balance sheet records), which corresponds to the risk category B. Larger decrease in the rate of risk of the credit portfolio in comparison with 2001 is due to the changes in the regulations, while in the second half of 2002, real minimal decline in the rate was registered.

8.2.2.3. *Country risk*

With the changes in the Decision on determining the methodology for classifying the Lending on-balance sheet and off-balance sheet items of the banks according to their risk level, the country risk has been defined for the first time in the Republic of Macedonia, and the banks are now obliged to calculate the potential losses on this basis.

As of December 31, 2002 the total exposure to a country risk equaled 29,813 million, or 32% of the total credit exposure of the banks. The total amount of the potential losses for the country risk equaled Denar 8 million, i.e. the indicator which measures the level of the

country risk exposure equaled only 0.03%. This is due to the fact that most frequent exposure of the banks in RM, is the exposure towards international first class banks, with agreed maturity of up to 3 months. Also, 91.1% of the placements with the clients - foreign entities, are in the countries having a risk weight of 0%.

8.2.2.4. Liquidity risk

The stabilization of the economic situation and the gradual rehabilitation from the last year crisis in the Republic of Macedonia, led to a significant decrease in the liquidity risk of the banks in 2002. Within the favorable trend of the general situation in the country, two main factors gave a strong additional impetus in reducing the liquidity risk: withholding of the largest part of the households' savings deposited during the Euro conversion, as well as the new payment system which enables the banks to plan and manage the liquidity on a daily basis directly and much more efficiently. In managing the liquidity risk, the banks are highly influenced by the monetary policy instruments.

With respect to the liquidity risk management, in 2002 the trend of stability of the deposit base is positively evaluated. The dynamics of the total deposit base of the banks in the Republic of Macedonia was mainly determined by the maintenance of the largest part of the deposited funds during the Euro conversion, as well as the additionally deposited households' deposits, having in mind their dominant share in the total deposit base (average monthly share of 56.8%). Namely, the withdrawal of the households' foreign exchange savings registered during the first quarter of the year, was followed by a period of stabilization of the banks' deposit potential, and as well as by a continuing moderate extension of the deposit base. Such trends point to a permanent strengthening of the propensity to save, which also signalizes the strengthened credibility of the banking system and positive expectations for the future developments.

Observed from the aspect of the asset management in 2002, high level of liquid assets in the structure of the total assets of the banks in the Republic of Macedonia is recorded, primarily determined by the maturity structure of the sources of funds, i.e. the dominant share of the sight deposits (average monthly share of 39.6% in the total sources of funds). Thus, the average share of the liquid assets in the total assets of the banking system during the year equaled 46.4%, i.e. it is by 9 percentage points more compared to 2001, which is an indicator for the higher liquidity of the banks in the Republic of Macedonia during the analyzed period.

The increased liquidity in 2002 on annual basis, as well as the stability of the deposit base mean smaller dependence on the secondary sources of funds on aggregate basis. During the analyzed period, the secondary sources of funds participated with 13.7% in the total sources of funds on average, (1.3 percentage points less compared to their average monthly share in 2001), i.e. 17.4% of the total liabilities of the banks (a decrease of 2.9 percentage points compared to their average monthly share in 2001).

The increased liquidity in the banking system of the Republic of Macedonia in 2002, in the absence of a developed financial market and diversified financial instruments, as well as the preference for risk-free placements, caused the banks to place a significant share of the liquid assets into CB bills. The Money Market, where the banks place part of the excess liquidity, plays a special role in the management of the liquidity of the banks. The unequal allocation of the liquidity in the banking system, as well as the fluctuations in the liquidity, especially with the largest banks during the year, caused several banks to use the Lombard Credit as a last resort facility, adhering to the stipulated terms for its utilization.

8.2.2.5. Analysis of the profitability of the banks in the Republic of Macedonia and evaluation of their efficiency

In 2002, the banks in the Republic of Macedonia showed positive financial results in the amount of Denar 396 million on aggregate level. However, 15 banks, representing 69.8% of the total financial potential of all banks, showed positive financial result in a total amount of Denar 972 million, while 5 banks showed negative financial results in the total amount of Denar 576 million.

Basically, the positive financial result of the banks in 2002 originates from the positive net interest income after provisioning, given the negative differential between other revenues and other expenditures. Since the banks registered a negative financial result in the first six months of 2002, which equaled Denar 894 million on aggregate basis, the sources of the registered profit of the banks for 2002 are to be found in the operations of the banks during the second half of 2002.

The registered positive financial result in 2002, leads to positive values of the indicator for the rate of return on assets (ROAA) and the indicator for the rate of return on equity (ROAE). The ROAA shows that in 2002, 100 units of assets of the banks in the Republic of Macedonia generate 0.4 units of profit, while ROAE shows that 100 units of equity of the banks in the Republic of Macedonia generate 2.06 units of profit. In case only the banks which generate profit in their operations are encompassed in the analysis, the rate of return on assets and the rate of return of equity are set on the level of 1,46%, i.e. 6.9%, respectively. This shows that most of the banks in the Republic of Macedonia, the financial potential of which equals 69.8% of the total financial potential, register an adequate allocation of the available resources and provide profitability, as well as return on assets and return on equity which adhere to the international standards.

IX. Other Activities of NBRM

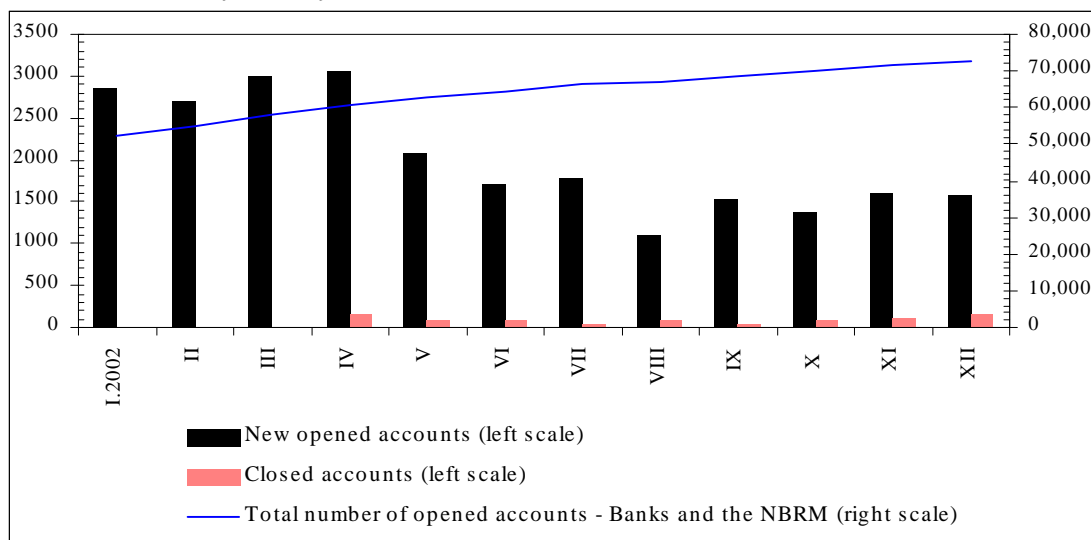
9.1. Payment system in the Republic of Macedonia

At the end of 2001, one of the larger systemic reforms – reform of the payment system was completed, by which starting from January 1, 2003 the payment operations in the Republic of Macedonia have been performed through the commercial banks (instead of through the specialized institution – Payment Operations Bureau), while the settlement between the banks has been performed in the NBRM settlement system – MIPS (Macedonian Inter-bank Payment System). Thus, 2002 is the first year of independent functioning of the reformed payment system after the short period of operating alongside the POB (July 30 – December 31, 2001).

The results of the reformed payment system are the following:

- Increased competition between the institutions responsible for the payment operations resulting in lower prices of the payment transactions, improvement of the service, application of new technologies in the payment operations and lower systemic risk;
- prompt settlement, resulting in reduction of the liquidity and the credit risk, and consequently, the systemic risk;
- direct contacts between the banks and their clients, resulting in improved monitoring of the clients by the bank, and larger possibilities for the economic agents when choosing the bank;
- dispersion of the client risk with the possibility of opening several accounts in different banks;
- improved liquidity management by the banks, since they execute all payments and
- harmonization of the payment system with the payment systems in the European Union, in line with the orientation of the Republic of Macedonia towards this integration.

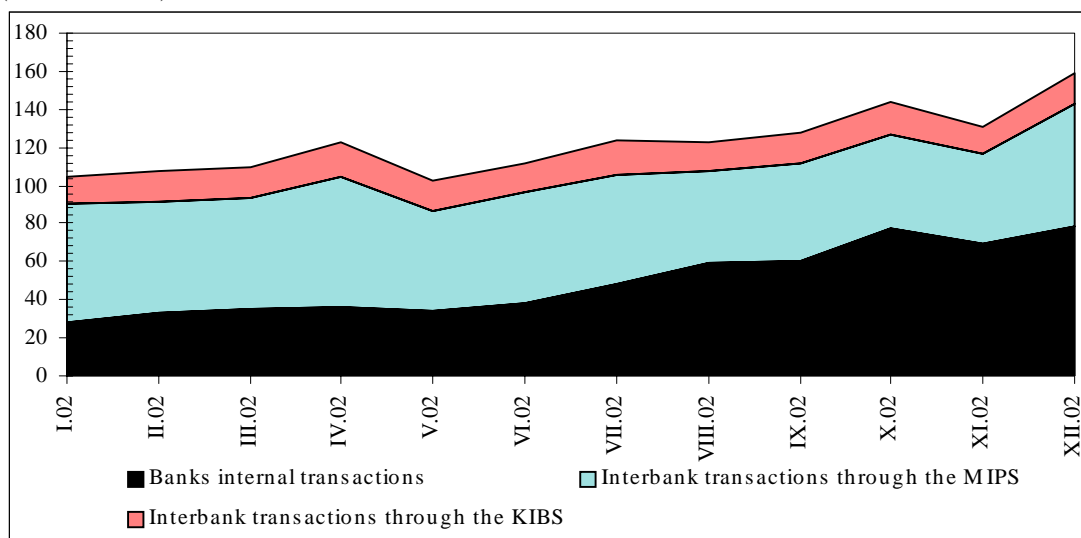
Chart 38
Accounts in the Payment System



In 2002, 24,380 new accounts were opened and 865 accounts were closed in the institutions responsible for conducting the payment operations in the Republic of Macedonia (banks and the NBRM), with the total number of opened accounts reaching 72,866 at the end of 2002. Payment operations in the total amount of Denar 1,465.1 billion were executed

through these accounts. Out of the total amount, 40.8% is internal transactions within the banks (between accounts in a same bank), 46.1% accounts for the inter-bank transactions through the MIPS, and 13.0% is an inter-bank operation through the KIBS (Clearing House).

Chart 39
Total domestic payment operations
(in Denar billion)



The Settlement system of the National Bank of the Republic of Macedonia – MIPS is the core of the new payment system through which the settlement of the institutions responsible for conducting the payment operations is carried out. The MIPS system provides execution of the transactions in real time, meaning that the funds are available for the recipient immediately after the order is submitted by the orderer. This is enabled by applying electronic documents, signed with an electronic signature, based on mutual written agreement between the participant and the National Bank of the Republic of Macedonia. The MIPS is the first system in the Republic of Macedonia using electronic documents, signed with an electronic signature.

Participants in MIPS are the following:

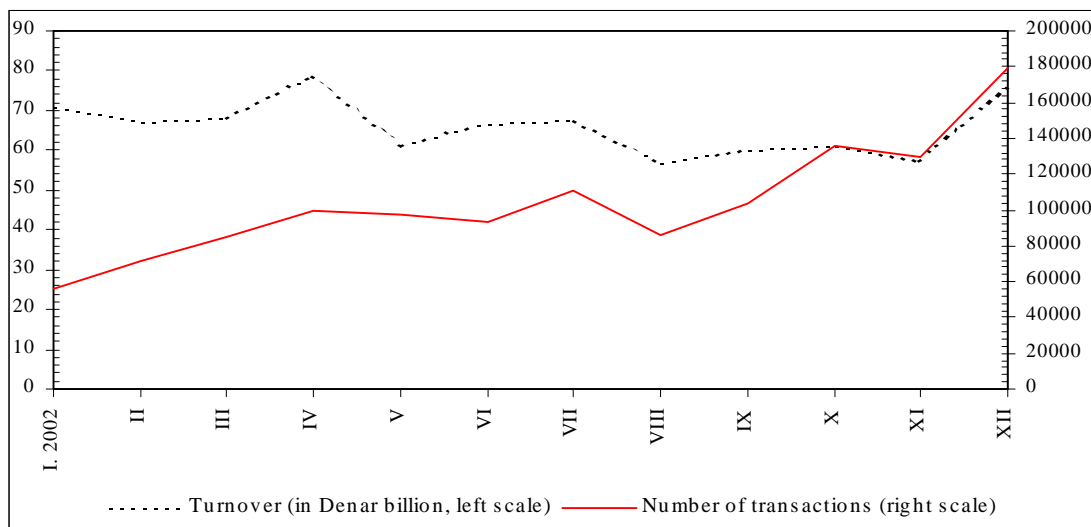
- the banks (21)
- the National Bank of the Republic of Macedonia
- the Treasury system of the Ministry of Finance
- the Central Securities Depository
- the Clearing House – KIBS and
- the National Payment Card

The participants may connect to the MIPS in three ways: through the international banking network – SWIFT, through the private network by using the lines of the Macedonian Telecommunications and through a private network by a direct connection. It provides flexible usage of the system, upon choice of the participant in the system. The standard interbank messages are used for communication between the participants, in accordance with the international SWIFT standards. The system enables payments of the participants, browsing through the sent messages, notification on the balance on the account, etc.

The system operates according to a strictly determined time-table. In 2002, the time-table was changed twice, with the office hours in the second half of the year starting from 07:30 to 16:30 for client payments and to 17:00 for inter-bank payments.

In 2002, 1,247,534 transactions were executed through the MIPS system, with a total value of Denar 791.2 billion. The largest portion of the transactions are inter-bank payments, with the transactions for settling the net balances of the private clearing systems being included, as well.

Chart 40
Turnover and number of transactions in the MIPS in 2002



Settlement of the securities on the basis of “delivery versus payment” is conducted through the MIPS, in cooperation with the Central Securities Depository. The delivery is made on the basis of gross/net method, i.e. the securities are settled on gross, while the cash is settled on net basis. The settlement is conducted between 10:00 and 11:00.

Also, the Clearing House for small-value payments-KIBS is settled in the MIPS. The Clearing House operates on a net basis, with the settlement being conducted once a day – in the period from 14:30 to 15:30. Numerous payments are executed through the Clearing House (87.39% of the total payments in 2002), however, in small amounts (22.06% of the amount of all executed payments). In addition, the transactions of the ATMs of the National Payment Card are settled in the MIPS.

Within its operational role, other than operating the MIPS, in 2002 the National Bank of the Republic of Macedonia received and processed 875 decisions for forced collection, 431 decisions of which were incomplete and had to be returned to the courts for their further completion, in order to be executed.

Due to the relatively short period of establishment and successful functioning in the initial period, the payment system in the Republic of Macedonia and particularly the NBRM settlement system – the MIPS were interesting for many central banks from other countries worldwide. In 2002, in order to acquaint with the payment system and to exchange experience, the NBRM was visited by representatives of the central banks of Moldavia, Serbia, Montenegro and Egypt, as well as by representatives of the Central Bank of the West African States (with a jurisdiction over 8 countries of the French-speaking region in Western Africa, with headquarter in Senegal).

9.2. Printing banknotes and minting coins

In 2002, considering the reserves of banknotes and coins as a regular activity, 8 million banknotes were printed in denomination of Denar 100 and 10 million banknotes in denomination of Denar 10. The minting of 10 million coins was completed by May 2002.

Following the abundant preparations, on January 1, 2002, upon the start of the reformed payment system, the NBRM smoothly took over the cash operations from the former Payment Operations Bureau. Ten local offices of the NBRM Cash Management Department started operating in different towns in the Republic of Macedonia in order to successfully support cash transactions.

In the last months of 2001 and the first months of 2002, the NBRM timely and securely performed the activities related to the preparations and the conversion of the EMU currencies with the Euro, for the needs of the entire state. The commercial banks were also included in the process of conversion of the Euro-currencies.

9.3. Numismatic activity of the NBRM

Over the last four years, the NBRM has been systematically purchasing numismatic material, processing the documentation related thereto and preparing catalogues, conducting scholar and research activities and issuing publications in the area of the numismatics. Besides these activities, a conservator laboratory has been operating within the NBRM for a year, supplied with modern equipment, carrying out all necessary conservatory activities related to the numismatic material.

On the occasion of the tenth anniversary of the monetary independence of the Republic of Macedonia, the Numismatic Museum was opened in the premises of the NBRM on April 25, 2002, with a permanent numismatic exhibit "Macedonia, the Money and the History", accompanied with proper catalog of the exhibited samples. Approximately 1,000 coins discovered on the territory of the Republic of Macedonia are exhibited in 42 glass showcases in the museum.

The NBRM numismatic collection is the first, and so far, the only specialized collection in the Republic of Macedonia, with approximately 13,000 samples of coins, medals, exagias, and contemporary banknotes. This numismatic material became a part of the collection by purchasing or donations of citizens. The collection is divided into several parts, exhibited in the museum in chronological order, as follows:

- Coins that circulated and were minted on the territory of Macedonia starting from VI/V century B.C., in which the Paeonian tribes Derrones and Laii existed;
- Coins of the antique Macedonian towns;
- The Macedonian rulers are presented in 117 coins (starters, tetradrachms, drachms);
- Coins from the Roman period. Special stress has been laid on the coins minted in Stobi, the only minting house from the Roman period operating on our territory. The fact that the NBRM owns the largest public collection of coins minted in this minting house in the world is a curiosity. This segment of the exhibition includes review of the first Christian symbols and iconography of the coins in the IV century B.C.;
- Byzantine coin-minting, where the period of Early Byzantium is presented with larger number of denominations, fractions and minting houses from all over the empire.

- The period of late Middle Ages is illustrated with the coins of several monetary systems such as Venice, Serbia, Bulgaria, as well as the coins of the independent Macedonian feudal lords;
- The period of the Ottoman Empire is presented with Turkish coins, among which are the coins from the Skopje, Ohrid and the Kratovo minting houses, including some contemporary coins from West European countries from the XVIII and the XIX century that circulated on our territory, alongside the coins of the Turkish monetary system;
- Contemporary banknotes in circulation on the territory of Macedonia in the XVIII, XIX and the XX century, the current banknotes of the Republic of Macedonia, jubilee gold coins and one particularly attractive golden bar.

Apart from the individual samples, collective numismatic findings discovered on the territory of Macedonia have been exhibited in the museum, showing the numismatic treasure of this region.

9.4 Internal audit

In 2002, the activities of the internal audit of the National Bank of the Republic of Macedonia were directed towards auditing the conduct of the business processes in the organizational units, improvement of the operating procedures for better management of the possible risks and staff training, in order to acquire the most recent practical knowledge in the conduct of internal audit.

In accordance with the Audit Plan, in 2002, 15 various processes of the operation of the organizational units of the National Bank of the Republic of Macedonia were audited. Besides the regular audits, one extraordinary audit was conducted in 2002, pertaining to the procedure for carrying out the procurements in the National Bank of the Republic of Macedonia.

In general, the findings of the audits indicate that there are satisfactory control processes and adherence to the laws and other regulations, as well as to the written policies and procedures of the National Bank of the Republic of Macedonia in its organizational units.

In 2002, adjustments and improvements were made, and new written procedures were designed for the total of 155 operating processes, as well as for two policies in the area of foreign exchange operations and accounting and financial operations in the National Bank of the Republic of Macedonia.

The technical cooperation with the Dutch Central Bank continued in 2002, basically for the purposes of conveying experience for carrying out the internal audit processes in the area of the information technology in the payment systems and the cash operations.

During the performance of the audits, recommendations and guidelines are given for further improvement of the internal control processes in the organizational units of the National Bank of the Republic of Macedonia.

According to the recommendations of the Internal Audit Department, the main areas that need further improvement are the following:

- improvement of the organization of the operating processes by enhanced exploitation of the information technology system in the exchange of data and e-documents;

- development of internal information system through which all employees would have an insight and information on the adopted internal by-laws and other regulations;
- regular and systematic analysis of the processes, risk assessment, and hence, proposing measures for improving the control systems.

9.5. Human resources policy

The NBRM human resources policy in 2002 was aimed at further recruitment of new employees, as well as further training of the staff by attending seminars and training courses, and realization of technical assistance and cooperation projects.

In 2002, 82 new persons were employed in the NBRM. Out of them, 25 are university graduates (16 persons graduated from the Faculty of Economics, one person completed the Law School, one person graduated from the Faculty of History of Art and Archeology, one person graduated from the Faculty of Biochemistry, and 6 persons completed the Faculty of Electrical Engineering) and 57 persons with completed high school. Out of the total number of newly employees, 65 are overtaken from the former Payment Operations Bureau, in accordance with the Law on Transformation of the Payment Operations Bureau, 12 of which with university degree and 53 with high school degree.

In 2002, in order to gain further professional experience, the NBRM staff attended large number of seminars and training courses organized by the following institutes and central banks: seminars of the IMF Institute, held in Washington, USA; seminars of the Joint Vienna Institute, in organization of the IMF, the World Bank, the EBRD, the OECD and the WTO, held in Vienna, Austria; seminars of the Central Bank of Switzerland, organized in the student center of Gerzensee, Switzerland; seminars of the Dutch Central Bank, held in Amsterdam; seminars of the Central Bank of Germany, held in Frankfurt; seminars of the Central Bank of France, in organization of the International Institute of Banking and Finance, held in Paris; seminars of the Central Bank of England in organization of the Center for Central Banking Studies, held in London, etc.

A new NBRM technical assistance project was agreed with the Dutch Central Bank in April 2002. This technical assistance project is actually a continuation and development of the previous NBRM technical assistance project of the Dutch Central Bank, successfully completed in the previous year. The new project will end at the end of 2003, and generally, covers the same subprojects and includes additional technical assistance in the area of payment systems (control of the payment systems and the operational activities).

The project for technical assistance for the NBRM provided by the International Monetary Fund (IMF) was implemented in 2002, and covers the following areas:

- banking supervision: tasks and activities of the Supervision Department related to money transfer by non-banking residents, defining the criteria for issuing licenses and supervision of such activities, compliance with the Law on Anti-Money Laundering, consistency with the current supervisory framework, etc.;
- monetary regulation: the interest rate policies of the Central Bank and their influence on the market interest rates, development of secondary short-term securities market, thus ensuring larger flexibility in the conduct of the monetary policy;
- payment systems: operational procedures for the RTGS system, control of the responsibilities (more clear distinction between the supervision and the control of the payment system);

- foreign exchange operations: improvement of the efficiency of the interventions on the market, introduction of contingent investment in securities;
- balance of payments: identification of the possible reasons for the “errors and omissions” item, proposals for further improvement of the collection of statistical data in the NBRM balance of payments, review of the revised methodology used for short-term commercial credits estimation.

9.6. Changes in the legislative and the legal regulation

Several laws in the area of finance, banking and monetary and foreign exchange operations were adopted and became effective in 2002.

The **Law on the National Bank of the Republic of Macedonia** (“Official Gazette of the Republic of Macedonia” no.3/2002) was adopted on January 15, 2002. This Law was in compliance with the laws of the central banks of the European Union member-states, emphasizing the sovereignty and the independence of the Central Bank from the Government (functional, institutional, personal and financial independence). According to the new Law, the primary objective of the National Bank of the Republic of Macedonia is to maintain the price stability. The National Bank of the Republic of Macedonia independently sets the goals of the monetary policy, as well as the instruments for their achievement. The Law specifies restrictive provisions pertaining to the government financing, with a possibility for extending only intra-day credits or loans, without a possibility to be renewed or rolled over. The reports on the National Bank of the Republic of Macedonia operations are submitted to the Parliament of the Republic of Macedonia, after being adopted by the National Bank of the Republic of Macedonia Council.

The **Law on Check and the Law on Bill of Exchange** (“Official Gazette of the Republic of Macedonia” no. 3/2002) were adopted on January 15, 2002. The **Law on Check** sets forth the contents of the check, the types of checks, the check issuance as well as the check operations and rules. The **Law on Bill of Exchange** sets forth the contents, the types of bills of exchange, as well as the operations and rules related to the bills of exchange.

The **Law on Leasing** (“Official Gazette of the Republic of Macedonia” no. 4/2002) was adopted on January 16, 2002. This Law sets forth the manner and the terms for leasing tangible movables. According to this Law, the license for performing the activity of leasing movables in the Republic of Macedonia is issued by the Ministry of Finance. The basic capital is set on minimum Euro 100,000 (in Denar equivalent calculated on the basis of the NBRM middle exchange rate), calling for increase in the basic capital to Euro 150,000 on January 1, 2004, and to Euro 200,000 on January 1, 2006. The leased movable shall be registered in a special registry maintained at the Central Registry.

The **Law on Anti-Money Laundering** (“Official Gazette of the Republic of Macedonia” no. 70/2001) became effective on March 1, 2002. This Law sets forth the obligation for all financial institutions, trade companies, other legal entities and individuals that render services, to report to the Anti-Money Laundering Department (body of the Ministry of Finance) on all suspicious transactions and all other transactions through which transfer of amounts exceeding Euro 10 thousand is executed.

The **Law on Supervision of Insurance** (“Official Gazette of the Republic of Macedonia” no. 27/2002) was adopted on April 11, 2002. This Law sets forth the criteria according to which the activities related to life insurance, insurance and reinsurance and insurance and brokerage may be performed. Furthermore, it also sets forth the founding, the operation, the supervision and the termination of the operations of the insurance and

reinsurance companies, the insurance brokerage companies and the National Insurance Bureau. In accordance with the new Law, the Ministry of Finance conducts supervision of the insurance companies in order to determine whether their operations are in compliance with the rules for risk management and the other legal regulations in the field of insurance. Each insurance company shall appoint a licensed actuary, who will assess the compliance of the data and the regularity of the calculations in the annual reports with the insurance accounting standards and the legal regulations and shall inform the Ministry of Finance thereto.

The Law on Compulsory Capital Financed Pension Insurance (“Official Gazette of the Republic of Macedonia” no. 29/2002) was adopted on April 24, 2002. This Law sets forth the compulsory capital financed pension insurance, the establishment and the operations of the pension funds and the pension fund management companies, as a part of the pension and disability insurance system. The pension funds and companies receive contributions from the insured, invest them in financial instruments and distribute the accumulated funds in accordance with the Law. The company shall elect a single custodian to which it will entrust the responsibility for safeguarding the funds of the pension funds. Custodian of the domestic funds of the pension funds may be a bank to which the NBRM has granted a license. This Law provides for establishing an Agency for supervision of the capital financed pension insurance which will issue operating licenses and approvals to the pension funds management companies, conduct supervision and perform other activities and functions stipulated by this Law. The primary objective of the Agency is to protect the interests of the pension funds members and to stimulate the development of the capital financed pension insurance. The payment of the contribution for the compulsory capital financed pension insurance (the second pillar) will start on January 1, 2004.

The Law on Amendments to the Banking Law (“Official Gazette of the Republic of Macedonia” no. 37/2002) was adopted on May 23, 2002. These changes allowed the National Bank of the Republic of Macedonia to verify the source of funds for each increase in the capital and for each change in the ownership structure of the shares with a right to manage the banks.

Law on Amendments to the Law on Deposit Insurance Fund (“Official Gazette of the Republic of Macedonia” no. 43/2002, adopted on June 18, 2002). In accordance with this Law, the value of the deposits of the natural persons subject to insurance increases (100% indemnification for deposits in Denar equivalent up till Euro 10,000 and 90% indemnification for deposits in Denar equivalent of Euro 10,000 to Euro 20,000).

Law on Trade Companies (“Official Gazette of the Republic of Macedonia” no. 58/2002). This Law sets forth the types, the establishment, the operations, the responsibilities and the cessation of the trade companies. The Law was adopted on July 1, 2002, and starting from January 1, 2003 shall apply to the trade companies established on the territory of the Republic of Macedonia. The trade companies established before the enforcement of this Law are required to comply their operations with the provisions of this Law, by December 31, 2004.

The Law on Banks for Microfinancing (“Official Gazette of the Republic of Macedonia” 61/2002) was adopted on July 18, 2002. This Law sets forth the establishment and the operation of the banks for microfinancing. The bank for microfinancing is established for financing the small-size proprietors, freelance professionals (lawyers, notaries, etc.) and persons performing agricultural or handicraft activity. The bank is established as a joint-stock company, with a minimum founding capital of Euro 4 million (in Denar equivalent). Domestic and foreign legal entities and natural persons may be shareholders. The bank for microfinancing is required to operate in accordance with the provisions of the Banking Law and should meet certain supervisory standards. The bank for microfinancing is expected to start operating in the first half of 2003.

The **Law on Foreign Exchange Operations** (“Official Gazette of the Republic of Macedonia” no. 34/2001, 49/2001, 103/2001 and 54/2002) became effective on October 15, 2002. This Law increases the liberalization of the capital and financial transactions between residents and non-residents. The liberalization will be conducted in stages, in compliance with the Association and Stabilization Agreement with the European Union. The Law provides for full liberalization of the direct investments and the credit transactions between residents and non-residents, gradual liberalization of the operations with securities and portfolio transactions, as well as the reforms of the foreign exchange market directed towards its deepening, development and higher liquidity.

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA

Financial Statements

31 December 2002

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Members of the Council

Lube Trpeski, Governor

Slobodan Kosev

Marina Kavrakova

Fadil Bajrami

Risto Gogovski

Lubomir Kekenovski

Registered office

Kompleks banki bb

1000 Skopje

Auditors

Ernst & Young (Skopje)

Marsal Tito 19,

1000 Skopje

INDEPENDENT AUDITORS' REPORT

To the Council of National Bank of the Republic of Macedonia

- 1 We have audited the accompanying balance sheet of National Bank of the Republic of Macedonia (the Bank) as of December 31, 2002, and the related statements of income, cash flows and changes in equity for the year then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audit.
- 2 Except as discussed in paragraph 4 below, we conducted our audit in accordance with International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.
- 3 As disclosed in note 2a to the accompanying financial statements, in accordance with the National Bank of the Republic of Macedonia Law, the Bank transfers net unrealized differences on translation of foreign currency monetary items at each balance sheet date directly to a revaluation reserve, to the extent that this reserve has a positive balance after the transfer for the period. This treatment is not in compliance with International Accounting Standard 21, which requires that both realized and unrealized foreign exchange differences are taken to the Income Statement.
- 4 As disclosed in note 3 to the accompanying financial statements, the Bank has provided MKD 173,500 thousand for losses on guarantees, given in respect of borrowings of a local commercial bank that was put in receivership in January 2003. These guarantees are secured by the pledge of foreign currency deposits of the Bank. In the event that these guarantees are exercised, the Bank is entitled to recover any payments made on the guarantees from the sale of assets of the commercial bank. Presently we are unable to make a reasonable estimate of the amount that is recoverable from the assets of the commercial bank and therefore we cannot determine a sufficiently reliable estimate of the provision for losses on these guarantees.
- 5 In our opinion, except for the non-compliance with IAS 21 in respect of unrealized foreign exchange differences and except for the effects of such adjustments that would have been determined to be necessary had we been able to satisfy ourselves as to the amount of provision required for losses on guarantees, the financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2002 and the results of its operations and cash flows for the year then ended in accordance with International Financial Reporting Standards.

Ernst & Young
Ernst & Young, Skopje
Skopje, 17 July 2003

National Bank of the Republic of Macedonia

BALANCE SHEET

all amounts in MKD'000

31 December 2002

ASSETS

	Note	2002	2001
FOREIGN ASSETS			
Sight deposits	3	11.001.356	38.826.740
Term deposits	3	28.985.243	13.051.572
Gold	4	3.979.644	3.707.346
Foreign currencies in vault	5	480.252	2.227.196
SDR holdings, net	6	358.302	154.018
Foreign securities	7	467.448	1.906.146
		<u>45.272.245</u>	<u>59.873.018</u>
RECEIVABLE FROM PUBLIC SECTOR			
Loans to Government	8	11.789	19.177
Receivables from Government related to IMF	9	914.452	1.177.498
Government securities	10	3.066.719	3.355.192
Receivable from external account transactions	11	3.804.814	3.798.357
		<u>7.797.774</u>	<u>8.350.224</u>
RECEIVABLE FROM BANKS			
Loans	12	62.802	62.802
Other accounts receivable	13	6.715	118.419
Overdue accounts receivable	14	2.443	153.775
		<u>71.960</u>	<u>334.996</u>
OTHER ASSETS			
Premises and equipment	15	1.033.536	879.258
Inventories	16	72.543	66.777
Receivables	17	172.047	32.997
Other assets	18	945.002	958.581
		<u>2.223.128</u>	<u>1.937.613</u>
TOTAL ASSETS		<u>55.365.107</u>	<u>70.495.851</u>

The financial statements were adopted by the Council of the National Bank of the Republic of Macedonia on 12 July 2002 and signed on its behalf by:

Lube Trpeski,
Governor



The accompanying notes form an integral part of these financial statements

National Bank of the Republic of Macedonia

BALANCE SHEET

all amounts in MKD'000

31 December 2002

LIABILITIES AND CAPITAL

	<i>Note</i>	2002	<i>2001</i>
RESERVE MONEY			
Narrow definition of reserve money	19	18.169.790	16.420.127
Compulsory reserves of banks and savings houses	20	4.849	1.806.342
NBRM bills	21	2.997.753	3.157.338
Demand deposits	22	15.313	-
		21.187.705	21.383.807
RESTRICTED DEPOSITS	23	553.383	587.247
FOREIGN LIABILITIES	24	3.948.733	4.896.924
DEPOSITS OF THE PUBLIC SECTOR			
Denar deposits of the public sector	25	4.040.311	3.812.404
Foreign exchange deposits of public sector	26	7.712.456	12.847.881
Stabilization Fund of the Government	27	6.579.998	8.559.998
		18.332.765	25.220.283
OTHER LIABILITIES			
Payables	28	92.618	558.394
Other liabilities	29	1.804.615	6.322.732
Counter-entries in NBRM accounts	30	510.828	414.741
		2.408.061	7.295.867
SDR ALLOCATION LIABILITY	31	667.490	728.360
CAPITAL ACCOUNTS			
General reserves	32	723.636	716.888
Funds	33	1.432.034	1.433.816
Revaluation reserves	34	6.483.455	8.610.732
IFRS adjustments	35	(372.155)	(378.073)
		8.266.970	10.383.363
TOTAL LIABILITIES AND CAPITAL		55.365.107	70.495.851

The accompanying notes form an integral part of these financial statements

National Bank of the Republic of Macedonia

INCOME STATEMENT

all amounts in MKD'000

Year Ended 31 December 2002

	<i>Note</i>	2002	<i>2001</i>
Interest income	36	1.722.200	2.483.425
Interest expense	37	1.319.095	1.592.833
NET INTEREST INCOME		403.105	890.592
Fee income	38	201.461	148.529
Other operating income	39	133.399	310.973
OPERATING INCOME		737.965	1.350.094
Staff expenses		288.703	192.321
Depreciation		62.226	44.855
Fee expense	40	35.399	89.780
Other expense	41	149.292	272.115
OPERATING EXPENSES		535.620	599.071
Loan loss provisions, net	42	154.357	-
PROFIT BEFORE TAXES		47.988	751.023
Income tax	43	8.329	130.835
NET PROFIT FOR THE YEAR		39.659	620.188

APPROPRIATION OF NET INCOME AFTER TAXES

NET PROFIT FOR THE YEAR	39.659	620.188
Net effect of IFRS adjustments	(5.918)	(54.594)
NET INCOME AFTER TAXES PER STATUTORY STATEMENTS	33.741	565.594
Reserves for net realized foreign exchange gains	-	100.388
General reserves	6.748	-
Fixed Assets Fund	-	117.475
Employee Amenities Funds	-	40.000
FOR DISTRIBUTION TO CAPITAL ACCOUNTS	6.748	257.863
FOR TRANSFER TO THE BUDGET	26.993	307.731

The accompanying notes form an integral part of these financial statements

National Bank of the Republic of Macedonia

STATEMENT OF CASH FLOWS

all amounts in MKD'000

Year Ended 31 December 2002

	<i>2002</i>	<i>2001</i>
Net income before allocation	39.659	620.188
Adjustments for:		
Depreciation	62.903	44.855
Debts written off earlier, foreclosed	(41.806)	-
Net income before changes in assets and liabilities	60.756	665.043
Gold	(272.298)	(1.704.259)
Foreign securities	1.438.698	1.498.946
Claims on public sector, excluding	491.580	(2.756.956)
Claims on banks, net of foreclosures	142.684	(80.525)
Inventories and other assets	(131.237)	(106.358)
(Increase)/decrease in current assets	1.669.427	(3.149.152)
Money in circulation	(856.521)	5.813.859
NBRM bills	(159.585)	(1.665.000)
Denar deposits of banks	820.004	(1.571.735)
Deposits of public sector, including restricted deposits	(6.921.382)	7.443.693
Foreign liabilities	(948.191)	(1.360.790)
Other liabilities	(4.914.800)	4.674.698
Increase/(decrease) in current liabilities	(12.980.475)	13.334.725
NET CASH FLOWS FROM OPERATING ACTIVITIES	(11.250.292)	10.850.616
Fixed assets additions, net of foreclosures	(62.997)	(121.391)
Fixed assets sales	8.680	572
NET CASH FLOWS FROM INVESTING ACTIVITIES	(54.317)	(120.819)
Net appropriations for premises and equipment	(2.488)	159.000
NET CASH FLOWS FROM FINANCING ACTIVITIES	(2.488)	159.000
Exchange rate effects	(2.127.276)	1.303.165
Net (decrease) increase in cash and cash equivalents	(13.434.373)	12.191.962
Cash and cash equivalents at the beginning of the year	54.259.526	42.067.564
Cash and cash equivalents at the end of the year	40.825.153	54.259.526
Analysis of cash and cash equivalents at end of the year		
Sight deposits	11.001.356	38.826.740
Term deposits	28.985.243	13.051.572
Foreign currencies in vault	480.252	2.227.196
SDR holdings, net	358.302	154.018
Total	40.825.153	54.259.526
The accompanying notes form an integral part of these financial statements		

National Bank of the Republic of Macedonia

STATEMENT OF CHANGES IN EQUITY

all amounts in MKD'000

Year ended 31 December 2002

	<i>General reserves</i>	<i>Reserves for net realized FX gains</i>	<i>Revaluation Reserves</i>	<i>Fixed Assets Fund</i>	<i>Employee Amenities Funds</i>	<i>Net profit for distribution to Budget</i>	<i>IFRS adjustments</i>	<i>Total capital and reserve accounts</i>
At 1 January 2002	547.043	169.845	8.610.732	1.251.512	182.304	-	(378.073)	10.383.363
Elimination of reserves for net realized FX gains	169.845	(169.845)	-	-	-	-	-	-
Unrealized FX gains/(losses)	-	-	(2.127.277)	-	-	-	-	(2.127.277)
IFRS adjustments to current year profit	-	-	-	-	-	-	5.918	5.918
Profit allocation	6.748	-	-	-	-	26.993	-	33.741
Distribution to Budget	-	-	-	-	-	(26.993)	-	(26.993)
Other	-	-	-	6.534	(8.316)	-	-	(1.782)
At 31 December 2002	723.636	-	6.483.455	1.258.046	173.988	-	(372.155)	8.266.970

The accompanying notes form an integral part of these financial statements

National Bank of the Republic of Macedonia

STATEMENT OF CHANGES IN EQUITY

all amounts in MKD'000

Year ended 31 December 2001

	<i>General reserves</i>	<i>Reserves for net realized FX gains</i>	<i>Revaluation Reserves</i>	<i>Fixed Assets Fund</i>	<i>Employee Amenities Funds</i>	<i>Net profit for distribution to Budget</i>	<i>IAS adjustments</i>	<i>Total capital and reserve accounts</i>
At 1 January 2001	547.043	69.457	7.423.149	1.104.691	153.110	-	(432.667)	8.864.783
Unrealized FX gains/(losses)	-	-	1.187.583	-	-	-	-	1.187.583
IFRS adjustments to current year profit	-	-	-	-	-	-	54.594	54.594
Profit allocation	-	100.388	-	117.475	40.000	307.731	-	565.594
Distribution to Budget	-	-	-	-	-	(307.731)	-	(307.731)
Other	-	-	-	29.346	(10.806)	-	-	18.540
At 31 December 2001	547.043	169.845	8.610.732	1.251.512	182.304	-	(378.073)	10.383.363

The accompanying notes form an integral part of these financial statements

31 December 2002

1 GENERAL INFORMATION

The National Bank of the Republic of Macedonia ("NBRM") is the central bank of the Republic of Macedonia and the sole issuer of money in the country. NBRM organization and its operations are regulated by the Law on the National Bank of the Republic of Macedonia, ("NBRM Law"), dated 22 January 2002. NBRM is a legal entity under the sole ownership of the state, with financial and administrative independence. NBRM is the legal successor of the former National Bank of Macedonia, established in 1946, which, when the Republic of Macedonia was a constituent part of the ex-Yugoslav federation, was operating within the system of national banks of the former National Bank of Yugoslavia.

Under the NBRM Law, the main objective of NBRM is to maintain the price stability. In addition, NBRM is expected to support the economic policy and the financial stability of the country. The performance of these functions takes priority over the achievement of profit.

NBRM submits to the Parliament of the Republic of Macedonia a semi-annual and annual report on its operations, on the supervision and the undertaken measures against banks and savings houses, and on handling the foreign exchange reserves.

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

NBRM is governed by the NBRM Council and the Governor.

The total number of employees as of 31 December 2002 was 386 (31 December 2001: 314).

31 December 2002

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**a) Basis of preparation of financial statements**

The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"), which comprise standards and interpretations approved by the IASB, and International Accounting Standards and Standing 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 by the revaluation of premises and equipment, and related amortization and depreciation, in accordance with the regulations of the Republic of Macedonia.

b) Foreign currency translation

Foreign exchange transactions are recorded at exchange rates prevailing at the day of the transaction. Resulting realized exchange differences are taken to the income statement.

At the balance sheet date, monetary assets and liabilities denominated in foreign currencies are remeasured at closing rates. Unrealized exchange differences are taken to revaluation reserves. The NBRM Law mandates this accounting policy. It represents a departure from IFRS, which requires that all foreign exchange gains and losses, realized and unrealized, to be taken to the income statements. Identical or similar provisions on the treatment of unrealized foreign exchange gains/losses are found in other central banks, due to the specific responsibility of central banks to manage the country's foreign reserves. The carrying value of revaluation reserves indicates the cumulative effect of net unrealized foreign exchange gains through the balance sheet date, while the movement in the revaluation reserves during the year indicates the amount of net unrealized foreign exchange gains/losses that, under IFRS, should have been taken to the income statement for the respective year.

c) Deposits with banks

Deposits with banks are stated at cost, less any amounts written off and provision 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 at the end of each month. At the balance sheet date, gold is valued at the MKD price per gram set by the NBRM Council, obtained by expressing in MKD the ruling market price.

Realized and unrealized gains and losses from end-month revaluations, resulting from changes in the market price of gold, are included in realized and unrealized foreign exchange gains and losses, respectively, and treated as described in note 2(b).

31 December 2002

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**e) Cash and cash equivalents**

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

f) Investments (securities)

Trading investments are initially recognized at cost and subsequently measured at fair value. All related realized and unrealized gains or losses are included in net income. Interest earned is included in interest income.

Non-trading investments are classified as follows:

- Held to maturity
- Available for sale

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

Premiums and discounts on non-trading investments are amortised using the effective interest rate method and taken to interest income.

Held to maturity

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

Available for sale

After initial recognition, investments, which are classified as “available for sale” are remeasured at fair value, except those whose fair value cannot be reliably measured, which are measured at cost, less provision for impairment. Unrealised gains and losses are reported as a separate component of equity until the investment is derecognised or the investment is determined to be impaired. On derecognition or impairment the cumulative gain or loss previously reported in equity, along with any transition adjustment to retained earnings arising from the adoption of IAS 39, is included in the statement of income for the period.

g) Fair values

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

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

h) Impairment and uncollectability of financial assets

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

31 December 2002

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**i) Trade and settlement date accounting**

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

j) Loans and advances

These are stated net of provisions for impairment.

k) Premises and equipment

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

Buildings	25 to 100 years
Equipment	5 to 12 years
Vehicles	6 years
Furniture and fixtures	5 to 12 years
Intangible assets (software)	5 to 6 years

Fixed assets (and related depreciation) are revalued at year-end using official revaluation coefficients based on the general manufactured goods price index. Such coefficients are applied to historical cost or later valuation and to accumulated depreciation. The resulting net revaluation surplus is capitalized through a corresponding increase in the Fixed Assets Fund.

This accounting policy is mandated by the Macedonian accounting regulations and practices.

l) Jubilee coins

Golden and silver coins minted to commemorate important anniversaries are carried at production cost, plus 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.

m) Notes and coins in circulation

Notes and coins in circulation are issued by NBRM and are presented in the balance sheet as a liability in favor of the holder, at face value.

31 December 2002

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**n) Short-term bills issued**

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

o) Deposits

Deposits are carried at cost less amounts repaid.

p) Revenue recognition

Interest income is recognized as it accrues.

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

Fee and other income are recognized when earned.

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

q) Taxation

Deferred income taxation is provided using the liability method on all temporary differences at the balance sheet date. Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realized or the liability is settled, based on laws that have been enacted at the balance sheet date.

The carrying amount of deferred income tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilized.

3 FOREIGN EXCHANGE DEPOSITS

Foreign exchange deposits are analyzed as follows:

a) Foreign exchange deposits by type of deposit

	<i>2002</i>	<i>2001</i>
Sight deposits	11.506.066	38.977.154
Provisions	(504.710)	(150.414)
Subtotal	11.001.356	38.826.740
Term deposits	29.134.325	13.400.593
Provisions	(149.082)	(349.021)
Subtotal	28.985.243	13.051.572
Total deposits (sight and term)	40.640.391	52.377.747
Provisions	(653.792)	(499.435)
Total	39.986.599	51.878.312

Sight deposits include total interest-earning deposits of MKD 10.812.125 thousand (2001: MKD 37.512.775 thousand), earning interest at rates mostly based on the currency of the deposit and up to 3,4% per annum (2001: up to 3%).

Term deposits earn interest at rates based mostly on the currency of the deposit, ranging from 1,33% to 6,75% per annum (2001: 1,72% to 6,28%). The structure of term deposits per remaining period to maturity is included in note 44a).

Sight and term deposits include MKD 547.215 thousand of deposits that are not freely available to NBRM, as they were pledged during 2002 to secure a guarantee in the same amount that was obtained in favor of a foreign bank (currently under administration) as a condition for releasing NBRM deposits in the bank, making sure that NBRM continues to bear full credit risk for the foreign bank exposure until the bank is rehabilitated or liquidated. In addition to sight and term deposits, NBRM has made a subordinated loan with the same bank of USD 5 million (MKD 292.990 thousand) maturing in 2002, which is fully provisioned. As the bank is under administration, the maturity of this loan did not change its subordinated status.

Sight and term deposits also include MKD 2.582.379 thousand (2001: MKD 3.501.097 thousand) of deposits that are not freely available to NBRM, as they are pledged to secure borrowings of Macedonian commercial banks from the foreign banks where those deposits are placed, in accordance with the NBRM Council "Decision on Criteria and Conditions for Using Part of Foreign Reserves for Providing Guarantees to Banks Authorized for Foreign Operations". Of these deposits, MKD 1.249.112 thousand are pledged in 2001 and 2002 to secure borrowings of a commercial bank, that was put in receivership in January 2003, including MKD 243.181 thousand that are pledged under a NBRM Council Conclusion in order to facilitate repayment of its obligations towards the foreign bank under administration, as a precondition for effecting the conditional release of NBRM deposits described above. NBRM has provided MKD 173,500 for losses on these deposits.

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3 FOREIGN EXCHANGE DEPOSITS (Continued)

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

	<i>Sight deposits</i>	<i>Term deposits</i>	<i>Subordinated loan</i>	<i>Total</i>
<i>At 31 December 2000</i>	148.058	3.075	326.641	477.774
Interest accrued and reversed	25.772	-	-	25.772
FX valuation	(23.416)	88	19.217	(4.111)
<i>At 31 December 2001</i>	<u>150.414</u>	<u>3.163</u>	<u>345.858</u>	<u>499.435</u>
Reclassifications arising upon the Deposit Release Agreement with the foreign bank in administration				
due to FX valuation	52.868	-	(52.868)	-
due to deposit maturity	3.163	(3.163)	-	-
Release of provisions to income	(87.143)	-	-	(87.143)
Charge for the year	92.418	149.082	-	241.500
<i>At 31 December 2002</i>	<u>211.720</u>	<u>149.082</u>	<u>292.990</u>	<u>653.792</u>

b) Foreign exchange deposits by counter-party

	<i>2002</i>	<i>2001</i>
International financial institutions	27.234.436	30.276.086
Central banks	9.480.171	11.489.908
Commercial banks	3.925.784	10.611.753
Subtotal	<u>40.640.391</u>	<u>52.377.747</u>
Provisions	(653.792)	(499.435)
Total	<u>39.986.599</u>	<u>51.878.312</u>

The term "International financial institutions" denotes the Bank for International Settlements ("BIS") in Basle, Switzerland. Provisions relate to deposits in commercial banks.

c) Foreign exchange deposits by geographical area

	<i>2002</i>	<i>2001</i>
Europe	31.886.302	51.909.367
Other	8.754.089	468.380
Subtotal	<u>40.640.391</u>	<u>52.377.747</u>
Provisions	(653.792)	(499.435)
Total	<u>39.986.599</u>	<u>51.878.312</u>

The bulk of the balances outside Europe relates to a sight deposit with the Federal Reserve Bank of New York. Provisions relate to deposits in Europe.

4 GOLD

Gold is analyzed as follows:

	<i>2002</i>	<i>2001</i>
Gold in NBRM vault	67.892	229.407
Gold deposits	3.911.752	3.477.939
Total	3.979.644	3.707.346

Total gold reserves of NBRM as of 31 December 2002 consisted of 194.764,682 fine troy ounces at a market value of USD 342,75 (MKD 20.084) per fine troy ounce.

Gold deposits are held at two correspondent banks: 4.060,751 fine troy ounces as non-interest-bearing sight deposit, and 190.703,930 fine troy ounces as rollover term deposits for two and three months, earning interest during 2002 at a rate of between 0,04 and 0,4% per annum (2001: 0,2% to 0,55%).

5 FOREIGN CURRENCY IN VAULT

Foreign currencies in vault comprise convertible foreign currencies held by NBRM.

6 SDR HOLDINGS

NBRM keeps a SDR-denominated current account with IMF for processing and settling transactions with IMF.

This current account earns interest at the so-called basic rate of IMF, which is obtained weekly as a weighted average of selected rates of 3-month money-market instruments of five countries whose currencies constitute the SDR valuation basket. During 2002, the basic rate ranged between 2,4% and 2,9%, per annum (2000: 2,6% to 5,3%).

7 FOREIGN SECURITIES

Foreign securities are analyzed as follows:

	<i>2002</i>	<i>2001</i>
Fixed-income securities (trading securities)	427.495	1.858.983
Other foreign securities (available-for-sale securities)	39.953	47.163
Total	467.448	1.906.146

Fixed-income securities comprise securities issued by BIS (so-called "FixBIS"). At 31 December 2002, these include securities denominated in EUR with a term of 90 days and a yield of 2,64%, per annum (2001: 3,23% for EUR securities and 1,72% for USD securities). They were sold back to BIS on 2 January 2003, at a price that resulted in a yield of 2,99%.

Other foreign securities comprise ordinary shares of BIS, representing less than 0,1% of the total equity of BIS, paid up at 25% of their nominal value of 2.500 gold francs each.

8 LOANS TO GOVERNMENT

These relate to loans granted to the Government of the Republic of Macedonia in 1993 for settling the government obligations to commercial banks in connection with the payment of household foreign exchange deposits guaranteed by the Republic of Macedonia. The term of the loan with original amount of MKD 64,348 thousand was 10 years, to be settled in 20 equal semi-annual installments, with the last installment due on 1 January 2004.

The loan earns interest at the rate of 5% per annum.

9 RECEIVABLES FROM GOVERNMENT RELATED TO IMF

Receivables from Government from relations with IMF are analyzed as follows:

	2002	<i>2001</i>
Receivable related to IMF STF-1 borrowing (Note 24)	246.962	449.138
Receivable related to SDR allocation liability (Note 31)	667.490	728.360
Total	914.452	1.177.498

The Republic of Macedonia borrowed from IMF in 1994, for the first time, on the basis of an IMF arrangement known as Systemic Transformation Facility (STF) for the repayment of outstanding arrears towards the International Bank for Reconstruction and Development ("IBRD"). NBRM established a receivable account from the Government for an equivalent amount, in accordance with the agreement between NBRM and the Government of the Republic of Macedonia, to be serviced in parallel with the associated liability towards IMF. NBRM charges the government the same interest rate incurred on the borrowing from IMF, which is the basic rate of IMF (see note 6).

The receivable related to SDR allocation concerns only the corresponding liability for the Macedonian share of the obligation towards IMF for the SDR allocated to, and received by, the former Yugoslavia., based on the Law on the Legal Succession of the Republic of Macedonia in the Membership of the IMF (see note 31).

Pursuant to the IMF Statute, ratified by the Parliament of the Republic of Macedonia, and the related Law on the Legal Succession of the Republic of Macedonia in the Membership of the IMF, NBRM acts as a fiscal agent of the Republic of Macedonia, and as a depository of IMF in the Republic of Macedonia. In this capacity, NBRM records the membership quota in IMF of the Republic of Macedonia, and also Accounts No.1, and No.2 with IMF. The balances of these three accounts, which are not reflected in these financial statements, were MKD 5.875.874 thousand, MKD 14.727 thousand, and MKD 173 thousand, respectively (2001: MKD 5.872.059 thousand, MKD 14.717 thousand, and MKD 173 thousand, respectively).

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10 GOVERNMENT SECURITIES

Government securities are analyzed as follows:

	<i>2002</i>	<i>2001</i>
Bond maturing in April 2020	610.612	592.072
Other Bonds	2.456.107	2.763.120
Total	3.066.719	3.355.192

Government securities represent Bonds issued by the Bank Rehabilitation Agency on behalf of the Republic of Macedonia for rehabilitation and restructuring of the largest Macedonian commercial bank, based on the provisions of the 1995 Law on Rehabilitation and Restructuring of Part of Banks in the Republic of Macedonia.

The Bond maturing in one lump-sum payment in April 2020, with a nominal value of MKD 1.039.318, does not earn any interest. For IFRS reporting purposes, this Bond is valued at the fair value of the assets that were given up in exchange, subsequently amortized to maturity.

The other Bonds are repayable in equal annual installments of MKD 307.013 thousand until 1 April 2010. These Bonds earn interest at a variable rate equal to the NBRM discount rate, which during 2002 was 10.7% per annum (2001: 7,9% until 28 June 2001, and 10,7% per annum thereafter), payable on a monthly basis.

11 RECEIVABLES FROM EXTERNAL ACCOUNT TRANSACTIONS

Foreign exchange transactions of the Government with regard to receiving and repaying Government foreign currency borrowings are conducted through a so-called external account of NBRM, in order to avoid any monetary impact from Government foreign exchange debt transactions. The balance of this account reflects the amounts paid by NBRM on behalf of the Government from its foreign reserves which have not been reimbursed by the Government by year-end. This account does not earn any interest.

12 LOANS TO BANKS

Loans to banks are analyzed as follows:

	<i>2002</i>	<i>2001</i>
Long-term loans from the conversion of selective loans in:		
1993	38.287	38.287
1996	24.253	24.253
Long-term loans from other conversions	262	262
Total	62.802	62.802

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

13 OTHER RECEIVABLES FROM BANKS

The balance at 31 December 2001 comprises mostly foreign exchange denominated claims from domestic banks that have arisen just before year-end as a result of regular NBRM operations of selling and buying foreign exchange with them, and were cleared in the first week of 2002.

14 OVERDUE RECEIVABLE FROM BANKS

Overdue receivable from banks are analyzed as follows:

	<i>2002</i>	<i>2001</i>
Overdue deposit auctions	9.268	160.600
Provisions	(6.825)	(6.825)
Total	2.443	153.775

Auction sales of deposits represent a monetary instrument designed to provide additional liquidity into the banking system by auctioning NBRM deposits to commercial banks for short periods of time and carrying interest rates set at the respective auction. Overdue receivable from banks represent auction deposits sold in 1999 to two banks, which were not repaid on the due date. In 2001, bankruptcy procedure was instituted against both, and it is still in progress. According to the Law on Banks, the claims of NBRM, together with the claims of the Republic of Macedonia, have priority over the claims of other creditors.

The movement of these claims is analyzed as follows:

	<i>Total</i>
31 December 2000	183.600
Collected in cash	<u>(23.000)</u>
Subtotal	160.600
Provisions	<u>(6.825)</u>
At 31 December 2001	153.775
Collected in cash	(30.980)
Foreclosed property	<u>(120.352)</u>
At 31 December 2002	<u>2.443</u>

During 2002, NBRM utilizing its preferred creditor position stipulated by law, acquired legal title over premises of the two banks in Skopje in exchange for its overdue receivable. The value of the premises acquired in respect of the one bank exceeded the auction deposit principal receivable by MKD 41.806, representing recovery of interest on the receivable and resulting in income, as this interest was previously fully written off.

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15 PREMISES AND EQUIPMENT

Premises and equipment are analyzed as follows:

<i>Description</i>	<i>Buildings</i>	<i>Furniture, equipment and vehicles</i>	<i>Works of art</i>	<i>Computer software</i>	<i>Construction in progress</i>	<i>Total assets for business purposes</i>	<i>Assets for employee amenities</i>	<i>Total fixed assets</i>
<u>At revalued amount</u>								
At 1 January 2002	671.021	372.222	16.120	50.448	4.315	1.114.126	34.600	1.148.726
Additions	171.975	25.893	5.946	3.977	8.547	216.338	68	216.406
Disposals	(8.724)	(3.075)	-	-	-	(11.799)	(36)	(11.835)
Assets received free of charge	-	703	3	-	-	706	-	706
Revaluation	7.330	4.120	2	555	-	12.007	379	12.386
At 31 December 2002	<u>841.602</u>	<u>399.863</u>	<u>22.071</u>	<u>54.980</u>	<u>12.862</u>	<u>1.331.378</u>	<u>35.011</u>	<u>1.366.389</u>
<u>Accumulated depreciation and amortisation</u>								
At 1 January 2002	81.838	175.540	-	9.197	-	266.575	2.893	269.468
Charge for the year	6.780	44.570	-	10.176	-	61.526	1.377	62.903
Disposals	(254)	-2.886	-	-	-	(3.140)	(15)	(3.155)
Revaluation	974	2.406	-	210	-	3.590	47	3.637
At 31 December 2002	<u>89.338</u>	<u>219.630</u>	<u>-</u>	<u>19.583</u>	<u>-</u>	<u>328.551</u>	<u>4.302</u>	<u>332.853</u>
Carrying amount:								
At 31 December 2002	<u>752.264</u>	<u>180.233</u>	<u>22.071</u>	<u>35.397</u>	<u>12.862</u>	<u>1.002.827</u>	<u>30.709</u>	<u>1.033.536</u>
At 1 January 2002	<u>589.183</u>	<u>196.682</u>	<u>16.120</u>	<u>41.251</u>	<u>4.315</u>	<u>847.551</u>	<u>31.707</u>	<u>879.258</u>

Assets for employee amenities include two buildings and other furniture and equipment, in those buildings that serve the recreational needs of NBRM employees.

As part of the 2001 payments system reform, NBRM took over the function of cash provision from the former Payments Operations Bureau ("ZPP"), as well as part of ZPP premises, equipment and furniture associated with that function in ten cities in Macedonia. The premises transferred from ZPP are currently used and maintained by NBRM and NBRM has made capital improvements shown as construction in progress in the above schedule. However, NBRM has not yet acquired legal title over this property, pending government formal decision on the distribution of ZPP assets and there has not been an evaluation for the premises, yet. Therefore, no value for the premises has been recorded in the financial statements of NBRM, yet.

16 INVENTORIES

Inventories are analyzed as follows:

	<i>2002</i>	<i>2001</i>
Jubilee coins	50.633	51.766
Other inventories	21.910	15.011
Total	72.543	66.777

Jubilee coins represent golden and silver coins produced out of the monetary gold in NBRM vault to honor anniversaries deemed important for the country, as decided by the Government. At 31 December 2002, NBRM held 5.854 golden coins and 476 silver coins (2001: 5.987 golden coins and 499 silver coins). The jubilee coins are mainly intended for resale and gratuity, and a part is kept permanently for the NBRM collection.

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

17 RECEIVABLES

Receivables are analyzed as follows:

	<i>2002</i>	<i>2001</i>
Income tax	110.451	-
Interest	24.043	27.288
Fees and commissions	23.014	1.057
Other	14.539	4.652
Total	172.047	32.997

The income tax receivable balance relate to the excess of the monthly income tax advances paid during 2002 over the final tax liability for the year ended 31 December 2002 per the annual income tax return.

The interest receivable is mainly due to the December accrual of interest on government bonds (see note 10).

Fees and commissions include MKD 9.980 thousand of fees receivable for foreign exchange guarantees from a commercial bank that is currently in receivership (see note 3).

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18 OTHER ASSETS

Other assets are analyzed as follows:

	<i>2002</i>	<i>2001</i>
Reserve funds	716.888	716.888
Funds for employee amenities	138.772	145.830
Deferred tax asset (Note 43)	58.313	61.287
Deferred income	26.238	25.651
Assets with special purpose	615	615
Other	4.176	8.310
Total	945.002	958.581

Reserve funds are a counterpart to earnings retained in General reserves against potential future losses of NBRM operations (see note 32), as the specific nature of central bank operations and the central bank balance sheet requires the retention of earnings to be accompanied by allocation of funds from the general NBRM account (giro account) to a specific account. These funds cannot be used for purposes other than covering potential future losses of NBRM.

Funds for employee amenities are also allocated from the general NBRM account (giro account) and they are intended to fund recreational and other needs of NBRM employees.

Deferred income includes mainly interest income accrued at the balance sheet date in relation to sight and term deposits in foreign banks.

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

19 NARROW DEFINITION OF RESERVE MONEY

The narrow definition of reserve money is analyzed as follows:

	<i>2002</i>	<i>2001</i>
Money in circulation	14.814.692	15.671.213
Deposit accounts of banks	3.355.098	748.914
Total	18.169.790	16.420.127

Money in circulation includes notes and coins held by the general public, i.e., not accounted for in NBRM.

Accounts of banks are placed with NBRM. No interest is paid on these balances.

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20 COMPULSORY RESERVES OF BANKS AND SAVINGS HOUSES

Banks and savings houses were obliged to hold as compulsory reserves with NBRM a percentage of deposits placed with them, as prescribed by NBRM. The compulsory reserves of banks were merged with their accounts with NBRM (Note 19), with effect from 11 February 2002. Only savings houses are now required to hold the compulsory reserves on a special account with NBRM.

NBRM paid interest on the amount of compulsory reserves of savings houses at 89% of the NBRM discount rate, amounting to 9,52% per annum, until 11 July 2002, and at 6% per annum, thereafter. (2001: 9,52%)

21 NBRM BILLS

NBRM bills represent a monetary instrument designed to withdraw excess liquidity from the banking system by offering securities to banks for a pre-determined period (from three days to three months). The bills are subscribed by the banks through an auctioning process, whereby they bid for amounts they want to purchase (in cases when NBRM chooses to fix and preannounce the yield for the auctioned bills, which was the type of auction held until July 2002), or, the banks bid discount percentages that reflect the yield sought by the banks (in cases when NBRM tenders out a pre-determined amount of bills). During 2002, yield has varied between 6,8% and 16%, per annum (2001: between 6,7 % and 18%).

22 DEMAND DEPOSITS

Demand deposits comprise deposits of brokerage houses that are placed with NBRM in accordance with the payment system regulations.

NBRM does not pay interest on these deposits

23 RESTRICTED DEPOSITS

Restricted deposits mainly include foreign exchange funds of depositors (government) pending completion of wire transfers abroad and funds of depositors (government) that represent a 100% cover of letters of credit issued by NBRM on their behalf.

NBRM does not pay interest on these deposits.

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24 FOREIGN LIABILITIES

Foreign liabilities comprise borrowings from IMF and are analyzed as follows:

	<i>2002</i>	<i>2001</i>
Systemic Transformation Facility - Part 1 (STF-1)	246.962	449.138
Systemic Transformation Facility - Part 2 (STF-2)	411.604	628.794
Enhanced Structural Adjustment Facility (ESAF)	2.100.899	2.371.537
Compensatory Contingency Financing Facility (CCFF)	960.563	1.197.895
Poverty Reduction and Growth Facility (PRGF)	137.223	149.737
Extended Fund Facility (EFF)	91.482	99.824
Total	3.948.733	4.896.924

Borrowings from IMF are for the purpose of supporting the balance of payments, with the exclusion of STF-1 borrowing, which was for the purpose of repaying arrears towards IBRD (see note 9). All IMF borrowings are denominated in SDR.

CCFF is for a period of five years, including a three-year grace period, with quarterly payments, maturing in 2004. STF, ESAF, PRGF and EFF arrangements are for a period of ten years, including a grace period of four and a half years (STF and EFF) or five and a half years (ESAF and PRGF). These borrowings are payable in semi-annual installments and should be settled fully between 2004 and 2010, depending on the arrangement type.

ESAF and PRGF arrangements incur interest at concessional rates of 0,5% per annum. Other borrowing arrangements incur interest at the basic rate of IMF (see note 6).

25 DENAR DEPOSITS OF THE PUBLIC SECTOR

Denar deposits of the public sector are analyzed as follows:

	<i>2002</i>	<i>2001</i>
Central government account (Budget)	2.557.165	2.897.662
Other denar accounts	1.483.146	914.742
Total	4.040.311	3.812.404

Government keeps its central account (the Budget) in NBRM.

NBRM also maintains deposits for compensatory accounts of the Ministry of Finance related to the PHARE program and a few special accounts of government agencies such as the National Enterprise Promotion Agency, the Deposit Insurance Fund, and the Central Depository of Securities. These deposits are included above as "other denar accounts".

NBRM pays interest on these deposits, with the exception of the Central Depository of Securities deposit. The interest rate is renegotiated annually. During 2002, the interest rate was 5,5% per annum until 1 October 2002, and 3% per annum thereafter (2001: 5% per annum).

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26 FOREIGN EXCHANGE DEPOSITS OF THE PUBLIC SECTOR

NBRM offers deposit facilities to government and government entities for foreign exchange received as a result of foreign borrowings, foreign donations or other purposes, on the condition that, the opening of such accounts is formally approved by the Ministry of Finance.

NBRM pays interest on USD deposits at 70% of Federal Reserve System discount rate, amounting to rates between 0,5% and 0,9%, per annum (2001: between 1,2% and 4,2%), and on EUR deposits at 70% of ECB refinancing tender rate, amounting to rates between 1,2% and 1,6%, per annum (2001: between 2,3% and 3,3%), with the exception of the special foreign exchange privatization deposit denominated in EUR amounting to MKD 6.698.477 thousand (2001: MKD 11.371.050 thousand), which earns interest at the full amount of the above mentioned benchmark rates for EUR deposits.

27 STABILIZATION FUND

For the purpose of coordinating monetary and fiscal policies, the Government maintains funds in a special stabilization fund with NBRM, in order to support the exchange rate of the Macedonian Denar. This deposit does not earn interest.

28 OTHER PAYABLES

Other payables are analyzed as follows:

	<i>2002</i>	<i>2001</i>
Interest payables	30.079	35.502
Payables from appropriation of net income	26.993	307.731
Liabilities from BNT bankruptcy	15.263	24.762
Payables from sale of socially-owned flats	10.300	168.782
Income tax payable	9.983	16.707
Other payables	-	4.910
Total	92.618	558.394

Interest payables comprise mainly interest accrued for December on public sector MKD deposits and compulsory reserves of banks, paid in January.

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

As a result of the NBRM guarantee of household deposits stipulated by the banking regulations at the time, when a commercial bank was declared bankrupt in 1996, its liabilities amounting to MKD 292.442 thousand were transferred to NBRM with a decision of the bankruptcy court. In this respect, the amount of MKD 124.533 thousand was paid out until 31 December 2002 to meet claims by the bank depositors. The amount of MKD 15.263 thousand reflects the amount NBRM management believes that will be paid for the same purpose in the foreseeable future.

28 OTHER PAYABLES (Continued)

Payables from the sale of socially-owned flats arise when such flats are bought by their residents with foreign currency deposited in commercial banks, as allowed by the relevant regulations. The foreign exchange collected this way is transferred to NBRM and deposited in a special account, and the MKD equivalent is paid to the government on a weekly basis.

NBRM does not pay interest on either of these payables.

29 OTHER LIABILITIES

Other liabilities are analyzed as follows:

	<i>2002</i>	<i>2001</i>
NBRM Apex operation inflows	746.206	484.211
Bank deposits related to swap operations	660.901	68.032
Temporarily confiscated foreign currencies	145.844	146.491
Equity payments pending operational license	122.142	-
Jubilee coins counterpart (note 16)	50.633	51.767
Expected litigation outlays	30.779	30.779
IBRD special deposit	20.212	19.712
Accrued interest to IMF	19.107	13.116
Other liabilities	8.791	12.452
Bank deposits related to EUR changeover	-	5.381.453
Special purpose bank deposits	-	114.719
Total	1.804.615	6.322.732

NBRM Apex operation inflows includes mainly principal collected from the commercial banks within the framework of the Private Sector Development Loan ("PSDL") from IBRD, where NBRM acts as an intermediary ("Apex" Unit) channeling IBRD loans to commercial banks for on-lending as sub-loans and, on the other side, commercial bank repayments to IBRD. Since sub-loans have shorter repayment terms compared to the IBRD borrowing, NBRM accumulates principal repaid from the banks, but not yet due to IBRD. This accumulated principal is intended for rollovers of sub-loans until IBRD repayment is due. NBRM does not pay any interest on these funds.

Bank deposits related to swap operations consist of foreign exchange deposits of domestic banks made available for intra-day or other swap facilities that NBRM offers to domestic banks as a stand-by or discretionary facility for the banks' liquidity in local currency. None of the above amounts outstanding was being used for that purpose as at 31 December 2002. NBRM pays interest on these funds amounting to 70% of the benchmark rates explained in note 26.

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29 OTHER LIABILITIES (Continued)

Temporarily confiscated foreign currencies represent foreign currency holdings of individuals that were confiscated for a variety of reasons and deposited with NBRM by the confiscating authority, until the court resolution of the dispute, when the foreign currencies are either returned to the original holder or conferred to the government. The above amount represents the foreign currencies that were temporarily confiscated up to 1993 and have been subsequently included in the foreign reserves under NBRM management. Thereafter, the temporarily confiscated foreign currencies have been kept physically separate from other foreign currencies, and do not constitute part of the foreign reserves under NBRM management, and are thus recorded in a memo account until a final court resolution. Those foreign currencies recorded off-balance sheet amount to MKD 101.788 thousand at 31 December 2002 (2001: MKD 72.021 thousand). NBRM does not pay interest on these funds.

Equity payments pending operational license include EUR 1 million deposit made in respect of a license application to the Ministry of Finance for an insurance company license, made in accordance with the Insurance Supervision Law, and a EUR 1 million deposit related to a license application to NBRM for money transfer activities, made in accordance with the NBRM regulation on money transfer. NBRM does not pay interest on these funds.

Expected litigation outlays relate to estimated amounts of interest that NBRM management expects to pay to insurance companies that have sued NBRM for foreclosing on their giro accounts the amounts that these insurance companies owed to NBRM with regard to insuring NBRM advances to exchange bureaus.

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

Bank deposits related to Euro changeover concern the aggregate amounts of banknotes of currencies replaced by Euro that were deposited by Macedonian banks before 31 December 2001 and were converted into Euro and released back to the banks at the beginning of 2002.

Special-purpose bank deposits arose when Macedonian commercial banks that had borrowed under a NBRM deposit guarantee from a foreign bank that was later put under administration started channeling their loan repayments to NBRM, pending resolution of the status of that bank. The accumulated deposits were released during 2001 and 2002, in conformity with the Deposit Release Agreement signed between NBRM and the bank administrators, that requires NBRM to encourage reduction of arrears of Macedonian banks towards the foreign bank in return for a conditional release of NBRM deposits.

30 COUNTER-ENTRIES IN NBRM ACCOUNTS

Counter-entries in NBRM accounts arise as a result of the specific nature of central bank operations, with respect to the following:

- counter-entries for local currency deposits maintained in NBRM,
- stocks of banknotes and coins in case of a need to issue them into circulation, as well as administrative forms and stamp duty that are also put in circulation by NBRM,
- for transactional giro account and special accounts for so-called "primary issue" that reflect changes in underlying assets and liabilities used for monetary policy purposes, etc.

Since the above categories do not represent liabilities or receivables against third parties, they are netted off and only the net amount is shown on the balance sheet.

31 SDR ALLOCATION

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

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

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

32 GENERAL RESERVES

It is stipulated in the NBRM Law that 20% of NBRM annual net income after taxes is transferred to the general reserves until the level of initial NBRM capital is reached.

General reserves act can be used to cover unexpected losses in NBRM operations. Before the 2002, the general reserves included also other special reserves components, such as, the Reserve from realized net foreign exchange gains, Reserves for crediting Deposit Insurance Fund, and General Reserves, which were unified in 2002.

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33 FUNDS

Funds are analyzed as follows:

	<i>2002</i>	<i>2001</i>
Fixed Assets Fund	1.258.046	1.251.512
Fund for Employee Amenities	173.988	182.304
Total	<u>1.432.034</u>	<u>1.433.816</u>

By its earlier constitution, and following its established central bank accounting practices, NBRM does not have equity capital. These fund accounts were originally a quasi-equity account for its fixed assets for business purposes and fixed assets for employee amenities, including the NBRM accounts that are used to finance those fixed assets. They were increased by retaining earnings in accordance with the Council Decision for appropriation of net income, based on the financial plan of NBRM for purchases of fixed assets, as approved by the Parliament, but also when fixed assets were received free of charge or converted to cash.

34 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.

35 IFRS ADJUSTMENTS

This retained earnings account accumulates all changes to statutory profit and loss statements up to and including year 2002 that were required for the financial statements to be compliant with IFRS in all material aspects applicable to central banks, with year 2001 being the first year NBRM prepared financial statements in compliance with IFRS (IAS). The movement of this account is analyzed as follows:

<i>At 31 December 2000</i>	-
IFRS adjustments to the statutory profit and loss statements up to 2000	432.667
IFRS adjustments to the statutory profit and loss statement for 2001	(54.594)
<i>At 31 December 2001</i>	<u>378.073</u>
IFRS adjustments to the statutory profit and loss statement for 2002	(5.918)
<i>At 31 December 2002</i>	<u>372.155</u>

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36 INTEREST INCOME

Interest income is analyzed as follows:

	<i>Loans granted</i>	<i>Deposits made</i>	<i>Securities purchased</i>	Total 2002	<i>Total 2001</i>
Government	868		277.001	277.869	266.485
Domestic banks	16.904			16.904	15.923
Foreign entities		1.418.858	8.569	1.427.427	2.201.017
Total 2002	17.772	1.418.858	285.570	1.722.200	2.483.425
Total 2001	17.147	2.114.147	352.131	2.483.425	

37 INTEREST EXPENSE

Interest expense is analyzed as follows:

	<i>Loans received</i>	<i>Deposits received</i>	<i>Securities issued</i>	Total 2002	<i>Total 2001</i>
Government		476.081		476.081	960.855
Domestic banks		174.495	568.663	743.158	483.927
Foreign entities	99.856			99.856	148.051
Total 2002	99.856	650.576	568.663	1.319.095	1.592.833
Total 2001	148.051	1.087.563	357.219	1.592.833	

38 FEE INCOME

Fee income is analyzed as follows:

	2002	<i>2001</i>
Fees from foreign exchange payments	50.760	106.144
Fees from guarantees for domestic bank borrowings	38.615	23.585
Fees from sales of duty stamps	20.289	10.074
Fees from providing cash to commercial banks	36.518	-
Fees from domestic bank payments clearing (RTGS)	26.277	1.611
Fees from Euro exchange for domestic banks	20.739	1.093
Other fees	8.263	6.022
Total	201.461	148.529

Fees from foreign exchange payments are mainly generated when NBRM sells foreign exchange to banks as part of NBRM and bank treasury operations and when NBRM sells foreign exchange and executes foreign payments upon instructions of government entities conducting payment operations through NBRM.

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38 FEE INCOME (Continued)

Fees from guarantees for domestic bank borrowings include fees of 0,1% a month, charged on the balance of guarantees issued by NBRM for borrowings of domestic banks from foreign banks, in accordance with a NBRM Council Decision that allows foreign exchange reserves managed by NBRM to be used as a guarantee to domestic banks for borrowing from foreign banks and on-lending the borrowing proceeds to Macedonian companies.

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

Fees from providing cash to commercial banks and fees from domestic bank payments clearing (RTGS) relate to services to domestic commercial banks, which NBRM commenced providing as from the beginning of 2002 and from the end of 2001, respectively.

Fees from changing EUR for domestic banks, earned around the EUR changeover cut-off date of 31 December 2002, were generated when domestic banks chose to use NBRM services for exchanging the currencies collected from the public into EUR.

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

39 OTHER INCOME

Other income is analyzed as follows:

	<i>2002</i>	<i>2001</i>
Realized foreign exchange gains, net	56.908	111.652
Collection of interest written off earlier (Note 14)	41.806	-
Fees from NBRM Apex operations (Note 29)	11.688	20.402
Dividend income from BIS (Note 7)	6.804	-
Other income	16.193	9.415
<u>Extraordinary items</u>		
BIS shares received without compensation	-	49.036
Cancelled liability to replace 1993 banknotes	-	120.468
Total	133.399	310.973

Realized foreign exchange gains, net, arise mainly from operations of buying and selling foreign exchange with domestic banks and from the 0,3% spread between the middle and buying official exchange rates when NBRM sells foreign exchange to government for foreign payments.

At 31 December 2001, the obligation to replace previous banknotes issued in 1993 with the existing legal tender (banknotes issued in 1996) expired, as set by a Decision of the NBRM Council, and the liability of NBRM to replace such banknotes was cancelled.

NOTES TO THE FINANCIAL STATEMENTS
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all amounts in MKD'000

40 FEE EXPENSE

Fee expense is analyzed as follows:

	<i>2002</i>	<i>2001</i>
Fees to foreign banks	19.666	13.249
Fees to domestic banks related to exchange operations	9.928	69.460
Other fees to domestic banks	5.805	7.071
Total	35.399	89.780

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

41 OTHER EXPENSE

Other expense is analyzed as follows:

	<i>2002</i>	<i>2001</i>
Services	74.743	85.049
Costs for production of banknotes and coins	31.926	121.170
Materials	27.087	22.465
Other administrative expenses	11.257	10.211
Expenses for expected litigation outlays (Note 29 and 45c)	-	30.779
Other expenses	4.279	2.441
Total	149.292	272.115

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

42 LOAN LOSS PROVISIONS, NET

Loan loss provisions are analyzed as follows:

	<i>2002</i>	<i>2001</i>
Provisions charged in 2002 against bank deposits	241.500	-
Reversal of provisions for interest collected from the foreign bank under administration (Note 3)	(87.143)	-
Total	154.357	-

43 TAXATION

	<i>2002</i>	<i>2001</i>
Deferred asset:		
At 1 January	61.287	76.353
Movement for the year relating to income statement		
Reversal of previous temporary differences	(2.974)	(6.152)
Origination of temporary differences	-	(8.914)
At 31 December	58.313	61.287

The net deferred tax asset comprises the following types of temporary differences:

	<i>2002</i>	<i>2001</i>
Deferred tax assets:		
Adjustment for non-interest earning bond (Note 10)	64.306	67.087
Cut-off of gold used for jubilee coins	-	804
Correction of prior year deferred taxation	-	3.115
Deferred tax liabilities:		
BIS shares obtained for free (Note 7)	(5.993)	(7.356)
Cut-off of interest for bank sight deposit	-	(2.363)
Net deferred tax asset	58.313	61.287

The relationship between the tax expense and the accounting profit can be explained as follows:

	<i>2002</i>	<i>2001</i>
Profit before taxation per income statement	47.988	751.023
Income tax at the statutory rate of 15%	7.198	112.653
Tax effects arising from:		
origination and reversal of timing differences	1.641	4.616
expenses that are not deductible for tax purposes	1.275	16.423
income that is not taxable for income tax purposes	-	(16)
tax relief for fixed assets additions	(1.785)	(2.841)
Tax at effective income tax rate 17,4% (2001: 17,4%)	8.329	130.835
Effective tax rate	17,4%	17,4%
Current income tax expense	5.355	115.769
Deferred tax expense	2.974	15.066
	8.329	130.835

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43 TAXATION (Continued)

NBRM income tax liabilities are based on the tax returns filed to the tax authorities and are finalized when audited by the Central Tax Authorities, or a ten-year period has elapsed from the year they are filed. The NBRM books and records have not been audited by the income tax authorities for 2002 and 2001. Therefore, the NBRM income taxes for these years may not be considered finalized.

44 FINANCIAL INSTRUMENTS

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

a) Liquidity risk

Liquidity risk is the risk that NBRM will be unable to meet its liabilities when they fall due.

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

The table below summarizes the maturity profile of the bank's assets and liabilities based on contractual repayment determined on the basis of the remaining period at the balance sheet date to the contractual maturity date, at **31 December 2002**:

	<i>Up to 1 month</i>	<i>1 to 3 months</i>	<i>3 months to 1 year</i>	<i>1 to 5 years</i>	<i>over 5 years</i>	<i>Total</i>
ASSETS						
Foreign assets	35.606.996	9.625.296	-	-	39.953	45.272.245
Receivable from public sector	4.476.137	82.321	393.263	1.314.401	1.531.652	7.797.774
Receivable from banks	9.158	-	2.863	35.424	24.515	71.960
Other assets	1.054.223	-	-	58.313	1.110.592	2.223.128
Total assets	41.146.514	9.707.617	396.126	1.408.138	2.706.712	55.365.107
LIABILITIES						
Reserve money	21.187.705	-	-	-	-	21.187.705
Restricted deposits	553.383	-	-	-	-	553.383
Foreign liabilities	-	511.536	728.870	2.507.812	200.515	3.948.733
Deposits of public sector	18.332.765	-	-	-	-	18.332.765
Other liabilities	2.408.061	-	-	-	-	2.408.061
SDR allocation liability	667.490	-	-	-	-	667.490
Capital accounts	-	-	-	-	8.266.970	8.266.970
Total liabilities and capital	43.149.404	511.536	728.870	2.507.812	8.467.485	55.365.107
GAP ANALYSIS						
Gap per individual band	(2.002.890)	9.196.081	(332.744)	(1.099.673)	(5.760.773)	
Cumulative gap	(2.002.890)	7.193.191	6.860.447	5.760.773	-	

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44 FINANCIAL INSTRUMENTS (Continued)**a) Liquidity risk (Continued)**

The maturity profile of the assets and liabilities at 31 December 2001 was as follows:

	<i>Up to 1 month</i>	<i>1 to 3 months</i>	<i>3 months to 1 year</i>	<i>1 to 5 years</i>	<i>over 5 years</i>	<i>Total</i>
ASSETS						
Foreign assets	59.089.801	327.858	408.196	-	47.163	59.873.018
Receivable from public sector	4.530.190	89.828	93.387	1.816.694	1.820.125	8.350.224
Receivable from banks	272.194	-	-	29.431	33.371	334.996
Other assets	925.526	-	-	61.287	950.800	1.937.613
Total assets	<u>64.817.711</u>	<u>417.686</u>	<u>501.583</u>	<u>1.907.412</u>	<u>2.851.459</u>	<u>70.495.851</u>
LIABILITIES						
Reserve money	21.383.807	-	-	-	-	21.383.807
Restricted deposits	587.247	-	-	-	-	587.247
Foreign liabilities	-	179.655	179.655	3.616.521	921.093	4.896.924
Deposits of public sector	25.220.283	-	-	-	-	25.220.283
Other liabilities	7.295.867	-	-	-	-	7.295.867
SDR allocation liability	728.360	-	-	-	-	728.360
Capital accounts	-	-	-	-	10.383.363	10.383.363
Total liabilities and capital	<u>55.215.564</u>	<u>179.655</u>	<u>179.655</u>	<u>3.616.521</u>	<u>11.304.456</u>	<u>70.495.851</u>
GAP ANALYSIS						
Gap per individual band	<u>9.602.147</u>	<u>238.031</u>	<u>321.928</u>	<u>(1.709.109)</u>	<u>(8.452.997)</u>	
Cumulative gap	<u>9.602.147</u>	<u>9.840.178</u>	<u>10.162.106</u>	<u>8.452.997</u>	<u>-</u>	

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44 FINANCIAL INSTRUMENTS (Continued)**b) Interest rate risk**

Interest rate risk arises from the possibility that changes in interest rates will affect future profitability or the fair values of financial instruments. NBRM is exposed to interest rate risk as a result of mismatches of interest rate re-pricing of assets and liabilities.

With regard to domestic assets and liabilities, NBRM has significant powers to influence interest rates, directly, through setting the discount rate which then determines the remuneration rate on bank compulsory reserves, loans to banks and government securities, and indirectly, through influencing the overall level of interest rates via its monetary policy. However, these powers are used in the context of the monetary policy and in the interest of the economy as a whole, are constrained by the overall framework of the country's economic policy, and are not guided by NBRM balance sheet or profitability considerations. With regard to foreign assets and liabilities, a large part of NBRM liabilities are at variable interest rates and the bulk of NBRM assets are at short terms that effectively simulate the interest rate variability on the liabilities side.

The Bank's interest sensitivity position based on contractual re-pricing arrangements at **31 December 2002** was as follows:

	<i>Interest-bearing items</i>				<i>Non-interest</i>		<i>Total</i>
	<i>Up to 1 month or at variable rate</i>	<i>1 to 3 months</i>	<i>3 months to 1 year</i>	<i>1 to 5 years</i>	<i>over 5 years</i>	<i>bearing items</i>	
ASSETS							
Foreign assets	35.058.852	9.625.296	-	-	-	588.097	45.272.245
Receivable from public sector	2.706.902	-	3.929	4.027	610.612	4.472.304	7.797.774
Receivable from banks	2.443	-	2.863	35.424	24.515	6.715	71.960
Other assets	-	-	-	-	-	2.223.128	2.223.128
Total assets	37.768.197	9.625.296	6.792	39.451	635.127	7.290.244	55.365.107
LIABILITIES							
Reserve money	3.002.602	-	-	-	-	18.185.103	21.187.705
Restricted deposits	-	-	-	-	-	553.383	553.383
Foreign liabilities	1.710.611	72.448	289.782	1.721.118	154.774	-	3.948.733
Deposits of public sector	10.720.429	-	-	-	-	7.612.336	18.332.765
Other liabilities	660.901	-	-	-	-	1.747.160	2.408.061
SDR allocation liability	667.490	-	-	-	-	-	667.490
Capital accounts	-	-	-	-	-	8.266.970	8.266.970
Total liabilities & capital	16.762.033	72.448	289.782	1.721.118	154.774	36.364.952	55.365.107
GAP ANALYSIS							
Gap per individual band	21.006.163	9.552.849	(282.990)	(1.681.666)	480.353	(29.074.708)	
Cumulative gap	21.006.163	30.559.012	30.276.021	28.594.355	29.074.708		

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44 FINANCIAL INSTRUMENTS (Continued)**b) Interest rate risk (Continued)**

The bank's interest sensitivity position based on contractual re-pricing arrangements at 31 December 2001 was as follows:

	<i>Interest-bearing items</i>				<i>Non-interest bearing items</i>		<i>Total</i>
	<i>Up to 1 month or at variable rate</i>	<i>1 to 3 months</i>	<i>3 months to 1 year</i>	<i>1 to 5 years</i>	<i>over 5 years</i>		
ASSETS							
Foreign assets	53.829.906	327.859	408.196	-	-	5.307.057	59.873.018
Receivable from public sector	3.215.731	-	3.559	12.145	-	5.118.789	8.350.224
Receivable from banks	153.775	-	-	29.431	33.371	118.419	334.996
Other assets	-	-	-	-	-	1.937.613	1.937.613
Total assets	57.199.412	327.859	411.755	41.576	33.371	12.481.878	70.495.851
LIABILITIES							
Reserve money	4.963.680	-	-	-	-	16.420.127	21.383.807
Restricted deposits	-	-	-	-	-	587.247	587.247
Foreign liabilities	2.375.651	-	-	1.343.876	1.177.397	-	4.896.924
Deposits of public sector	12.572.442	-	3.792.081	-	-	8.855.760	25.220.283
Other liabilities	182.751	-	-	-	-	7.113.116	7.295.867
SDR allocation liability	728.360	-	-	-	-	-	728.360
Capital accounts	-	-	-	-	-	10.383.363	10.383.363
Total liabilities & capital	20.822.884	-	3.792.081	1.343.876	1.177.397	43.359.613	70.495.851
GAP ANALYSIS							
Gap per individual band	36.376.528	327.859	(3.380.326)	(1.302.300)	(1.144.026)	(30.877.735)	
Cumulative gap	36.376.528	36.704.387	33.324.061	32.021.761	30.877.735		

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44 FINANCIAL INSTRUMENTS (Continued)**c) Foreign exchange risk**

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates.

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

The table below shows main categories of assets and liabilities analyzed by their currency of denomination, as at **31 December 2002**:

	EUR	USD	SDR	other	MKD	Total
ASSETS						
Foreign assets	27.010.470	12.136.781	358.302	6.420.4814	(653.792)	45.272.245
Receivable from public sector	-	3.804.814	914.452	-	3.078.508	7.797.774
Receivable from banks	-	-	-	-	71.960	71.960
Other assets	5.331	18.294	-	2.613	2.196.890	2.223.128
Total assets	27.015.801	15.959.889	1.272.754	6.423.097	4.693.566	55.365.107
LIABILITIES						
Reserve money	-	-	-	-	21.187.705	21.187.705
Restricted deposits	44.395	445.039	-	63.949	-	553.383
Foreign liabilities	-	-	3.948.733	-	-	3.948.733
Deposits of public sector	7.409.123	303.333	-	-	10.620.309	18.332.765
Other liabilities	1.577.201	112.786	-	14.021	704.053	2.408.061
SDR allocation liability	-	-	667.490	-	-	667.490
Capital accounts	-	-	-	-	8.266.970	8.266.970
Total liabilities and capital	9.030.719	861.158	4.616.223	77.970	40.779.037	55.365.107
GAP ANALYSIS						
Gap per currency	17.985.082	15.098.731	(3.343.468)	6.345.127	(36.085.471)	

44 FINANCIAL INSTRUMENTS (Continued)**c) Foreign exchange risk (Continued)**

The table below shows main categories of assets and liabilities analyzed by their currency of denomination, as at 31 December 2001:

	EUR	USD	SDR	other	MKD	Total
ASSETS						
Foreign assets	41.721.416	13.939.082	154.018	4.058.502	-	59.873.018
Receivable from public sector	-	3.798.357	1.177.498	-	3.374.369	8.350.224
Receivable from banks	1.093	80.915	-	30.086	222.902	334.996
Other assets	19.104	2.949	-	5.862	1.909.698	1.937.613
Total assets	41.741.613	17.821.303	1.331.516	4.094.450	5.506.969	70.495.851
LIABILITIES						
Reserve money	-	-	-	-	21.383.807	21.383.807
Restricted deposits	163.987	369.774	-	53.486	-	587.247
Foreign liabilities	-	-	4.896.924	-	-	4.896.924
Deposits of public sector	12.054.230	793.542	-	109	12.372.402	25.220.283
Other liabilities	6.313.240	42.852	12.679	8.574	918.522	7.295.867
SDR allocation liability	0	-	728.360	-	-	728.360
Capital accounts	-	-	-	-	10.383.363	10.383.363
Total liabilities and capital	18.531.457	1.206.168	5.637.963	62.169	45.058.094	70.495.851
GAP ANALYSIS						
Gap per currency	23.210.156	16.615.135	(4.306.447)	4.032.281	(39.551.125)	

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44 FINANCIAL INSTRUMENTS (Continued)**d) Credit risk**

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss.

The size and concentration of the exposure of NBRM to credit risk can be obtained directly from the balance sheet and notes to balance sheet positions that describe financial assets. In the case of NBRM, the main credit risk arises in respect of correspondent banks where foreign exchange deposits and other foreign assets are placed and in respect of domestic banks regarding the use of NBRM guarantees. The table below shows main concentrations of credit risk by counter-party, as of 31 December.

	<i>Deposits</i>	<i>Securities</i>	<i>Total 2002</i>	<i>2001</i>
BIS Basle	30.247.039	467.448	30.714.487	32.048.072
Federal Reserve Bank of New York	8.708.892	-	8.708.892	365.321

Main instrument for managing credit risk is the NBRM Council regulation requirement foreign reserves to be placed with banks that cumulatively meet both a criterion of size (to be among 200 largest according to the Banker's Almanac) and a criterion of credit rating (to be rated at least A3 per Moody's or comparable), with exceptions approved by the NBRM Council. These requirements are monitored when opening a new bank account and continually thereafter until account closure.

e) Fair value

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

	<i>31 December 2002</i>			<i>31 December 2001</i>		
	<i>Carrying value</i>	<i>Fair value</i>	<i>Difference</i>	<i>Carrying value</i>	<i>Fair value</i>	<i>Difference</i>
Financial assets						
Non-interest earning government bond (Note 10)	610.612	238.791	(371.821)	592.072	219.275	(372.797)
Long-term loans to banks from conversion of selective loans (Note 7)	62.802	38.004	(24.798)	62.802	35.385	(27.417)
Net difference between			(396.619)			(400.214)

The fair values were estimated by discounting to net present value the future cash flows associated with the financial instruments using the discount rate of NBRM of 8.9% prevailing during the last two years.

As explained in note 7, included under available-for-sale investments are BIS shares with a value of MKD 39,953 thousand (2001: MKD 47,163 thousand), for which fair value cannot be reliably determined due to the fact that these shares are not actively traded.

Carrying amounts of other financial assets and liabilities approximate their fair values.

31 December 2002

45 COMMITMENTS AND CONTINGENCIES**a) Capital commitment**

NBRM has uncalled capital on its investment in BIS shares amounting to 806.250 gold francs or MKD 119.859 thousand (see note 7). In accordance with the BIS Statute, the unpaid capital is callable at three months notice by decision of the BIS Board.

b) Guarantees

Based on the NBRM Council "Decision on Criteria and Conditions for Using Part of Foreign Reserves for Providing Guarantees to Banks Authorized for Foreign Operations" and "Decision on Using Part of Foreign Reserves for Providing Guarantees to Banks Authorized for Foreign Operations Aimed at Supporting Economic Activities", NBRM pledges part of the foreign reserves in form of bank deposits to guarantee borrowings of domestic banks from foreign banks to finance sub-loans to domestic enterprises, mainly for export and manufacturing purposes.

As of 31 December 2002, there were 12 such individual guarantees outstanding, in the total amount of MKD 2.582.378 thousand (2001: 22 individual guarantees, MKD 3.501.097 thousand).

c) Litigation

NBRM is defendant in a number of lawsuits. 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 note 29).

d) Derivatives

NBRM had no derivatives as of 31 December 2002 (2001: nil).