National Bank of the Republic of Macedonia

ANNUAL REPORT 2003

Skopje, 2004

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Dear Sir/Madam,

The performances of the Macedonian economy in 2003 clearly indicate the capacity of the country for successful mitigation of the unfavourable effects of the security crisis in 2001 and resuming the positions of normal and stable economic functioning. Thus, after the moderate increase in 2002, 2003 registered an economic growth rate of 3.2%, thus exceeding the projected acceleration of 2.8%. One of the major generators of the real GDP increase in 2003 is the industry sector, the 4.5% growth rate of which is an encouraging indicator for the possibilities for more intensive growth. Moreover, the indicators of the foreign trade show gradual return of the Macedonian exporters to the international markets and normalization of the relations with the foreign partners, which is an additional signal for successful consolidation of the economy. In 2003, the economic activity was properly supported by the successful price stability maintenance, which contributes towards reducing the uncertainty and stabilizing the expectations of the economic entities.

The perceptions of the international community for gradual and successful recovery of the economy, the clear determination for conducting consistent macroeconomic policy and the consistent determination for implementing the commenced reforms were confirmed by the conclusion of the Stand-By Arrangement with the IMF on April 30, 2004. The arrangement meant establishing a consistent macroeconomic program, focused on proper fiscal consolidation, low and stable inflation rate and maintenance of a capacity for persistent implementation of the current monetary strategy.

The IMF support, through the concluded arrangement, apart from the financial effects was also a signal for the international investors for lower risk and uncertainty and substantial stabilization of the overall developments. Thus the conclusion of the arrangement also meant an access to additional external financing based on foreign credits and donations, which is an adequate support of the process of economic recovery.

In 2003, the FSAP Mission (joint IMF and World Bank Mission within Financial Sector Assessment Program) visited Macedonia for the first time, and reached positive conclusions for the resistance of the Macedonian banking system to various types of shocks, for the institutional layout of the National Bank of the Republic of Macedonia (NBRM) and the transparency in its operations, as well as for the payment system effectiveness and security. Thus the international financial institutions confirmed the successful convergence of the Macedonian financial system towards the internationally accepted operating standards and principles.

The Republic of Macedonia orientation towards integration into the global trade courses, its readiness to accept the commitments which are inevitably imposed by the integration, as well as the willingness of the international factor to include the country in its structures were confirmed with the official membership of the Republic of Macedonia in the World Trade Organization (WTO) on April 4, 2003. The membership in the WTO also means a clear determination for promoting competitive environment, which should contribute to larger effectiveness, higher quality and better standard of living.

In 2003, the NBRM continued with successful implementation of the strategy of targeting the exchange rate of the Denar against the Euro. The maintenance of the exchange rate stability as a nominal anchor essentially contributed towards preserving low and stable inflation rate, which means successful achievement of the ultimate goal of the monetary policy. Thus 2003 ended with an average inflation rate of 1.2%, which is below the projected inflation of 1.8%. The successful "inflation file" is a factor which contributes towards approximating of the Republic of Macedonia to the European Union and its further successful integration.

In 2003, compared to the previous two years, the monetary policy was conducted in a considerably changed environment. The successful fiscal consolidation, the substantially lower risk and the *stabilized expectations of the economic agents called for gradual modification of the monetary policy design. Thus in 2003 the NBRM dynamics of the interest rates indicates gradual relaxation of the monetary policy. This, in particular, could be perceived through the average weighted interest rate on the CB bills (which remained a basic monetary regulation instrument), which from 15.2% at the end of 2002, reduced to 6.2% at the end of 2003. The operational flexibility of the monetary policy was proved through the adjustment of the CB bills layout in this year. Thus in April 2003, the NBRM switched towards "volume tender" auctions with fixed interest rate of 7%, while the "interest rate tender" auctions, i.e. market-based setting of interest rates with bidding by the banks, were reintroduced in October.*

The maintenance of the exchange rate at a stable level, as an intermediary monetary goal, still imposes the need of an active role of the NBRM on the foreign exchange market. With the set of amendments to the regulations in the area of foreign exchange operations (aimed at larger liberalization) the foreign exchange market started operating in a new manner at the end of January 2003. This means equal participation of the NBRM, which is to be aimed at larger effectiveness of the operations on the foreign exchange market and optimal allocation of the foreign assets. In 2003, the NBRM was permanently intervening on the foreign exchange market in order to overcome the discrepancy between the demand for and the supply of foreign exchange, with the interventions being directed towards cumulative net-sale of foreign exchange. Such interventions layout partially reflects the possibility of the enterprises to freely handle the foreign assets (and consequently, lower supply of foreign exchange), as well the further maintenance of a deficit in the current account of the balance of payments (which results in an unfavourable foreign exchange demand to supply ratio). Notwithstanding the aforementioned, the gross foreign exchange reserves went up on annual basis and remained at an adequate level of 4.7-month import coverage, with the liabilities to the external creditors being regularly serviced. Notwithstanding the increase in the external indebtedness (the total debt reached US Dollar 1,813 million), the Republic of Macedonia still remains within the group of low, i.e. moderately indebted countries. Thus in line with the structure of currency of denomination of the external debt and the change in the value of the US Dollar, 84.7% of the increase in the total external debt in 2003 reflects the positive exchange rate differentials (the annual increase in the external debt amounted to US Dollar 177.6 million, US Dollar 150.4 million of which pertains to exchange rate differentials).

Conversely to the considerable reduction of the fiscal deficit and the successful maintenance of the price stability, the high deficit in the current account of the balance of payments remained in 2003, particularly due to the trade deficit. Private transfers remained to be dominant in the deficit financing, while the structure of the capital and the financial account indicates the need of stimulating the foreign direct investments, as a potential high-quality and productive source of financing. Nevertheless, in 2003, the current account deficit was substantially reduced (and equaled 6% of the GDP), thus approximating to the sustainable deficit of 5%, set as a rule of thumb.

The further strengthening of the confidence in the banking system and the stronger preferences for saving within the official banking channels were illustrated with the continuous growth in the deposit potential. Thus the total deposits of the private sector in the banks registered considerable annual increase of 26.8% in 2003. Such a dynamics of the deposits might be explained with the accelerated economic activity and the higher income level, the larger credibility of the banking system, as well as the lowered risk, i.e. the lower uncertainty. Nevertheless, a portion of the additional deposit potential was generated from the payment of the regular installments of the Government bonds for the old foreign exchange savings, with preferences for keeping these funds on the banks' accounts being registered. In addition, a dominant portion of these funds was kept in Denars, which indicates strengthening of the confidence in the domestic currency. This is also illustrated through the high annual growth rate of the Denar deposits in the banks of 32.9%. Positive dynamics was also registered in the deposits denominated in foreign currency (annual growth of 23.7%), partially due to the possibility of the enterprises to freely handle the foreign assets. Such movements of the banks' deposit potential resulted in high annual growth rates of the monetary aggregates. Thus the monetary *aggregates M2 – Denar component and M4 picked up by 15.6% and 18.1%, respectively, on annual basis.*

In 2003, the banks actively supported the process of intensifying the economic activity through accelerated lending to the private sector. Thus the deposit base extension (higher credit potential), the considerably lower risk, i.e. the higher financial reliability of the customers, the expansion of the credit supply (introduction of new types of credits and diversified terms and conditions for using the credits), the lower credit price, as well as the further liberalization of the foreign exchange operations (possibility for foreign exchange lending to all interested entities) resulted in a growth rate of the lending to the private sector of 18.8%. Thus additional funds were allocated through the banks to both the households and the enterprises, generating positive impulses for stimulation of the economic growth.

In 2003, a positive trend was also registered in the area of banks' interest rate policy, where the lending and the deposit interest rates indicated downward trend. The changes in the banks' interest rates largely corresponded with the modified monetary policy design (particularly since April 2003), signalizing larger responsiveness of the banks to the monetary signals. On average, the average weighted lending interest rate (on the short-term Denar credits) equaled 16% in 2003, which compared to the average of the preceding year went down by 2.4 percentage points. Less intensive reduction was registered in the average weighted deposit interest rate on the three-month Denar deposits (which equaled 8% on average and reduced by 1.6 percentage points compared to the preceding year). Such movements resulted in narrowing of the average interest rate margin by 0.8 percentage points, which indicates positive developments in the efficiency of the banks' operations and the level of competitiveness in the banking system.

The process of harmonization of the regulation in the country with the internationally accepted standards continued in 2003. Thus amendments to the Law on the NBRM were made aimed at further increasing of the degree of NBRM independence and higher transparency, as essential presumptions for effective and successful operation of the Central Bank. The amendment allowing full independence of the NBRM in the selection of the exchange rate regime is of a special relevance and it is aimed at successful achievement of the ultimate goal of the monetary policy. Also, amendments were made to the Banking Law which should allow larger security, stability and efficiency in the operations of the banking system. Essential amendment to the Law on Foreign Exchange Operations is the possibility of the banks to extend foreign exchange credits to all interested entities, irrespective of their use. The amendments made to the regulations are aimed at further convergence to the internationally accepted standards and practices, thus ensuring prompter and more efficient integration of the Republic of Macedonia into the global developments.

Conversely to the positive tendencies in the area of maintaining the price stability, accelerating the economic growth and stable and more efficient operating of the banking system, the high unemployment rate remains to be the crucial problem of the Macedonian economy. Thus in 2003, the unemployment rate equaled 36.7%, which is an annual increase of 4.8 percentage points. Such deepening of the problem of high structural unemployment indicates the still present negative effects of the process of transition of the economy towards market-defined operating principles. In addition, the above refers to the need of further structural reforms, which would mean efficient restructuring of the economy, creation of sufficient capacity for absorbing a part of the population fit for work, reduction of the unemployment problem and improvement of the living standard.

In 2003, the Republic of Macedonia reaffirmed its orientation towards integrating into the global trade and capital flows. The membership in the WTO, as well as the further liberalization of the capital flows confirm the capacity of the country to face the challenges imposed by these trends. Also, the permanent process of harmonization of the legal framework with the internationally accepted principles, and the established European directives, in particular, means establishing a basis for easier and faster international integration.

The 2003 developments indicate gradual economic recovery, which partially reflects the conduct of coordinated and consistent macroeconomic policy. Especially important is the successful operation of the financial system, the growing stability and effectiveness of which were illustrated also with the positive movements in the CAMELS summary rating of the banks (in 2003, one bank was given the highest summary rating "1", and the number of banks with summary rating "4" was reduced from eight banks in 2002 to four banks in 2003). The growing stability and the efficiency of the financial system, along with the maintenance of the macroeconomic stability and the endeavours for further restructuring of the real sector of the economy should contribute to achieving high economic growth rates and high-quality economic development.

Also, in 2003, the NBRM also showed its clear determination to conduct monetary policy directed towards maintaining low and stable inflation rate. Furthermore, the continuing promotion of the banking supervision contributes towards successful maintenance of the financial stability. The focus on the price and financial stability is a successful convergence of the NBRM to the positioning of the modern central banks in the developed market economies. Through the successful achievement of these goals, the NBRM further contributes to the creation of a favourable environment for sustainable economic growth on a long run.

Skopje, May 2004

Ljube Trpeski,
Governor and President of the
National Bank of the Republic of Macedonia Council

I. Economic developments in the world[1]

The global economic developments in 2003 were under the major influence of the non-economic factors, such as the war in Iraq, the "SARS" epidemic and the international fight against terrorism. The uncertainty of the further development of the events adversely affected the economic growth in the first half of the year. Nevertheless, in the second half of the year, the prompt completion of the military offensive in Iraq and the putting the "SARS" virus under control enabled acceleration of the economic activity (especially in the USA, Japan and in some parts of Asia). Thus the economic growth achieved the projected rate of 3.2%, which is an increase of 0.2 percentage points relative to the preceding year. The macroeconomic policy in some countries acted as an inducer of the economic growth. The interest rates in the USA, the EU and in some developing countries fell, and the fiscal policy in the USA and in some Asian countries was relaxed. The macroeconomic stimulations (the expansive monetary and fiscal policies) in the USA and Great Britain contributed substantially to achieving higher growth rates (2.6% and 1.7%, respectively), unlike the Euro-zone where the average GDP growth rate equaled 0.5%.

The economic growth was accompanied by the increase in the international trade of 2.9%, compared to 3.2% in 2002. The movement of the prices of primary products in 2003 varied depending on the impact of the geopolitical factors. The oil price reached US Dollar[2] 34.8 per barrel prior to the outset of the war in Iraq, and in early May it reduced to US Dollar 23 per barrel. At the end of 2003, the oil price reached US Dollar 30 per barrel. The prices of the primary commodities and the industrial goods went up by 5.0%, i.e. by 12.8% relative to the preceding year. Thus the inflation rate in the developed and the developing countries increased compared to the previous year and equaled 1.8% and 5.9%, respectively. The countries in transition registered lower inflation rate (9.7%, while in the preceding year it equaled 11.1%).

Table 1
Selected indicators for the world economy

	1999	2000	2001	2002	2003
			(in %)		
Real GDP growth rate	3.6	4.8	2.4	3.0	3.2
Developed countries	3.4	3.9	1.0	1.8	1.8
Developing countries	3.9	5.7	4.1	4.6	5.0
Transition countries	4.1	7.1	5.1	4.2	4.9
Growth in the world trade	5.8	12.6	0.1	3.2	2.9
Inflation rate					
Developed countries	1.4	2.2	2.2	1.5	1.8
Developing countries	6.5	5.8	5.8	5.3	5.9
Transition countries	44.4	20.7	16.2	11.1	9.7
Prices					
Oil	37.5	57.0	-14.0	2.8	14.2
Primary products	-6.7	4.5	-4.0	0.6	5.0
Industrial products	-1.8	-4.7	-2.4	2.6	12.8
			(% of GDP)		
Saving rate	23.0	23.6	23.1	23.4	23.3
Investment	23.2	23.5	23.1	22.9	23.2

Source: IMF World Economic Outlook, September

[1] The analysis is based on the IMF World Economic Outlook, September 2003 and the EBRD Transition Report 2003.
[2] Price of "brent" crude oil per barrel.

1.1. Developed countries

The growth rate of the gross domestic product in the developed countries remained at the level of the preceding year (1.8%). Driving forces behind the growth were the USA and Japan, which registered growth of 2.6% and 2.0%, respectively, unlike the twelve countries of the European Monetary Union which registered a minimum increase of 0.5%. The total domestic demand in the developed countries picked up by 2.1%, with more dynamical growth being registered in the public consumption (2.6%) relative to the personal consumption (1.9%). The average unemployment rate in the developed countries went up by 0.3 percentage points and reached 6.7%, with an increase being registered in all countries in the group, other than Greece and Great Britain. In 2003, the average inflation rate in the developed countries registered a moderate increase and equaled 1.8%. The more significant pickup in the imports relative to the exports contributed to increasing the negative balance in the current account in the group of developed counties, reaching US Dollar 245.2 billion (i.e. 0.9% of the GDP). Nevertheless, if the exceptionally high deficit of the USA (US Dollar 553.3 billion) is excluded, the other developed counties have a surplus in the current account of the balance of payments in the amount of US Dollar 308.1 billion.

Table 2
Selected economic indicators for the developed countries

	GDP (real growth rate in %)			Inflation (in %)			Unemployment (in %)			Current Account Balance in the Balance of Payments (in US Dollar billion)		
	2001	2002	2003	2001	2002	2003	2001	2002	2003	2001	2002	2003
Developed countries	1.0	1.8	1.8	2.2	1.5	1.8	5.9	6.4	6.7	-190.9	-186.6	-245.2
European Union	1.5	0.9	0.5	2.4	2.3	2.0	8.0	8.4	9.1	11.8	61.2	62.4
Germany	0.8	0.2	-	1.9	1.3	1.0	7.9	8.6	9.5	0.9	46.1	57.0
France	2.1	1.2	0.5	1.8	1.9	1.9	8.5	8.8	9.5	23.0	25.9	21.4
Greece*	4.1	4.0	4.0	3.4	3.7	4.0	10.4	9.9	9.8	-7.2	-8.2	-11.3
USA	0.3	2.4	2.6	2.8	1.6	2.1	4.8	5.8	6.0	-393.7	-480.9	-553.3
Japan	0.4	0.2	2.0	-0.7	-0.9	-0.3	5.0	5.4	5.5	87.8	112.7	121.1

Source: IMF World Economic Outlook, September 2003
* GDP deflator

The GDP growth rate in the Euro zone[3], which is the most important trading partner of the Republic of Macedonia, continued going down also in 2003 (the growth rate reduced to 0.5%). Thus major generators of the low economic growth are the weak personal consumption and the Euro appreciation. The increase in both the personal and the public consumption equaled 1.1% and 1.6%, respectively, and the continuing appreciation of the Euro relative to the US Dollar contributed to more dynamical increase in the imports relative to the exports. The inflation in the Euro zone (measured through the Harmonized Index of Consumer Prices - HICP) in 2003 equaled 2.0%, compared to 2.3% in the preceding year. The lower inflation rate is in line with the European Central Bank (ECB) policy for achieving inflation rate of up to 2.0% on a medium term. The unemployment rate increased by 0.7 percentage points compared to 2002, reaching 9.1%, with an increase in the unemployment being registered in almost all countries of the Union.

Following a three-year period of continuous low economic growth rates, in the first half of 2003, the German economy entered a recession stage[4]. Thus the unemployment rate reached the highest level in the last decade (excluding 1997 when it equaled 9.6%). The poor condition in the largest economy in the Union restricts the possibilities for recovery of the economic activity in the region, thus adversely affecting the Macedonian economy, as well. Germany is a major trading partner of the Republic of Macedonia, with 20.4% of the Macedonian exports being placed in Germany in 2003. The promotion

[3] This group includes the twelve European Monetary Union member states.
[4] Negative growth rates were registered in the first two quarters.

of the package of reforms (Agenda 2010) by the German Government, as well as the returning of the confidence of the economic agents[5] at the end of the year, arouse a hope for moderate increase in 2004. Greece, which is the second largest trading partner of the Republic of Macedonia, continued registering growth rate of over 4%, due to the increase in the domestic demand and the accelerated investment activity due to the Olympic games in 2004. Thus, in 2003, Macedonia increased the export placement to Greece by 54% compared to the preceding year.

In 2003, the US economy again was a driving force of the economic growth registering the most significant GDP increase in the group of most developed countries (2.6%). The end of the war in Iraq was the turning point in the economy, which was also a beginning of the gradual returning of the confidence of the economic entities. Thus in the second quarter, the GDP exceeded the expected growth rate, primarily as a result of the higher public consumption, as well as the gradual increase in the personal consumption. The fiscal policy stimulated the economic growth through the higher consumption in the area of defense and the lower tax rates. The interest rates on the three-month treasury bills dropped to 1.1%, which is the lowest level ever, and the long-term interest rates are still kept at a low level. In 2003, the increase in the labour productivity equaled 4.5%, which is a key factor for the achieved economic growth. Given the increase in the unit labour cost of 0.9%, the inflation equaled 2.1%, compared to 1.6% in the preceding year. The continuous depreciation of the US Dollar by mid-May stimulated the economy. On the other hand, the deficit in the current account reached 5.1% of the GDP, which is the highest percentage ever (an increase of 0.5 percentage points), notwithstanding the significant fall in the value of the US Dollar relative to the Euro and the Yen. An increase was also registered in the deficit of the budget of the Central Government and the federal states (the deficit of the consolidated budget equaled 6.0% of the GDP). The large increase in the budget deficit in the last three years might be a grave problem on a medium and long run, primarily due to the expected growths in the social transfers.

1.2. Developing countries

In 2003, the developing countries registered an increase in the GDP of 5.0%, compared to 4.6% in the preceding year. Analyzing by regions, the most significant growth rates were registered in the developing Asia region[6] (6.4%) and in the Middle East and Turkey[7] (5.1%). The more dynamical economic growth in the developing countries contributed to lower share of the external debt in the GDP by 3.2 percentage points, thus reducing to 37.7%. The economic expansion in the developing countries was accompanied by a moderate inflation rate (5.9%) and more dynamical increase in the imports relative to the exports.

Table 3
Selected economic indicators for the developing countries

	GDP (real growth rate in %)			Inflation (in %)			Nadvore{en dolg (vo % od BDP)			Current Account Balance in the Balance of Payments (in US Dollar billion)		
	2001	2002	2003	2001	2002	2003	2001	2002	2003	2001	2002	2003
Developing countries	4.1	4.6	5.0	5.8	5.3	5.9	40.1	40.9	37.7	25.9	74.0	65.7
Africa	3.7	3.1	3.7	12.9	9.3	10.6	61.0	59.3	49.2	-2.2	-5.9	-3.8
Developing Asia	5.8	6.4	6.4	2.7	2.0	2.5	29.9	27.4	25.3	35.6	65.4	42.4
Middle east and Turkey	2.0	4.8	5.1	17.1	15.7	13.5	61.2	62.7	54.8	45.0	29.3	40.6
West hemisphere	0.7	-0.1	1.1	6.4	8.7	10.9	38.9	45.3	44.1	-52.5	-14.9	-13.5

Source: IMF World Economic Outlook, September 2003

[5] Measured through the IFO Business Climate Index of the Economic Research Institute in Munich.
[6] China, India, Indonesia, Malaysia, Philippines and Thailand.
[7] Including Malta.

After the successful coping with the "SARS" epidemic in the developing Asia region, the economic activity accelerated in the second half of the year (higher economic growth rate is expected in 2004). China (the third country in the region according to the GDP criterion) continued registering high growth rates (7.5%), and this pace is expected to continue in the future. As for the other countries in the region, the future economic growth will be contingent upon the expected increase in the personal consumption, as well as the recovery of the Information Technology industry.

In spite of the prospects for stabilization of the situation in the region, the counties of the Western Hemisphere region[8] continued registering low growth rates (1.1%). Argentina registered positive growth rate (5.5%) for the first time after it entered the economic crisis in 1999. The economic activity in Brazil is also improving after the debt crisis, however the political risks and the problems concerning the excessive indebtedness still represent potential threat for the economic growth.

The prompt resolving of the conflict in Iraq and the higher oil production enabled larger economic growth in the Middle East countries (5.1%). Nevertheless, the volatile security and the lower oil prices could slow down the economic growth in 2004. The economic growth rate in Africa equaled 3.7% in 2003, and it is expected to intensify in 2004. The acceleration of the economic growth in the poorest countries is a result of the improved conduct of the macroeconomic policy, the higher prices of the primary commodities, as well as the partial debt exemption through the HIPC (Heavily Indebted Poor Countries) Program of the World Bank and the International Monetary Fund (IMF).

1.3. Countries in transition[9]

In 2003, the countries in transition kept going forward with the structural and institutional reforms towards democracy and market economy development. The countries of the Central and Eastern Europe and the Baltic countries (CEB) completed the negotiations for full membership in the EU and are getting ready for accession to the Union in May 2004. However, the process of transition in these countries will not end with their accession to the Union and the reforms will have to move on, especially in the financial sector, the public administration and the business climate promotion. The accession of the most developed transitional economies to the EU instigated other countries to accelerate the reforms for sooner integration into the EU. Thus Bulgaria and Romania are on the right track in the negotiations with the EU, and their accession to the Union is expected to take place in 2007 at the earliest. The economies of the Southeast Europe (SEE) countries continue to grow. Nevertheless, in the assessment of the results, one should take into account the majority of these countries. Within the CIS, the Russian economy made a progress in several areas and the implementation of the reforms should continue in the future. The other CIS countries registered variations in the process of transition, with particular accomplishments in some countries and stagnation and regression in those countries that implement the reforms inconsistently. The large variations in the economic growth in the transitional economies are a reflection of the various degree of democratization. The most developed countries in transition are those which achieved high degree of liberalization and democracy, while the countries that lag behind are characterized with closeness, poor rule of law and political repression.

[8] Countries of Latin America.
[9] Central and Eastern Europe and the Baltic countries (CEB), Southeast Europe (SEE) and the Commonwealth of Independent States (CIS)

Table 4
Selected economic indicators for the countries in transition

	GDP (real growth rate in %)			Inflation (in %)			Current account of the Balance of Payments (% of GDP)			Foreign direct investment (in US Dollar billion)		
	2001	2002	2003	2001	2002	2003	2001	2002	2003	2001	2002	2003
Countries in transition	4.3	3.8	4.7	15.3	8.3	6.8	-4.6	-4.8	-5.3	26.0	27.8	26.4
Central and Eastern Europe	2.5	2.5	3.3	5.5	3.0	2.9	-5.0	-5.9	-5.8	18.8	20.7	13.7
Czech Republic	3.1	2.0	3.0	4.7	1.8	0.2	-5.7	-6.5	-4.3	5.5	9.0	5.0
Estonia	6.5	6.0	4.5	5.8	3.6	1.4	-6.1	-12.3	-12.8	0.3	0.2	0.2
Croatia	3.8	5.2	4.2	4.9	2.4	2.4	-3.7	-7.2	-6.0	1.4	0.4	0.7
Latvia	7.9	6.1	6.5	2.5	1.9	3.3	-9.5	-7.8	-8.4	0.2	0.4	0.4
Lithuania	6.5	6.7	6.0	1.3	0.3	-0.8	-4.8	-5.3	-5.5	0.4	0.7	0.6
Poland	1.0	1.4	3.0	5.5	1.7	0.5	-3.9	-3.6	-2.9	6.9	3.7	4.0
Slovak Republic	3.3	4.4	3.8	7.1	3.3	8.5	-8.8	-8.2	-6.3	1.5	4.0	1.5
Slovenia	3.0	3.2	2.3	8.4	7.5	6.1	0.2	1.7	0.9	0.4	1.7	0.1
Hungary	3.7	3.3	3.0	9.2	4.8	4.7	-2.2	-4.0	-7.1	2.3	0.6	1.3
South and Eastern Europe	4.6	4.5	3.9	28.3	11.5	6.7	-8.5	-9.7	-8.6	2.7	2.5	3.7
Albania	6.8	4.7	6.0	3.1	5.4	3.5	-6.2	-9.1	-8.0	0.2	0.1	0.2
Bosnia and Herzegovina*	4.5	3.8	3.5	3.2	0.3	1.1	-15.8	-20.0	-15.0	0.1	0.2	0.3
Bulgaria	4.0	4.8	4.5	7.4	5.9	2.0	-6.5	-4.4	-4.9	0.6	0.4	0.9
Serbia and Monte Negro	5.5	4.0	2.0	91.3	21.4	12.0	-9.7	-12.9	-11.7	0.2	0.6	0.9
Macedonia**	-4.5	0.9	3.2	5.5	1.8	1.2	-6.5	-9.6	-6.0	0.4	0.1	0.1
Romania	5.3	4.9	4.2	34.5	22.5	14.5	-5.8	-3.5	-4.7	1.2	1.1	1.4
Community of Independent States	6.0	4.8	6.2	17.2	11.0	9.8	-2.3	-1.5	-3.1	4.5	4.6	9.0

Source: EBRD Transition report 2003
* IMF World Economic Outlook, September 2003
** Source of the data for the Republic of Macedonia are the relevant official institutions.

The economic growth in the countries in transition in 2003 equaled 4.7%, compared to 3.8% in the preceding year. Major driving forces of the intensive growth were the CIS, i.e. Russia (6.2%), the economic growth of which was due to the high prices of oil and the other primary resources. The growth strategy, which relies exclusively upon the high prices of the natural resources these countries are rich in, is still unsustainable and risky on a long run. Thus in 2004, a more moderate increase is expected due to the expected fall in the oil price. The CIS countries rich in natural resources are not sufficiently focused on developing an economic diversification strategy, thus reducing the dependence on the prices of the natural resources. The other CIS countries (which are not rich in natural resources) are fully oriented towards the Russian market and have no regional trade cooperation, and consequently, their economic growth is influenced by the movement of the prices of the primary commodities. Despite the higher export potential, the deficit in the current account of the CIS increased by 1.6 percentage points, reaching 3.1% of the GDP. On the other hand, the foreign direct investments (FDI) reached US Dollar 9 billion, in 2003, which is the highest level ever, with US Dollar 2.3 billion being invested in Azerbaijan, and in Kazakhstan and Russia, US Dollar 2.5 billion each. In 2003, the CIS countries registered a one-digit inflation rate (9.8%) for the first time, but the average inflation rate still considerably exceeds the one in the developed countries and in the other countries in transition.

The economic growth in the CEB countries equaled 3.3% in 2003. The increase in the most of the accessing countries to the EU is due to the enhanced personal consumption and the higher exports. Notwithstanding the projected acceleration of the economic activity in 2004, the increase will largely depend on the recovery of the economic activity in the EU and the movement of the Euro exchange rate. The Baltic countries continued registering high growth rates (5.5%)[10] due to the successful conduct of the macroeconomic policy and the structural reforms, as well as the sustainable level of

[10] Source: IMF World Economic Outlook, September 2003.

FDI. The largest problem, the most of the CEB countries face with, is the high budget deficit, which is not sustainable on a long run (this problem is particularly evident due to the need of fulfilling the Maastricht criteria for entering the Euro zone). The CEB countries continued the trend of reducing the average inflation rate (2.9%) and approach the inflation level in the Euro zone, which is another prerequisite for joining the EMU.

The economic situation in the SEE is improving, but the adverse effect of the political tensions in the most of the countries in the region is still present. The GDP growth rate equaled 3.9%, with a one-digit inflation rate (6.7%) being registered for the first time. Special success in the reduction of the inflation was registered in Romania and Serbia and Montenegro, while the other countries maintained the low inflation level. On the other hand, the current account deficit deepened in the last months of the year as a result of the slowed economic growth of the EU, which is the major trading partner of the SEE countries. Besides the high trade deficit, the SEE countries register relatively high total budget deficit[11]. Albania registers the highest budget deficit (5.8%), which, however, is a considerable improvement of the performances (budget deficit of 12.9% in 1997). The risk of double deficits is particularly evident in the SEE due to the already existing high level of indebtedness and the reduced foreign assistance. The SEE countries (excluding Romania) failed to attract sufficient foreign investments in the period of transition which would meet the needs for capital investments. In 2003, the amount of FDI in the SEE equaled US Dollar 3.7 billion, or 14% of the total amount of FDI in the countries in transition.

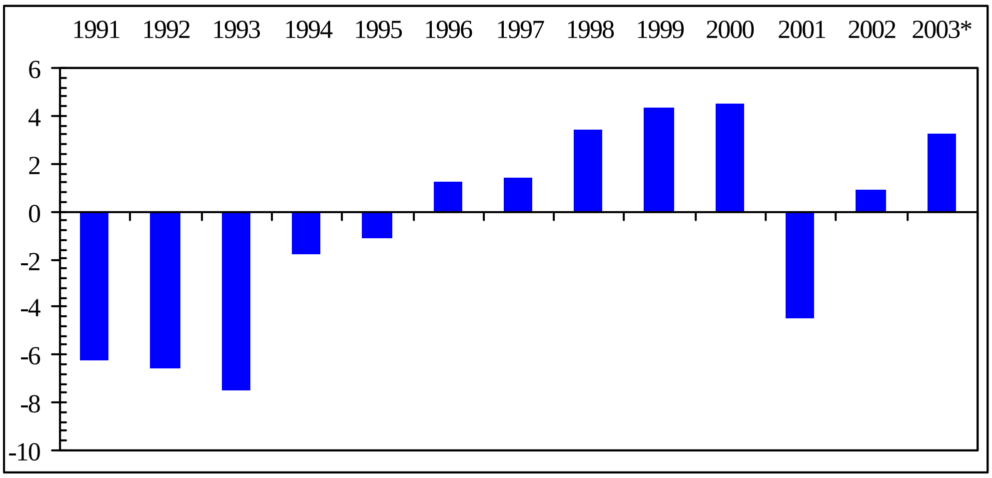
[11] Central Government budget and social funds.

II. Economic developments in the Republic of Macedonia

2.1. Gross domestic product[12]

The improved economic situation, evident through the acceleration of the overall economic activity, supported by the price stability and the stable exchange rate of the domestic currency were a favourable macroeconomic environment for achieving faster economic growth in 2003. After the modest improvement of the Macedonian economy in the previous year (a growth of 0.9%, primarily due to the slow recovery from the adverse effects of the security crisis in 2001), 2003 registered a real increase in the gross domestic product (GDP) of 3.2%. The achieved economic growth meets the expectations, thus exceeding the projected GDP real growth for 2003 (2.8%).

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



*Estimation.

Analyzing by quarters, in 2003 positive growth rates of the gross domestic product were constantly achieved, which corresponds with the positive movements in all sectors of the economy. Compared to the same period of the preceding year, in the first quarter of 2003, the gross domestic product went up by 2.1%, in the second quarter the increase was faster and equaled 3.1%, while in the third quarter the increase was the most intensive and reached 5.6%. The fourth quarter registered lower intensity of GDP growth of 2.1% due to the high comparison base of the preceding year, when the last quarter registered the most intensive growth.

Analyzed from the aspect of the production side of the gross domestic product in 2003, all sectors registered a real growth. Dominant sector in the GDP creation is the industry, which achieved real growth in the value added of 4.5%. Thus its share reached 24.3% (an increase of 0.3 percentage points), while the shares of the other sectors remain almost unchanged. The value added in the trade (11.9% of the GDP) and in the agriculture (9.2% of the GDP) went up by 4.3% and 2.2%, respectively. The “transport, storage and communications” and the “construction” sectors registered real growth rates of 5.6% and 4.8%, making up 8.3% and 5.2% of the GDP, respectively.

The 2003 analysis of the movement of the GDP expenditure aggregates[13] indicates a nominal growth in the export of goods and services (of 3.5%), with a simultaneous fall being registered in the import

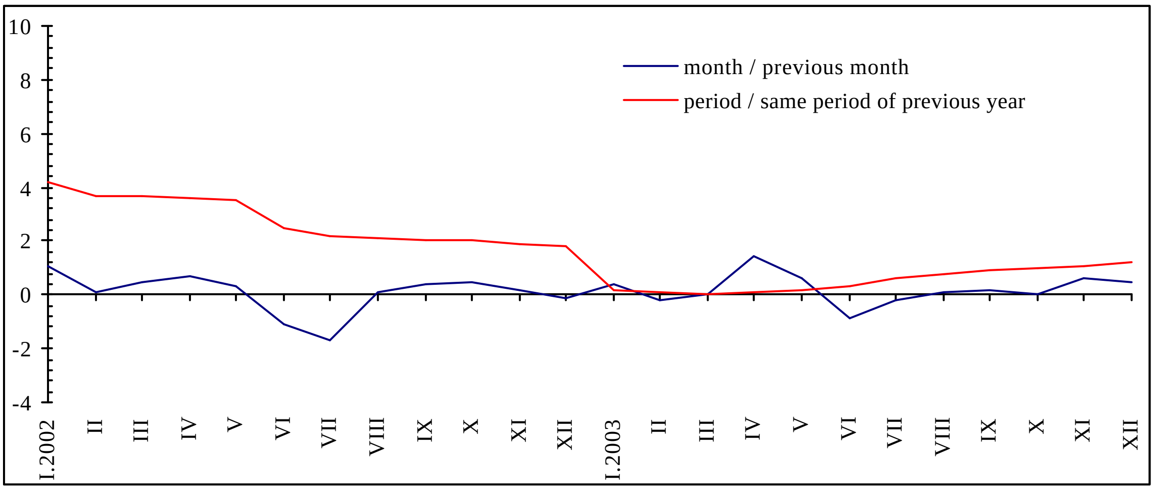
[12] Source: State Statistical Office of the Republic of Macedonia. The 2003 data are estimated. The quarterly estimations for the GDP are given in Denars at permanent prices since 1997. The structure is according to the National Classification of Activities (NCA).
[13] In the reports of the State Statistical Office (SSO) on the quarterly movement of the GDP, only the public consumption, the investments in machinery and equipment, the import and export of goods and services (all at current prices), are calculated for the expenditure side of the

of goods and services (of 2.9%), which is in line with the registered foreign trade activity in 2003. The investments in machinery and equipment and the public consumption registered a nominal decrease of 7.7% and 3.2%, respectively.

2.2. Prices[14]

The consolidation of the Macedonian economy in 2003, reflected through the accelerated economic activity is primarily due to the favourable macro economic environment, the basic feature of which is the maintained price stability. The achieved price stability in the Republic of Macedonia reflects the successful achievement of the basic statutory established goal of the monetary policy. The maintained stable level of the exchange rate, as an intermediary monetary goal, considerably contributed to further registering of low and stable inflation rates. Thus given the high liquidity in the banking system and the pressure on the foreign exchange market, the proper application of the available monetary regulation instruments and the interventions on the foreign exchange market by the NBRM in 2003 enabled maintenance of stable exchange rate and low and relatively stable inflation rate (the average inflation rate, expressed through the consumer price index equaled 1.2%). The registered average inflation rate is lower than the projected one (in 2003, the average inflation rate was expected to be 1.8%), which is also lower than the inflation registered in 2002 (by 0.6 percentage points). On annual basis (December 2003 / December 2002), the inflation rate equals 2.6%.

Chart 2
Consumer Prices
(change in %)



Analyzing by structure, the average growth in the consumer prices of 1.2% in 2003, is primarily due to the increase in the costs of services (of 5.9%, with a simultaneous increase being registered in the costs of goods of 0.3%) which corresponds with the higher costs of housing and transport and communication services (by 3.9% and 4.2%, respectively), as categories having more significant share in the total consumer price index. Nevertheless, the upsurge in the above categories, as well as in almost all other categories of consumer prices in 2003, was considerably offset by the fall in the costs of food (of 1,4%) as a category with dominant share in the total consumer prices. In 2003, the lower costs of food result from the high comparison base, i.e. from the high prices of agricultural products (vegetables, in particular) in the preceding year.

The movement of the inflation in 2003 was determined by several more relevant factors. The amendments to the Law on Value Added Tax were the most influential (on April 1, 2003, the general tax rate of 19% was reduced to 18%, and its application expanded over the most of the products,

GDP. The SSO works on establishing a methodology also for calculation of the personal consumption, the investments in construction buildings and the change in the inventories.

[14] Source: State Statistical Office of the Republic of Macedonia.

which, until then, were taxed at a preferred VAT rate of 5%). The changed tax policy had a one-time effect on the general price level in the economy (more evident monthly increase in the prices in April), but it had no considerable impact on the average inflation rate.

The increase in the PSTN (Public Switched Telephone Network) prices at the beginning of May (an increase in the prices of the pulses in the domestic telephone traffic of 15%) is also a factor which has more considerable effect on the inflation in the analyzed period, which caused an increase in the costs of services.

The increase in the retail prices of the oil derivatives was aimed at same direction (in mid-January, they went up by 3.73%, on average, and remained at that level by the third 10-day period of May). Such decision resulted in an increase in the costs of transport and communication services, and it was instigated by the developments on the international markets of crude oil, in the period of uncertainty arising from the US military intervention in Iraq.

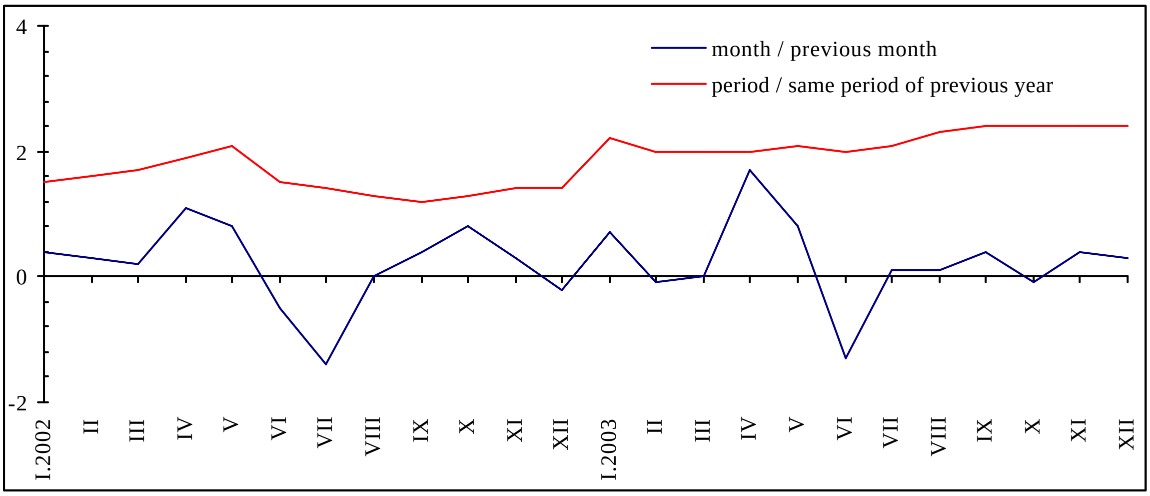
In 2003, the movement of the inflation was also determined by the increment in the prices of thermal energy (since January) and the electricity (since July, due to the postponed application of the changes in the value added tax rates in this category) that affected the costs of housing. The increase in the prices of alcoholic drinks (of 6.2% in December) made additional contribution to the moderate intensification of the inflation at the end of the year.

In 2003, the monthly level of the consumer prices was relatively stable and registered no larger oscillations. Thus in most of the cases (in six months of the year), the consumer price level remained almost unchanged, on monthly basis. A more significant monthly deflation was registered in June (0.9%), primarily due to the transferred effect of the reduction in the retail prices of the oil derivatives at the end of May (12.65%, on average). In the January – May period, the regular two-week adjustment of the prices of oil derivatives in the domestic economy to the oil prices on the international markets, which after the US attack on Iraq (March 21, 2003) started to reduce rapidly, did not take place. Consequently, the adjustment which was made at the end of May resulted in a significant fall in the index of the prices of oil derivatives in June (of 10%) and caused a reduction in the costs of transport and communication services and the costs of housing (primarily fuel and lighting). The most substantial monthly increase in the consumer prices was registered in April (1.4%), which corresponds with the amendments to the Law on VAT.

The interrelation of the retail prices and the consumer prices arises from the fact that the changes in the level of the prices indirectly affect the level of consumer prices. Therefore the aforementioned factors of inflation in 2003 are actually major driving forces also of the movement of the retail prices, which in 2003, compared to the preceding year registered an average increase of 2.4% and a monthly dynamics of which fully corresponds with the dynamics of the consumer prices (having slight divergences in the intensity of the change). With respect to the structure, the prices of services registered more considerable average increment (5.6%) compared to the increment in the prices of goods (0.8%). The annual growth rate of the retail prices (December 2003 / December 2002) equaled 2.9%[15].

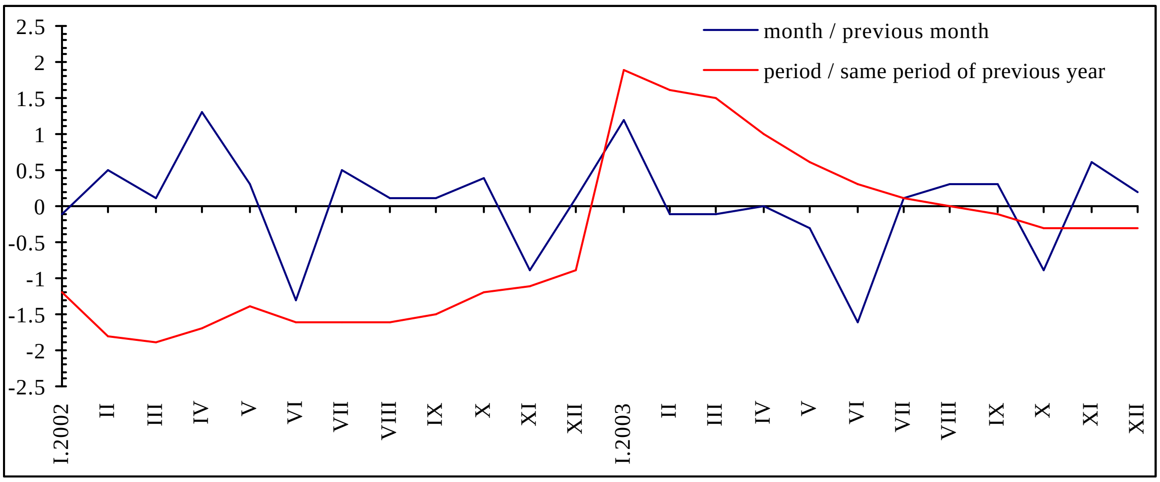
[15] Notwithstanding the effect of identical factors, the different level of the retail prices relative to the consumer prices is due to their different weighs applied to certain categories.

Chart 3
Retail prices
(change in %)



In 2003, the value of the consumers' basket for food and beverages[16] amounted to Denar 10,231, on average, which is by 1.0% lower compared to 2002. It is due to the fall in the average value of almost all categories of products. Thus the average value of the categories "fresh and processed meat" and "grain and grain products" which have the most significant share in the total value of the consumers' basket, in 2003, dropped by 2.3% and 1.3%, respectively. The lower value of the consumers' basket in 2003 corresponds with the lower level of the prices of agricultural products, which determine the level of the costs of food, at the most. On annual basis, the value of the consumers' basket in December 2003 was by 1.2% higher compared to the same month of the preceding year, primarily due to the higher value in the category "fresh and processed vegetables", due to the higher level of the prices of agricultural products (the vegetables, in particular) on annual basis, in December 2003.

Chart 4
Prices of producers of industrial products
(change in %)



In 2003, compared to the preceding year, the level of prices of the producers of industrial products went down by 0.3%, on average (in spite of their average rise in the first half of 2003, caused by the higher retail prices of the oil derivatives). The lower level of the prices of producers of capital products (by 1.4%) and non-durable goods for joint consumption (by 0.9%) was partially offset by the

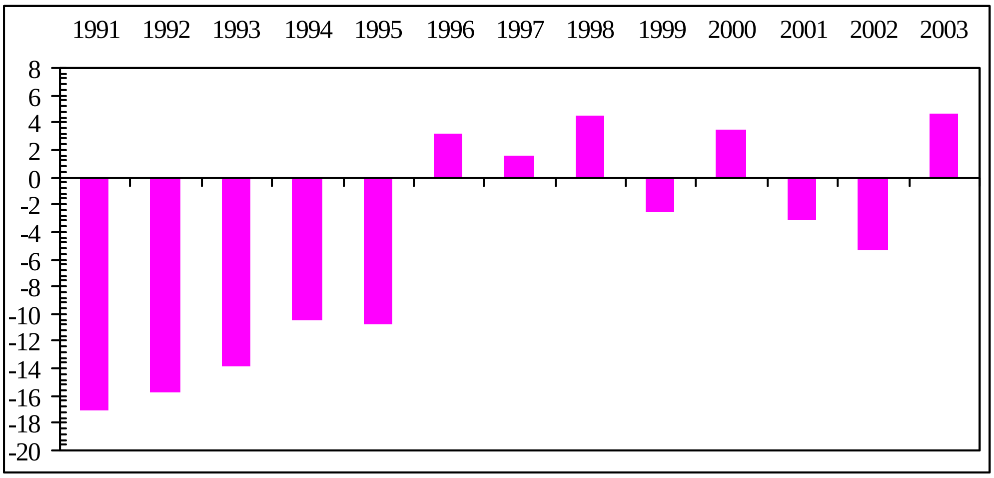
[16] All products of the category food and beverages that compose the basket are considered to be average monthly needs of one four-member non-agricultural household. The structure of the products is constant (same products – same quantities) within a year.

almost unchanged level of prices of the producers of electricity, intermediary goods and durable goods for joint consumption. Thus a reduction in the production prices was registered in 6 out of 22 industrial branches (in 10 of the analyzed branches the prices remain unchanged). Among the leading branches, the most significant fall was registered in the prices of producers of food products and beverages (1.2%). With respect to the monthly dynamics, a more essential monthly fall in the prices of producers of industrial products was registered in June and October (of 1.6% and 0.9%, respectively), with the fall in the both cases being caused by the reductions in the retail prices of oil derivatives (registered at the end of May and at the end of September). On annual basis, the prices of the producers of industrial products were by 0.2% lower.

2.3. Domestic production[17]

The year 2003 registered a higher production activity and an increase in the industrial output which was the major driving force behind the Macedonian economy. The improved economic and foreign trade activity in 2003, particularly as a result of the normalized operating conditions, the renewal of the agreements with the foreign partners (in line with the lower risk) and the industrial sector recovery contributed to gradual economic consolidation and considerable improvement of the Macedonian economy. The favourable weather conditions, as well as the improvement of the situation in the steel industry throughout the world add to the above. Consequently, the volume of the industrial output in 2003 registered an average increase of 4.7%, which is the highest growth rate registered since 1996 (higher even than the increase registered in 2000, which is deemed to be one of the most successful years of the Macedonian economy). Thus one should take into account the low comparison base of the preceding year in which the economy was in a post-crisis stage. Nevertheless, the results achieved in 2003 can be construed as a signal for getting the economy back on the track which leads towards achieving faster economic growth.

Chart 5
Industrial output
(average change in %)



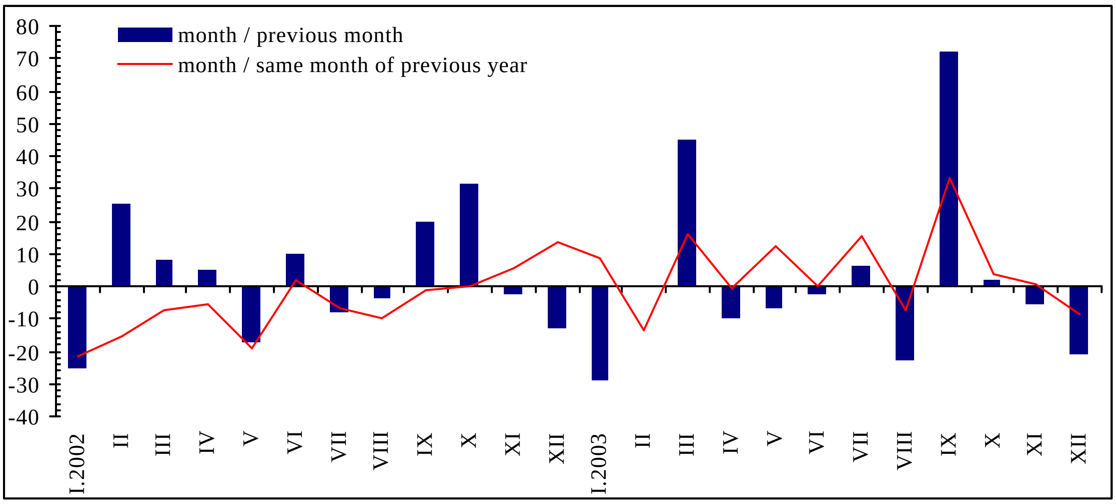
Analyzed from the aspect of the leading industrial branches, in 2003, a significant increase was registered in the production of energy (of 28.7%), durable goods for joint consumption (of 36.9%) and non-durable goods for joint consumption (of 19%), but their increase was primarily relativised by the fall in the production of intermediary products (except the energy) of 12.1% - group with dominant share in the total production. The sector-by-sector analysis indicates an increase in the production of the processing industry and electricity, gas and water supply of 5.9% and 9.8%, respectively, while the production in the sector "mining and quarrying", which accounts for only 3.2% of the total industrial output plunged (by 39.1%).

[17] Source: State Statistical Office of the Republic of Macedonia.

The analysis of the movements by industrial branches indicates an increase in the production in nine out of twenty four industrial branches. Nevertheless, considering the considerable share of these branches in the total industrial output (58.1%), their increase substantially contributed towards changing the total industrial output. Thus the increase is a result of the production of food products and beverages, basic metals, oil derivatives and electricity, gas and water supply, which are branches with the largest share in the total production (55.2%).

In 2003, the industrial output was primarily registering common monthly changes, with certain divergences in the intensity of the changes. The common movements in the industrial output in 2003 constitute another signal for getting the economy back on track, which deviated due to the economic crisis. The most evident monthly increase in the industrial output was registered in March and September, while January, August and December are characterized with the most significant monthly fall in the production. The fast monthly increase in March (44.9%) is a result of the commonly larger number of working days relative to the preceding month and the activities pertaining to the purchase and the processing of tobacco, but also due to the extraordinarily low comparison base of the preceding month (the seasonal increase typical for February did not take place, and consequently, the industrial output remained at the level of January). The increase in September (71.9% - the most significant increase ever) primarily reflects the earlier seasonal effect (which is typical for October) of the considerable crop of grapes in 2003 and the early start of its processing (the low comparison base of August has an additional impact, when the output registered an unusually significant fall caused by seasonal factors). On the other hand, the most substantial monthly decline in the output was registered in January (28.9%) under the influence of the seasonal factor (smaller number of working days in the month). The decline in August (22.7%) and December (20.7%) are also typical and caused by seasonal factors, and their more evident intensity is due to the high comparison bases.

Chart 6
Dynamics of the industrial output
(change in %)



In 2003, compared to the previous year, the total agricultural output of the Republic of Macedonia went up by 1.8%[18]. The increase in the agricultural output is a result of output in the viticulture which is almost twice higher (an increase of 93.5%). It was due to the considerably more favourable weather conditions in 2003 compared to the preceding year, when due to the frost in the early spring, the vine plantations froze. In the other agricultural branches, the output registers a decline, which is the most evident in the fruit growing (8%). The production in the farming reduced by 3.8% due to the lower production of grains and industrial plants. The late autumn sowing (in 2002) and the inadequate weather conditions in winter and spring adversely affected the stages of vegetation of the cereal crops

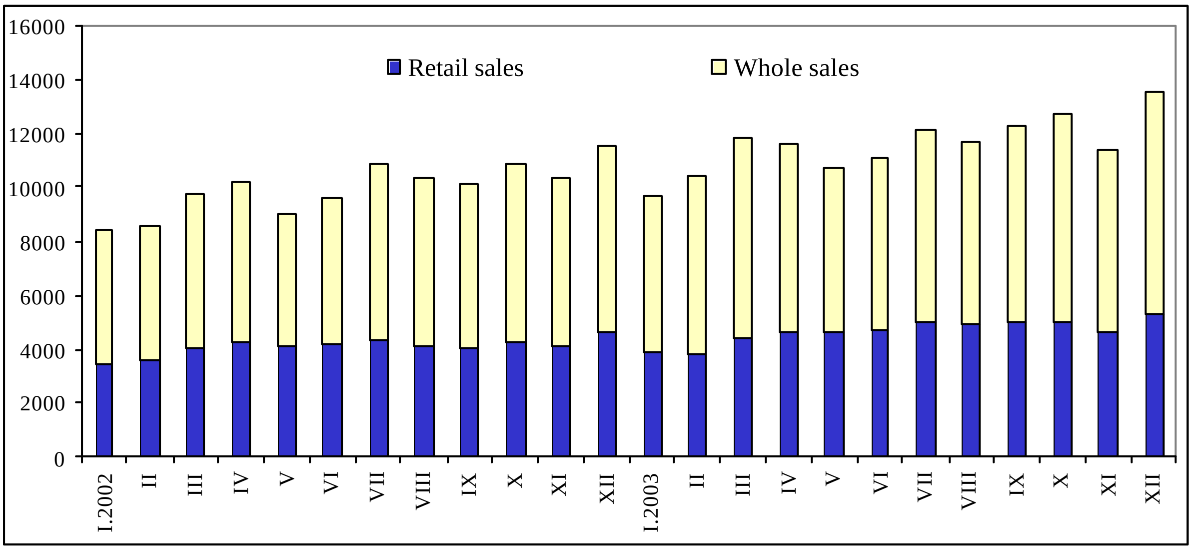
[18] Estimated data of the State Statistical Office of the Republic of Macedonia.

in 2003, which resulted in subsistence crop. Simultaneously, the cattle breeding production declined by 2.9%, with the most significant fall being registered in the sheep breeding (5.3%).

2.4. Turnover in the trade and the construction[19]

In 2003, the total trade turnover registered an annual increment of 16% and reached Denar 138.797 million. The increase in 2003 is a result of the accelerated trade activity in all four quarters of the year. Thus, the first quarter of 2003, compared to the same period of the preceding year, registered an intensive increase of 18.7%. In the remaining period, the growth pace moderately declined (the growth rates in the other quarters, compared to the respective period of the preceding year equaled 16.0%, 15.2% and 14.6%, respectively). From the aspect of the monthly dynamics, the highest growth rates were registered in March (13.7%) and December (19.0%, which corresponds with the enhanced volume of the trade prior to the New Year's and Christmas holidays).

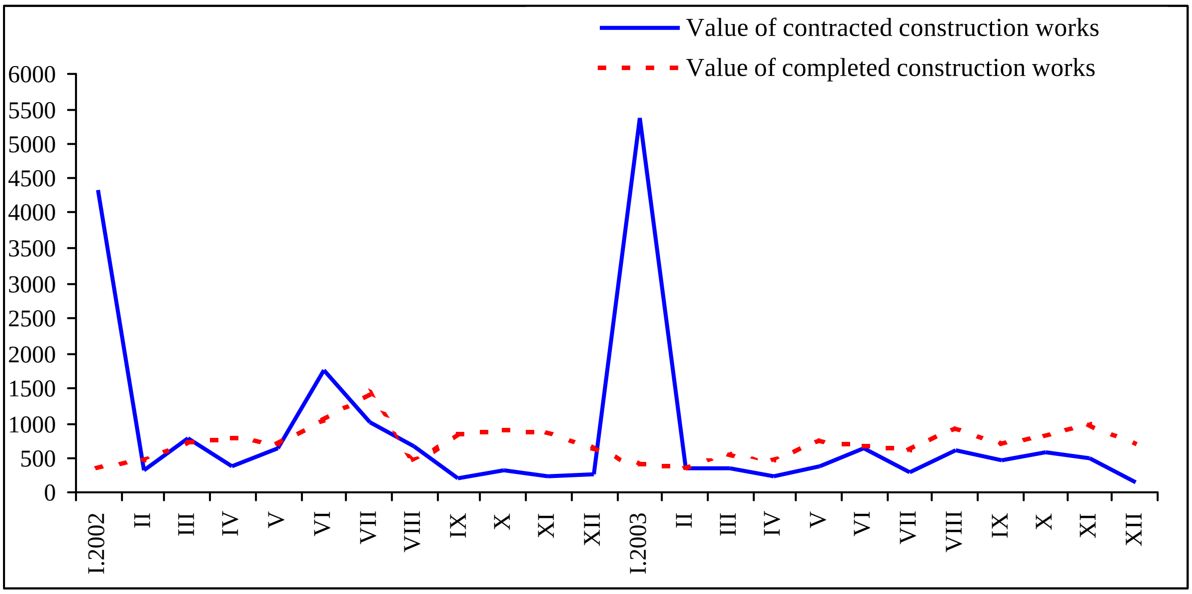
Chart 7
Total turnover in the trade
(in Denar million)



Analyzing by structure, the increase in the total trade turnover in 2003 is a result of the simultaneous increment in the retail sale and the wholesale. Thus in 2003 the turnover in the retail sale registered an annual increase of 13.9% and reached Denar 55,697 million, while the annual growth rate of the turnover in the wholesales equaled 17.4% (in 2003, the total turnover in the wholesales equaled Denar 83,101 million).

[19] Source: State Statistical Office of the Republic of Macedonia.

Chart 8
Value of contracted and completed construction works
(in Denar million)



In 2003, the construction activity was characterized with a slower intensity, with a simultaneous decline being registered in the value of the contracted and the completed construction works. Thus in 2003, the total of contracted construction works totaled Denar 9,901 million, which is by 9.4% less compared to the previous year. The decrease in the total value of the completed construction works equaled 12.8% in 2003 (thus reducing to Denar 8,017 million).

2.5. Labour market[20]

The high structural unemployment still remains one of the key issues of the Macedonian economy. Thus this problem further deteriorated in 2003. The unemployment rate (proportionate share of the number of employees in the total labour force[21]) equaled 36.7% in 2003, which is by 4.8 percentage points higher compared to the preceding year. In 2003, compared to the preceding year, the total number of unemployed persons picked up by 52,385 persons or by 19.9%. In 2003, the population fit for work (total labour force) amounted to 860,976 persons, which is by 36,152 persons, or by 4.4% more compared to the previous year. On the other hand, the total number of employees in 2003 was by 2.9% lower and equaled 545,108 persons. Consequently, the employment rate (share of the employed persons in the total population at the age of over 15) dropped by 1.3 percentage points and reduced to 34.5%.

[20] The total labor force (economically active persons) encompases employed and unemployed persons from 15 to 80 years of age.
[21] According to data of the Labour Force Survey (April 2003). 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 it is in accordance with the methodological recommendations of the International Labour Organization (ILO) and the recommendations of the European Statistical Bureau (EUROSTAT).

Chart 9
Employment and unemployment rates
(in %)

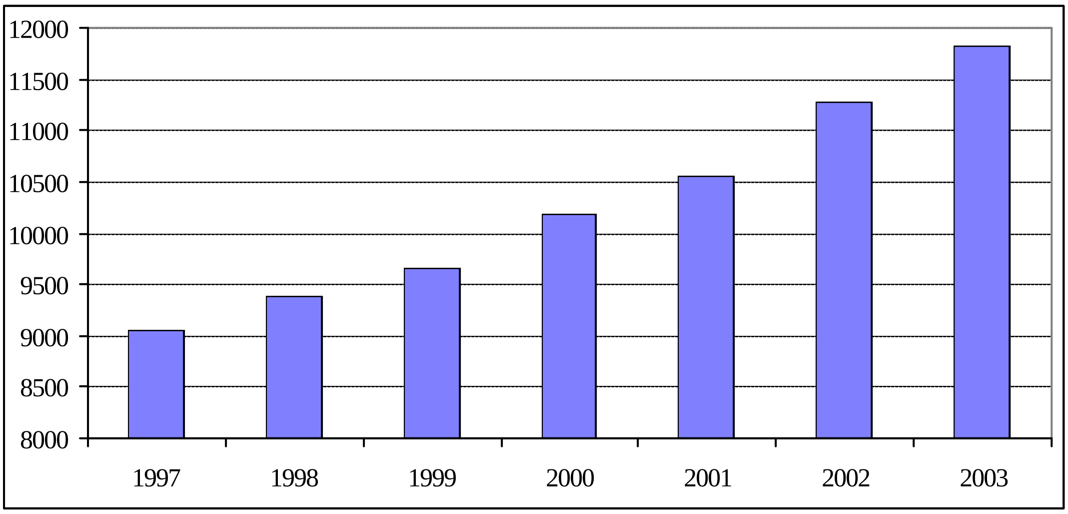
From the aspect of the gender structure, 191,850 persons or 60.7% of the total number of unemployed persons are males, and 124,018 or 39.3% are females. Thus the male and the female population register almost identical unemployment rates (37.0% and 36.3% respectively). With respect to the age, the young population, i.e. the persons at the age of 15 to 19 (66.6%), from 20 to 24 (65.5%) and from 25 to 29 (50.8%) still register the highest unemployment rates. The highest increase in the unemployment rate (of 7.7 percentage points) is registered in the population at the age of 20 to 24.

Out of the total number of employees, 60% are males, which implies higher employment rate of the male population (41.3%), compared to the employment rate of the female population (27.7%). Analyzed by the age, the highest employment rate was registered in the population at the age of 45 to 49 (59.4%), from 40 to 44 (59.0%) and from 35 to 39 (54.4%).

2.6. Wage policy

The implementation of the Law on Wages continued In 2003, which limits the increase in the wages in the Government institutions and in all legal entities the degree of privatization of which is below 51%. Nevertheless, in line with the increase in the degree of privatization of the legal entities, the effect of this Low gradually reduces. In the private sector, there is a free setting of wages, with the wage policy of the private enterprises being determined by the business policy and the performances of certain enterprises.

Chart 10
Minimum average paid net wage per worker



In 2003, the nominal average paid net wage per worker in the Republic of Macedonia amounted to Denar 11,824, thus registering a nominal increase of 4.8% compared to 2002. Analyzed by structure, a nominal increase was registered in the wages in all branches, except for the fishing. The most intensive increase in the wages was registered in the public administration and defense and the compulsory social care (of 11.2%), the retail sale and wholesale (of 10.1%) and the health and social work (of 7.6%).

Table 5
Paid net wage per worker in the Republic of Macedonia

	Amount in denars	Nominal growth 2003/2002	Real growth 2003/2002
	2003	(in %)	
Average monthly wage, total	11,824	4.8	3.6
Selected activities:			
Mining and quarring	13,238	3.1	1.9
Processing industry	10,028	0.8	-0.4
Transport, storage and communications	23,515	5.5	4.3
Financial intermediation	14,205	3.5	2.3
Public administration and defense, compulsory social security	12,911	11.2	10
Education	11,544	6.5	5.3
Health care and social work	11,865	7.6	6.4
Other activities of communal, cultural and personnel services	12,025	2.4	1.2
December wage, total	11,955	0.6	0.1

*The real rates are nominal rates corrected by the inflation rate.

In 2003, the average inflation rate remained at a stable and low level (1.2%). Thus the more intensive nominal increase in the wages relative to the increase in the average inflation rate resulted in a real increase in the average net wage of 3.6%.

On annual basis (December 2003 / December 2002), the average net wage per worker in nominal and real terms was higher by 3.5%, and 0.9%, respectively (given the annual inflation rate of 2.6%).

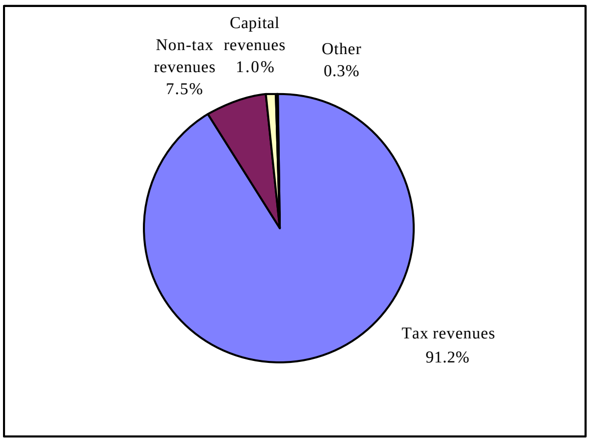
2.7. Fiscal policy[22]

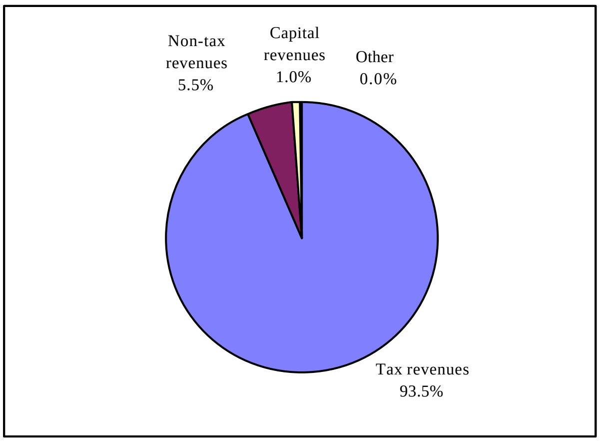
In 2003, the level of revenues of the Central Government Budget dropped, with a simultaneous considerable decrease being registered in the budget spending. One of the factors of the dynamics of the budget spending in 2003 was the late adoption of the Budget of the Republic of Macedonia in March 2003. From the aspect of the changes in the tax policy, the amendments to the Law on Value Added Tax became effective on April 1, 2003, according to which the general value added tax rate from 19% was reduced to 18%, and its application extended over the most of the products and services which until then were taxed at a preferred rate of 5%.

In 2003[23], the total Central Government Budget revenues amounted to Denar 53,881 million (97% of the planned revenues), which is by 7.4% less compared to 2002. The tax and capital revenues went down, unlike the non-tax revenues, which went up.

The tax revenues, which are the main component in the revenue structure, amounted to Denar 49,163 million in 2003, and compared to 2002, they dropped by 9.6%. The fall is primarily due to the abolishment of the financial transactions tax (through which Denar 6,336 million were collected in 2002, which makes up 10.9% of the total budget revenues). The revenues from the customs duties, the excises and the personal income tax fell notwithstanding the increase in their structural share in the total budget revenues. On the other hand, the revenues from the profit tax, the value added tax and revenues in the category "other taxes" were higher (by 24.7%, 3.2% and 40.0%, respectively). Despite the moderate increment in the revenues from the value added tax (with only 93% of the planned revenues being generated), it remains the major generator of the revenues, through which almost half of the tax revenues were collected. The non-tax revenues which make up 7.5% of the total budget revenues went up by 27.4% in 2003. An increase was registered in all non-tax categories. The most considerable increment was registered in the revenues from public and financial institutions (of 71.0%) primarily due to the higher inflows based on dividends.

Chart 11
Structure of the total budget revenues



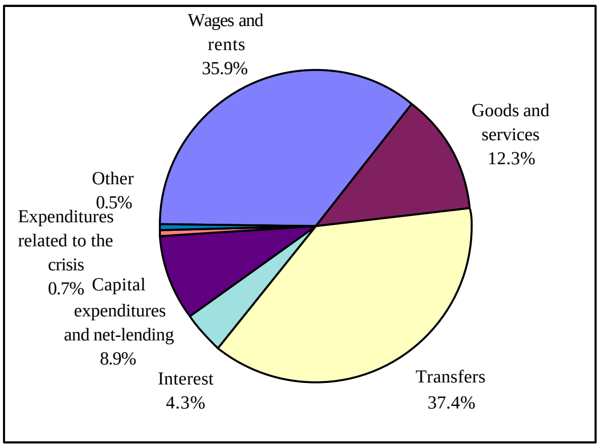


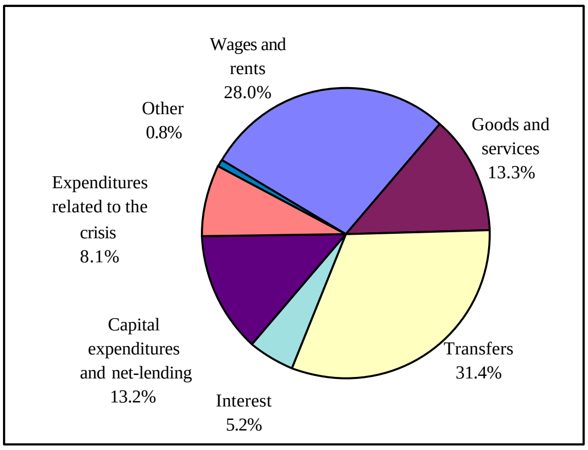
The total budget expenditures amounted to Denar 56,432 million in 2003[24], or 95% of the planned expenditures. Compared to 2002, they were considerably lower (by 13.8%), with a fall in the current, the capital expenditures and the expenditures for security needs (which were reduced to minimum in 2003) being registered.

[22] Source: Ministry of Finance
[23] In 2003, the Budget items were subject to restructuring, according to which the total budget revenues do not include the revenues generated from financing.
[24] In 2003, the Budget items were subject to restructuring, according to which the total budget expenditures do not include the expenditures generated from financing.

In 2003, the current expenditures, which are the largest expenditure category, amounted to Denar 50,984 million, which is by 11.5% less compared to 2002. The costs for goods and services and the costs for interest repayment were considerably lower, whereas the costs for wages and salaries and the costs for transfers picked up. A decline was registered in the capital expenditures. Thus compared to the preceding year they dropped by 41.7%.

Chart 12
Structure of the total budget expenditures





In 2003, the total revenues of the social funds (Pension and Disability Insurance Fund, Health Insurance Fund and the Employment Fund), equaled Denar 49,130 million, while the total expenditures of these funds amounted to Denar 48,632 million. On annual basis, the total revenues and expenditures of the social funds picked up by 8.3%, or 7.2%, respectively. The revenues and the expenditures of the Pension and Disability Insurance Fund and the Health Insurance Fund were almost within the planned ones, whereas the Employment Fund failed to fulfil the revenues and expenditures plan. The total revenues of the Road Fund amounted to Denar 3,669 million in 2003, which is almost identical with the expenditures (which amounted to Denar 3,661 million). Compared to the preceding year, the Road Fund's total revenues and expenditures were higher by 6.8% and 7.0% respectively. Nevertheless, the total revenues and the total expenditures were lower than the projected by 21.1% and 21.3%, respectively.

III. Monetary Policy

3.1 Monetary policy objectives

The considerable decrease in the risk, the gradual consolidation of the economy, the conduct of prudent fiscal policy and the stable banking system, in 2003, created prerequisites for gradual relaxation of the monetary policy evident through the gradual reduction in the NBRM interest rates in this year.

According to the legal provisions, in 2003, the NBRM was also oriented towards preserving the price stability as a main monetary objective. The monetary policy creates an environment for sustainable economic development by the maintenance of low and stable inflation rate. From the aspect of the monetary strategy, the NBRM continued applying the strategy of exchange rate targeting (Denar – Euro). Thus the nominal exchange rate constitutes an intermediary monetary policy objective, i.e. it plays the role of a nominal anchor, thus contributing towards maintaining the price stability. In this year, the exchange rate stability was maintained through the combined application of the NBRM direct interventions on the foreign exchange market and active engagement of the monetary regulation instruments (the CB bills auctions, in particular).

The initial monetary projection for 2003 was based on the presumptions for achieving average inflation rate of 3% and a real growth of the GDP of 3%. The projected inflation dynamics for 2003, was primarily based on the further maintenance of the price stability through the conduct of suitable monetary policy and efficient and active coordination between the monetary and the fiscal policies. Taking into account the considerable effects of the changes in the international oil prices on the domestic inflation, their movement in the current year was a major factor of uncertainty in the projection of the inflation rate.

The expected acceleration of the pace of the economic growth in 2003, as a second relevant element of the monetary projection, was a result of several presumptions: 1) reduction of the country risk and creation of preconditions for normal course of the overall economic developments; b) recovery of the domestic demand following the restraint of the domestic economic agents from personal and investment consumption; c) gradual recovery of the export demand for domestic products in accordance with the expected renewal and conclusion of new agreements with the foreign partners (in the textile industry, in particular); d) expected restart of a part of the loss-making enterprises and e) the higher level of public capital investments, as an additional impetus to the economic activity.

Taking into account the projected growth rates of the inflation and the GDP, an annual increase in the money supply M2 – Denar component of 9.6% was projected within the monetary projection, which was expected to ensure smooth execution of the transactions in the economy. Simultaneously, the initial projection for 2003 called for an annual decrease in the reserve money of 2.1%. Given the external imbalance (evident through the further maintenance of the deficit in the current account of the balance of payments), NBRM interventions on the foreign exchange market were planned, with a net-sale of foreign exchange, aimed at maintaining the exchange rate stability (as an intermediary monetary objective). Adequate level of foreign exchange reserves (four-month import coverage) was expected to be achieved through the external inflows announced for 2003 (after the extension of the arrangement by the IMF, foreign exchange inflows based on credits and donations from the World Bank, the European Union, the USA and the Netherlands were expected).

The anticipated acceleration of the economic activity was expected to be appropriately supported through active credit policy of the banks. Thus an annual growth in the total banks' credits to the private sector of 9.5% was planned for 2003. Such financial support of the economy by the banking sector was expected to be generated by: a) the higher supply of credits, as a result of the lower risk and thus the higher financial reliability of the customers; b) the expansion of the banks' deposit base (i.e. an increase in their credit potential), in accordance with the perceptions for further strengthening of the propensity to save within the banking system; c) the amendments to the Law on Foreign Exchange Operations, which allow the banks to lend in foreign exchange to all interested entities (instead of the possibility previously enjoyed to extend foreign currency loans only for payments and investment operations abroad).

The macroeconomic performances in the first two quarters of 2003, partially diverged from the initial projection. The macroeconomic program was subject to a revision on the basis of the available data and the modified presumptions. Thus the achieved real growth rates of the GDP signalised the need of minor revision of the projected growth rate (from 3% to 2.8%) in accordance with the expectations for lower domestic demand. Simultaneously, the deficit in the current account of the balance of payments was revised from 9.3% to 8.5%. More essential correction was made in the projection of the average inflation rate for 2003. Notwithstanding the higher level of the prices of thermal energy, the prices in the telephone pulses, the oil price, as well as the changes in the VAT structure in the first half of the year, the average inflation rate remained below 1%. Therefore the initial projection of he inflation of 3% was reduced to 1.8%.

In line with the revision of the projection of the monetary projection inputs, the projected dynamics of the monetary variables was also a subject to revision. Thus the annual growth rate of the monetary aggregate M2 – Denar component was corrected to 12.4% (in compliance with the expectations for considerably higher propensity to save in domestic currency on a short run). The NBRM reserve money were expected to drop by 4.3%. The initial projected annual growth rate of the total banks' placements to the non-government sector remained at 9.5%.

From the aspect of the operational structure of the monetary policy, the CB bills auctions were further exploited as a basic monetary regulation instrument. The projected dynamics at the level of CB bills (within the initial projection and within the revised projection) was based on the need for offsetting the effects of the autonomous factors on the liquidity of the banks through this instrument and maintaining an adequate level of liquidity. The maintenance of the liquidity at an optimal level and the active role of the NBRM on the foreign exchange market were expected to result in successful maintenance of the exchange rate stability, and consequently, successful maintenance of the price stability.

3.2. Monetary developments in 2003

The combined conduct of the CB bills auctions, as a basic monetary regulation instrument and the NBRM interventions on the foreign exchange market enabled maintenance of stable nominal exchange rate (Denar – Euro) and consequently, made considerable contribution towards maintaining low and stable inflation rate. Thus the average inflation rate for 2003 equals 1.2% (the projected inflation rate equals 1.8%), which is a successful achievement of the legally established monetary policy objective.

The monetary policy in 2003 was conducted in an environment of lower country risk, prudent fiscal policy, gradual acceleration of the economic growth, further maintenance of high trade deficit and stable operation of the banking system. Thus in the first three quarters, the public consumption was considerably lower relative to the one that was anticipated (partially due to the late adoption of the budget in March 2003 and the failure to generate a larger portion of the anticipated capital expenditures). Following the considerable net-sale of foreign exchange in the first month of the year, the NBRM interventions on the foreign exchange market continued to be directed towards a net purchase of foreign exchange, while the second quarter registered net-sale of foreign exchange, but with the minor incompliance between the supply of and the demand for foreign exchange. In the third quarter, the NBRM again intervened on the foreign exchange market by a net purchase of foreign exchange (given the high purchase of foreign exchange from the exchange offices by the banks, as well as a high net-purchase of foreign exchange on the exchange offices market by the banks). Such cumulation of foreign exchange by the NBRM, given the disciplined budget consumption created a capacity for proper response in the last quarter of the year. In the last three months of the year, the higher demand, due to seasonal factors, relative to the supply of foreign exchange resulted in NBRM interventions on the foreign exchange market by a net-sale of foreign exchange.

In 2003, the CB bills auctions, as a major monetary policy instrument, successfully offset the liquidity effects of the autonomous factors. The type of CB bills was changed in line with the changes in the economic environment. Thus after the permanent reduction in the interest rate in the first three months of the year, in April 2003, the NBRM switched towards "volume tender" auctions and fixed interest rate of 7%. The high demand for CB bills signalized maintaining of the attractiveness of the CB bills. Given the considerably higher demand for relative to the supply of CB bills (in line with the considerable inflow of Denar liquidity on the basis of the repayment of a part of the Government bonds for the old foreign exchange savings), at the end of October, the NBRM switched towards "interest rate tender" auctions (market-based setting of interest rates), which resulted in a trend of further decreasing.

With respect to the dynamics of the money supply, in 2003, the monetary aggregate M2 – Denar component registered a considerable annual growth rate of 15.6%. Given the minor annual change in the currency in circulation (even though, major reduction in the demand for currency in circulation was registered at the beginning of the year, due to the abolishment of the financial transactions tax), the increase in the money supply M2 – Denar component was generated from the higher amount of transaction deposit funds and the higher level of savings on a short run in domestic currency. Thus the increase in the transactions deposits constitutes a combined effect of the usual cumulation of liquid funds by the enterprises at the end of the year, as well as of the preferences to keep a portion of the available income of the enterprises and the households on their transaction accounts. On the other hand, the considerable increase in the short-term Denar deposits reflects the preferences for keeping the additional available income (especially the additional funds, obtained through the payment of the Government bonds for the old foreign exchange savings) of the sight deposits and the Denar short-term time deposits.

The positive annual dynamics of the monetary aggregate M2 - Denar component, is primarily generated from the strengthened money multiplication process (with an inconsiderable annual increase being registered in the reserve money of 0.4%). The money multiplier of the money supply M2 – Denar component equaled 2.35 in December 2003 (2.04 in the same month of the preceding year). Given the lower demand for currency in circulation in this year, in spite of the insignificantly higher level of liquidity, in 2003, the reserve money registered an average monthly decrease of 8.7%. In 2003, the average annual growth rate of the money supply M2 – Denar component and the broadest monetary aggregate M4 equaled 5.4% and 8.1%, respectively,

In 2003, the banks continued providing additional financial potential to the private sector through intensified credit activity. Thus the lower country risk, the higher creditworthiness of the consumers, the lower credit price, the broader deposit base, the diversified supply of credits, as well as the possibility for extending foreign exchange credits to all interested entities resulted in an annual increase in the total credits of the banks of 18.8% (with a simultaneous significant increase being registered in the Denar and the foreign exchange credits of 17.6% and 26.4%, respectively). In 2003, the banks' interest rate policy registered gradual adjustment to the monetary signals. Such responsiveness contributed to adequate reduction in both the lending and the deposit interest rates of the banks.

Chronology of the monetary policy measures

February 20, 2003

The NBRM Council adopted a Decision on decreasing the interest rates. Thus the interest rate on the Lombard credits (credits for overcoming the temporary shortages of liquidity extended on the basis of a pledge on securities) reduced from 23% to 17.5% p.a., with the restriction on the number of days for using the Lombard credits in the current month being abolished. The discount rate was reduced from 10.7% to 8% p.a. Thus the legal penalty rate was reduced from 32.1% to 24%.

February 21, 2003

The NBRM adopted a Decision on changing the interest rate paid on the compulsory reserve of the banks and the savings houses. Thus the interest rate on the compulsory reserve was reduced from 6% to 5%, and started to be applied on March 11, 2003.

March 19, 2003

The NBRM Council adopted a Decision on uniform rates of allocation of compulsory reserve on the Denar deposits of the banks and the savings houses. Thus unlike the previously differentiated rates of 10% and 5% for the deposits with maturity of up to three months and over three months, respectively, a uniform banks' compulsory reserve rate of 7.5% was introduced. Unlike the allocation of compulsory reserve of the deposits with maturity of up to three months and over three months of 4% and 1.5%, respectively, a uniform rate of 2.5% was introduced for the savings houses.

Moreover, a Decision on introduction of a compulsory reserve on the foreign exchange deposits was adopted. The banks are required to calculate and allocate compulsory reserve on the foreign exchange liabilities to residents and non-residents, legal entities and natural persons. The compulsory reserve rate equals 7.5%, and the base for the calculation is determined as an average of the daily amounts on the accounts for each calendar day of the previous month and it is expressed in Euro by application of the NBRM middle exchange rate valid on the last day of the calculation. Unlike the system for average allocation of the compulsory reserve on the Denar deposits, the compulsory reserve on the foreign exchange deposits is kept in a fixed amount (it is allocated on a special foreign exchange account with the NBRM, with the period of maintaining the liability for compulsory reserve beginning on the 11th in the current month and lasts until the 10th in the following month, and the NBRM pays a remuneration for the funds allocated in the amount of the requirement). The obligation for allocation started to be applied on June 11, 2003.

April 8, 2003

The NBRM Council adopted a Decision for further decrease in the NBRM interest rates. Thus the National Bank discount rate reduced from 8% to 6.5%, while the interest rate on the Lombard Credits was reduced from 17.5% to 16%.

Simultaneously, a change in the design of the CB bills auction was made, i.e. the NBRM switched towards "volume tender" auctions with fixed interest rate of 7% and maturity of the CB bills of 28 days (it started to be applied on April 11, 2003).

September 29, 2003

In September, the frequency of conducting CB bills auctions was reduced in order to induce the secondary market of trade in CB bills. Thus the frequency of the conduct of auctions was reduced to twice a week (Wednesday and Friday), unlike the previous period, when they were conducted three times a week.

October 22, 2003

The NBRM changed the type of the CB bills auctions again, thus switching towards “interest rate tender” auctions, which implies market-based setting of the interest rates, through bidding by the banks. Thus a maximum interest rate of 7% was established.

November 6, 2003

The NBRM adopted a Decision on changing the interest rates, according to which the interest rate on the Lombard credits was reduced from 16% to 14%. The Decision started to be applied on November 10, 2003.

November 7, 2003

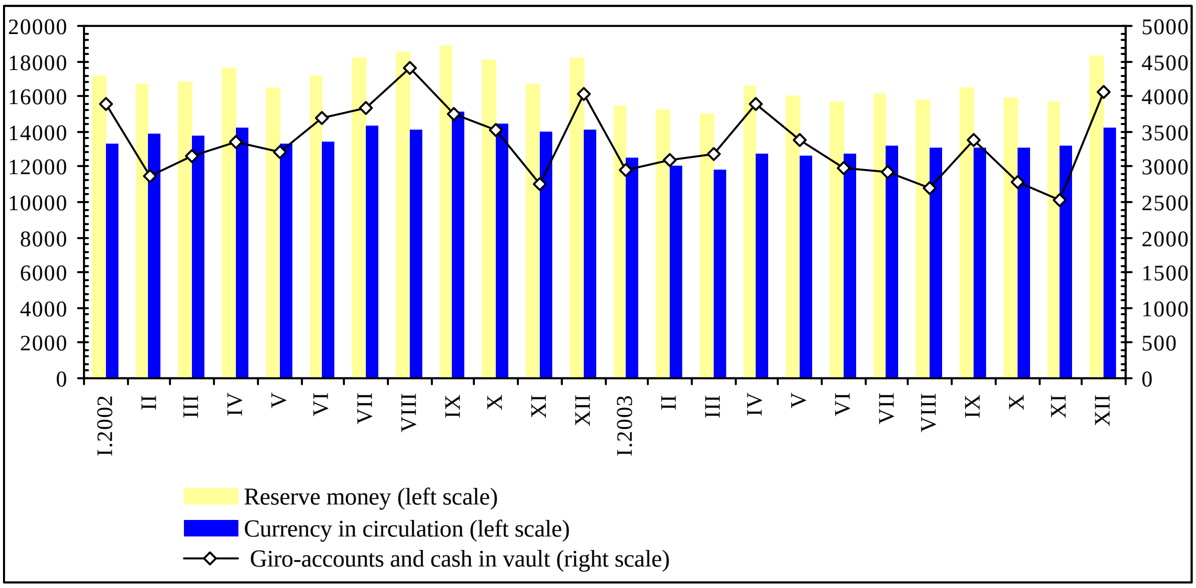
A Decision on reducing the interest rate on the compulsory reserve from 5% to 4% was adopted. The Decision started to be applied on November 11, 2003.

IV. Monetary developments in the Republic of Macedonia

4.1. Reserve money

In 2003, the dynamics of the reserve money was under the influence of the demand for currency in circulation (which after the abolishment of the financial transactions tax was considerably reduced and oscillated in line with the seasonal factors) and the total liquidity in the banking system (substantially determined by the policy of the banks for allocation of significant excess liquid funds over the compulsory reserve requirement). At the end of 2003, the level of reserve money amounted to Denar 18,252 million, which is a minor annual growth of Denar 77 million, or 0.4% (combined effect of the insignificant positive changes in the currency in circulation and the liquidity of the banks). Analyzing by structure, the annual comparison indicates almost unchanged share of the currency in circulation (at the end of the year it equaled 77.7%).

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



The quarterly analysis indicates considerable drop in the level of reserve money in the first quarter and continuous upward trend in the remaining three quarters of the year. The negative dynamics of the reserve money in the first quarter (decrease of 17.3%) is due to the substantial decline in the intensity of the demand for currency in circulation (exhaustion of the seasonal effect of the New Year's and Christmas holidays and the effect of the abolishment of the financial transactions tax) and the simultaneous decrease in the level of liquidity (given the net sale of foreign exchange on the foreign exchange market by the NBRM and the higher interest in investing in CB bills). In the second quarter, given the higher level of currency in circulation (which results from the seasonal effect of the Easter and the Labour Day holidays and the higher payment of social transfers[25]), given the simultaneous quarterly decline in the liquid funds (having in mind the further increase in the demand for CB bills), the reserve money picked up by 4.5%. The increase in the reserve money in the third quarter (of 4.6%) is a result of the simultaneous increment in the currency in circulation (as a seasonal effect of the summer vacations and the new school year) and the liquid funds of the banks (which given the higher amount of CB bills and stable net position of the Government with the NBRM is due to the NBRM interventions on the foreign exchange market directed towards net purchase of foreign exchange). The increase in the currency in circulation due to seasonal factors (New Year's and Christmas holidays)

[25] Given the slow dynamics of the payment of social transfers in the first quarter, due to the late adoption of the Budget for 2003.

and the cumulation of liquidity in the banking system at the end of the year, resulted in an increase in the reserve money of 11.1% in the fourth quarter.

Table 6
Reserve money
(in Denar million)

	Balance as of	Changes by quarters					Balance as of
	31.12.2002	I	II	III	IV	Total	31.12.2003
Reserve money	18,175	-3,144	674	729	1,818	77	18,252
- currency in circulation	14,136	-2,275	865	320	1,131	41	14,177
- banks' liquidity*	4,039	-869	-191	409	687	36	4,075

* The liquidity of the banks includes the banks' account with the NBRM and the cash in the vaults.

The NBRM balance sheet indicates reserve money creation in 2003, through the both components, the NBRM net domestic assets and net foreign assets. Thus the NBRM net domestic assets were directed towards reserve money creation in the first quarter of the year, which given the higher amount of CB bills and the stable fiscal position is solely due to the changes in the other assets. The growing interest in investing in CB bills, as well as the prudent fiscal policy, resulted in reserve money withdrawal through the NBRM net domestic assets in the second and the third quarter of the year. Given the concentration of the Government spending in the last days of December, as well as the considerable outflows in the last quarter, particularly as a result of the repayment of the liabilities on the basis of the bonds for the old foreign exchange savings in October, with simultaneous lower demand for CB bills being registered, the NBRM net domestic assets acted towards reserve money creation in the last quarter of 2003.

Table 7
NBRM survey
(in Denar million)

	Balance as of	Changes by quarters					Balance as of
	31.12.2002	I	II	III	IV	Total	31/12/2003
Reserve money	18,175	-3,144	674	729	1,818	77	18,252
Net foreign assets [1]	41,851	-3,966	3,741	2,350	-1,475	650	42,501
Net domestic assets	-23,676	822	-3,067	-1,621	3,293	-573	-24,249
1. Credits to banks, net	-2,784	-849	-347	-1,280	963	-1,513	-4,297
- Credits	214	-118	3	-1	-16	-132	82
- Instruments	-2,998	-731	-350	-1,279	979	-1,381	-4,379
2. Net position of the Government with the NBRM	-9,857	129	-1,482	29	2,639	1,315	-8,542
- Claims on Government	3,754	-89	-314	-80	-4	-487	3,267
- Government deposits [2]	-17,416	-1,724	4,579	109	2,643	5,607	-11,809
- External account [3]	3,805	1,942	-5,747	0	0	-3,805	0
3. Other items, net	-11,035	1,542	-1,238	-370	-309	-375	-11,410

1/ The foreign exchange categories are valued at a current exchange rate.
2/ Since these are liabilities accounts presented in the assets side, the amounts as of December 31, 2002 and December 31, 2003 are presented with a minus sign. Change with negative sign, in the changes by quarters, denotes an increase in the deposits and vice versa.
3/ In June, the positive balance on the account of the Monetary Policy Support Fund was netted with the Government external account with the NBRM, after which these two accounts were closed, and the remaining positive balance was transferred to the Single Treasury Account.

From the aspect of the annual dynamics, the NBRM net foreign assets acted towards reserve money creation in 2003. Thus in the first quarter, given the cumulative net sale of foreign exchange on the foreign exchange market by the NBRM, the low level of external inflows and the regular servicing of the liabilities towards the external creditors, the NBRM net foreign assets was directed towards reserve money withdrawal. Notwithstanding the further interventions with net sale of foreign exchange and the regular repayment of the due liabilities, the major external inflows in the second quarter (after the conclusion of the Stand By arrangement with the IMF) resulted in reserve money creation through the NBRM net foreign assets. The movements in the third quarter were aimed at the same direction, primarily as a result of the NBRM interventions on the foreign exchange market by a net purchase of foreign exchange. With the demand exceeding the supply of foreign exchange, i.e. net sale of foreign exchange by the NBRM, in spite of the considerable external inflows at the end of the year, the NBRM net foreign exchange assets was directed towards reserve money withdrawal.

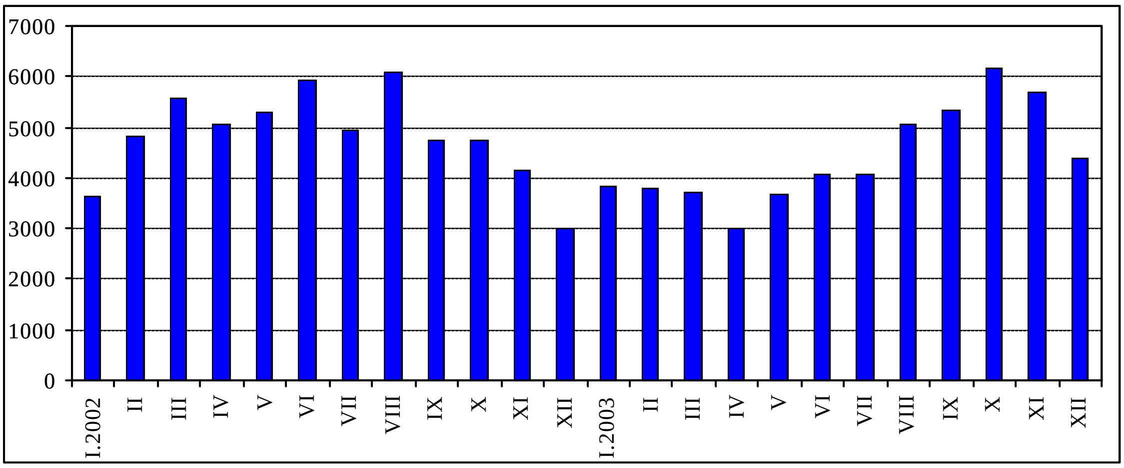
4.1.1. Basic monetary regulation instruments

Also in 2003, the monetary regulation instruments were set on a flexible basis thus being in function of efficient management of the liquidity of the banking system. Besides the need of maintaining satisfactory level of liquidity, the design of the monetary instruments was aimed at redirecting of the Denar liquidity from the foreign exchange market, thus affecting the demand for foreign exchange (given the application of the exchange rate targeting strategy, this is a contribution of the monetary regulation instruments towards maintaining the exchange rate stability).

The considerable risk reduction, the gradual stabilization of the overall economic developments, as well as the conduct of prudent fiscal policy ensured proper adjustment of the monetary policy design in 2003. With respect to the monetary instruments, the flexible adjustment was reflected through the change in the type of CB bills auctions, as well as through the change in the compulsory reserve allocation rates.

In line with the high level of liquid funds in the banking system, and given the underdeveloped financial market and the insufficiently diversified financial instruments portfolio, the CB bills still remain an attractive alternative for investing of the excess liquidity. Taking into account their function of sterilizing the excess liquidity, the above contributes towards high efficiency of the monetary instruments. Moreover, given the application of the exchange rate targeting strategy, the attractiveness of the NBRM short-term securities substantially contributes towards successful sterilization of the effects of the autonomous factors on the liquidity and the exchange rate stability. Analyzing the compulsory reserve, it is founded on the average allocation system (with a possibility of using 60% of the allocated amount), thus contributing to more flexible and more rational liquidity management by the banks.

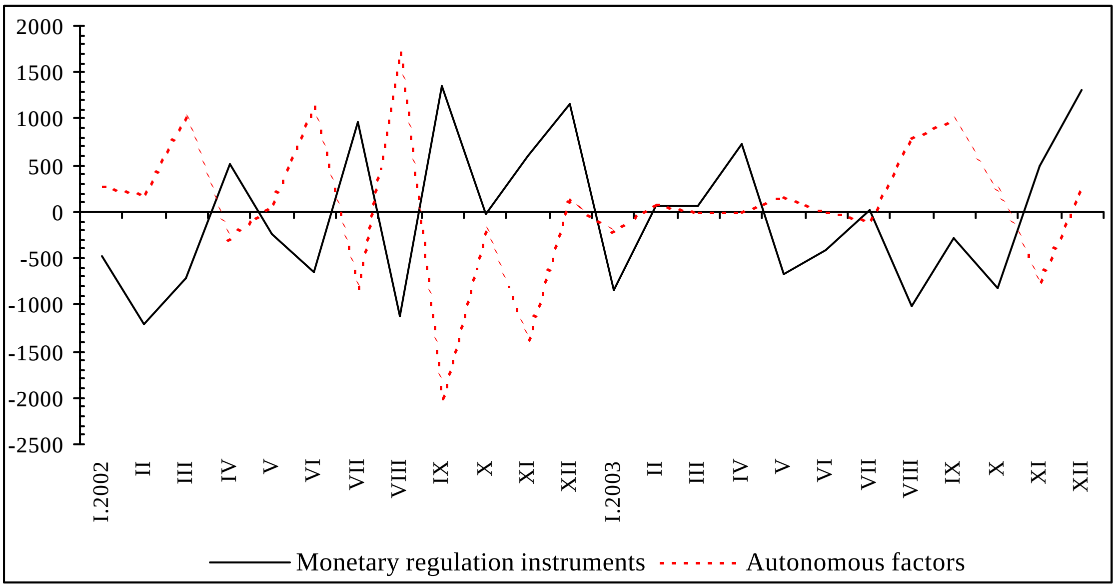
Chart 14
CB bills*
(in Denar million)



*The discounted amount of CB bills is presented.

In 2003, the monetary regulation was implemented in conditions of considerable excess of liquid funds of the banks over the compulsory reserve requirement. Thus the CB bills auctions acted towards liquidity withdrawal. By mid-April 2003, the CB bills auctions were founded on the “interest rate tender” principle (bidding with interest rates and their market-based setting), which given the higher demand for relative to supply of CB bills contributed towards permanent drop in the average weighted interest rate (from 15.2% in December 2002 to 9.6% in March 2003). In mid-April 2003, the NBRM switched towards “volume tender” auctions, with the interest rate being fixed at 7%. Such change resulted in temporary decrease in the interest in investing in CB bills (primarily due to the lower interest of the banks' customers, given the possibility for higher interest yield of funds deposited in the banks, with maturity identical with the CB bills maturity). Nevertheless, the attractiveness of the CB bills, in spite of the change in the type of auctions, remained at a satisfactory level, which is confirmed with the high demand relative to the offered amount. This was particularly evident in October 2003, when the substantial inflow of Denar liquidity (due to the payment of the regular installment of the Government bonds for the old foreign exchange savings) created additional demand for CB bills (in October 2003, the demand exceeded the supply by 2.5 times, on average, which in spite of the high liquidity, is also a result of the so-called "overbidding" – unreal growth in the demand, aimed at increasing the proportionate share of the banks in the realization). Under such circumstances, in October, the NBRM again switched towards "interest rate tender" auctions which resulted in gradual decrease in the interest rates (reducing to 6.15%, in December). In 2003, CB bills with maturity of 28 days were offered, with three auctions a week being organized by September. In September, the number of auctions reduced to twice a week, as a step towards gradual decrease of the NBRM presence and stimulation of the development of the CB bills secondary market (as well as stimulation of the short-term securities market, which will start operating in 2004).

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



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

In 2003, the CB bills auctions acted in accordance with their defined function of liquidity withdrawal. Thus at the end of December 2003, they amounted Denar 4,379 million, which is additionally withdrawn liquidity of Denar 1,381 million compared to the end of the preceding year. In this year, the CB bills auctions partially offset the liquidity effects of the autonomous factors (the currency in circulation, the fiscal position and the NBRM interventions on the foreign exchange market). From the aspect of the quarterly dynamics, the considerable decrease in the demand for currency in circulation in the first quarter (stabilization of the seasonal effect and the effect of the financial transactions tax), in spite of the net sale of foreign exchange on the foreign exchange market and the relatively stable net position of the Government, resulted in an increase in the liquidity and higher demand for CB bills. Thus in the first quarter, the additional liquidity withdrawn through the CB bills auctions amounted to Denar 731 million. A higher level of CB bills was also registered in the second quarter (quarterly increment of Denar 350 million). The excess supply of relative to the demand for foreign exchange on the foreign exchange market in the third quarter of the year resulted in NBRM interventions through a net purchase of foreign exchange and creation of additional Denar liquidity in the banking system. Additionally, this period registered lower Government deposits with the NBRM. Such movements were offset through higher amount of CB bills (an increase of Denar 1,279 million, compared to the preceding quarter). In line with the cumulation of liquidity typical for the end of the year (due to the expected cash outflows prior to the holidays), lower interest of the banks for investing in CB bills was registered at the end of the fourth quarter. Thus in the last quarter, the amount of CB bills went down by Denar 979 million.

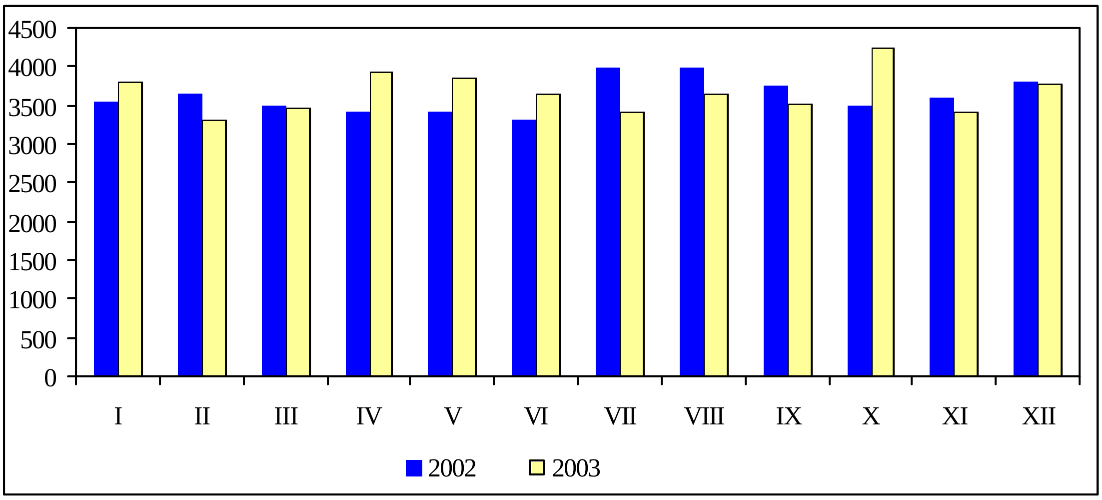
The highest amount of CB bills was registered in November 2003 (Denar 6,239 million), reflecting the effect of the payment of a portion of the Government bonds for the old foreign exchange savings.

From the aspect of the compulsory reserve, in March 2003, the compulsory reserve allocation rates were unified. Thus instead of the previous allocation at rates of 10% for the demand deposits, the sight deposits and the deposits with up to three months of maturity and 5% for other deposits, a uniform compulsory reserve allocation rate of 7.5% was introduced for all Denar deposits. Such changes acted towards creation of additional available liquid funds of the banks. In addition, a compulsory reserve allocation requirement on the foreign exchange deposits was introduced which started to be applied on June 11, 2003. Thus Denar 2,634 million, on average, were allocated on the above basis (with an allocation rate of 7.5%, where the compulsory reserve was allocated in Euro, and there is no possibility for using the allocated funds). This change is partially due to the amendment to the Law on Foreign Exchange Operations, regarding the possibility for foreign exchange lending to all entities, irrespective of the use.

4.2. Liquidity of banks

In 2003, the average liquidity of the banks was almost the same as in the preceding year. The changes in the liquidity position of the banks reflect the effects of the factors with autonomous character (the Government deposits with the NBRM, the currency in circulation, the foreign exchange transactions). On the other hand, the level of liquidity was also determined by the NBRM liquidity management (through the CB bills auctions), as well as the banks' liquidity management policy (reflected through the allocated excess liquid funds over the compulsory reserve requirement).

Chart 16
Average daily amount of banks' liquid funds
(in Denar million)



In 2003, the average daily amount of banks' liquid funds[26] amounted to Denar 3,671.1 million, which compared to the preceding year picked up by Denar 51.5 million, or by 1.4%.

[26] According to the 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 also the amount of Denar compulsory reserve, besides the cash in the vaults and the amount on the giro-account of the banking system.

With respect to the quarterly dynamics, the average daily liquidity of the banks went down in the first quarter of 2003 compared to the previous quarter and reduced to Denar 3,524.1 million. Given the considerably lower demand for currency in circulation (as a combined effect of the seasonal adjustment and the abolishment of the financial transactions tax), lower average level of the Government Denar deposits, as well as the interest in investing in CB bills, which is lower on average, the lower average liquidity results from the liquidity withdrawal through the NBRM foreign exchange transactions in this period. Notwithstanding the inconsiderably higher demand for currency in circulation (as an effect of the Easter holidays and the beginning of the summer vacations), the liquidity withdrawal through the NBRM interventions on the foreign exchange market and the almost unchanged level of CB bills, in the second quarter the average daily amount of liquidity of the banks went up (it equaled Denar 3,812.7 million). Such dynamics of the liquidity in this period reflects the level of the Government Denar deposits with the NBRM, which is lower, on average (with considerable outflows for the payment of a part of the bonds for the old foreign exchange savings being registered).

Given the relatively stable fiscal position in the third quarter, the liquidity creation through the net purchase of foreign exchange by the NBRM was compensated with the higher level of currency in circulation and the monetary regulation instruments. In line with such movements, the average daily level of liquidity reduced to Denar 3,530.6 million in the third quarter of 2003. In the last quarter of the year, the average level of liquidity reached Denar 3,816.9 million. Additional liquidity creation was registered at the very end of the year, given the concentration of considerable budget spending within a short period of time (larger outflows from the Government Denar account were also registered in October, due to the payment of the regular installment of the bonds for the old foreign exchange savings). Simultaneously, given the higher need for liquidity due to seasonal factors (as a result of the high outflows of cash prior to the end of the year), the banks preferred to hold higher amount of liquid funds. On the other hand, the demand for currency in circulation which was higher due to seasonal factors, the demand for CB bills which was higher, on average, as well as the net sale of foreign exchange by the NBRM (with higher needs for foreign exchange for payment of the liabilities based on imports being registered) acted towards liquidity reduction.

In 2003, the banks' liquidity management was conducted in conditions of considerable excess allocated liquid funds of the banking system. Thus on average, in 2003, the excess liquid funds of the banks at the end of the period of fulfilling the compulsory reserve requirement equaled 27.9% (an annual increase of 4.1 percentage points). The unifying of the compulsory reserve allocation rates[27] partially contributed towards higher excess liquid funds, which created additional free liquidity in the banking system. The allocated excess liquid funds signalizes the need of more rational and more efficient liquidity management by some banks. The above should result in lower opportunity cost for holding non-yield bearing liquid funds.

Taking into account the high level of liquidity of the banking system, this year, two Lombard credits were extended to two banks in January and December (as a way of overcoming the temporary shortages of liquid funds).

In spite of the high level of liquidity in the banking system, the cumulative supply of liquid funds on the institutionalized Money Market exceeded the cumulative demand, signalizing inadequate liquidity dispersion. On the other hand, the demand for and the supply of liquid funds on the Money Market were almost balanced, on average.

4.3. Monetary aggregates

In 2003, the monetary growth dynamics was under the influence of the larger intensity of the economic activity, the increasing propensity of the households to save within the banking system, the

[27] In June 2003, instead of the previous compulsory reserve allocation at the rates of 10% and 5% of the deposits with up to three months and over three months of maturity, respectively, a uniform compulsory reserve allocation rate of 7.5% was introduced.

creation of additional available income of the households through the payment of a part of the Government bonds for the old foreign exchange savings (and the preferences for keeping these funds on the accounts in the banks), as well as under the influence of some changes of a systemic nature (the possibility for the legal entities to handle their foreign exchange unlimitedly, without having an obligation to sell them on the foreign exchange market after a certain time period).

The money supply M1 (currency in circulation and demand deposits) registered an annual increment of Denar 1,059 million or 4%, thus amounting to Denar 27,273 million at the end of 2003. The positive annual dynamics of the monetary aggregate M1 is a result of the inconsiderable increase in the reserve money and the simultaneous strengthening of the money multiplication process. Thus in December 2003, the money multiplier of the money supply M1 equaled 1.49 (1.44 in the same month of the preceding year). With the level of currency in circulation being almost unchanged, the higher money multiplier reflects the higher amount of funds on the transaction accounts. The average annual growth rate of the money supply M1 was negative and equaled 5.4% in 2003 (which is primarily due to the level of currency in circulation which is lower, on average – effect of the abolishment of the financial transactions tax).

Table 8
Monetary survey*
(in Denar million)

	Balance as of 31.12.2002	Changes by quarters I	II	III	IV	Total	Balance as of 31/12/2003
Money Supply M4 (total)	70,374	-1,982	5,479	3,964	4,633	12,094	82,468
Money Supply M4 (non-government sector)	68,436	-1,849	5,255	3,690	5,281	12,377	80,813
Net foreign assets [1]	62,901	-3,275	3,116	3,711	-661	2,891	65,792
Net domestic assets [1]	7,473	1,293	2,363	-983	5,038	7,711	15,184
Domestic credits	40,485	1,326	-641	2,146	5,802	8,633	49,118
Deposit money banks	50,342	1,197	841	2,117	3,163	7,318	57,660
out of which:							
Non-government sector credit	42,365	1,510	1,409	2,397	2,647	7,963	50,328
- in Denars	36,630	946	1,030	2,207	2,268	6,451	43,081
- in foreign currency	5,735	564	379	190	379	1,512	7,247
Government sector credit	7,977	-313	-568	-280	516	-645	7,332
NBRM claims on Government, net	-9,857	129	-1,482	29	2,639	1,315	-8,542
Other items, net	-33,012	-33	3,004	-3,129	-764	-922	-33,934

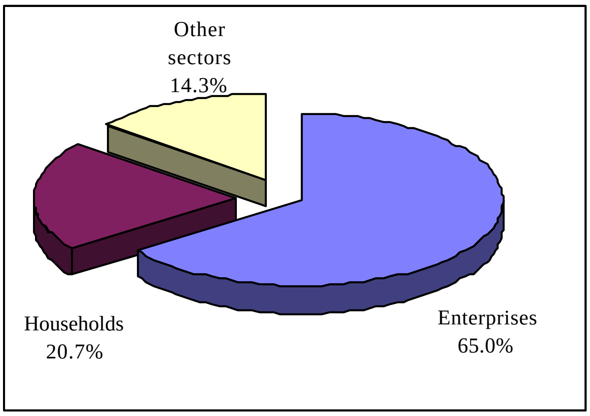
1/ (+) Money supply (M1) creation; (-) Money supply (M1) withdrawal;
* The foreign exchange categories are valued at a current exchange rate.

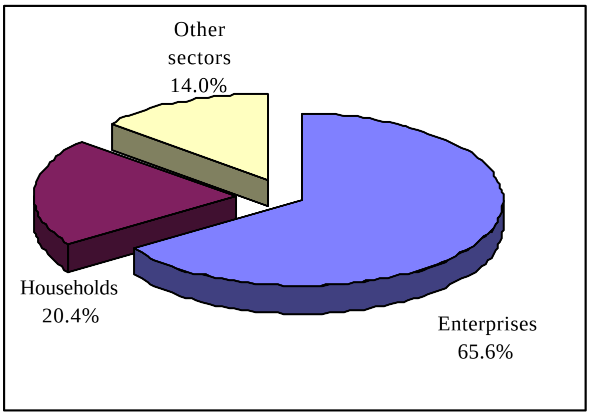
From the aspect of the quarterly dynamics, in the first quarter, the money supply M1 dropped by considerable 14.2%, which corresponds with the effect of the abolishment of the financial transactions tax, supplemented with the depletion of the effect of the seasonal factors on the currency in circulation, as well as the stabilization of the level of demand deposits (following the cumulation of funds by the enterprises typical for the end of the year). In the second quarter of the year, the monetary aggregate M1 registered an increment of 7,1%, with simultaneous acceleration of the demand for currency in circulation (extended seasonal effect of the Easter holidays) and the higher level of demand deposits. The higher level of currency in circulation in the period of summer vacations and the start of the new school year, as well as the higher level of transaction funds, resulted in higher money supply M1 by 3.5% in the third quarter. In line with the intensified demand for currency in circulation, due to seasonal factors and the usual cumulation of funds on the transaction accounts of the enterprises, the money aggregate M1 was higher by considerable 9.5% in the last quarter of the year.

The insignificant annual change in the currency in circulation and the simultaneous higher level of demand deposits resulted in positive changes in the structure of the money supply M1. Thus on December 31, 2003 the currency in circulation accounted for 52% in the money supply M1, which is an annual fall of 1.9 percentage points. The decline was also registered in the average monthly share, which equaled 53% in 2003, which is by 1.6 percentage points lower on annual basis.

At the beginning of the year, the currency in circulation registered a considerable decline which reflects the adjustment of the demand for currency in circulation after the abolishment of the financial transactions tax. In addition, in this year, the fluctuations of the currency in circulation were in line with the regular seasonal dynamics. Thus in the first quarter of the year, the currency in circulation went down by 16.1%, in line with the aforementioned effect of systemic nature (the abolishment of the financial transactions tax) and the exhausted seasonal effect after the New Year's and the Christmas holidays. With the demand for currency in circulation being intensified in the period of the Easter and Labour Day holidays, combined with the partial effect of the payment of the Government bonds for the old foreign exchange savings (in April) and the beginning of the summer vacations, in the second quarter the level of currency in circulation was by 7.3% higher. The increase in the demand for currency in circulation in the third and the fourth quarter equaled 2.5% and 8.7%, respectively. Thus the positive dynamics of the currency in circulation in the third quarter is a reflection of the period of summer vacations and the start of the new school year. The changes in the demand for currency in circulation in the last quarter constitute a combined effect of the payment of a part of the Government bonds for the old foreign exchange savings (in October), the higher demand for currency in circulation prior to the New Year's and the Christmas holidays and the high public consumption, concentrated in the last days of the year.

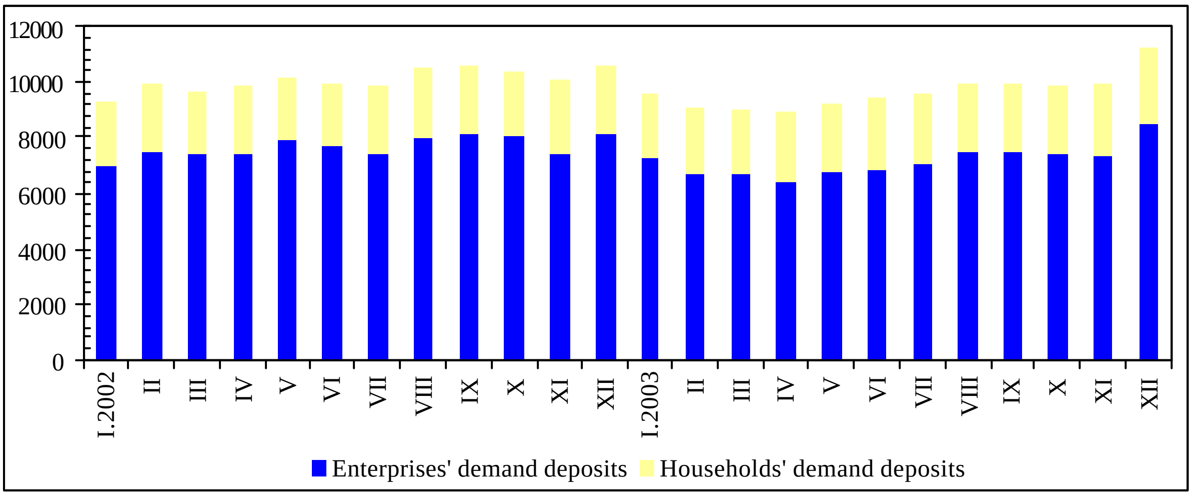
Chart 17
Structure of the demand deposits by sectors





At the end of 2003, the total demand deposits (current and giro accounts) registered an annual increase of Denar 1,018 million, or 8.4% with a simultaneous increase being registered in the demand deposits of both the enterprises and the households. Thus the enterprises' demand deposits registered an annual increment of 7.2%, with a significant contribution made by the usual cumulation of funds on the enterprises' transaction deposits at the end of the year. The analysis of the dynamics indicates continuous decrease in the enterprises' demand deposits in the first four months of the year. An intensive positive monthly dynamics was registered in the May – August 2003 period. In the remaining period (excluding December) the enterprises' demand deposits were relatively stable. According to the new provisions of the Law on Foreign Exchange Operations (a possibility for free handling of the foreign assets by the legal entities – having no obligation to be sold after a certain time period), the average monthly level of the enterprises' demand deposits in 2003 was lower compared to the preceding year (by 6.5%). Structurally observed, at the end of 2003, the enterprises' demand deposits made up 65% of the total demand deposits, which is a drop of 0.6 percentage points on annual basis.

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



The annual growth rate of the households' demand deposits equaled 10.3% in 2003. In this year, the funds on the households' transactions accounts were constantly oscillating. Thus considerable cumulation of liquid funds was registered in April and December in line with the larger needs of the households for funds for transaction purposes (seasonal effect prior to the holidays). Also, the increase in the households' demand deposits in April is partially a result of the payment of a part of the Government bonds for the old foreign exchange savings. The share of the households' demand deposits in the total demand deposits registered an annual increment of 0.3 percentage points in 2003, thus reaching 20.7% on December 31, 2003.

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

	Balance as of					Changes by quarters				
	31/12/2002	31/03/2003	30/06/2003	30/09/2003	31/12/2003	I	II	III	IV	Total
Currency in circulation	14,136	11,861	12,726	13,046	14,177	-2,275	865	320	1,131	41
Demand deposits	12,078	10,633	11,355	11,867	13,096	-1,445	722	512	1,229	1,018
Money Supply M1	26,214	22,494	24,081	24,913	27,273	-3,720	1,587	832	2,360	1,059
Quasi-Denar deposits	10,855	11,684	13,635	13,979	15,568	829	1,951	344	1,589	4,713
Quasi-foreign currency deposits	26,594	27,541	29,622	31,810	33,187	947	2,081	2,188	1,377	6,593
Money Supply M2	63,663	61,719	67,338	70,702	76,028	-1,944	5,619	3,364	5,326	12,365
Non-monetary Denar deposits	3,493	3,555	3,288	3,337	3,497	62	-267	49	160	4
Non-monetary foreign currency deposits	1,280	1,313	1,216	1,493	1,288	33	-97	277	-205	8
Money Supply M4	68,436	66,587	71,842	75,532	80,813	-1,849	5,255	3,690	5,281	12,377

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

Besides the effects of the dynamics of the money supply M1 components, the movement of the broader monetary aggregates in 2003 was determined by the following factors: a) strengthened orientation of the economic agents to saving within the banking system, which indicates higher credibility of the banking system and perceptions for stable developments in the following period; b) considerable increment in the available income of the households, created through the regular payment of the liabilities based on the Government bonds for the old foreign exchange savings (mostly kept on the households' Denar accounts) and c) cumulation of foreign exchange deposits by the enterprises (in line with the amendments to the Law on Foreign Exchange Operations pertaining to the free handling of the foreign exchange funds).

The money supply M2 (money supply M1, sight deposits and deposits with maturity of up to one year) amounted to Denar 76,028 million at the end of 2003, which is an annual increase of Denar 12,365 million or 19.4%. Its Denar component went up by 15.6% (largely due to the higher level of short-term deposits in domestic currency). The monetary aggregate M4 (money supply M2, restricted and long-term time deposits) registered an annual increase of Denar 12,377 million, or 18.1%, thus reaching Denar 80,813 million at the end of the year.

4.3.1. Total deposits

In 2003 (excluding January and November), the banks' deposit potential registered permanent increase. Such trend of the total deposits of the non-government sector (sight deposits, deposits with maturity of up to one year and over one year) is a reflection of the strengthened orientation of the economic agents to save in both domestic and foreign currency. At the end of 2003, the total deposits in the banking system reached Denar 53,540 million, which is an annual increment of Denar 11,318 million, or 26.8%. The high annual growth rate might be explained with the effect of several factors: a) lower risk and consequently, retaining a large portion of the funds within the banking system; b) intensified economic activity and higher available income; c) higher credibility of the banking system and high degree of protection of the households' deposits[28], which contributes towards further directing of the available funds in the banking system; d) creation of additional available income for the households through payment of the regular installments of the Government bonds for the old foreign exchange savings, most of which was kept on the banks' accounts, and e) the new provision for free handling of foreign exchange by the legal entities (without an obligation to be sold on the foreign exchange market after certain time period) acted towards considerable increase in the enterprises' foreign exchange deposits.

Table 10
Total deposits*
(in Denar million)

	Balance as of					Changes by quarters				
	31/12/2002	31/03/2003	30/06/2003	30/09/2003	31/12/2003	I	II	III	IV	Total
Total deposits of the non-government sector	42,222	44,093	47,761	50,619	53,540	1,871	3,668	2,858	2,921	11,318
- Denar	14,348	15,239	16,923	17,316	19,065	891	1,684	393	1,749	4,717
- foreign currency	27,874	28,854	30,838	33,303	34,475	980	1,984	2,465	1,172	6,601
I. Short-term deposits/1	37,449	39,225	43,257	45,789	48,755	1,776	4,032	2,532	2,966	11,306
- Denar	10,855	11,684	13,635	13,979	15,568	829	1,951	344	1,589	4,713
- foreign currency	26,594	27,541	29,622	31,810	33,187	947	2,081	2,188	1,377	6,593
II. Long-term deposits/2	4,773	4,868	4,504	4,830	4,785	95	-364	326	-45	12
- Denar	3,493	3,555	3,288	3,337	3,497	62	-267	49	160	4
- foreign currency	1,280	1,313	1,216	1,493	1,288	33	-97	277	-205	8

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

The analysis of the dynamics indicates expansion of the banks' deposit base in all four quarters of the year. Thus, in the first quarter, the total deposits in the banking system went up by 4.4%, with an increment being registered in all types of deposits from the aspect of their maturity structure and structure of currency of denomination. Such dynamics of the deposits in the first quarter reflects the strengthened propensity of the households and the enterprises to save on a short run in domestic and foreign currency. The increase in the second quarter was more intensive and equaled 8.3%, reflecting the inflows on the accounts of the households and the payment of the regular installments of the Government bonds for the old foreign exchange savings (most of which were cumulated on the Denar sight accounts and the deposits with maturity of up to one month and three months in Denars), as well as the higher amounts of short-term Denar deposits of the enterprises (in line with their lower demand for CB bills) and the considerable increase in the enterprises' foreign exchange deposits (given the possibility for free handling of foreign exchange). In the third quarter, the total deposits registered an increase of 6%, given the higher propensity of the households and the enterprises to save in foreign exchange (77% of the quarterly increase in the total deposits in the third quarter is due to the higher level of short-term foreign exchange deposits). The payment of the regular installment of the

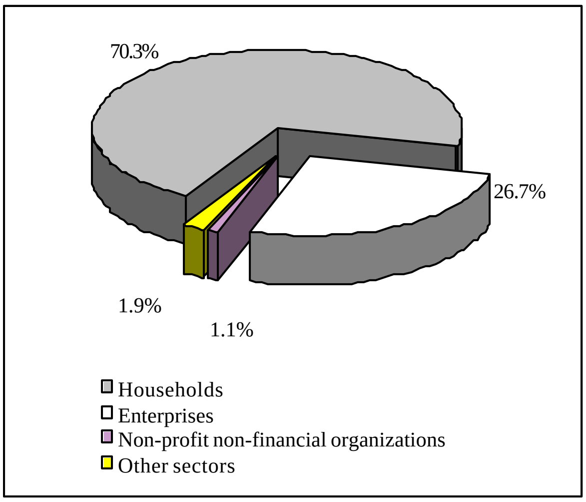
[28] The current deposit insurance model calls for indemnification of 100% and 90% for the households' deposits in the amount of up to Euro 10,000 and Euro 20,000, respectively.

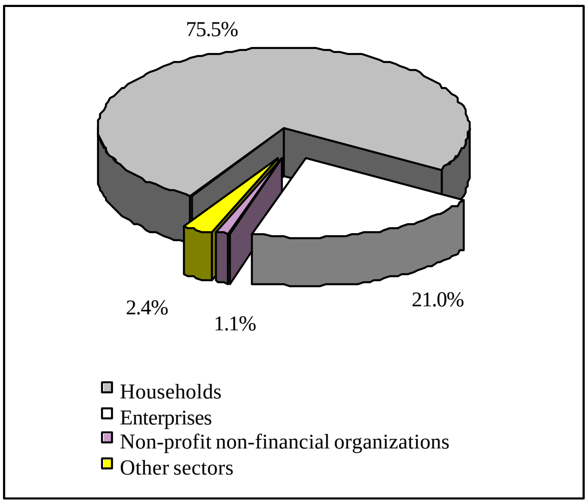
Government bonds for the old foreign exchange savings, as well as the higher amounts of the Denar time deposits of the enterprises and their foreign exchange sight deposits resulted in higher level of the total deposits in the fourth quarter by 5.8%.

With respect to the maturity structure, the strengthening of the deposit potential of the banks is almost solely due to the increase in the short-term deposits. The annual growth rate of the short-term deposit potential equals 30.2% in 2003, while the short-term Denar and foreign exchange deposits simultaneously upsurged by 43.4% and 24.8%, respectively. With respect to the dynamics, in this year, the short-term deposits registered continuous increase, which was the most evident in the second quarter. The long-term time deposits registered no considerable changes (an annual increment of 0.3 percentage points). With respect to the oscillations in this year, after the moderate increase in the first quarter, the second quarter registered a decline in the long-term deposit potential, as a reflection of the lower preferences of the households to save on a long run. The increase in the third quarter is a combined effect of the moderate increase in the long-term deposits of the households and the higher level of restricted foreign exchange deposits of the enterprises (intended for transactions based on the international payment operations instruments). Notwithstanding the further moderate increase in the long-term savings of the households, the lowering of the enterprises' restricted deposits (with a volatile nature) resulted in a decline in the total long-term deposits in the fourth quarter.

With respect to currency of denomination, an increase was registered in the both Denar and foreign exchange deposits. Their dynamics was generated from the oscillations in the short-term deposit potential. Thus the Denar deposits registered an annual increment of 32.9% (with an increase being registered in both the short-term and the long-term Denar deposits of 43.4% and 0.1%, respectively). In December 2003, compared to the same month of the previous year, the foreign exchange deposit potential was by 23.7% higher, given the increase in the short-term and the long-term foreign exchange deposits of 24.8% and 0.6%, respectively (taking into account the depreciation of the US Dollar and the lower Denar equivalent of the deposits denominated in US Dollar arising thereof).

Chart 19
Structure of deposits by sectors





The sector structure registers movements directed towards increase in the share of the enterprises, in line with the possibility for free handling of foreign exchange by the legal entities, whereas the share of the households' deposits dropped. As of December 31, 2003, the households' deposits accounted for 70.3% of the total deposits (an annual decline of 5.2 percentage points). The annual increment in the share of the deposits of the enterprises equaled 5.7 percentage points, thus reaching 26.7% at the end of 2003.

The preferences of the households for keeping most of the additional income within the banking system, given the lower risk, the strengthened confidence in the banking sector and the higher propensity to save, resulted in a considerable annual increase in the total households' deposits of Denar 5,766 million, or 18.1%, thus reaching Denar 37,645 at the end of the year. With respect to the quarterly dynamics, the total households' deposits were continuously going up in this year. Thus given the higher amount of Denar deposits with maturity of up to one and three months (with a partial redistribution from sight deposits to short-term time deposits being registered) and an increase in the savings in foreign currency, the increment in the households' deposits equaled 2.8% in the first quarter. Faster increase was registered in the second quarter (4.4%) with 64% of the quarterly increase being generated from the households' Denar deposits (given the additional inflows on the households' accounts through the payment of the regular installment of the Government bonds for the old foreign exchange savings in April 2003). The upward trend continued in the third quarter, as well (increment of 3.5%), while in the last quarter of the year, the increase in the households' deposits equaled 6.3%. The growth in the last quarter is primarily due to the additional inflow generated from the payment of the regular installment of the Government bonds for the old foreign exchange savings in October 2003.

In 2003, the total enterprises' deposits were permanently going up, reflecting the preferences for cumulation of funds on the banks' Denar accounts, as well as the new provision of the Law on Foreign Exchange Operations (a possibility for free handling of foreign assets, without being obliged to sell them on the foreign exchange market after a certain time period). Thus the annual growth rate of the total enterprises' deposits equaled 61.3% (with an increase being registered in both the Denar and the foreign exchange deposits of 38.5% and 96.6%, respectively) thus reaching Denar 14,277 million at the end of the year. In the first quarter, the enterprises' deposits went up by 10%, with the considerable increase in the short-term time Denar deposits having a dominant effect. The growth rates in the second and the third quarter were significantly high (22.4% and 13.7%, respectively) in line with the intensive cumulation of foreign assets on the enterprises' accounts (the high growth rate in the second quarter reflects the redirection of the investments from CB bills to saving in the banks, after the CB bills interest rate was fixed). The fourth quarter registered relative stabilization of the level of enterprises' deposits, i.e. quarterly growth of 5.4%.

4.4. Banks' placements[29]

The intensified lending to the private sector by the banks in 2003 constituted additional financial support of the economic activity. The intensive annual dynamics of the total banks' credits extended to the non-government sector is a resultant of the effect of several factors: a) considerable risk reduction, and thus the higher financial reliability of the customers and the lower credit risk; b) the further expansion of the banks' deposit base, i.e. increase in their credit potential; c) the gradual increase in the flexibility of the interest rate policy, which given the relatively stable developments and adequate changes in the monetary policy resulted in lower credit prices; d) the diversified supply of credits (diversification of the types of credits and the terms and conditions for their usage), which increased the attractiveness of the credits, as an additional source of financing and e) entrance of a new bank with foreign capital, the main orientation of which is the micro crediting.

The effects of the lending through the banking sector on the inducement of the economic activity may be grouped into two categories: direct and indirect. Thus in 2003, the short-term and the long-term lending to the enterprises enhanced, which is a direct impulse for accelerating the investment activity. On the other hand, almost 60% of the increase in the banks' total credits in domestic currency pertains to placing funds to the households sector. Thus the banks continued supplementing the financial potential of the households by extending short-term consumer credits, which is aimed at stimulating the consumption and inducing the pace of the economic growth through this channel. Moreover, in 2003, the long-term credits for housing construction extended to the households went up, thus generating positive effects on the economic growth.

[29] The banks' placements are shown according to the accounting balance and all comparisons are adequately adjusted (previously, the actual balance was shown, which differs from the accounting balance by the corrections made in the written-off claims and the re-recordings with the banks).

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

	Balance as of					Changes by quarters				
	31/12/2002	31/03/2003	30/06/2003	30/09/2003	31/12/2003	I	II	III	IV	Total
1. Total banks' placements to the private sector (accounting value)	42,365	43,875	45,284	47,681	50,328	1,510	1,409	2,397	2,647	7,963
in Denar	36630	37576	38606	40813	43081	946	1,030	2,207	2,268	6,451
in foreign currency	5735	6299	6678	6868	7247	564	379	190	379	1,512
2. Total banks' placements to the private sector (actual value)	47,505	48,975	50,357	51,769	54,629	1,470	1,382	1,412	2,860	7,124
in Denar	39955	40861	41864	43038	45567	906	1,003	1,174	2,529	5,612
in foreign currency	7550	8114	8493	8731	9062	564	379	238	331	1,512

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

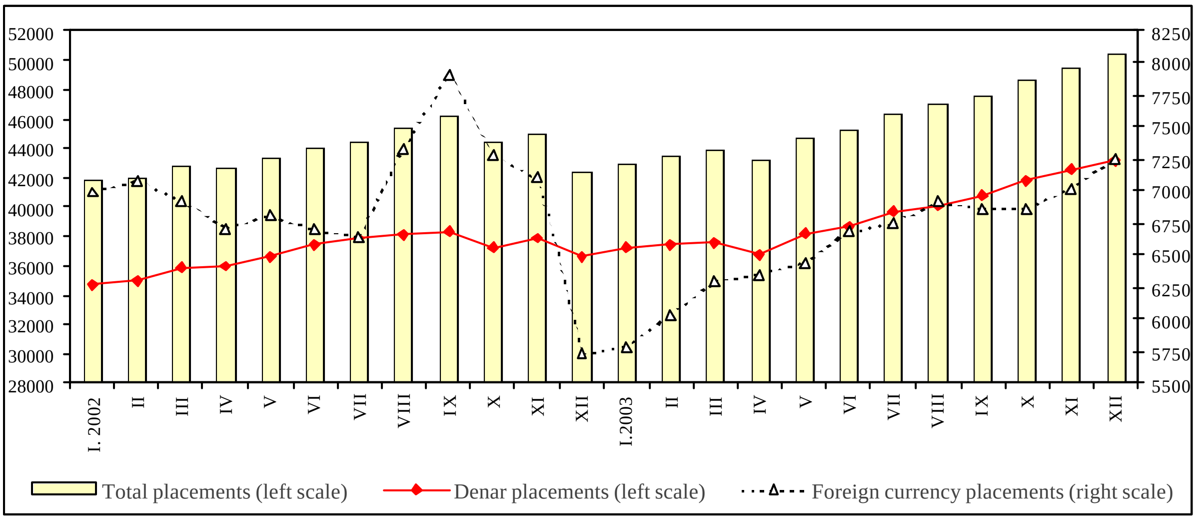
Given the accelerated crediting to the private sector in Denars and in foreign exchange, at the end of 2003 the banks' total placements to the private sector reached Denar 50,328 million, which is an increase of Denar 7,963, or 18.8% compared to the previous year.

The total Denar placements extended to the private sector registered a substantial annual increment of Denar 6,451 million or 17.6%, thus reaching Denar 43,081 million at the end of 2003. Such dynamics of the Denar credits was generated from several factors: 1) more intensive crediting to the enterprises on both short and long term; 2) strengthened orientation of the banks towards short-term and long-term lending to the households for different purposes and 3) higher amount of doubtful and disputed claims based on credits extended to enterprises[30].

The quarterly analysis of the dynamics of the banks' Denar placements shows permanent acceleration of the credit activity of the banks in 2003. Thus the quarterly growth rates of the lending in domestic currency were relatively moderate (2.6% and 2.7%, respectively) in the first two quarters, while in the third and the forth quarter, the lending in domestic currency was more intensive (quarterly increase in the third and the fourth quarter of 5.7% and 5.6%, respectively). The intensive lending to the households for various purposes, the upward trend of the lending to the enterprises aimed at supplementing their long-term sources of funds and the higher level of overdue claims were major factors that acted towards higher level of the Denar placements in the first half of the year. On the other hand, this period registered lower volume of credits extended to the enterprises on a short run. Such trend also continued in the third quarter with more intensive dynamics, while the last quarter registered positive qualitative movements in the lending structure. Thus the banks continued financing the short-term and the long-term needs of the households and the enterprises, with a moderate decline in the overdue claims being registered (which signalizes more suitable selection of the clients, more proper credit portfolio management by the banks and stronger financial discipline).

[30] Which primarily reflects the decision on abolishing the previous practice of off-balance sheet recording of the placements with a deferred collection of more than two quarters.

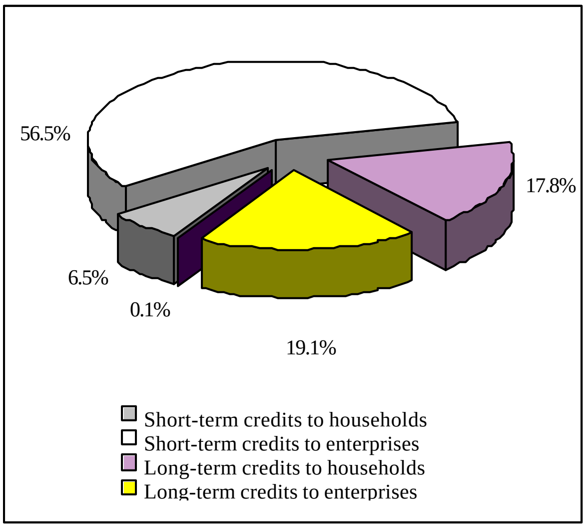
Chart 20
Banks' placements
(in Denar million)

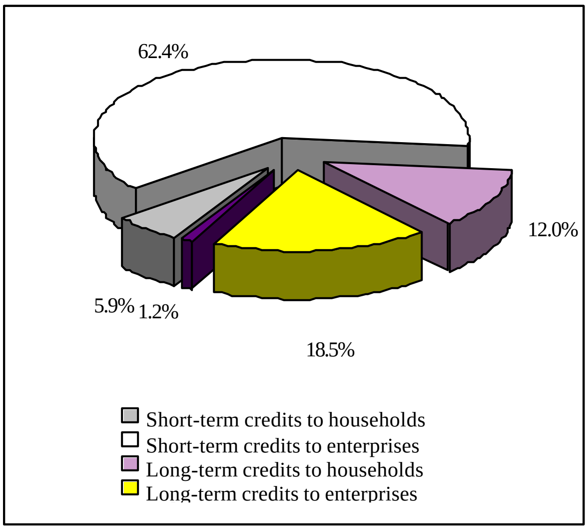


The increasing role of the banks in the process of supporting the economic growth is proved through the analysis of the maturity structure of the Denar placements. Thus given the stabilization of the economic developments and the relatively stable economic environment, the orientation of the banks towards lending on a long run was strengthened in 2003. Thus, the long-term Denar placements registered an annual increase of 42.4%, with more intensive long-term lending to the enterprises and long-term lending to the households (an annual growth of the long-term placements extended to the households and the enterprises of 74.5% and 21.5%, respectively). The above resulted in movements in the maturity structure of the Denar placements, aimed at increasing the share of the credits extended on a long rung by 6.3 percentage points, thus reaching 36.9% on December 31, 2003. The annual growth rate of the credits extended on a short run was more moderate (7.3%) with their share in the maturity structure of the Denar placements remaining dominant (at the end of 2003, it equaled 63.1%). The sector-by-sector analysis indicates that the short-term lending to the households picked up by 31.7% on annual basis, while the credits extended to the enterprises on a short run went up by 6.8%, on annual basis.

The banks' orientation towards enhanced long-term lending to the households sector resulted in an annual increment of the share of the Denar credits extended to the households in the total Denar placements of 6.5 percentage points, thus reaching 24.4% at the end of the year. On the other hand, the Denar placements extended to enterprises accounted for 75.6% on December 31, 2003, which is by 5.4 percentage points lower on annual basis. The short-term credits are still dominant (74.8%) in the maturity structure of the Denar placements extended to enterprises, with evident preferences of the banks for long-term lending to the households being registered (long-term credits extended to the households make up 73.1% of the total credits of this sector).

Chart 21
Sector and maturity structure of the Denar placements





At the end of 2003, the banks' total foreign exchange placements to the private sector amounted to Denar 7,247 million which is an annual increment of Denar 1,512 million, or 26.4%[31]. Thus the annual comparison indicates lower interest in using foreign credit lines as a source of financing. The enhanced banks' foreign exchange lending is due to the higher volume of short-term credits for payment of due liabilities to non-residents, the used foreign exchange credits for domestic payments[32], as well as the intensified long-term lending to the enterprises.

In the first quarter, the total banks' foreign exchange placements went up by 9.8%, primarily generated from the higher overdue claims based on short-term foreign exchange credits and the higher volume of lending to the enterprises on a long run. The retained trend of movement of these factors, supplemented with the more intensive short-term foreign exchange lending to the enterprises resulted in a quarterly growth in the foreign exchange placements of 6% in the second quarter. In the third quarter, the growth rate of the foreign exchange placements was more moderate (2.8%), with higher amount of overdue claims based on short-term credits being registered and simultaneous further lending to the enterprises on a long run. In the last quarter, along with the quantitative increment in the foreign exchange placements (5.5%), positive qualitative movements were registered directed towards lowering the level of overdue claims and higher volume of short-term and long-term foreign exchange credits.

The more intensive growth in the short-term foreign exchange lending (an annual increase in the short-term foreign exchange placements of 32%) relative to the foreign exchange credits extended on a long run (annual growth rate of 22.1%) resulted in a moderate annual increase in the share of the short-term placements in the maturity structure of the total foreign exchange placements of 1.9 percentage points, and equaled 44.6%. Analyzing by sectors, almost the entire amount of foreign exchange placements was allocated to the enterprise sector (97.1%).

4.5. Net foreign exchange assets of the monetary system

Given the simultaneous increase in the NBRM net foreign exchange assets and the net foreign exchange assets of the deposit money banks, at the end of December 2003, the net foreign exchange

[31] Taking into account the substantial annual depreciation of the US Dollar, the changes in the foreign exchange placements are also partially reflected by the changes in the exchange rate. Thus the annual change in the foreign exchange placements, valued at a constant exchange rate is more intensive and equals 29%.
[32] Registered in December, and in accordance with the amendments to the Law on Foreign Exchange Operations, which allow lending in foreign exchange to all legal entities and natural persons, regardless of the purpose.

assets of the monetary system (transactions of the NBRM and the banks with non-residents) reached Denar 65,792 million, which is an annual increment of Denar 2,891 million or 4.6%.

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

	Balance as of 31/12/2002	Changes by quarters					Balance as of 31/12/2003
		I	II	III	IV	Total	
Net foreign assets of the monetary system	62,901	-3,275	3,116	3,711	-661	2,891	65,792
Net foreign assets of NBRM	41,851	-3,966	3,741	2,350	-1,475	650	42,501
Foreign assets	45,923	-4,245	3,796	1,834	-1,454	-69	45,854
Foreign liabilities	4,072	-279	55	-516	21	-719	3,353
Net foreign assets of the deposit money banks	21,050	691	-625	1,361	814	2,241	23,291
Foreign assets	31,941	1,423	-867	690	-106	1,140	33,081
Foreign liabilities	10,891	732	-242	-671	-920	-1,101	9,790

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

In spite of the inconsiderably lower level of NBRM foreign assets (of 0.2%), the decrease in the NBRM liabilities to non-residents (of 17.7%) enabled moderate annual growth in the NBRM net foreign exchange assets of Denar 650 million, or 1.6% in 2003. Given the cumulative net sale of foreign exchange, regular repayment of the Government external liabilities and minor external inflows, the NBRM foreign assets significantly dropped in the first quarter. Notwithstanding the further net sale of foreign exchange on the foreign exchange market, the high level of external inflows (after the approval of the Stand-By Arrangement with the IMF in April 2003) contributed towards intensive increase in the NBRM foreign assets in the second quarter. The continuation of this trend in the third quarter primarily reflects the NBRM interventions on the foreign exchange market by a net purchase of foreign exchange. In the fourth quarter, in spite of the major external inflows based on donations and credits, given the net sale of foreign exchange by the NBRM (with higher demand for foreign exchange for repayment of the liabilities based on imports due to seasonal factors being registered) the NBRM foreign assets dropped again. The changes in the NBRM foreign exchange liabilities were primarily due to the withdrawal of three tranches based on the concluded Stand-By Arrangement, as well as to the regular dynamics of servicing the liabilities to the IMF.

In December 2003, the net foreign exchange assets of the deposit money banks amounted to Denar 23,291 million, which is by Denar 2,241 million or 10.6% more compared to the same month of the preceding year. Such change is due to the increase in the banks' foreign assets (of 3.6%) and the simultaneous drop in the level of foreign exchange liabilities (of 10.1%). The quarterly analysis shows an increase in the net foreign exchange assets of 3.3% in the first quarter, as a result of the higher foreign assets of the banks on the accounts abroad (which corresponds with the increase in the foreign exchange deposits of the residents in this period). On the other hand, the growth in the banks' foreign exchange liabilities (due to the higher level of non-residents' foreign exchange deposits and the higher indebtedness of the banks with non-residents) acted towards reducing the banks' net foreign assets. In the second quarter, the more intensive decline in the foreign assets of the banks (in line with the obligation of the banks to allocate compulsory reserve on the foreign exchange deposits in foreign currency), relative to the lower indebtedness of the banks with non-residents resulted in a decline in the net foreign exchange assets of the banks of 2.9%. The further cumulation of foreign assets on the accounts abroad, with simultaneous lower level of the non-residents' deposits and the lower indebtedness abroad resulted in an increment of 6.4% in the net foreign exchange assets of the banks in the third quarter. This trend continued in the last quarter of the year, however in more moderate pace (quarterly growth of 3.6%).

V. Interest rates

In 2003, the interest rates registered a downward trend, which is an adequate support of the process of accelerating the economic activities. Thus in 2003, the monetary policy gradually relaxed (through reduction of the NBRM interest rates), given the tightening of the fiscal policy, as well as the considerably lower risk and stability of the banking system. Such nature of the monetary policy directly affected the fall in the average weighted interest rate on the Money Market (caused primarily by the movement of the interest rates on the CB bills auctions). In 2003, the interest rate policy of the banks showed more evident responsiveness to the monetary signals, indicating higher efficiency of the banking system, higher degree of competitiveness between the banks, as well exhaustion of the negative effects of the security crisis (lower credit risk of the customers and possibility for gradual reduction in the interest rates). Nevertheless, the interest rate margins remained at a relatively high level, indicating the still high costs for financial intermediation and the need of further improvement of the efficiency of the banks' operations.

In 2003, the NBRM interest rate policy was directed towards continuous reduction in the interest rates. In 2003, the discount rate (an interest rate used as a basis for calculation of the penalty interest rates) and the interest rate on the Lombard credits (as an indicator for the maximum interest rate in the set of interest rates) were reduced several times. Thus with the two-time reduction in the discount rate in February[33] (of 2.7 percentage points) and in April (of additional 1.5 percentage points), it was reduced from 10.7%, in early 2003, to 6.5%. The interest rate on the Lombard credits was reduced in February[34] (by 5.5 percentage points), April (by 1.5 percentage points) and in November (by 2 percentage points), thus being lowered to 14% (from the initial level of 23%). Such interest rate policy of the NBRM was a clear signal for the changes in the direction of the monetary policy and the need of adequate adjustment of the banks' interest rate policy.

Within the set of NBRM interest rates, the interest rate on the CB bills is a key interest rate, which has the most significant influence on the establishment of the interest rate on the Money Market. In line with the general establishment of the monetary policy on more relaxed ground, many changes in the design of the CB bills auctions were made in 2003, primarily from the aspect of the type of tender and the frequency of conduct, which resulted in considerable reduction in the average weighted interest rate on the CB bills. With respect to the maturity of the CB bills, it remained unchanged in 2003 (28 days), still sending signals to the banks to meet their liquidity needs on a shorter run through the Money Market.

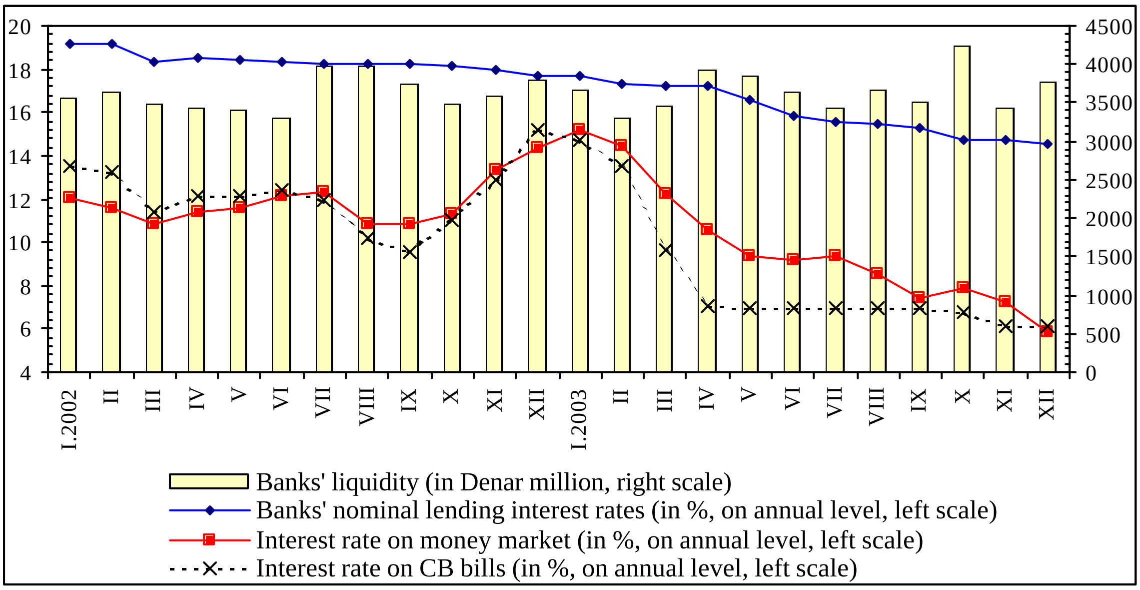
In the first three months of 2003, "interest rate tender" auctions were conducted, where setting of the interest rate is market-based. In the analyzed period, the banks were extremely interested in investing in CB bills, as a result of the high liquidity in the banking sector, which resulted in a continuous decline in the average weighted interest rate on the CB bills auctions, which from 14.8%, in January, reduced to 9.6% in March 2003. On April 11, 2003, the NBRM switched towards "volume tender" auctions, with a fixed interest rate of 7%. Although fixed, this interest rate remained to be attractive, which is proved through the permanent increment in the amount of sold CB bills. Such type of tender was applied till the beginning of the third 10-day period of October 2003, when the NBRM switched again towards market-based setting of the interest rate on the CB bills auctions. On October 22, 2003, the "interest rate tender" auction was reintroduced, with a maximum interest rate of 7% being set. As a result of the high demand for CB bills in this month, caused by the excess liquidity due to the payment of the Government bonds for the old foreign exchange savings, the average weighted interest rate on the CB bills reduced to 6.4% at the end of October 2003 (the average interest rate equaled 6.8% during the whole month). Such trend continued in the last two months of 2003, which resulted in achieving average weighted interest rates of 6.1% in November and 6.2% in December.

[33] Started to be applied in March 2003.
[34] See footnote 1.

In 2003, the average weighted interest rate on CB bills equaled 8.2%, on average, which is by 3.9 percentage points less compared to the average level in 2002.

In 2003, changes in the frequency of conducting auctions were made. Thus at the end of September 2003, the frequency of conducting auctions was reduced from three to two auctions a week. Such changes were made in order to decrease the presence of the NBRM on the market of liquid funds, thus allowing a greater room for interbank cooperation in solving the issue of excess, or lack of liquid funds.

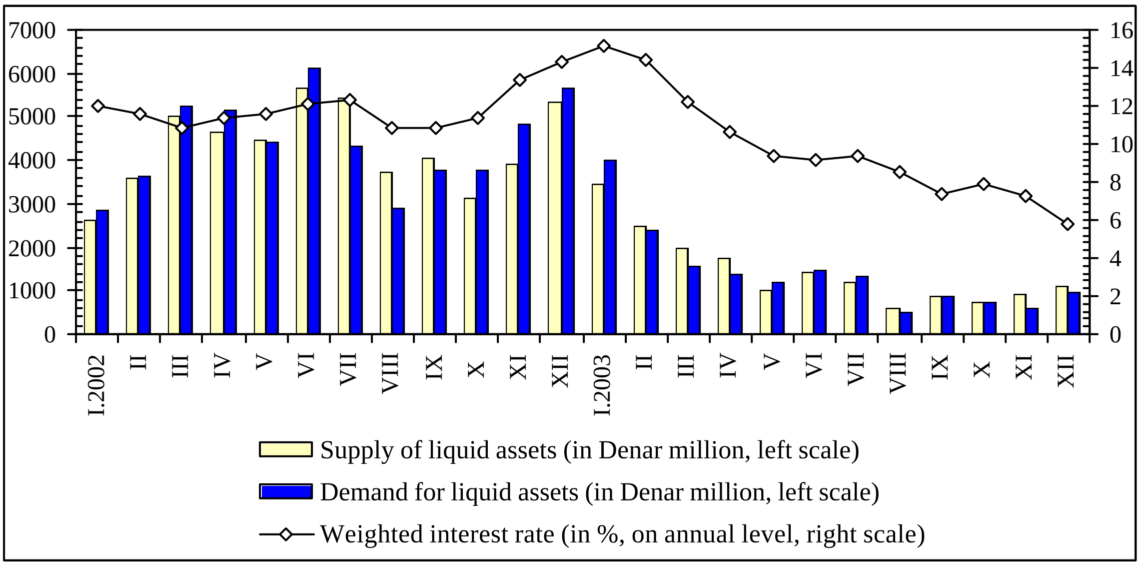
Chart 22
Nominal weighted interest rates and average liquidity



The movement of the average weighted interest rate on the institutionalized Money Market in 2003 corresponds with the dynamics of the interest rate on the CB bills auctions, showing high responsiveness to the monetary signals. Given the high liquidity in the banking system, in 2003 the supply exceeded the demand for liquid funds on this market. Thus the average weighted interest rate on the institutionalized Money Market continuously dropped (except in July and October) and equaled 9.8% in 2003, which is by 2.1 percentage points lower compared to the preceding year.

From the aspect of the dynamics, in the first quarter of 2003, the average weighted interest rate on the institutionalized Money Market equaled 13.9%. Thus the highest level was registered in January (15.2%) due to the higher demand relative to the supply of liquid funds on this market, caused by the net sale of foreign exchange by the NBRM and the higher demand for CB bills. In the second quarter, the average weighted interest rate significantly dropped and equaled 9.7%, in line with the changes in the monetary policy and the higher supply of liquid funds in April (due to the payment of the Government bonds). The reduction in the average weighted interest rate continued in the third quarter and equaled 8.4%, given the relatively balanced supply of and demand for liquid funds on the Money Market. In the last quarter of 2003, the average weighted interest rate was reduced to 6.8%, registering substantially higher supply of relative to demand for liquid funds (of 18.3%). Thus the level in December (5.8%) is the lowest level registered in 2003 (also, the lowest level ever) and it is a result of the high liquidity in the banking system caused by the intensified budget spending in the last month of 2003.

Chart 23
Supply, demand and interest rates on the Money Market



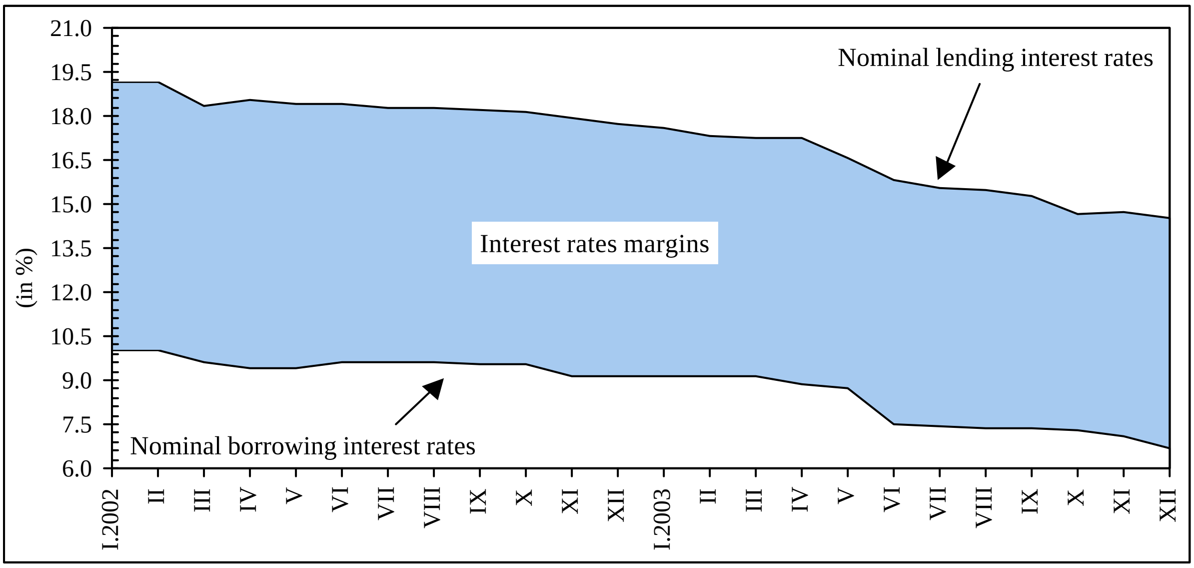
In 2003, the degree of rigidity of the banks' interest rate policy gradually mitigated. It was a result of the effect of several factors: a/ lower risk, i.e. lower credit risk; b/ high level of liquidity in the banking system; c/ further increase in the banks' deposit potential; d/ change in the monetary policy design; e/ larger competition among banks; f/ developments on the Money Market.

In line with the aforementioned factors, in 2003, the average weighted nominal lending and deposit interest rates of the banks were continuously dropping. Thus the nominal weighted lending interest rate[35] of the banks in 2003 equaled 16%, on average, which is by 2.4 percentage points less compared to the preceding year. The reduction in the nominal weighted deposit interest rate[36] of the banks in 2003 was more moderate (by 1.6 percentage points), and equaled 8%, on average. The more intensive fall in the lending relative to the deposit interest rates resulted in moderate decline in the average interest rate margin (of 0.8 percentage points), which in 2003 equaled 8 percentage points, on average. The fact that the interest rate margin still remains at a relatively high level reflects the still high banks' operational costs which arise from the problem regarding the overdue claims on customers over the previous period, the insufficient effectiveness and rationality in the operations, as well as the need of further promotion of the competitiveness in the banking sector. The above was also a result of the present prudence of the banks in placing the funds, as well as the further orientation of the economic agents towards banking credits, given the lack of alternative sources of funds.

Taking into account the relatively low average inflation rate in 2003, the real lending and deposit interest rates of the banks equaled 14.6% and 6.7%, respectively in 2003.

[35] Pertains to Denar short-term credits (up to one year).
[36] Pertains to three-month Denar deposit.

Chart 24
Nominal lending and deposit interest rates and interest rate margins of the banks
(on annual basis)



Analyzed by the dynamics, in the first half of 2003, the nominal weighted lending interest rates of the banks dropped by 1.9 percentage points compared to the end of 2002. More considerable drop was registered in May and June 2003 (by 0.7 percentage points, in each month, equally) as a result of the monetary policy measures (fixing of the interest rate on the CB bills auctions in April 2003 and decline in the compulsory reserve allocation requirement). Simultaneously, the nominal weighted deposit interest rates of the banks reduced by 1.7 percentage points, with the most evident reduction (of 1.2 percentage points) being registered in June 2003. The downward trend of the interest rates of the banks continued in the second half of the year (reduction in both the lending and the deposit interest rates of the banks of 1.3 and 0.8 percentage points, respectively). Their fall corresponds with the movement of the interest rates on the CB bills which, after the abolishment of the volume tender auctions (in October), reduced to a level below 7%, as well as with the reduction of the interest rate on the Lombard credits (in November). Such trend contributed towards reducing the nominal weighted lending and deposit interest rates of the banks to the lowest level ever of 14.5% and 6.7%, respectively, at the end of 2003.

The average weighted interest rate on the short-term foreign exchange credits was relatively stable in 2003 (maintained at the level of 7.7%, on average). In December 2003, it equaled 7.8% and remained almost unchanged relative to the end of the preceding year (an increase of 0.1 percentage points). The significantly lower level of interest rates on the foreign exchange placements relative to the interest rates on the Denar placements is due to the lower costs of the sources of funds and the absence of exchange rate risk. In 2003, the interest rates on the households' deposits with maturity of up to three months ranged from 1.38% to 5.50%, for Euro deposits, and from 0.72% to 4% for US Dollar deposits.

The positive trend of the banks' interest rates in 2003 reflects the favourable effects of the reforms in the banking sector and at the same time indicates a gradual motion in the transmission channel of the monetary policy through the interest rates. In order to maintain such trend constant, it is necessary to move on with the process of restructuring of the banking sector, taking into account that the level of interest rates (and the interest rates margins), although at the lowest level ever, is still relatively high (compared to other countries in transition).

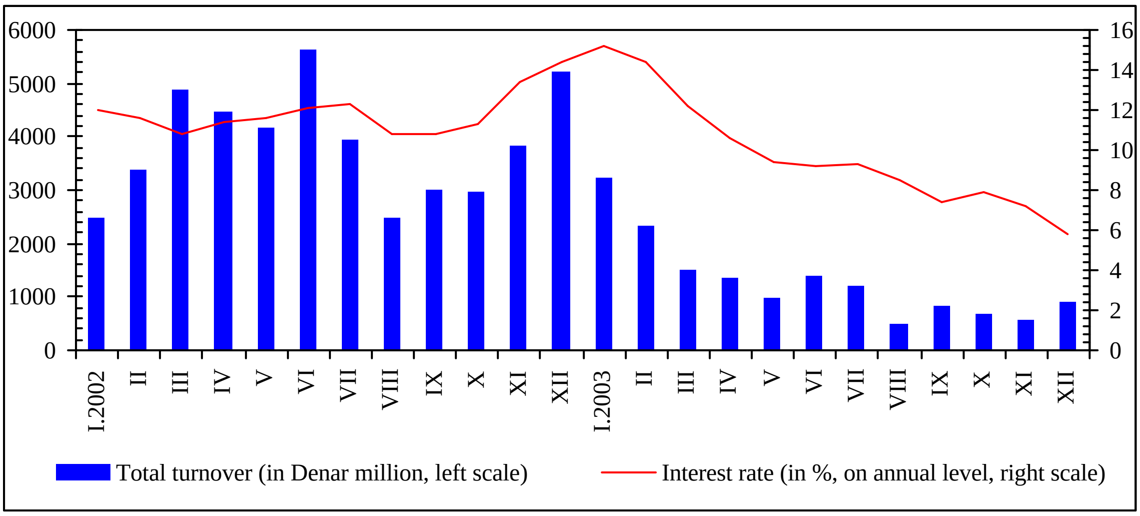
VI. Financial markets in the Republic of Macedonia

The improvement of the macroeconomic performances in 2003 may also be perceived through the financial markets operations. Thus in 2003, the Stock Exchange activity accelerated and the foreign exchange market turnover increased. On the other hand, the volume of trading through the institutionalized Money Market considerably dropped. Nevertheless, the negative trend on this market was primarily due to the change in the behaviour of the banks in the direction of significant preferences for trading on a bilateral basis. The intensified foreign trade, the amendments to the regulations and the new method of operating on the foreign exchange market contributed towards adequate increase in the foreign exchange market turnover. Simultaneously, the volume of trading on the Macedonian Stock Exchange was considerably higher compared to the preceding year, largely due to the amendments to the regulations[37] (and consequently, the larger number of companies and securities listed on the Stock Exchange), as well as the second issue of denationalisation bonds of the Republic of Macedonia and the larger Government participation on the Stock Exchange (by a sale of Government owned shares). The above was also a result of the continuous endeavours aimed at permanent modernization of the operations on the Stock Exchange and its linking with the capital markets in the region.

6.1. Money and short-term securities market

In 2003, the activity on the Money and short-term securities market in the Republic of Macedonia (institutionalized market) is considerably slower compared to the preceding year (the total supply of and demand for liquid funds, as well as the turnover on this market in 2003 constitute only one third of what was achieved in 2002). Taking into account the high liquidity in the banking system in 2003 and the still unbalanced liquidity dispersion, such situation on the Money Market is due to several reasons: a/ increasingly evident tendency of the banks to trade on a bilateral basis (mutual direct trading), instead of trading through the institutionalized Money Market, and b/ high comparison base of the preceding year, when the turnover registered the highest level since the establishment of the market (in 2002, the trade through the Money Market was exempted from the financial transactions tax, which contributed to higher turnover). The average weighted interest rate on the Money Market was significantly reduced in 2003, partly reflecting the considerable stabilization of the economy.

Chart 25
Total turnover and weighted interest rate on the institutionalized Money Market



[37] Compulsory listing of the joint-stock companies.

In 2003, the total turnover on the Money Market is lower by 66.9% on annual basis, as a result of the simultaneously lowered amounts of the supplied and demanded liquid funds (by 65.9% and 67.7%, respectively). Notwithstanding the higher supply of relative to the demand for liquid funds (of 3%), 9.8% of the total demand remained uncovered. Out of the total amount of supplied liquid funds, 12.4% remained non-traded. The lower total turnover on the Money Market in 2003, and simultaneously larger number of working days compared to the preceding year resulted also in a decrease in the average daily turnover. Thus in 2003, Denar 60.5 million were traded daily, on average, which is one third of the average daily turnover in the preceding year.

Table 13
Review of the trade on the Money and Short-term Securities Market

	Supply of liquid assets (in Denar million)		**Demand for liquid assets (in Denar million)**		**Realized turnover (in Denar million)**		**Average weighted interest rate (in %)**	
	2002	***2003***	***2002***	***2003***	***2002***	***2003***	***2002***	***2003***
I	2.620,1	3,460.0	2.841,1	3,994.8	2.491,6	3,225.0	12,03	15.20
II	3.571,3	2,505.2	3.642,3	2,401.7	3.390,3	2,330.7	11,62	14.44
III	5.021,0	1,979.7	5.269,7	1,569.3	4.888,5	1,494.0	10,85	12.19
IV	4.659,2	1,761.4	5.147,2	1,396.3	4.473,2	1,350.3	11,41	10.59
V	4.472,9	1,012.5	4.415,4	1,199.8	4.145,9	978.5	11,62	9.36
VI	5.646,1	1,411.5	6.126,8	1,474.0	5.631,1	1,371.5	12,11	9.16
VII	5,417.9	1,206.8	4,325.9	1,314.3	3,938.9	1,204.8	12.33	9.34
VIII	3,734.2	582.5	2,923.3	495.0	2,460.1	476.5	10.84	8.52
IX	4,035.4	895.4	3,783.3	886.7	3,008.9	837.4	10.83	7.41
X	3,130.4	737.0	3,797.5	726.5	2,970.4	658.5	11.35	7.87
XI	3,897.0	900.5	4,833.4	619.5	3,843.0	559.5	13.36	7.25
XII	5,353.2	1,111.5	5,666.0	978.0	5,213.2	893.0	14.36	5.81
Total	**51,558.7**	**17,564.0**	**52,771.9**	**17,055.9**	**46,455.1**	**15,379.7**	**11.9**	**9.8**

Analyzing by the dynamics, in 2003, the largest portion of the total turnover on the Money Market (about 70%) was realized in the first half of the year. Thus major concentration of the turnover was registered in the first quarter (45.8% of the total turnover on the Money Market in 2003). In this year (except in June, September and December), the demand, the supply and the turnover on the Money Market registered a steady decrease. Highest amounts of supply, demand and turnover were registered in January, whereas the lowest level was registered in August. With respect to the supply-to-demand ratio, higher supply of relative to the demand for liquid funds was dominating in this year, with the most evident discrepancy being registered in November (45.4%).

Unlike the intensive fall in the trade through the institutionalized Money Market, the direct trade between the banks on bilateral basis (non-institutionalized Money Market[38]) was twice higher compared to the preceding year.

In 2003, the average weighted interest rate on the institutionalized Money Market was continuously dropping (reducing to 15.2% in January and 5.8% in December). The dynamics of the interest rate on the Money Market substantially corresponded with the changes in the interest rate on the CB bills. In 2003, the average weighted interest rate on this market (mean of the average weighted interest rates in some months of the year) equaled 9.8%, which is by 2.1 percentage points lower compared to 2002.

6.2. Foreign exchange and exchange offices market

The total turnover on the foreign exchange market in the Republic of Macedonia in 2003 equaled US 2,967 million, which is by considerable 64.9% higher compared to the preceding year. The Law on Foreign Exchange Operations (started to be applied on October 15, 2002) does not allow direct trading in foreign exchange between the enterprises on the foreign exchange market (that is the trade in foreign exchange is made with an intermediation of the banks). Thus 84.5% of the total turnover on

[38] The bilateral trade in liquid funds includes the transactions with maturity of up to one month.

the foreign exchange market in 2003 is trading between the banks and the enterprises[39]. The turnover in foreign exchange realized from the transactions between the banks in 2003 equaled 2.1% of the total turnover, while the residual of 13.4% pertains to NBRM transactions.

Major factors that determined the dynamics of the supply of and the demand for foreign exchange of the enterprises on the foreign exchange market in 2003 are: a) the high deficit in the foreign trade that resulted in higher demand for relative to the supply of foreign exchange and b) the possibility of the enterprises for free handling of foreign assets (having to obligation to sell them on the foreign exchange market after certain time period). Evident preferences for cumulation of foreign exchange on the enterprises' accounts were registered, thus contributing towards widening of the discrepancy between the demand for and the supply of foreign exchange. The annual comparison indicates an increase in the total trade in foreign exchange between the banks and the enterprises of 85.2%[40].

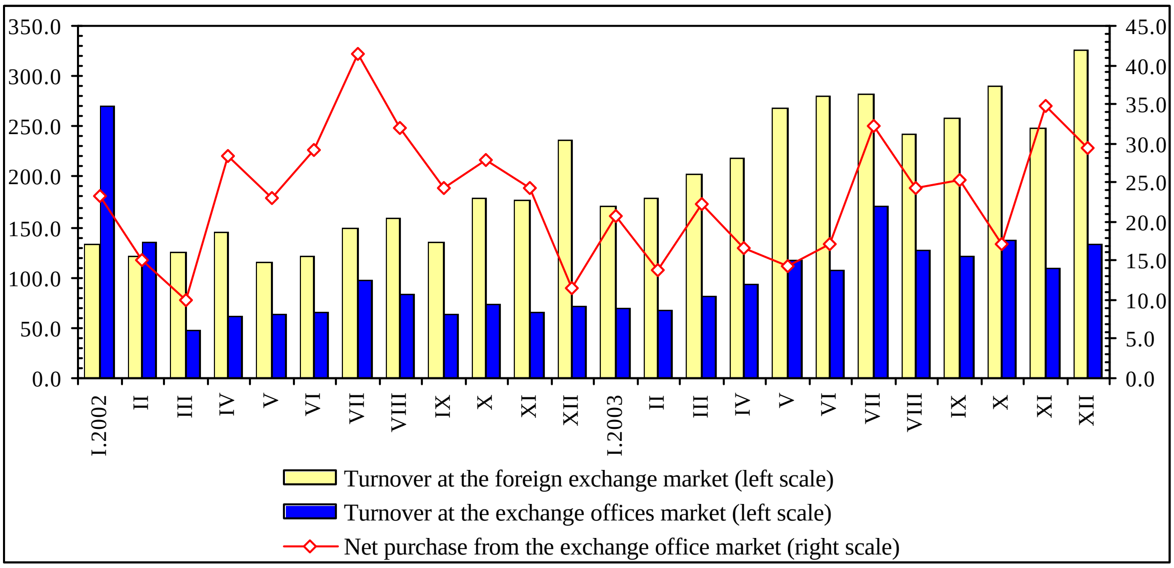
In 2003, more intensive dynamics of interbank trade with foreign exchange was registered on the foreign exchange market. Thus the annual increase in the amount of interbank transactions equals US Dollar 15.5 million, or 34%.

Given the implementation of the exchange rate targeting strategy, the NBRM plays an active role on the foreign exchange market aimed at overcoming the difference between the demand for and the supply of foreign exchange and maintaining the exchange rate stability. In 2003, compared to the preceding year, the NBRM transactions on the foreign exchange market were by US Dollar 1.6 million or 0.4% lower. Their lower share in the total turnover (by 8.8 percentage points) indicates covering of a considerable portion of the demand for foreign assets through the banks. Also, the above reflects the new method of trading of the NBRM on the foreign exchange market (since January 31, 2003), which means interventions based on market principles in order to ensure optimum allocation of the foreign assets, as well as larger flexibility and transparency.

Analyzed by the dynamics, a larger portion (55.5%) of the turnover on the foreign exchange market in 2003 was realized in the second half of the year. The turnover in this period of the year exceeded the turnover in the first half of 2003 by 24.6%. In the second half of the year, the fastest increase was registered in the turnover realized in the transactions between the NBRM and the other participants on the foreign exchange market (primarily due to the high net purchase of foreign exchange on the foreign exchange market by the NBRM in the third quarter of the year, when the banks registered considerable foreign exchange inflows from natural persons in the period of summer vacations).

[39] Includes the purchase and the sale of foreign exchange from and to the exchange offices and the non-residents.
[40] In order to create an adequate comparison base, the transactions between the banks and the enterprises for 2002 are adjusted by the amounts of the direct transactions among the enterprises by October 2002.

Chart 26
Turnover on the foreign exchange and exchange offices market
(in US Dollar million)



In 2003, an accelerated activity was registered also on the exchange offices market. Thus in 2003, the total turnover on this market equaled US Dollar 1,335.5 million, which is by US Dollar 232.2 million, or 21% more compared to the preceding year. The purchase of foreign assets from natural persons (supply of foreign exchange) equaled US Dollar 801.7 million (an increment of US Dollar 105 million, or 15.1%). The sale of foreign assets to natural persons (demand for foreign exchange) significantly upsurged (US Dollar 127.2 million or 31.3%) and reached US Dollar 533.8 million. The higher supply of relative to the demand for foreign exchange on the exchange offices market in 2003, resulted in a net purchase of foreign exchange by the exchange offices in the amount of US Dollar 267.9 million, which is by US Dollar 22.1 million, or 7.6% less compared to the preceding year.

The analysis of the dynamics indicates the lowest amount of turnover on the exchange offices market in the first quarter (US Dollar 217.9 million, or 16.3% of the total turnover on this market), where the movements registered were relatively stable. In the second and the third quarters of the year, the total turnover on the exchange offices market registered the most intensive and almost identical growth and equaled US Dollar 318.3 million or US Dollar 420.5 million, respectively. The exceptionally high level of turnover in the third quarter was primarily a result of seasonal factors (higher supply of and demand for foreign exchange due to the summer vacations). The upward trend, however at a slower pace, continued in the last quarter, and consequently, the turnover on the exchange offices market remained at a relatively high level and equaled US Dollar 378.7 million.

6.3. Stock Exchange

In 2003, the Macedonian Stock Exchange registered an intensified activity. The following might be mentioned as major factors that acted towards accelerating the activity on the capital market: 1) the listing of the second issue of denationalization bonds of the Republic of Macedonia (since March 2003); 2) commencement of auction sale, at the Stock Exchange, of the shares owned by the Government (since June 13, 2003) and of the shares owned by the Pension and Disability Insurance Fund (since November 14, 2003); 3) the larger number of listed joint-stock companies on the official market of the Stock Exchange (in accordance with the amendments to the Law on Securities pertaining to compulsory listing). In 2003, the activities directed towards further development and modernization of the operations on the Stock Exchange continued. Thus, the new internet application "Bestnet" for electronic monitoring of the trade in real time was promoted. Also, bilateral cooperation with the Belgrade and the Bulgarian Stock Exchange and the Thessalonica Stock Exchange Centre started.

The accelerated activity on the Macedonian Stock Exchange in 2003 denotes not only an increase in the total Stock Exchange turnover, but also a larger number of traded securities (given the larger number of listed securities), larger number of executed transactions, higher average Stock Exchange turnover and higher value of the Stock Exchange Index (MBI).

Table 14
Review of the trade on the Macedonian Stock Exchange

Stock Exchange indicators	2002	2003	2003 / 2002 (in %)
Total turnover (in Denar million)	**1,869.5**	**2,309.5**	**23.5**
Stocks	857.0	777.4	**-9.3**
Bonds	708.9	1,275.8	**80.0**
Other securities	303.6	256.3	**-15.6**
Volume (securities)			
Stocks	1,226,005	2,049,128	**67.1**
Bonds (nominal value in Euro)	17,921,502	33,051,890	**84.4**
Other securities (nominal value in Denars)	671,731,684	805,077,538	**19.9**
Total number of transactions	**13,686**	**17,248**	**26.0**
Number of quoted securities	**45**	**98**	**2,2 times**
Number of trading days	**200**	**203**	
Average daily turnover (in Denar million)	**9.3**	**11.4**	**22.6**
MBI	**1,094.7**	**1,178.7**	**7.7**
Block transactions			
Value (in Denar million)	2,912.0	3,768.5	**29.4**
Number of transactions	179	136	**-24.0**
Government segment			
Value (in Denar million)	961.9	1,481.7	**54.0**
Number of transactions	160	230	**43.8**

Source: Macedonian Stock Exchange.

In 2003, the trade turnover on the Stock Exchange (excluding block transactions[41] and Government segment) is by substantial 23.5% higher on annual basis. The increment is solely a result of the considerably higher value (and volume) of trade in bonds. Thus, although a significantly larger volume of shares and convertible certificates for the claims on the collapsed savings houses were traded, the value of the turnover from their trade dropped. The number of executed transactions was larger by 26%, taking into account the almost identical number of trading days. The average daily turnover reached Denar 11.4 million, which is an increase of 22.6%.

Structurally observed, the largest portion of the turnover (77.3%) was realized on the official market, where most of the total number of transactions (83.6%) were executed. The remaining portion of the turnover pertains to the unofficial market (11.6%) and the trade in convertible certificates (11.1%).

[41] Stock Exchange transactions in which at least 10% of the value of the company - basic capital were traded, or turnover in the amount of over Denar 5,000,000 was realized.

Table 15
Structure of the Stock Exchange turnover by market segments

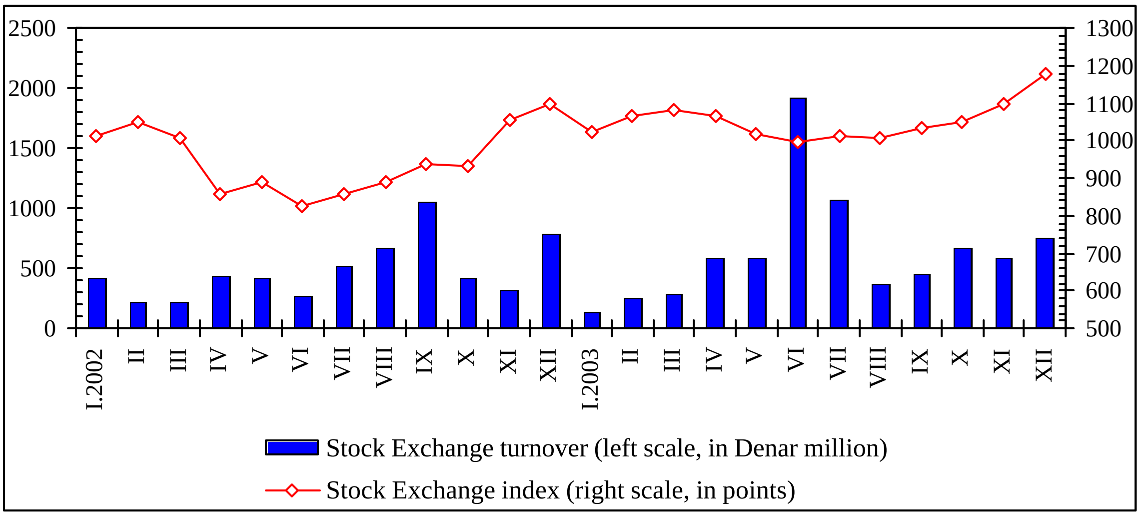
	2003		
Turnover structure by market segments	Turnover (in Denar million)	Share in %	Number of transactions
Official market	1,784.5	77.3	14,427
Unofficial market	268.7	11.6	1,147
Other securities	256.3	11.1	1,674
Total	*2,309.5*	*100.0*	*17,248*
Block transactions	3,768.5		136
Government segment	1,481.7		230
Total	**7,559.7**		**17,614**

Source: Macedonian Stock Exchange.

Considerable annual increase was also registered in the trade in block transactions and the trade in securities owned by the Government. The value of the trade in block transactions went up by 29.4%, although the number of executed transactions was smaller. The trade on the Government segment registered faster increase (of 54%), with the number of executed transactions being increased as well.

In line with such developments, in 2003, a total amount of Denar 7,559.7 million were realized, in 17,614 transactions in total, which is an increase of 31.6% and 25.6%, respectively, compared to 2002. With respect to the dynamics, the largest portion (Denar 3,092.6 million or 40.9%) of the total turnover was realized in the second quarter of 2003, primarily due to the exceptionally high turnover in June (Denar 1,923 million, which is the highest monthly amount realized in 2003), primarily due to the high value of executed block transactions in this month.

Chart 27
Total Stock Exchange turnover and value of the Stock Exchange Index



* Includes block transactions and trade on the Government segment.
Source: Macedonian Stock Exchange.

The Stock Exchange Index (MBI)[42], as an indicator for the Stock Exchange developments, reached 1,178.7 points at the end of 2003 (the highest value in 2003), which is by 84 points or 7.7% more compared to the end of 2002. In 2003, the MBI was continuously maintained above its initial value (1000 points), except in June (995 points). With respect to the monthly dynamics, in the first half of

[42] Unweighted index that includes the five most liquid common shares of companies listed on the official market ("Alkaloid" – Skopje; "Evropa" – Skopje; Komercijalna Banka – Skopje, "Makpetrol" – Skopje and "Toplifikacija" – Skopje.

2003, the value of the Stock Exchange Index registered a downward trend, mainly registering a monthly fall (except in February and March). An upward trend was registered in the second half of the year, when the Stock Exchange Index was continuously registering a monthly growth (except in August).

VII. External sector

In 2003, the high deficit on the current account of the balance of payments continued (while the negative balance in the trade balance remained high). Positive trend was registered in the balance of services (significant decrease in the deficit), while the private transfers continued to increase with faster pace. Also, part of the deficit was financed through the positive balance on the capital and financial account. Having in mind the application of the strategy of targeting the Denar exchange rate against the Euro, the NBRM took an active participation in the foreign exchange market in order to overcome the difference between the demand for and the supply of foreign exchange and to maintain a stable exchange rate. The gross foreign exchange reserves were preserved at an adequate level (4.7-month coverage of the imports), which was a result of the significant external inflows on the basis of credits and donations (the dynamics of which was especially intensified after the conclusion of the Stand-By arrangement with the IMF on April 30, 2003). Despite the annual increase in the external debt (with 84.7% of the registered increase in the total external debt in 2003 reflecting the effect of the positive exchange rate differentials), the indicators for the external indebtedness show low, i.e. moderate external indebtedness of the Republic of Macedonia. In 2003, the Republic of Macedonia regularly serviced its liabilities to the foreign creditors.

7.1. Balance of payments

In 2003, the deficit registered in the current account of the balance of payments equaled US Dollar 278.2 million, or 6%[43] of the GDP (a decrease of US Dollar 83.7 million compared to the previous year), having in mind the continuing high foreign trade deficit, significant amount of inflows based on private transfers and positive balance of the capital and the financial account (given the continuous relatively low level of inflows on the basis of foreign direct investments).

[43] Estimated data for the GDP.

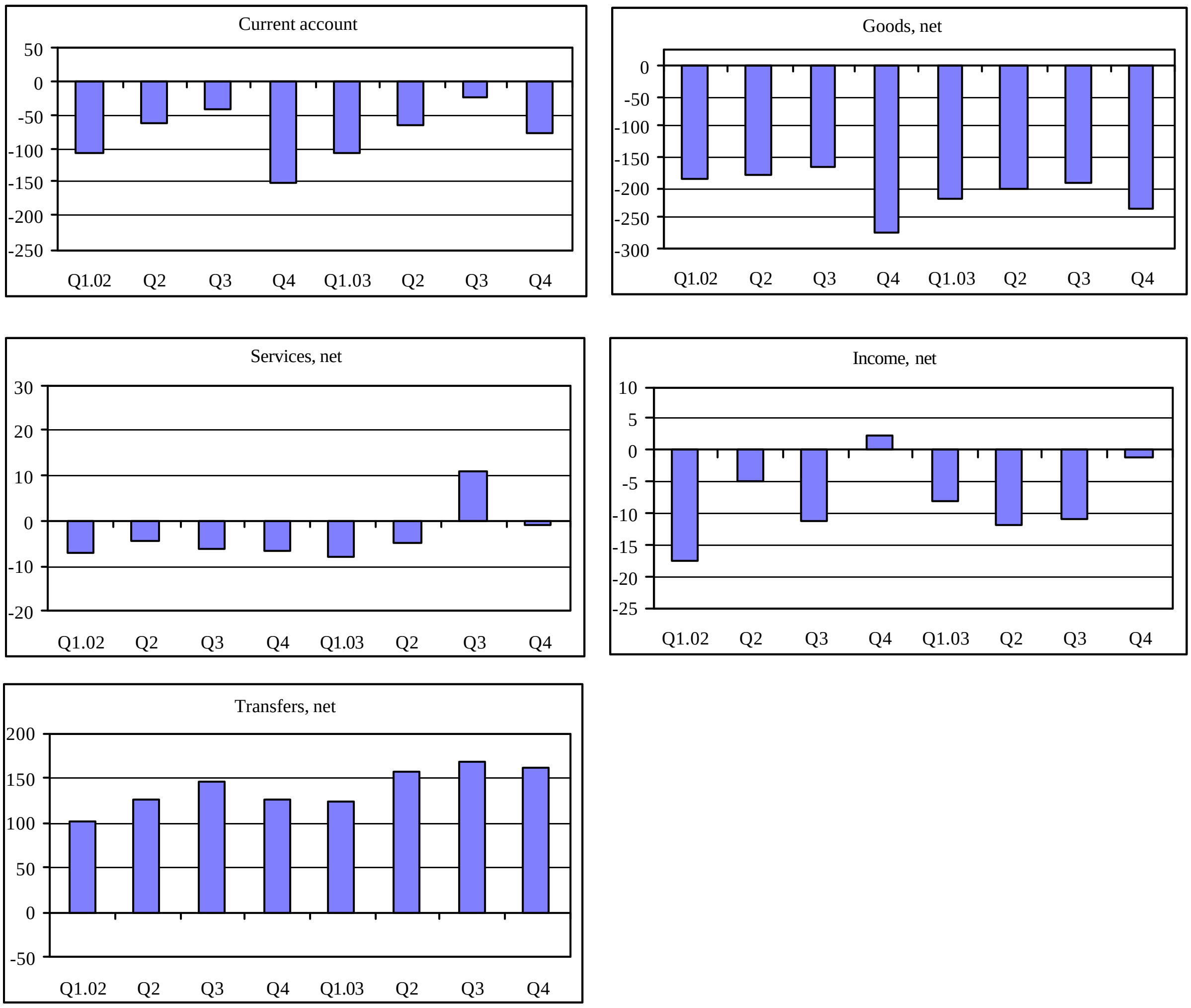
Table 16
Balance of payments of the Republic of Macedonia
(in US Dollar million)

	2002					2003[1]				
	Q1	Q2	Q3	Q4	2002	Q1	Q2	Q3	Q4	2003
1. Current account	-106.8	-63.3	-40.6	-151.2	-361.9	-109.0	-64.3	-25.5	-79.4	-278.2
1.1. Goods, net	-183.5	-180.0	-167.1	-273.8	-804.3	-217.9	-203.5	-192.5	-237.6	-851.5
Exports, f.o.b.	243.6	263.4	304.8	300.3	1,112.2	292.0	355.1	337.4	374.6	1,359.1
Imports, f.o.b. 2	-427.1	-443.4	-471.9	-574.1	-1,916.5	-509.8	-558.6	-529.9	-612.1	-2,210.5
1.2. Services, net	-6.9	-4.7	-6.4	-6.6	-24.7	-7.9	-5.1	11.2	-0.8	-2.6
1.3. Income, net	-17.6	-5.0	-11.3	2.5	-31.4	-8.2	-11.7	-11.2	-1.0	-32.0
1.4. Current transfers, net	101.2	126.4	144.1	126.7	498.4	124.9	156.1	166.9	160.0	607.9
Official	47.3	21.0	13.7	18.5	100.5	23.5	29.5	11.7	38.7	103.4
Private	53.9	105.5	130.4	108.2	398.0	101.5	126.5	155.2	121.3	504.5
2. Capital and financial account	107.4	84.4	30.3	164.2	386.3	105.3	68.8	-26.4	65.0	212.6
2.1. Capital transfers, net	1.3	2.7	1.8	2.5	8.3	-0.3	-1.9	-2.5	-2.0	-6.6
Official	2.7	2.7	1.9	2.6	9.9	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	-0.1	-0.1	-0.3	-1.9	-2.5	-2.0	-6.6
Acquisition/disposal of nonprod., nonfinan. assets	-1.5	0.0	0.0	0.0	-1.6	0.0	0.0	0.0	-0.1	-0.1
2.2. Financial account, net	106.2	81.7	28.5	161.7	378.1	105.6	70.6	-23.9	67.0	219.3
Direct investments, net	2.9	16.1	44.7	14.0	77.7	4.4	19.1	10.2	60.5	94.3
Portfolio investments, net	0.0	0.3	-0.3	0.3	0.4	0.3	2.6	0.8	-0.3	3.4
Other investments, net	116.1	43.6	-56.6	66.4	169.4	25.8	132.0	3.4	9.6	170.8
Trade credits, net	0.0	30.6	-19.4	102.8	114.1	58.7	35.8	-2.2	-7.0	85.3
Loans, net	9.1	-16.6	12.2	-31.0	-26.3	-28.9	48.4	0.9	2.1	22.5
Foreign currency and f.c. deposits, net	99.7	24.3	-55.7	-15.1	53.2	-8.4	44.8	-0.3	5.6	41.7
o/w: Monetary authority, net	71.2	-11.1	1.4	7.3	68.8	-8.7	14.1	7.7	4.7	17.8
Commercial banks, net	160.8	40.1	-48.3	-32.0	120.7	-1.5	17.9	-22.9	-9.2	-15.7
Households, net	-132.3	-4.7	-8.9	9.6	-136.3	1.8	12.8	14.9	10.1	39.7
Other, nets	7.3	5.3	6.2	9.6	28.5	4.4	3.1	5.0	8.9	21.3
Gross official reserve 3	-12.8	21.7	40.7	81.0	130.6	75.1	-83.1	-38.3	-2.9	-49.2
3. Errors and omissions	-0.6	-21.0	10.3	-13.0	-24.4	3.7	-4.5	51.9	14.4	65.5

1/ Preliminary data
2/ The imports are presented on a f.o.b. basis in accordance with the V edition of the IMF's Manual for the balance of payments
The calculation of the c.i.f. - f.o.b. factor as a percentage of the c.i.f. imports equals 3.8%
3/ The increase in the funds is denoted with a negative sign; Without monetary gold and exchange rate differentials; The funds received on the basis of the succession of the former SFRY in May 2003 do not represent a balance of payments transaction, because of which they are encompassed only in the amounts of the foreign exchange reserves, and not in the changes.

The more intensive increase in the imports in the absolute amount, compared to the increase in the exports in 2003, resulted in a continuing increase in the trade balance deficit. Thus in 2003 it reached US Dollar 851.5 million, which is by US Dollar 47.1 million more compared to the previous year. The reduced risk and the gradual stabilization of the overall economic developments contributed to more intensive activity of the Macedonian exporters. In 2003, the export of goods reached US Dollar 1,359.1 million, which is an annual increase of US Dollar 246.9 million. On the other hand, the import of goods registered an annual increase of US Dollar 294.0 million, thus reaching US Dollar 2,210.5 million at the end of the year. However, having in mind the increase in the import of reproduction products, such movements can generate delayed positive effects. Within the total imports, the import of goods for further processing registers an increase (mainly due to the improved performances of the steel and the textile industry, the production and the import of which are to a great extent based on a tolling manufacturing).

Chart 28
Components of the current account of the balance of payments
(in US Dollar million)



In 2003, the balance of services in the current account of the balance of payments registered a significant improvement (a deficit in the amount of US Dollar 2.6 million was registered, which is a decrease of US Dollar 22.1 million compared to 2002). The decrease in the deficit is primarily a result of the increased inflows registered in the category "other services"[44] (mainly inflows on the basis of telecommunication, investment operations and business services), as well as the surplus registered on the basis of tourism. The category "transport services" registered larger outflow than inflow, which is due to the increased import of goods.

In 2003, the income, as a component of the current account of the balance of payments, registered a deficit in the amount of US Dollar 32.0 million, which is an insignificant increase of US Dollar 0.6 million. The deficit is mainly due to the paid interest on the basis of short-term and long-term capital, as well as to the outflows on the basis of dividends.

On the other hand, 71.4% of the trade deficit is covered by the current transfers of the balance of payments. Namely, the net transfers in 2003 reached US Dollar 607 million, which is an increase of US Dollar 109.4 million compared to the previous year. It is due to the increased surplus in private transfers (by US Dollar 106.6 million), with the most intensive inflow being registered on the basis of exchange offices operations, as well as on the basis of remittances from abroad. In 2003, the net

[44] The category "other services" encompasses: services in the area of telecommunications, investment services, insurance, business services, Government services, etc.

official transfers equaled US Dollar 103.4 million, the realized inflows of funds from the EU, the Netherlands, the USA and Germany had the highest share.

The major part of the deficit on the current account of the balance of payments in 2003 was financed through the capital and financial account, which registered a surplus of US Dollar 212.6 million (reduced surplus by US Dollar 173.7 million on an annual basis). It is completely due to the realized surplus in the financial account (US Dollar 219.3 million), which mainly originates from the inflows of funds based on trade credits, direct investments and currencies and deposits. Thus in 2003, the net inflow originating from trade credits amounted to US Dollar 85.3 million, pointing to the reduced foreign crediting of the domestic importers (a decrease of US Dollar 28.8 million compared to the previous year). On the other hand, in 2003, the category "loans" registered a net inflow of US Dollar 22.5 million, which is due to the larger amount of withdrawn funds from foreign creditors than the repayments based on used short-term and long-term loans and credits (contrary to the previous year when this category registered a deficit). In 2003, the item "currencies and deposits, net" registered a decrease of US Dollar 41.7 million, which is due to the decrease in the funds registered in the categories "households" and "monetary authority" (of US Dollar 39.7 million and US Dollar 17.7 million, respectively), given the increase in the foreign assets with the commercial banks on a net basis of US Dollar 15.7 million.

In 2003, the net direct investments in the Republic of Macedonia reached US Dollar 94.3 million, which is an increase of US Dollar 16.5 million in comparison with the same period of the previous year. The largest share of the foreign direct investments in 2003 was recorded in the sector "services" (US Dollar 78.8 million), new (green field) investments of which in the amount of US Dollar 31.0 million in the telecommunications and US Dollar 5.9 million in the banking sector. In 2003, an amount of US Dollar 12.3 million was invested in the production.

In 2003, the gross foreign reserves[45] (excluding monetary gold and exchange rate differentials) of the National Bank of the Republic of Macedonia registered an increase of US Dollar 49.2 million. The item "errors and omissions" (an item for balancing the statistical discrepancy present when preparing the balance of payments) is positive and equals US Dollar 65.5 million, (pointing to non-recorded inflows from non-residents).

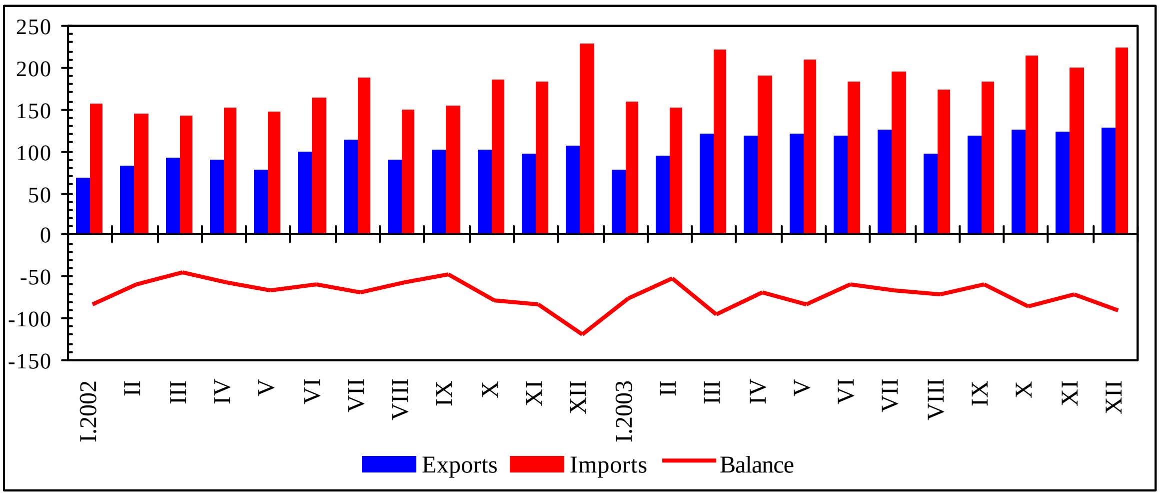
7.2. Foreign trade

The foreign trade of the Republic of Macedonia in 2003 increased by 17.8%, with the export registering faster increase (22.2%) compared to the imports (15.3%). The increase in the foreign trade is a result of the registered economic growth (the GDP registered an increase of 3.2%, while the industrial output was higher by 4.7%). However, the actual increase in the foreign trade volume is lower because of the depreciation of the US Dollar against the Euro in 2003 (having in mind that 69.4% of the total foreign trade is in Euros)[46]. The depreciation of the US Dollar in 2003 had a negative impact on the exporters to the USA (especially the textile enterprises).

[45] The changes in the gross official reserves presented in the balance of payments exclude the change in the value of the monetary gold and the exchange rate differentials. The funds received from the succession of the former SFRY are included only in the amount of the foreign reserves, an not in the changes, since they do not represent a balance of payments transaction.

[46] The exchange rate of the Euro relative to the Dollar appreciated by 19.9% in 2003 compared to 2002.

Chart 29
Foreign trade of the Republic of Macedonia
(in US Dollar million)



In 2003, the total export of Macedonian products equaled US Dollar 1,363.3 million[47], i.e. it increased by US Dollar 247.8 million, or by 22.2%. The high increase is partially due to the low comparison base as a result of the poor export performances in the two previous years when a consequent drop in the exports of 12.4% (in 2001) and 3.7% (in 2002) was registered. Analyzed by product categories, all product categories of higher importance registered an increase in the export. The highest increase was registered in the export of iron, steel and their products (US Dollar 96.9 million), the share of which in the total export equals 19.6%. The increase is due to the improved performances and increased output in the steel industry[48] (increase in the production of basic metals of 18.8%), as well as to the increased import of iron and steel for further processing (21.6%). The export of clothing and textile also registered high increase (US Dollar 74.6 million, or 21.7%), primarily as a result of the increased import of products for further processing (tolling manufacturing). Analyzed by separate products, the export of mineral fuels (oil derivatives) increased by almost two times compared to the previous year, which is due to the increased production of oil derivatives (44.2%). The export of tobacco and tobacco products registered an increase of 6.7%, reaching US Dollar 81.3 million, despite the lower production of tobacco products of 2.1%.

In 2003, the total imports[49] of the Republic of Macedonia increased by US Dollar 304.8 million, or by 15.3% reaching US Dollar 2,299.9 million. Analyzed by products, all categories of higher importance registered an increase, except the import of vehicles, which registered an expected drop of 22.3% due to the high comparison base registered in the previous year and the announced decrease in the customs duties since January 01, 2004.

The increase in the in the import of oil is mainly a result of the increased prices of oil, the average level of which in 2003 was higher by 15.7% compared to 2002, as well as of the higher export of oil derivatives. The largest share in the temporary import of products for further processing (with a share of 19.4% in the total import) accounts for the textile for further processing, which registered an increase of 25.5%.

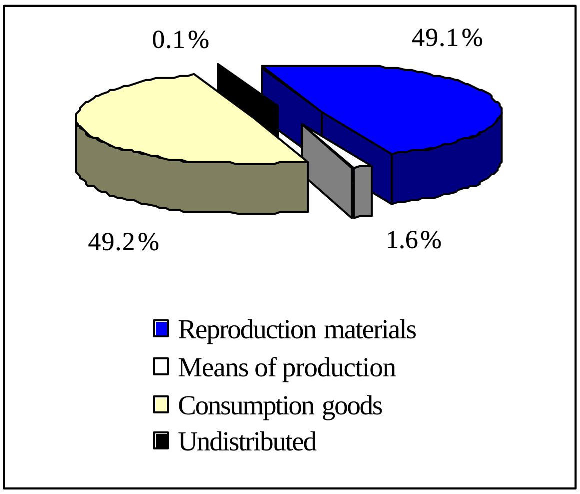
The foreign trade deficit of the Republic of Macedonia in 2003 registered an increase of 6.5% and equaled US Dollar 936.6 million. The more intensive increase in the exports relative to the imports contributed to an increase in the export - import coverage of 3.4 percentage points, reaching 59.3%.

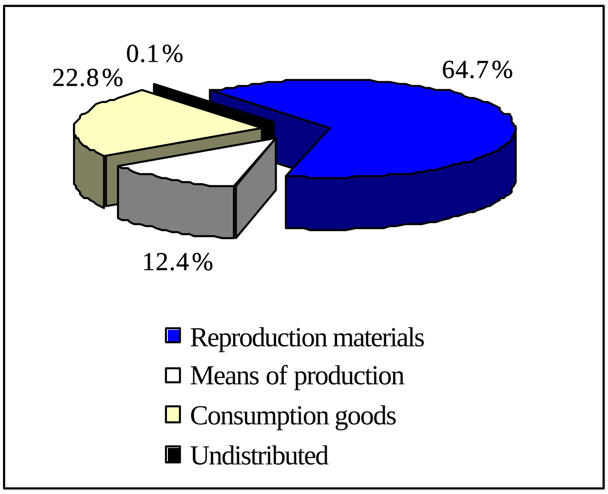
[47] The value of the export in the balance of payments and the foreign trade differs due to the different methodology in the balance of payments and in the trade statistics.
[48] The Steel Sector Reconstruction Project of the European Agency for Reconstruction (EAR), the realization of which started at the beginning of the year, also contributed to the increased export of iron and steel.
[49] The import of goods is presented on c.i.f. basis.

Analyzed by the economic use of the products, the consumption goods and the reproduction products dominate in the exports, with their share being equal to 49.2% and 49.1%, respectively. However, the share of the consumption goods decreased by 2.4 percentage points compared to the previous year, while the share of the reproduction products increased by 3.3 percentage points. Such negative changes in the structure of the exports point to a return to the export of products with low level of finalization.

Positive movements were registered in the imports, with the share of the reproduction products in the total import being increased by 1.7 percentage points, reaching 64.7%. On the other hand, the consumption goods reduced their share by 1.1 percentage points, so it equaled 22.8% at the end of the year.

Chart 30
Structure of the foreign trade of the Republic of Macedonia in 2002 analyzed by the economic use of the products
(in US Dollar million)





In 2003, the trend of increase in the trade with the European Union continued. Thus the export of the Macedonian products to the EU countries increased by 30.7%, with the share of the EU in the total export reaching 54.7% (compared to 51.1% in 2002). The export to the countries of the former SFRY increased by 11.4%, with simultaneous decrease in their share in the total exports by 2.8 percentage points. The trade with the countries of Central and Eastern Europe[50] registered an increase in the imports by 15.5%, while their share in the total exports equaled 5.0%.

[50] This group of countries also includes the countries from the former USSR.

Table 17
Foreign trade of the Republic of Macedonia with economic groups of countries
(in US Dollar million)

Economic groups of countries	Exports	Structure	Imports	Structure	Foreign trade	Structure
	I - XII.2003					
Republic of Macedonia (total)	1,363	100.0%	2,300	100.0%	3,663	100.0%
1. Developed countries	881	64.6%	1,214	52.8%	2,095	57.2%
out of which:						
EU	745	54.7%	1,005	43.7%	1,750	47.8%
EFTA	20	1.4%	29	1.3%	48	1.3%
Other developed countries	116	8.5%	180	7.8%	296	8.1%
2. Countries of Central and Eastern Europe and former USSR	69	5.0%	517	22.5%	585	16.0%
3. Undeveloped countries	1	0.1%	3	0.1%	4	0.1%
4. Developing countries	28	2.0%	136	5.9%	164	4.5%
5. Republics of the former SFRY	385	28.2%	431	18.7%	815	22.3%
6. Other countries	0	0.0%	0	0.0%	0	0.0%

In 2003, the analysis of the structure of the imports from the aspect of separate groups of countries points to a decrease in the share of the European Union by 1.2 percentage points, which equaled 43.7% in 2003. The share of the imports from the countries of the former SFRY also registered a decrease (0.5 percentage points) and equaled 18.7%. On the other hand, the structural share of the Central and Eastern European countries increased by 2.2 percentage points, reaching 22.5%, as a reflection of the increased import of raw materials for the needs of the iron and steel industry.

In 2003, the most significant trading partner of the Republic of Macedonia was Germany, with which goods in the amount of US Dollar 581.8 million were traded (an increase of 12.1% compared to 2002), with more intensive increase being registered in the exports (of 18.9%) relative to the imports (6.7%). Serbia and Montenegro follows with a foreign trade in the total amount of US Dollar 485.2 million being registered (an increase of 12.4% compared to 2002). The foreign trade with Greece continued to increase with faster pace, with an increase in the volume of trade of 35.2% being registered (contrary to the increase of 23.4% registered in 2002). The increase in the absolute amount in the exports was almost identical to the increase in the imports (about US Dollar 63 million), while the increase in the exports and the imports in real terms equaled 54.0% and 26.2%, respectively.

Table 18
Ten most important trading partners of the Republic of Macedonia
(in US Dollar million)

	Foreign trade	Share	Exports	Share	Imports	Share	Import - export coverage ratio
	I-XII.2003						
Republic of Macedonia	**3,663**		**1,363**		**2,300**		**59.3%**
out of which:							
Germany	582	15.9%	278	20.4%	304	13.2%	91.6%
Serbia and Montenegro	485	13.2%	274	20.1%	213	9.2%	128.8%
Greece	480	13.1%	180	13.2%	300	13.1%	59.9%
Italy	218	6.0%	95	7.0%	123	5.3%	77.8%
Russia	192	5.2%	14	1.0%	178	7.7%	7.7%
Bulgaria	175	4.8%	26	1.9%	149	6.5%	17.3%
Slovenia	160	4.4%	21	1.6%	139	6.0%	15.3%
Croatia	129	3.5%	66	4.8%	64	2.8%	104.1%
USA	129	3.5%	73	5.3%	56	2.4%	129.3%
Turkey	112	3.0%	33	2.4%	79	3.4%	41.6%
Total (10 largest trading partners)	2,662	72.7%	1,060	77.7%	1,604	69.7%	66.1%

In 2003, the foreign trade of the Republic of Macedonia with the ten most important partners registered a trade surplus only with three countries: Serbia and Montenegro, the USA and Croatia. The highest surplus was registered in the foreign trade with Serbia and Montenegro (US Dollar 61.2 million), while the largest deficit was recorded in the trade with Russia (US Dollar 164.1 million). The trade deficit with the three more important regional partners (Greece, Bulgaria and Slovenia), with which the Republic of Macedonia concluded Free Trade Agreements, equaled US Dollar 361.2 million, thus pointing to the poor placement of the Macedonian products to these markets, despite the advantages arising from the Free Trade Agreements.

On April 4, 2003, the Republic of Macedonia officially became the 146th member country of the World Trade Organization - WTO[51]. In order to harmonize the legal framework with the WTO standards, the new Law on Customs Tariffs[52] was enforced in April 2003. The customs duties prescribed in this Law are applied for goods originating from the WTO member states, the countries with which the Republic of Macedonia has concluded agreements containing the provision for the most privileged nation, as well as with countries which apply this provision for goods originating from the Republic of Macedonia. For the goods originating from the countries with which the Republic of Macedonia has concluded agreements for preferential trade regime, the customs duties prescribed with those agreements are applied. Duties higher by 70% than the customs duties stipulated in this Law are charged for products originating from all remaining countries, while for the goods for which customs duty "free" is determined, a duty of 30% is applied.

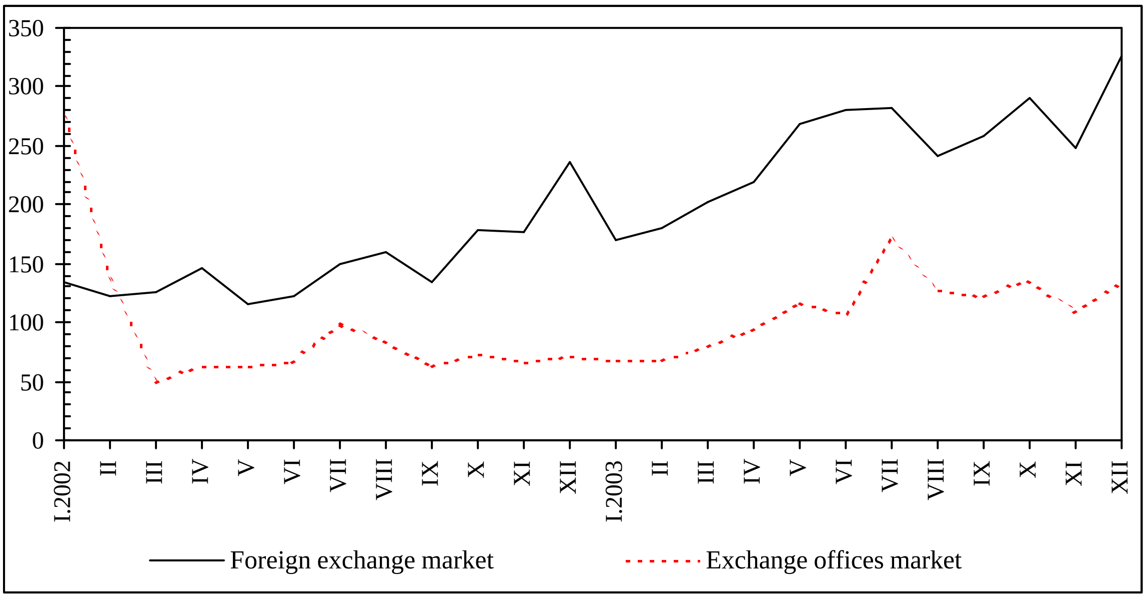
Until the end of 2003, the Republic of Macedonia concluded Free Trade Agreements with ten countries[53] and two economic groups, EU[54] and EFTA. With the admission of the ten new countries to the European Union in May 2004, the trade with these countries shall be regulated according to the Stabilization and Association Agreement with EU, which is especially important for the trade with Slovenia, for which the quotas set in the agreement shall be applied (which are lower than the export quotas of Slovenia so far).

[51] The Agreement for the admission to the WTO was signed in October 2002.
[52] According to the new Law on Customs Tariffs, the average customs duties in the following five years shall be decreased from 15% as they equaled until now, to 8%.
[53] Albania, Bosnia and Herzegovina, Bulgaria, Moldavia (the Agreement was concluded at the beginning of 2004), Romania, Slovenia, Serbia and Montenegro, Turkey, Ukraine and Croatia.
[54] The trade with the EU is regulated by the interim agreement of the Stabilization and Association Agreement (2001).

7.3. Denar exchange rate

In 2003, the Denar exchange rate against the Euro on the foreign exchange market was stable. Thus as of December 31, 2003, Denar 61.29 per one Euro[55] were traded, which is a depreciation of 0.4% compared to the end of 2002. At the end of January, the new manner of trading on the foreign exchange market commenced, which means an equal participation of the NBRM on the foreign exchange market. The ultimate goal of such a trading is obtaining an optimal allocation of the foreign assets, transparency among the participants on the foreign exchange market and optimization of the foreign exchange turnover. The deteriorated situation in the foreign trade (high trade deficit) contributed to a more intensive increase in the demand for foreign exchange, which acted towards depreciation of the value of the Denar. The pressures for depreciation of the Denar were especially intensified in the last quarter, due to the seasonally higher demand for foreign assets intended for servicing the liabilities based on imports. In accordance with such movements, in 2003, the NBRM intervened on cumulative basis with a net sale of foreign assets, thus preserving the exchange rate stability.

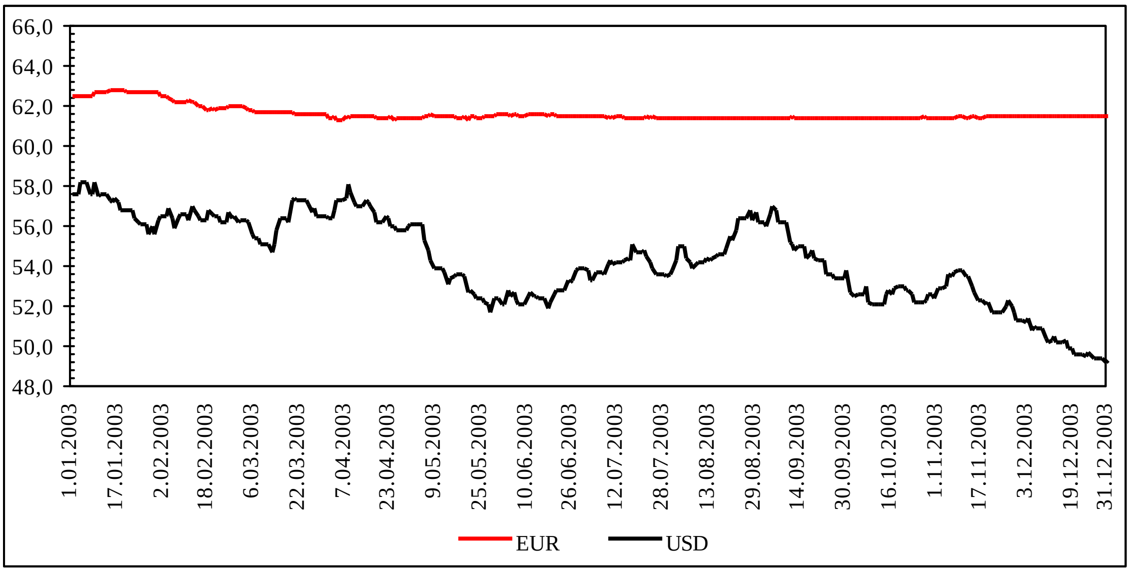
Chart 31
Movements in the total trade on the exchange offices market
(Denar per foreign currency unit)



In December 2003, the average Denar exchange rate on the exchange offices market equaled Denar 61.5 per one Euro, which is an appreciation of 1.3% compared to 2002. Such movements of the exchange rate are a result of the higher supply of foreign assets. The supply was higher than the demand in every month of the year, while the total turnover in 2003 registered an annual increase of 20.8%, which is mostly due to the higher private transfers in 2003.

[55] In 2003, the average value of the Denar exchange rate equaled Denar 61.26 per one Euro.

Chart 32
Nominal Denar exchange rate relative to the Euro and the US Dollar on the exchange offices market
(Denar per foreign currency unit)



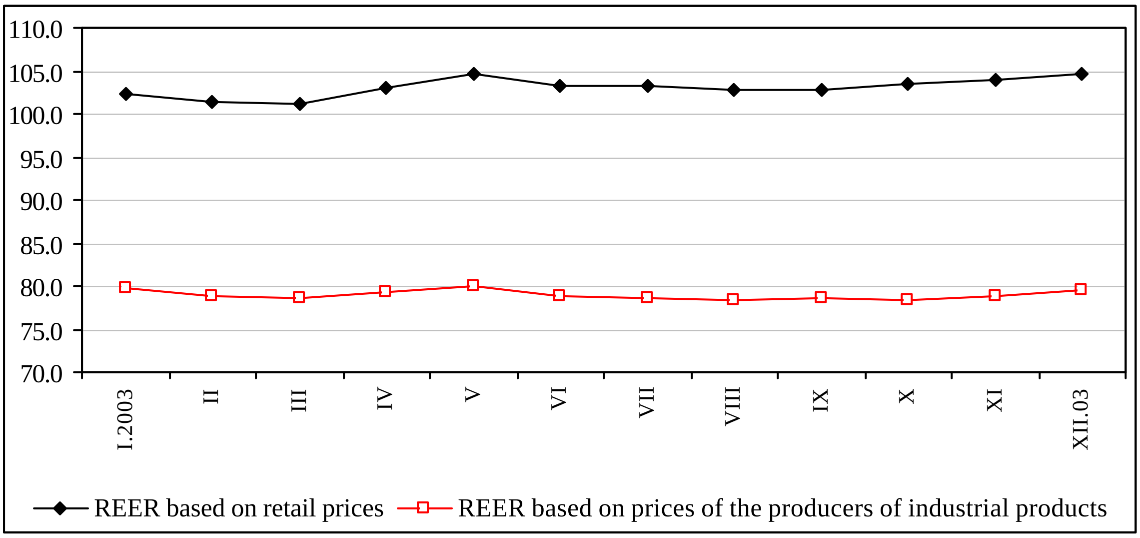
In accordance with the strategy of targeting the Denar exchange rate relative to the Euro, the Denar exchange rate relative to other foreign currencies depends on the movements on the global foreign exchange markets. In 2003, the value of the US Dollar against the Euro reached the lowest level so far. The uncertainty from the developments in Iraq contributed the US Dollar to lose 8.7% of its value in the first half of the year. The Denar exchange rate against the US Dollar on the foreign exchange market in the Republic of Macedonia followed these movements, so in the first half of the year it appreciated by 8.4%. The problems in the US economy, the highest trade deficit registered so far and the high biggest deficit diminished the confidence of the investors in the US Dollar. In the second half of the year, the US Dollar decreased again, so US Dollar 1.25 per one Euro were traded at the end of the year (depreciation of the US Dollar of 16.6% compared to the end of the previous year). The Denar exchange rate relative to the US Dollar appreciated by 8.6%[56]. On December 31, 2003, Denar 49.05 per one US Dollar were traded on the foreign exchange market, i.e. it appreciated by 16.3% compared to the end of the previous year.

The Denar exchange rate against the US Dollar on the exchange offices market also followed the movement of the US Dollar on the global foreign exchange market. At the end of 2003, Denar 49.23 per one US Dollar were traded, which is an annual appreciation of 14.8%.

The real effective exchange rate (REER) is an indicator for the changes in the price competitiveness of the national economy relative to foreign trading partners. The changes in the domestic prices of goods and services relative to the changes in the prices abroad can be followed through the real effective exchange rate. At the end of 2003[57], the real effective Denar exchange rate[58] measured through the retail price index appreciated by 3.8%. This appreciation is due to the higher increase in the domestic prices relative to the foreign prices, as well as to the appreciation of the nominal effective exchange rate of 3.4% (as a result of the drop in the value of the US Dollar). Despite the lower prices of the domestic producers of industrial products and the increase in the foreign prices, measured through the index of the prices of the producers of industrial products, the real effective exchange rate appreciated by 0.7%.

[56] Change as of December 31,2003 compared to June 30, 2003.
[57] Preliminary data for the foreign prices are used for October, November and December.
[58] Estimation of NBRM.

Chart 33
Index of REER of the Denar



7.4. Foreign reserves of the Republic of Macedonia

At the end of 2003, the total foreign exchange potential[59] of the Republic of Macedonia amounted to US Dollar 1,668.6 million, which is an increase of US Dollar 313.8 million compared to December 31, 2002. The positive dynamics is generated from the simultaneously higher level of foreign assets with the commercial banks and the foreign assets of the National Bank of the Republic of Macedonia.

The total foreign assets of the NBRM increased by US Dollar 151 million on an annual basis, reaching US Dollar 934.9 million at the end of 2003. In order to obtain diversification in the portfolio and to reduce the risk of change in the interest rate on the international markets, part of the foreign assets (US Dollar 87.3 million) was placed in debt securities of non-residents. The remaining funds refer to the monetary gold, cash foreign currency and funds deposited abroad.

At the end of 2003, the gross foreign reserves of the NBRM equaled US Dollar 903.4 million, which is an annual increase of US Dollar 168.8 million. However, having in mind the depreciation of the US Dollar against the Euro and in accordance with the currency structure of the gross foreign reserves, 60.4% of the increase is due to positive exchange rate differentials.

The analysis of the dynamics indicates a decrease in the foreign reserves in the first quarter, which is due to the cumulative net sale of foreign exchange on the foreign exchange market, regular repayment of the external debt and low level of external inflows. The conclusion of the Stand-By Arrangement with the IMF in April resulted in an increased level of external inflows, which in combination with the inflows originating from the succession in the amount of US Dollar 17.8 million and the high amount of positive exchange rate differentials, resulted in a positive dynamics in the gross foreign reserves in the second quarter of the year. Main factor for the increase in the gross foreign reserves of the NBRM in the third quarter of the year were the interventions of the NBRM with a net purchase of foreign exchange in the amount of US Dollar 46.6 million (having in mind the higher supply than the demand on the foreign exchange market, which to a large extent originates from the high purchase of foreign exchange of the banks from the exchange offices and natural persons during this period). The high amount of external inflows registered in the last month of the year (grant and credit from the EU and grant from the Netherlands) and the significant positive exchange rate differentials are the main causes for the increase in the foreign reserves in the fourth quarter of 2003.

[59] The total foreign assets of the NBRM and the foreign assets with deposit money banks.

Table 19
Inflows and outflows in the gross foreign reserves of the NBRM

	31/12/2002	IQ	IIQ	IIIQ	IVQ	01.01-31.12.2003
Foreign exchange reserves	734.6	684.5	803.0	846.7	903.4	
Increase in foreign exchange reserves, net		-50.1	118.5	43.7	56.7	168.8
Realized change in foreign exchange reserves, on net basis						
Purchase and sale		-31.5	-22.8	46.6	-61.8	-69.5
Interest on foreign currency deposits		3.9	3.9	5.1	4.2	17.1
Succession			17.8			17.8
IMF credits		-2.7	-1.2	-2.6	3.7	-2.8
Government deposits, net		2.8	47,8*	-8.6	55.3	49.5
Banks' compulsory foreign exchange reserves			47.2	3.6	1.9	52.7
Cross-currency relations		13.0	29.7	5.3	54.0	102.0

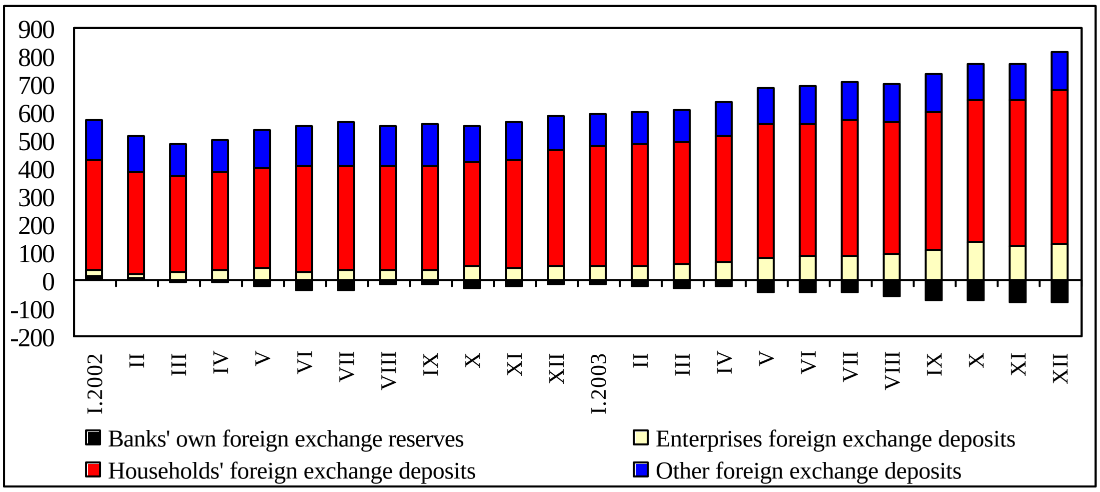
* Part of the quarterly change has an accounting feature (closing of the external account).

In 2003, net inflow of foreign assets on the basis of Government deposits on cumulative basis was registered, while the debt to the foreign creditors was serviced on a regular basis, with inflows based on foreign credits and donations being also registered. The increase in the gross foreign reserves of the NBRM was also influenced by the collected interest on the deposited foreign assets with foreign banks in the amount of US Dollar 17.0 million.

On the other hand, in 2003, an outflow of funds on the basis of realized net sale of foreign assets to the commercial banks in the amount of US Dollar 69.5 million was registered.

At the end of December 2003, the liabilities of the Republic of Macedonia to the International Monetary Fund (IMF) equaled US Dollar 68.3 million (an annual increase of US Dollar 1 million). However, on the basis of the concluded Stand-By Arrangement with the IMF in April 2003 and with the regular repayment of the liabilities to the IMF, the net foreign reserves of the National Bank of the Republic of Macedonia (differential between the gross foreign reserves and the liabilities to the IMF) reached US Dollar 835.1 million (by US Dollar 167.8 million more compared to the level registered at the end of 2002).

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



At the end of 2003, the total foreign assets with banks registered an increase of US Dollar 162.8 million, thus reaching US Dollar 733.8 million. The continuous strengthening of the households' propensity to save, as well as the growing trend of the foreign exchange deposits of the enterprises (largely caused by the possibility for free handling of foreign assets without an obligation for their sale after the expiration of a certain period) results in a significant increase in the liabilities of the banks based on foreign exchange deposits. Thus the foreign exchange deposits of the households and the enterprises registered an annual increase of US Dollar 143.3 million and US Dollar 73.6 million, respectively. The remaining foreign exchange deposits increased by 8.2 million and amounted to US Dollar 131.1 million. Consequently, on December 31, 2003, the foreign exchange deposits of the economic agents with banks equaled 812.3 million, which is an increase of US Dollar 225.1 million compared to December 31, 2002.

7.5. External debt of the Republic of Macedonia[60]

At the end of 2003, the total external debt of the Republic of Macedonia (based on used short-term and long-term credits) equaled US Dollar 1,812.6 million, 2.3% (or US Dollar 41.9 million) of which refer to the liabilities based on short-term credits while US Dollar 1,770.6 million, or 97.7% account for the long-term liabilities. Within the long-term debt, US Dollar 1.751 million are liabilities based on principle, while the remaining share of US Dollar 19.7 million accounts for the liabilities originating from the due interest (US Dollar 9.3 million) and estimated late interest (US Dollar 10.4 million).

Compared to the end of the previous year, the total external debt increased by 10.9%. The increased indebtedness originates to a great extent (84.7%) from the positive exchange rate differentials, having in mind the significant depreciation of the US Dollar against the remaining currencies. In addition, the larger amount of withdrawn funds based on long-term credits in the amount of US Dollar 59.8 million also influenced on increased indebtedness.

The indicators for the level of indebtedness in 2003[61] show positive performances. Thus according to three indicators (correlation between the total debt and the average export of goods and services during the three previous years - 122.3%, the correlation between the debt servicing and the average export of goods and services during the past three years - 16.1%), and the repayments of the interest relative to the average export of goods and services during the past three years - 3.6%), the Republic of Macedonia belongs to the group of less indebted countries with medium amount of income. The ratio of total external debt to average GDP ratio in the past three years (45.8%) shows moderate indebtedness of the Republic of Macedonia.

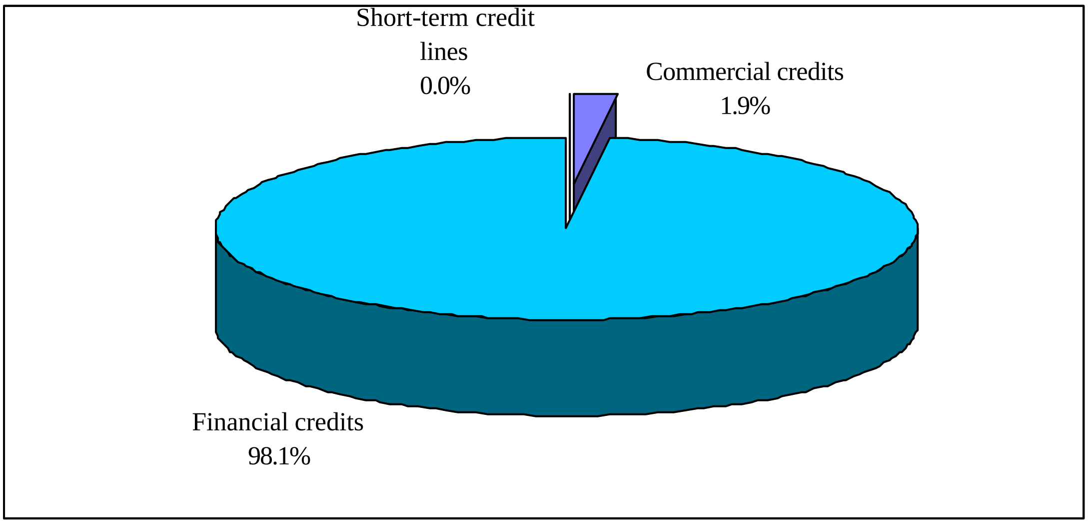
7.5.1. Debt structure

The short-term debt includes all credits with maturity of up to one year, extended to residents by non-residents.

At the end of 2003, the short-term external debt of the Republic of Macedonia equaled US Dollar 41.9 million (US Dollar 63.6 million at the end of 2002), 88.8% of which are liabilities based on principle. Observed from the aspect of the type of the short-term credits, the dominant share in the short-term debt accounts for the financial credits (98.1%), while the share of the commercial credits equals 1.9%. In 2003, no utilization of the short-term bank credit lines was registered.

[60] Preliminary data of the NBRM.
[61] Calculation of the International Credit Relations Department according to the methodology of the World Bank.

Chart 35
Structure of the short-term debt based on types of external credits
(as of December 31, 2003)



The external long-term debt encompasses the liabilities of the residents to non-residents, with a maturity of exceeding one year.

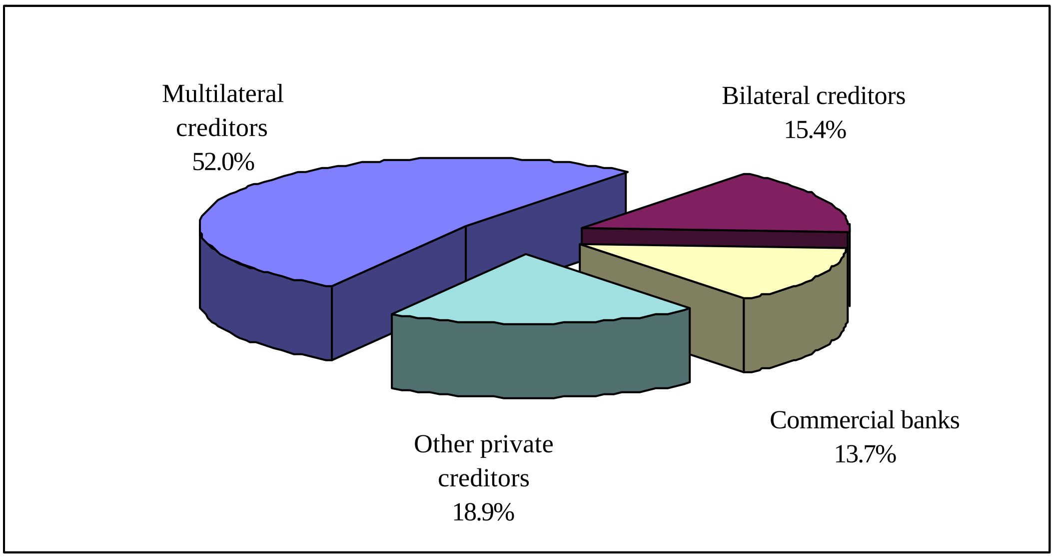
At the end 2003, the long-term debt of the Republic of Macedonia amounted to US Dollar 1,770.6 million (with 98.9%, or US Dollar 1,751 million of the total long-term debt being liabilities based on principal, 0.5%, or US Dollar 9.3 million accounting for the overdue interest, while the estimated late interest equals US Dollar 10.4 million, or 0.6% of the total long-term debt.

Table 20
External debt of the Republic of Macedonia in 2003

		Balance as of 31.12.2003		Structure	Changes relative to 31.12.2002	
		(in USD million)	(in %)	(in %)	(in USD million)	(in %)
Long-term loans and credits		**1,771**	**100.0**	97.7	199	12.7
	Principal	1,751	98.9			
	Interest	20	1.1			
Short-term credits		**42**	**100.0**	2.3	-22	-34.2
	Principal	37	88.8			
	Interest	5	11.2			
Total debt		**1,813**		100.0	178	10.9

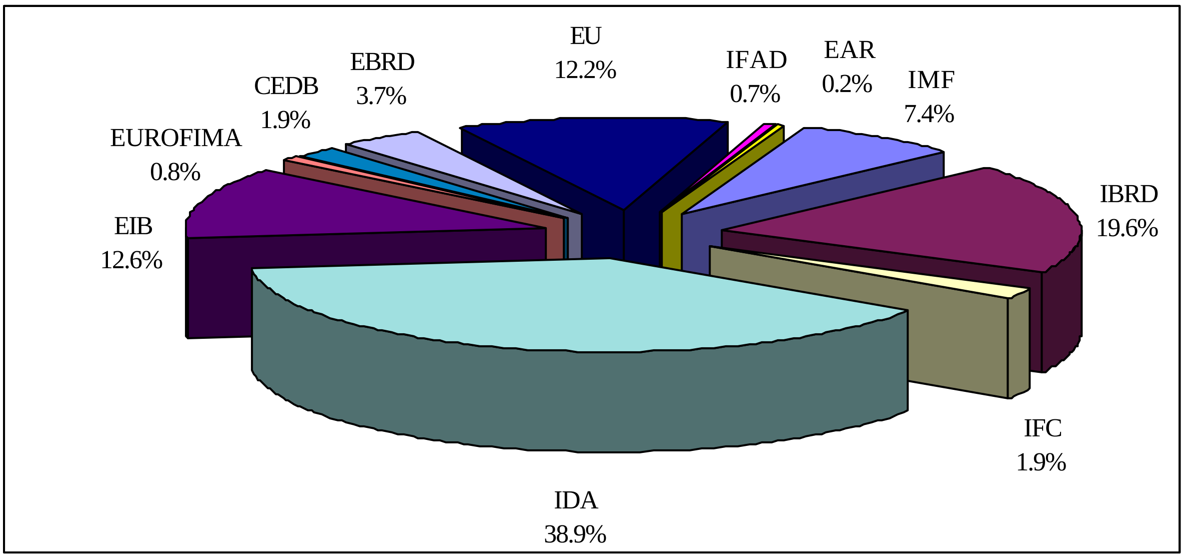
The structure of the long-term external debt of the Republic of Macedonia by individual foreign creditors in 2003 registered certain structural changes. Namely, the official creditors still dominate in the structure of the long-term debt with their share being equal to US Dollar 1,193.3 million (or share of 67.4% which registers an annual increase of 1.6 percentage points). Within this group of creditors, the multilateral creditors participate with US Dollar 920.7 million, or 52.0% (an increase of 3.8 percentage points compared to 2002), while US Dollar 272.5 million, or 15.4% account for the bilateral creditors (lower share by 2.2 percentage points compared to the previous year).

Chart 36
Structure of the long-term debt by types of foreign creditors
(as of December 31, 2003)



The largest individual creditor of the Republic of Macedonia among the group of multilateral creditors is the International Development Agency (IDA) with its share in the total long-term debt of the Republic of Macedonia being equal to 20.2% (18.8% in 2002). IDA is followed by the International Bank for Reconstruction and Development (IBRD) with 10.2% (9.3% in 2002) and the European Investment Bank (EIB) with 6.5% (the share of which remained unchanged in comparison with the previous year).

Chart 37
Structure of the debt to multilateral creditors
(as of December 31, 2003)



The analysis of the indebtedness of the Republic of Macedonia to bilateral creditors shows that the dominant share of the rescheduled debt (in 1995 and 2000) accounts for the Paris Club of Creditors (10.5%, i.e. a decrease in the share of 2.9 percentage points compared to 2002), which at the end of 2003 equaled US Dollar 186.7 million. The newly concluded credits on bilateral basis equaled US Dollar 76.3 million at the end of 2003. Thus their share in the total liabilities based on long-term credits reached 4.3% (an increase of 0.7 percentage points compared to the previous year).

On December 31, 2003, the long-term debt of the Republic of Macedonia to the private creditors equaled US Dollar 577.4 million, with its share being reduced by 1.6 percentage points compared to December 31, 2002, reaching 32.6% of the total liabilities based on used long-term credits. Observed from the aspect of separate private creditors, the share of the debt to the London Club of Creditors in the total long-term debt equals 13.7% (a decrease of 2.4 percentage points in the liabilities to this group of creditors compared to the previous year). Simultaneously, the share of the liabilities to banks, financial institutions and enterprises increased by 0.9 percentage points (so it equaled 18.9% at the end of the year). Such a tendency of increased indebtedness of the private sector reflects the perception of the foreign creditors for lower risk and consolidation of the Macedonian economy, and also corresponds with the liberalization of the capital transactions pursuant to the new Law on Foreign Exchange Operations. On December 31, 2003, the debt to the London Club of Creditors equaled US Dollar 243.3 million, while the debt to the remaining private creditors equaled US Dollar 334.1 million (US Dollar 119.1 million of which account for the debt to private enterprises, and US Dollar 215.0 million are debt of the residents to private banks and financial institutions).

7.5.2. Registered movements in 2003

At the end of 2003, compared to the end of the previous year, the foreign debt of the Republic of Macedonia increased by US Dollar 177.5 million, or by 10.9%. The long-term external debt of the Republic of Macedonia, which represents the dominant part of the total external debt, increased by US Dollar 199.2 million, or by 12.7%, with simultaneous decrease in the short-term liabilities of US Dollar 21.7 million, or 34.1%. The annual increase in the long-term debt is to a large extent caused by the high amount of positive exchange rate differentials (US Dollar 141.2 million due to the significant depreciation of the US Dollar).

In 2003, funds in the amount of US Dollar 323 million were withdrawn on the basis of short-term and long-term loans and credits, which is by US Dollar 33.4 million more compared to the previous year.

Observed from the aspect of maturity, an amount of US Dollar 82.8 million based on short-term credits from foreign sources of financing was withdrawn in 2003 (US Dollar 80.3 million were withdrawn in 2002). The withdrawals were completely realized by the private sector, and are mostly based on financial credits.

In 2003, the funds withdrawn on the basis of long-term credits equaled US Dollar 240.2 million, which is an annual increase of US Dollar 30.8 million. Funds in the amount of US Dollar 125 million were withdrawn from the multilateral creditors (US Dollar 49.5 million more compared to 2002). Simultaneously, the withdrawals from bilateral creditors registered an increase of US Dollar 10.3 million and equaled US Dollar 20.4 million, while an amount of US Dollar 94.7 million was withdrawn from private creditors (decrease of US Dollar 29.0 million on annual basis).

Within the multilateral creditors, the largest amount (US Dollar 34.1 million) was withdrawn from the European Union on the basis of the Structural Adjustment Project. In 2003, funds in the amount of US Dollar 32.9 million were withdrawn from the International Development Agency (IDA), mainly on the basis of the PSMAC I (Public Sector Management Adjustment Credit) and FESAL (Financial and Enterprise Sector Adjustment Loan), as well as projects intended for supporting the reforms in the public administration and the reform program for strengthening of the financial sector and the sector of the enterprises.

In 2003, an amount of US Dollar 26.2 million was withdrawn from the World Bank, mainly on the basis of the FESAL and on Power System Improvement Project.

At the end of April 2003, a Stand-By Arrangement with the International Monetary Fund was concluded, so three tranches in the total amount of US Dollar 17.2 million were withdrawn during the year.

Simultaneously, funds in the amount of US Dollar 9.3 million were withdrawn from the European Bank for Reconstruction and Development (EBRD) for the purposes of the PSMAC, Road Project II and for the Civil Aviation Project.

Funds in the amount of US Dollar 1.5 million and US Dollar 2 million were withdrawn from the European Development Agency (EAR) and the International Financial Corporation (IFC), respectively, which are completely based on projects of private enterprises in the Republic of Macedonia.

In 2003, funds in the amount of US Dollar 20.4 million were withdrawn from bilateral creditors (newly concluded credits). The largest share accounts for the credit for small-size and medium-size enterprises support - KFW (US Dollar 6.8 million). Funds in the amount of US Dollar 0.9 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 Small-size and Medium-size Enterprises (KFW), funds from the credit extended by the Government of the Republic of Germany, and withdrawals on the basis of projects of private enterprises.

In 2003, funds in the amount of US Dollar 94.7 million were withdrawn from the private creditors, which is a decrease of US Dollar 29.0 million compared to the previous year. Observed from the aspect of the use, the largest share accounts for the credit aimed at the construction of the Hydroelectric Power Station Kozjak, the credit for construction of small-size hydroelectric power stations and the credit for the Macedonian Railway. The withdrawals from the private creditors originate from foreign banks and other private financial institutions, as well as from foreign private enterprises (US Dollar 50.6 million and US Dollar 44.1 million, respectively).

Table 21
Withdrawn funds and serviced liabilities breakdown by creditors in 2003
(in US Dollar million)

	Withdrawn assets	Paid liabilities		
		Total	Principal	Interest
LONG-TERM LOANS AND CREDITS	**240**	**237**	**186**	**50**
MULTILATERAL CREDITORS	125	79	58	21
International Monetary Fund	17	23	22	1
World Bank	26	15	8	7
International Financial Corporation	2	6	5	1
International Deveopment Agency	33	3	0	2
European Investment Bank	1	11	6	5
European Railway Funding Company	0	6	5	1
European Development Bank Council	0	1	0	1
European Bank for Reconstruction and Development	9	13	11	2
European Union	34	2	0	2
International Fund for Agriculture Development	1	0	0	0
European Agency for Reconstruction	2	0	0	0
BILATERAL CREDITORS	20	56	43	13
Paris club (total)	0	48	37	11
New credits	20	8	6	2
PRIVATE CREDITORS	95	102	85	16
London club	0	17	10	6
Other private creditors	95	85	75	10
Banks and private financial institutions	51	66	58	9
Foreign enterprises	44	18	17	1
SHORT-TERM CREDITS	**83**	**93**	**91**	**2**
Commercial credits	2	**2**	2	0
Financial credits	80	**90**	88	2
Short-term credit lines	1	**1**	1	0
Credit for liquidity in international payments	0	**0**	0	0
TOTAL	**323**	**330**	**277**	**53**

At the end of 2003, the total amount of serviced liabilities to foreign creditors based on used short-term and long-term credits reached US Dollar 329.8 million (US Dollar 302.7 million in 2002). The repayments of the long-term debt equaled US Dollar 236.8 million, while the remaining amount refers to the repayment of liabilities on the basis of used short-term credits.

In 2003, the total amount of serviced liabilities based on short-term credits equaled US Dollar 93.0 million (in 2002 it equaled US Dollar 68.0 million). US Dollar 90.6 million out of the total amount of serviced short-term liabilities are repaid principal, while US Dollar 2.4 million account for the repaid interest.

At the end of 2003, the total amount of serviced liabilities to foreign creditors based on used long-term credits reached US Dollar 236.8 million (at the end of 2002, the repayments equaled US Dollar 234.7 million). US Dollar 186.5 million of this amount refer to the serviced principle, while US Dollar 50.3 million account for the serviced interest. The analysis by individual creditors indicates that the largest share of the funds (US Dollar 135.3 million), was repaid to the official creditors. Amount of US Dollar 79.1 million was paid to the multilateral creditors, and US Dollar 56.1 million to the bilateral ones. Within the multilateral creditors, the largest amount was repaid to the International Monetary Fund (US Dollar 22.7 million) and the World Bank (US Dollar 14.7 million). Simultaneously, among bilateral creditors, the largest amount was paid to the Paris Club of Creditors (US Dollar 47.6 million).

During 2003, liabilities in the amount of US Dollar 101.5 million were repaid to the private creditors (in 2002, US Dollar 81.5 million). The repayments based on principal equaled US Dollar 85.0 million and US Dollar 16.5 million were interest. The largest share of the total repayments (US Dollar 66.4 million) accounts for the regulation of the liabilities to foreign banks and private financial institutions.

Despite the increase in the newly concluded credits, largest portion of the funds was not used during the year. The concluded loans and credits referred to the following creditors and projects:

- The Republic of Macedonia concluded a Stand-By Arrangement with the International Monetary Fund (IMF) in the amount of US Dollar 29.7 million;
- Credit arrangements in the total amount of US Dollar 24.1 million were concluded with the International Development Agency (IDA), out of which US Dollar 6.1 million refer to the Communities Development Project, and US Dollar 18.0 million account for the PSMAC;
- The European Bank for Reconstruction and Development (EBRD) approved a credit in the amount of US Dollar 50.6 million aimed at ESM (Electricity Supply of Macedonia), for the construction of the transmission lines and US Dollar 50.0 million for the Roads Project II;
- The European Investment Bank (EIB) approved a credit in the amount of US Dollar 16.2 million for the purpose of the Substations Construction Project;
- The Government of Japan approved a credit in the amount of US Dollar 90.5 million for construction of Hydroelectric Power Station Zletovica;
- The Macedonian Railways concluded a credit agreement with the International Union of Railways (UIC) in the amount of US Dollar 15.3 million for the assumed part of the unpaid convention liabilities to several national railway companies.

VIII. Other activities of NBRM

8.1. Payment system in the Republic of Macedonia in 2003

The payment system in the Republic of Macedonia continues to operate successfully two years after the completion of the reform in the payment system in the country. In 2003, the NBRM was successfully managing the Macedonian Interbank Payment System (MIPS) as a point at which lace where final gross settlement in real time is executed, and the banks successfully continued performing their function as entities responsible for conducting payment operations.

In the May - August 2003 period, the Financial Sector Assessment Program (FSAP) was implemented, the main objective of which was estimating the level of development of the financial system of the country and identification of its shortcomings and weaknesses. An estimation of the MIPS was made, as a composite part of the financial system, from the aspect of its compliance with the Basic Principles for Systemically Important Payment Systems (published by the BIS). It was ascertained that the MIPS is harmonized with many of the recommendations and that it represents a reliable payment system which generally has good security features. Several recommendations were also given, which have already been accepted and represent an integral part of the activities of the operating team responsible for their realization.

The MIPS is compliant with four out of the total number of ten basic principles and four responsibilities through which the role of the central bank in the payment system is defined. Significant compliance is registered with four principles, partial compliance with one principle, while one principle is inapplicable, therefore it has not been examined (principle 5 which pertains to net systems, since the MIPS is a gross system). From the aspect of the responsibilities of the NBRM, as a Central Bank, a complete compliance is registered with one, significant compliance with two, while one responsibility is inapplicable and therefore it has not been examined (responsibility C which refers to overseeing other systemically important payment systems by the NBRM, which is inapplicable because there are no other systemically significant payment systems in the country.

8.1.1. The role of the NBRM in the payment operations

In order to provide efficient and reliable payment system in the Republic of Macedonia, the NBRM performs its role in the payment system through the following functions:
- operational;
- regulatory; and
- oversight.

8.1.1.1. Operational function

Within the performance of its operational function, the NBRM manages the settlement system - MIPS. In 2003, the MIPS operated in real time during all 254 working days with accessibility of 99.8%, i.e. it was not accessible only for 277 minutes out of the projected time for the whole year. The average dynamics of the system was 7,203 orders per day, while the maximal number of processed orders equaled 18,171.

Two new participants joined the payment system during the year, with the total number of participants reaching twenty eight.

The payment system in the Republic of Macedonia, and especially the MIPS, was interesting for a number of central banks of other countries because of the relatively short period of its establishment and its successful functioning from the very beginning. For these reasons, in 2003, representatives of more than twenty central banks visited the NBRM in order to familiarize with the functioning of the MIPS.

Besides that, in performing its operational function, in 2003 the NBRM received and processed 1,325 decisions for forced collection, 854 of which were implemented completely, while the remaining were incomplete and were returned to the courts for revision and completion or the procedure was called off the courts.

8.1.1.2. Regulatory function

In 2003, performing its regulatory function in the payment operations, the NBRM made an amendment to the Decision on Small Interbank Payment, with which the level of small interbank payment from Denar 3 million to Denar 1 million was reduced. This reduction contributed to increase in the number of transactions which are settled immediately (in real time) by 4%, thus enabling the receiver of funds to dispose of immediately and to have an accurate information on its own liquidity.

In 2003, a Decision on conducting oversight over the operations of banks and other institutions providing services in the payment operations was adopted.

In 2003, new version of the Rules for operation of the MIPS system was adopted (version 2.3 which is in force since September 15, 2003). The amendments were made for the purpose of introducing new payment message MT103 and cancellation of the payment message MT100, obligatory testing of reserve lines, etc.

8.1.1.3. Oversight function

Within the implementation of the licensing activities in 2003, one bank submitted an application for obtaining license for conducting payment operations, which was approved.

As a part of the function of overseeing the payment systems, in 2003 the NBRM was conducting a constant oversight over the operations of banks and the Clearing House. The oversight was carried out indirectly and directly. The payment system was monitored regularly through the implemented information system developed on the basis of the Manual for the internal and the external clearing, according to which the data on the payment operations of the banks are submitted electronically. On the other hand, the operations of the entities responsible for conducting payment operations were subjected to immediate inspections on various basis, with recommendations for lawful, efficient and transparent execution of the activities being given. In 2003, sixteen oversights were conducted.

In accordance with the Basic Principles for Systemically Significant Payment Systems of the BIS, an assessment of the Clearing House - KIBS was also made.

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

8.1.2.1. Open accounts

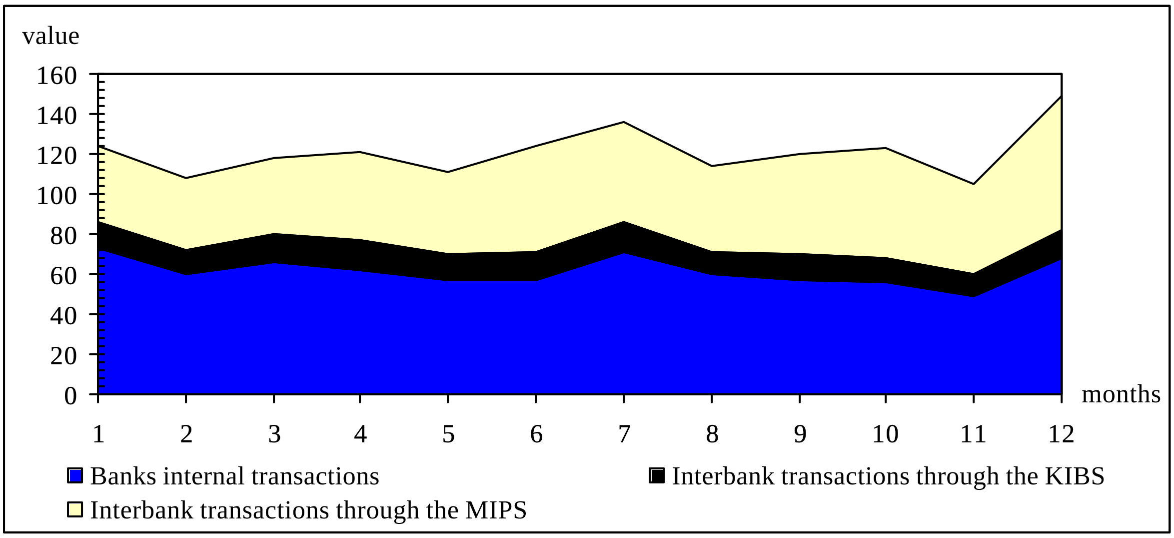
In 2003, total number of 19,883 new accounts were opened and 2,630 accounts were closed with the entities responsible for conducting payment operations, with which the total number of opened accounts at the end of the year reached 90,124. Owners of these accounts are 69,209 different entities (natural persons and legal entities), with 80.1% of them having only one account, while on average, there is about 1.3 account per entity.

Since the implementation of the new payment system until the end of 2003, a total number of 3,173 accounts were blocked. In 2003, 11,673 blockades were initiated, 8,048 were closed, which is 68.9% of the total number of initiated blockades.

8.1.2.2. Total payment operations in the Republic of Macedonia

In 2003, the total value of the performed payment operations equaled Denar 1,453.852 million. The total payment operations do not encompass the transactions for settlement of the net balance of the Clearing House KIBS. However, 50.6% of the total amount are internal operations in the banks (among accounts within the same bank), 38.6% refer to the interbank payment operations through MIPS, and 10.8% account for the interbank operations through KIBS.

Chart 38
Total domestic payment operations in 2003 by months
(in Denar billion)

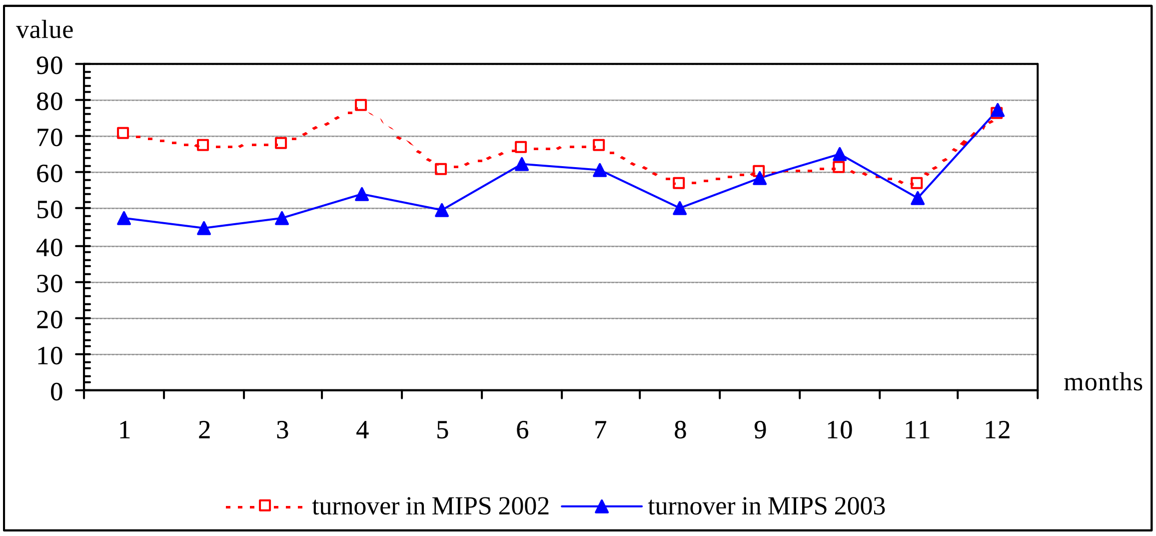


The total number of executed transactions in the domestic payment operations in 2003 equals 17,395,053, 10.5% of which are executed through the MIPS, 48.2% are executed through the KIBS system, and 41.3% are transactions executed through the internal clearing.

8.1.2.3. Payment operations and number of transactions executed through MIPS

In 2003, total payment operations in the amount of Denar 670,578 million were carried out through the MIPS system of the NBRM, with total number of 1,829,571 transactions being executed, including also the transactions for settlement of the net balances of the clearing house KIBS. The payment operations registered through the MIPS system in 2003 registered a decrease of 15.3% compared to the previous year. 51% out of the total payment operations carried out through MIPS account for the interbank payment operations initiated by other entities responsible for conducting payment operations, while 49% are turnover initiated by Government institutions, the National Bank of the Republic of Macedonia, the Treasury System, etc).

Chart 39
Value of payment operations carried out through MIPS by months
(in billion Denar)



In 2003, the total number of executed transactions compared to the previous year increased by 46.7%. 63.5% of the total number of transactions are initiated by the entities responsible for conducting payment operations - the commercial banks.

8.1.2.4 Interbank payment operations

The analysis of the conducted payment operations in 2003 among the accounts of depositors opened in the system of a same entity responsible for conducting payment operations indicates an annual increase in the value of the interbank payment operations of 23%, and equals Denar 735,271 million, while the number of executed transactions equaled 7,184,304, which is a decrease of 11.4% compared to the previous year.

8.2. Printing of banknotes and minting of coins

Banknotes in denomination of 10, 50, 100, 500, 1000 and 5000 Denars are in circulation in the Republic of Macedonia. In 2003, besides the regular activities, new improved banknotes in denomination of 500 and 1000 Denars were prepared and printed. The printing was carried out abroad in quantity of 10 million banknotes in denomination of 500 Denars and 15 million banknotes in denomination of 1000 Denars. The new issue of banknotes was put in circulation in August 2003.

On the occasion of the 100 years of Ilinden, a serial containing twelve gold and one silver jubilee coins was organized and minted. It is worth mentioning that the successfulness of the minting of the jubilee coins was proved by their sale in a very short period of time.

Printing of ten million pieces of cord stamps on the behalf of and for the account of the Ministry of Finance is also an extraordinary activity.

8.3. Numismatic activity of the NBRM

In 2003, the NBRM continued performing its museum related activity through systematic and selective purchase of numismatic material, with which the numismatic collection significantly enriched with rare and valuable pieces. In 2003, a total number of 2420 coins were purchased, while about 1500 pieces were cleaned and conserved in the laboratory.

From the aspect of publications from the area of numismatics, the bilingual catalogue Macedonia and Paeonia: Sheldarov Collection by the author Nikola Sheldarov was published, and the catalogue was promoted on April 25, 2003. Large portion of the coins from the collection published in the catalogue is now in the possession of the NBRM. In 2003, the translation of the English version of the catalogue for the permanent museum exhibition Macedonia: Coins and History was completed. The publication of the catalogue is planned for 2004.

In 2003, the attendance of the museum exhibition increased, thus leading to a conclusion that the exhibition titled as "Macedonia: Coins and History" stirs up great interest among the public two years after its opening. Also, an intervention was made in the chamber numismatic exhibition in the Governor's Office in the NBRM, i.e. its concept was changed and it was supplemented with new numismatic material.

Besides the aforementioned activities in 2003, the NBRM representatives participated with their studies in the 13th International Numismatic Congress held in Madrid. It was also the first participation of the Macedonian numismatists in such an important event for the analysts of the monetary and economic history, and the extremely rare coins which were included in the studies of the NBRM representatives attracted the attention of the participants in the Congress.

8.4. Internal audit

The internal audit represents an independent and objective activity of conviction (verification) and consulting focused on increasing the value and improving the performances.

The internal audit assists in improving the efficiency in the risk management through a systematic, disciplined approach.

For the purpose of regulating and controlling the process of risk management in the Bank, the Internal Audit prepared a Manual for regulating the internal controlling system in the NBRM.

The Internal Audit prepared a long-term plan for conducting an audit based on risk assessment.

The employees in the Internal Audit Department had a constant cooperation and held consultative meetings with experts from other central banks and representatives of institutions from the internal audit area.

8.4.1. Audit activities

According to the Audit Program for 2003 adopted by the NBRM Council, fourteen regular audits were planned and performed.

The audits were carried out on the basis of a description of the processes (procedures) which were previously prepared by the employees in relevant departments, and the risk assessment was made on the basis of the performed analysis.

Generally, the results from the conducted audits reveal satisfactory controlling processes in the relevant organizational units, and compliance with the policies and procedures.

While conducting the individual audits, recommendations and directions for further improvement of the internal controlling processes in the relevant organizational units of the Bank were given.

In 2003, the internal audit followed up the implementation of the given recommendations related to the conducted audits, and it was ascertained that the recommendations given in the audit reports were implemented by the Bank's officials.

On request of the NBRM management and according to the information that the Internal Audit Department had, three extraordinary audits were conducted.

8.4.2. Development of the Internal Audit

The development of the Internal Audit is focused on developing the audit of information systems and the financial audit.

The need for conducting IT audit is stressed because of the fact that the business processes in the contemporary business environment and in the Bank are increasingly being performed through modern software applications (electronic form of the documents, data and signatures).

Also, the strengthened audit of the accounting system and financial operations in the NBRM imposes the need of comprehensive knowledge of the International Accounting Standards and closer cooperation with the external auditor.

The further objectives for development of the Internal Audit are focused on a full application of the International Internal Audit Standards, which are generally accepted international standards for the best practice in performing the profession of internal audit.

The conduct of the Internal Audit requires a continuing education and upgrading of the staff. For that purpose, Plan for qualification of the employees in the Internal Audit was prepared.

8.5. Personnel policy

The NBRM personnel policy in 2003 was focused on further recruitment of new employees, as well as further training of the staff by attending seminars and training courses, and delivery of technical assistance and cooperation projects.

In 2003, eleven new persons were employed in the NBRM. Out of them, six are university graduates (two persons graduated from the Faculty of Economics, three persons completed the Law School, one person graduated from the Faculty of Electrical Engineering) and five persons with completed high school.

In 2003, in order to gain further professional experience, the NBRM staff attended large number of seminars and training courses organized by numerous institutions and central banks. Thus seminars of the IMF Institute (held in Washington, USA) were attended, as well as seminars of the Joint Vienna Institute (organized of the IMF, the World Bank, the EBRD, the OECD and the WTO, held in Vienna, Austria), seminars of the Swiss National Bank (organized in the student town of Gerzensee, Switzerland), seminars of De Nederlandsche Central Bank (held in Amsterdam), seminars of the Central Bank of Germany (held in Frankfurt), seminars of the Bank of France (organized by the International Institute of Banking and Finance, held in Paris), seminars of the Bank of England, organized by the Central Bank Study Center, held in London, etc.

In 2003, the cooperation of the National Bank of the Republic of Macedonia with De Nederlandsche Bank in the area of technical assistance continued. The implementation of the project for technical assistance for the NBRM provided by De Nederlandsche Bank, which was agreed in 2002, as a continuation and upgrading development of the previous technical assistance project between two institutions, continued in 2003. This project covered almost all main functions and activities of the National Bank of the Republic of Macedonia. At the end of the year, several meetings were held with Mr. Bob Spinhoven, coordinator of the Technical Assistance Project for the NBRM provided by De Nederlandsche Bank, at which both sides expressed their readiness to continue of their mutual extremely successful cooperation in the area of technical assistance.

Attachment 1

Changes in the legislation

Regarding the legislation, in 2003 important amendments to several laws from the area of finances, the banking and monetary and foreign exchange operations were made.

The **Law on Amendments to the Law on Foreign Exchange Operations** (“Official Gazette of the Republic of Macedonia” no. 51/2003) was adopted on June 22, 2003. Pursuant to the amendments, the banks are enabled to extend foreign exchange credits to residents, while the terms and the manner according to which the residents may conclude credit operations in foreign exchange are set by the NBRM. The amendments also create a possibility of purchasing securities abroad not only by the banks, but also by the Deposit Insurance Fund, insurance companies, as well as the pension and investments funds, in accordance with the laws which regulate their operations. Simultaneously, this Law also introduced certain changes in the domain of investing in real estate and in credit transactions reporting and surveillance.

In 2003, the implementation of the **Law on Trade Companies** ("Official Gazette of the Republic of Macedonia" no 58/2002 and 98/2002) was postponed twice. Namely, on June 24, 2003 the **Law on Amendments to the Law on Trade Companies** ("Official Gazette of the Republic of Macedonia" no. 42/2003) postponed the implementation of the Law dated July 01, 2003 for January 01, 2004, while on December 29, 2003 the **Law on Amendments to the Law on Trade Companies** ("Official Gazette of the Republic of Macedonia" no. 85/2003) postponed the implementation of the Law from January 01, 2004 for May 01, 2004.

The **Law on Amendments to the Law on Leasing** (“Official Gazette of the Republic of Macedonia” no. 49/2003) was adopted on July 18, 2003. Pursuant to the amendments, this Law includes also the leasing of real estate (and not only movables) and distinction between the financial from the operational leasing is made. In order to stimulate the enterprises and the banks to conduct this activity, the requirement for depositing Euro 100,000 for conducting leasing, that has been in place so far, was removed.

Law on Amendments to the Law on the Deposit Insurance Fund (“Official Gazette of the Republic of Macedonia” no. 49/2003) was adopted on July 18, 2003. In accordance with the amendments, the Fund shall pay indemnification to the depositors from certain bank three months after the revocation of the license for conducting operations of the bank at latest. The reduction of the premium the banks are paying to the Fund, the maximum of which will now equal 0.7% of the amount of the deposits of the natural persons in the bank (instead of the so far maximum of 2.5%) is also a novelty, introduced in order to reduce the costs of the banks and to decrease the interest rates. Also, instead of the 5% of the savings deposits, as the banks' premium should have reached, it is decreased to 4%. The newly established banks should pay an access premium in the Fund of 1%.

In 2003, amendments to the **Law on the National Bank of the Republic of Macedonia** were made. The amendments from July 22, 2003 ("Official Gazette of the Republic of Macedonia" no. 51/2003) were directed towards increasing the independence of the NBRM, as well as towards total transparency in its operations. Namely, with the amendments the NBRM became fully independent in establishing the Denar exchange rate policy, for which prior approval from the Government of the Republic of Macedonia has been required so far.

The second significant aspect of the increased independence of the NBRM refers to the appointment of the Vice-Governors, which according to the previous regulations, was carried out on the proposal of the President of RM, while pursuant to the amendments, the three Vice-Governors shall be proposed by the Governor. The supervisory function of the NBRM is supplemented with rights and responsibilities for issuing and revoking of a license for founding and operating of a bank and a savings house and for status changes in accordance with the Banking Law, about which the NBRM is obliged to submit a written report to the Ministry of Finance. The NBRM was given the possibility for larger exchange of information with domestic and international supervisory bodies regarding the supervision of the internationally active banks. For the purpose of monitoring the financial system, the NBRM is obliged to inform the Ministry of Finance about the undertaken supervisory measures and to submit data on the performances of the banking system (on a quarterly basis). The amendments require from the Governor to hold meetings with the competent commissions in the Parliament of the Republic of Macedonia at least twice a year, in order to inform them on the NBRM operations, also contribute for a larger transparency in the operations of the NBRM. From the aspect of the functioning of the NBRM Council, the provision stipulating that two out of six members of the Council shall be professionally engaged in the Council, is abolished. Members of the Council are university graduates in economics or law, and persons with processional experience of at least five years (in the last ten years before the appointment) in finance, banking or scholarly work in the area of economics. Contemporaneously, all members of the Council, as well as the Vice-Governor who is not a member of the Council, can not be members of managing bodies, employ in or establish a bank or a savings house during and two years after the termination of the term of office. Pursuant to the amendments, contrary to the previous practice, the NBRM is required to publish all reports it submits to the Parliament of the Republic of Macedonia within six months after the expiration of the period they refer to (previously, this obligation was valid only for the semi-annual and annual report on the operations).

The second amendment was adopted on December 12, 2003, ("Official Gazette of the Republic of Macedonia" no. 85/2003) and refers to the broadening of the NBRM functions by issuing a license for conducting prompt money transfer and a license for conducting operations of an exchange office, as well as overseeing the operations of the entities conducting prompt money transfer services, and the operations of the exchange offices.

In 2003, two **Laws on Amendments to the Banking Law** were adopted (on July 22, 2003 - “Official Gazette of the Republic of Macedonia” no. 51/2003 and on December 31, 2003 - "Official Gazette of the Republic of Macedonia" no. 85/2003), in accordance with the need for further adjustment of the Macedonian banking legislation and practice to the international supervisory standards and European Directives. The significant changes in the Banking Law made in July 2003 primarily refer to strengthening of the provisions pertaining to licensing of the banks. More significant changes made in this area are the following:

- In order to prevent the possibility suspicious entities to become shareholders of the banks, the limit of the change in the shares with voting right for which prior approval from the NBRM is reduced (from 10% to 5%). Regarding the structural changes in the shares with voting right in the bank from 1% to 5%, the NBRM examines only the source of funds from which the shares in the bank are purchased;
- Complete functioning of the mechanism of prior approval from the National Bank is enabled. Namely, the brokerage houses and the Macedonian Stock Exchange are not allowed to execute a transaction for purchasing of shares with a voting right in a bank for which prior approval from the NBRM is required, but it is not obtained. Such legal provisions enable larger cooperation and coordination among institutions which are directly involved in the trade of banks' shares and their control. The acquiring of shares with voting right without prior approval of the NBRM shall be treated as a criminal act;
- The criteria for estimating the suitability of the potential shareholder strengthened. In that direction, criteria according to which the NBRM may reject the request for prior approval for acquiring shares with voting right in the bank, were defined, among which more important are the following: submission of incorrect or false data, the financial and the economic standing of the entity do not correspond with the value of shares it intends to purchase, the manner in which it operates, i.e. the nature of the activities that the entity - potential shareholder performs, indicate a tendency of high risk, reason for suspecting the legality of the source of the funds, the integrity or the real identity of the entity, involvement of the bank in a group which does not enable adequate supervision and other;

- Banks are obliged to require prior approval from the NBRM when acquiring capital investment in another financial and non-financial institution, which exceeds 10% of the guarantee capital of the bank is also envisaged. This provision should provide full compliance with Principle 5 of the Basle Principles for Efficient Banking Supervision;
- The provisions according to which the unauthorized use of the word bank and/or unauthorized collection of deposits, i.e. conducting banking activities without obtaining a license from the NBRM are treated as criminal acts, have been strengthened, with which larger compliance with Principle 2 of the Basle Principles for Efficient Banking Supervision was achieved.

The other amendments of higher importance refer to the changes in the prudential limits for the capital investments and fixed assets of the bank, as well as to the changes in the accounting and the audit of the banks and oversight over their operations, which create basis for preparation of consolidated financial reports and conducting supervision on a consolidated basis.

The amendments to the Banking Law dated December 31, 2003, refer to the inclusion of the services prompt money transfer as a regular activity of the financial institutions.

On November 11, 2003, the **Law on Conducting Prompt Money Transfer Services** was adopted ("Official Gazette of the Republic of Macedonia" no. 77/2003), which regulates the manner and the conditions for carrying out such services in the Republic of Macedonia. The prompt money transfer represents an electronic transfer of funds from one natural person in one country to another natural person in another country within one hour from the payment, with the transfer being executed through a bank. Pursuant to this Law, service provider can be a trade company registered in the Republic of Macedonia which participates in the financial mediation and which is licensed for conducting prompt money transfer by the National Bank of the Republic of Macedonia. Besides licensing, the NBRM runs a Registry of the providers of such services, oversees their operations and the implementation of this Law. The provisions of this Law do not refer to the banks which already have an approval from the NBRM for conducting international payment operations. This Law entitles trade companies to perform prompt money transfer on the basis of the license issued by the NBRM after they meet certain conditions.

The **Law on Amendments to the Law on Compulsory Capital Financed Pension Insurance** (“Official Gazette of the Republic of Macedonia” no. 85/2003) was adopted on December 31, 2003, which practically postpones all the activities which should have commenced in January 2004 until the adoption of a Decision of the Government of the Republic of Macedonia on the date of commencement of the payment of the contribution for compulsory capital financed pension insurance.

Law on Amendments to the Law on Securities ("Official Gazette of the Republic of Macedonia" no. 85/2003 from December 31, 2003), with the most significant changes being made in the part pertaining to the trade in securities, definition of the registry of the Securities and Exchange Commission, the joint stock companies which included in the registry of the Securities and Exchange Commission, the quoting and the trade in securities of these joint stock companies, and reporting to the public, introduction of the possibility for OTC trade in short-term securities is introduced, envisaging also the possibility for trade in treasury bills through the Macedonian Stock Exchange.

NATIONAL BANK OF THE REPUBLIC OF MACEDONIA

Financial Statements

31 December 2003

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GENERAL INFORMATION

Members of the Council

Petar Gosev, Governor
Emilija Naceska, Vice Governor
Fatmir Besimi, Vice Governor
Slobodan Kosev
Marina Kavrakova
Fadil Bajrami
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INDEPENDENT AUDITORS' REPORT

To the Council of National Bank of the Republic of Macedonia

1. We have audited the financial statements of the National Bank of the Republic of Macedonia (the NBRM) on pages 2 to 40, which comprise the balance sheet as of 31 December 2003 and the statement of income, cash flows statement, and the statement of changes in equity for the year then ended, and the related notes. These financial statements are the responsibility of the NBRM's management. Our responsibility is to express an opinion on these financial statements based on our audit.

2. Except for the matter described in paragraph 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 2b to the accompanying financial statements, the NBRM, in accordance with the provisions of the Law on the National Bank of the Republic of Macedonia, transfers the net unrealized exchange losses on translation of foreign currency 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 notes 3 and 41 to the accompanying financial statements, the NBRM has issued guarantees during 2001 and 2002 by pledging foreign currency deposits as security for the borrowings of a local commercial bank that was put in bankruptcy procedure during March 2004. During January 2004, the NBRM paid the amount of MKD 1.018.258 thousand in respect of these guarantees and recorded a receivable from the bankrupt bank. This receivable has been disputed by the bankruptcy trustee and therefore the NBRM has made provision for the whole amount as of 31 December 2003, although it intends to pursue the confirmation of its claim through a court procedure. Owing to the uncertainties pertinent to the case, we are at present unable to make a reasonable estimate of the accuracy of the recorded provision for losses in respect of 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 necessary had we been able to satisfy ourselves as to the accuracy of the provisions for losses on guarantees, the financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2003 and the results of its operations and cash flows for the year then ended in accordance with International Financial Reporting Standards.

Ernst & Young

Ernst & Young,
Certified Auditors Ltd. - Skopje
Skopje, 14 July 2004

ЕРНСТ И ЈАНГ ОВЛАСТЕНИ РЕВИЗОРИ ДООЕЛ СКОПЈЕ скенир

BALANCE SHEET
At 31 December 2003

all amounts in MKD'000

ASSETS

	Note	*2003*	*2002*
FOREIGN ASSETS			
Sight deposits	3	**13.544.733**	11.001.356
Term deposits	3	**24.511.489**	28.985.243
Gold	4	**1.818.581**	3.979.644
Foreign currencies	5	**312.017**	480.252
Special Drawing Rights (SDR) holdings, net	6	**13.771**	358.302
Foreign securities	7	**4.323.307**	467.448
		44.523.898	45.272.245
RECEIVABLE FROM THE GOVERNMENT			
Loans to Government	8	**4.027**	11.789
Receivables from Government	9	**686.015**	914.452
Government securities held to maturity	10	**2.778.826**	3.066.719
Receivable from the Government related to repayment of foreign debt	11	**-**	3.804.814
		3.468.868	7.797.774
RECEIVABLE FROM BANKS			
Loans	12	**53.753**	62.802
Other accounts receivable		**6.711**	6.715
Overdue accounts receivable	13	**2.443**	2.443
		62.907	71.960
OTHER ASSETS			
Premises and equipment	14	**987.919**	1.033.536
Inventories	15	**93.416**	72.543
Receivables	16	**210.758**	172.047
Other assets	17	**1.034.849**	945.002
		2.326.942	2.223.128
TOTAL ASSETS		**50.382.615**	55.365.107

The financial statements were adopted by the Council of the National Bank of the Republic of Macedonia on 13 July 2004 and signed on its behalf by:

Petar Gosev,
Governor

НАРОДНА БАНКА НА МАКЕДОНИЈА • СКОПЈЕ

The accompanying notes form an integral part of these financial statements

BALANCE SHEET all amounts in MKD'000
At 31 December 2003

LIABILITIES AND CAPITAL

	Note	2003	2002
RESERVE MONEY			
Narrow definition of reserve money	18	**18.245.805**	18.169.790
Reserve requirements of banks	19	**2.776.421**	4.849
NBRM bills	20	**4.379.215**	2.997.753
		25.401.441	21.172.392
FOREIGN LIABILITIES	21	**3.352.542**	3.948.733
RESTRICTED DEPOSITS	22	**641.878**	553.383
DEPOSITS OF THE GOVERNMENT			
Denar deposits of the government	23	**3.828.934**	3.019.693
Foreign exchange deposits of the government	24	**8.352.071**	7.712.456
Fund for support of the monetary policy of the Government	25	**-**	6.579.998
		12.181.005	17.312.147
OTHER DEPOSITS	26	**1.313.593**	1.035.931
OTHER LIABILITIES			
Payables	27	**77.817**	92.618
Other liabilities	28	**1.096.984**	1.804.615
Counter-entries in NBRM accounts	29	**551.632**	510.828
		1.726.433	2.408.061
SDR ALLOCATION LIABILITY	30	**610.698**	667.490
CAPITAL AND RESERVES			
Capital	31	**1.289.789**	-
General reserves	32	**853.564**	723.636
Revaluation reserves	33	**4.210.390**	6.483.455
Unrealized losses on investment securities available-for-sale		**(75.706)**	-
Undistributed net income		**12.113**	-
Funds	31	**-**	1.432.034
IFRS adjustments	34	**(1.135.125)**	(372.155)
		5.155.025	8.266.970
TOTAL LIABILITIES AND CAPITAL		**50.382.615**	55.365.107

The accompanying notes form an integral part of these financial statements

INCOME STATEMENT

all amounts in MKD'000

For the year ended 31 December 2003

	Note	***2003***	*2002*
Interest income	35	**1.097.493**	1.722.200
Interest expense	36	**815.310**	1.319.095
NET INTEREST INCOME		**282.183**	403.105
Fee income	37	**127.384**	201.461
Other operating income	38	**209.212**	133.399
OPERATING INCOME		**618.779**	737.965
Staff expenses		**285.507**	288.703
Depreciation		**64.433**	62.226
Fee expense	39	**23.742**	35.399
Other expenses	40	**226.848**	149.292
OPERATING EXPENSES		**600.530**	535.620
Provision for potential losses, net	41	**710.793**	154.357
(LOSS) / PROFIT BEFORE TAXES		**(692.544)**	47.988
Income tax	42	**(58.313)**	8.329
NET (LOSS) / PROFIT FOR THE YEAR		**(750.857)**	39.659

APPROPRIATION OF NET INCOME AFTER TAXES

NET (LOSS) / PROFIT FOR THE YEAR	**(750.857)**	39.659
Net effect of IFRS adjustments	**762.970**	(5.918)
UNDISITRIBUTED NET INCOME AFTER TAXES PER STATUTORY STATEMENTS	**12.113**	33.741
General reserves	**-**	6.748
FOR DISTRIBUTION TO CAPITAL ACCOUNTS	**-**	6.748
FOR TRANSFER TO THE BUDGET	**-**	26.993

The accompanying notes form an integral part of these financial statements

STATEMENT OF CASH FLOWS all amounts in MKD'000
Year Ended 31 December 2003

	2003	2002
Net (loss) / income before allocation	**(750.857)**	39.659
Adjustments for:		
Depreciation	**64.169**	62.903
Debts written off earlier, foreclosed	**-**	(41.806)
Net (loss) / income before changes in assets and liabilities	**(686.688)**	60.756
Gold	**2.161.063**	(272.298)
Foreign securities	**(3.855.859)**	1.438.698
Claims on government	**4.272.114**	491.580
Claims on banks, net of foreclosures	**9.053**	142.684
Inventories and other assets	**(149.431)**	(131.237)
Increase in current assets	**2.436.940**	1.669.427
Money in circulation	**196.590**	(856.521)
NBRM bills	**1.381.462**	(159.585)
Deposits of banks	**2.711.821**	820.004
Deposits of government, including restricted deposits	**(4.825.809)**	(6.921.382)
Foreign liabilities	**(596.191)**	(948.191)
Other liabilities	**(681.628)**	(4.914.800)
(Decrease) in current liabilities	**(1.813.755)**	(12.980.475)
NET CASH FLOWS USED IN OPERATING ACTIVITIES	**(63.503)**	(11.250.292)
Fixed assets additions, net of foreclosures	**(20.652)**	(62.997)
Fixed assets sales	**-**	8.680
NET CASH FLOWS USED IN INVESTING ACTIVITIES	**(20.652)**	(54.317)
Net appropriations for premises and equipment	**(10.217)**	(2.488)
NET CASH FLOWS USED IN FINANCING ACTIVITIES	**(10.217)**	(2.488)
Exchange rate and unrealized losses effects	**(2.348.771)**	(2.127.276)
Net (decrease) in cash and cash equivalents	**(2.443.143)**	(13.434.373)
Cash and cash equivalents at the beginning of the year	**40.825.153**	54.259.526
Cash and cash equivalents at the end of the year	**38.382.010**	40.825.153
Analysis of cash and cash equivalents at end of the year		
Sight deposits	**13.544.733**	11.001.356
Term deposits	**24.511.489**	28.985.243
Foreign currencies in vault	**312.017**	480.252
SDR holdings, net	**13.771**	358.302
Total	**38.382.010**	40.825.153

The accompanying notes form an integral part of these financial statements

STATEMENT OF CHANGES IN EQUITY

all amounts in MKD'000

Year ended 31 December 2003

	Capital	*General reserves*	*Revaluation Reserves*	*Investment securities available-for-sale*	*Fixed Assets Fund*	*Employee Amenities Funds*	*Undistributed net income*	*IFRS adjustments*	*Total capital and reserve accounts*
At 1 January 2003	-	723.636	6.483.455	-	1.258.046	173.988	-	(372.155)	8.266.970
Transfer to capital account (note 31)	1.289.789	129.928	-	-	(1.257.950)	(161.767)	-	-	-
Unrealized FX (losses)	-	-	(2.273.065)	(75.706)	-	-	-	-	(2.348.771)
IFRS adjustments to current year profit	-	-	-	-	-	(12.221)	-	(762.970)	(775.191)
Profit for allocation	-	-	-	-	-	-	12.113	-	12.113
Other	-	-	-	-	(96)	-	-	-	(96)
At 31 December 2003	1.289.789	853.564	4.210.390	(75.706)	-	-	12.113	(1.135.125)	5.155.025

The accompanying notes form an integral part of these financial statements

STATEMENT OF CHANGES IN EQUITY

all amounts in MKD'000

Year ended 31 December 2002

	General reserves	*Reserves for net realized FX gains*	*Revaluation Reserves*	*Fixed Assets Fund*	*Employee Amenities Funds*	*Net profit for distribution to Budget*	*IFRS adjustments*	*Total capital and reserve accounts*
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 (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

1 GENERAL INFORMATION

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

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

The bodies of NBRM are the Council and the Governor.

The total number of employees as of 31 December 2003 was 395 (31 December 2002: 386).

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a) Basis of preparation of financial statements

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

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

b) Foreign currency translation

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

At the balance sheet date, assets and liabilities denominated in foreign currencies are remeasured at closing rates. The accounting policy related to the unrealized exchange differences is regulated by the Law on the National Bank of the Republic of Macedonia and is in accordance with the specific role of the Central Bank. The unrealized exchange losses are taken to revaluation reserves, to the extent that this reserve has a positive balance after the transfer for the period. The remaining portion of the net unrealized exchange losses and the unrealized losses from revaluation of the monetary gold are taken to the income statement. This represents a departure from IFRS, which requires all foreign exchange gains and losses, realized and unrealized, to be taken to the income statements.

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 on a monthly basis. At year-end, gold is valued at the MKD price per gram set by the NBRM Council, obtained by expressing in MKD the market price at the balance sheet date.

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

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)

Securities held for trading 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.

Investment securities at the balance sheet date 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.

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

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

g) Fair values

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

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

h) Impairment and uncollectability of financial assets

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

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

i) Trade and settlement date accounting

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

j) Loans and advances

These are stated at amortized cost, net of provisions for impairment.

k) Premises and equipment

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

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

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

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

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. When coins are withdrawn from circularization the inventory of notes and coins and the liability in favor of the holders are reduced.

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

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

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

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

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

3 FOREIGN EXCHANGE DEPOSITS

Foreign exchange deposits are analyzed as follows:

a) Foreign exchange deposits by type of deposit

	2003	*2002*
Sight deposits	**14.038.211**	11.506.066
Provisions	**(493.478)**	(504.710)
Subtotal	**13.544.733**	11.001.356
Term deposits	**25.382.596**	29.134.325
Provisions	**(871.107)**	(149.082)
Subtotal	**24.511.489**	28.985.243
Total deposits (sight and term)	**39.420.807**	40.640.391
Provisions	**(1.364.585)**	(653.792)
Total	**38.056.222**	39.986.599

Sight deposits include total interest-earning deposits of MKD 14.038.211 thousand (2002: MKD 10.812.125 thousand), earning interest at rates mostly based on the currency of the deposit and range from 0,25% to 6,26% per annum (2002: up to 3,4% per annum). Term deposits earn interest at rates based mostly on the currency of the deposit, ranging from 0,95% to 6,75% per annum (2002: 1,33% to 6,75% per annum). The structure of term deposits per remaining period to maturity is included in note 42a).

Sight and term deposits include MKD 1.787.229 thousand of deposits that are not freely available to NBRM use.

Part of these deposits amounting to MKD 490.130 thousand were pledged as security for a guarantee in the same amount that was obtained in favor of a foreign bank (currently under liquidation) as a condition for releasing NBRM deposits of MKD 1.010.757 thousand in this bank. NBRM has provided MKD 101.076 thousand for losses on these deposits. According to the latest representations of the liquidators of the foreign bank, the potential losses on these deposits that NBRM should sustain are MKD 34.172 thousand. NBRM has made a subordinated loan with the same bank of USD 5 million (MKD 245.251 thousand) maturing in 2002, which is fully provisioned. As the bank is in liquidation, the maturity of this loan did not change its subordinated status.

The remaining balance of MKD 1.297.099 thousand (2002: MKD 2.582.379 thousand) of the restricted deposits were pledged as security in respect of guarantees given for the borrowings of Macedonian commercial banks from the foreign banks where those deposits are placed. These guarantees were given 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". These deposits include issued guarantees during 2001 and 2002 as security for the borrowings of a local commercial bank, which was put in bankruptcy procedure during March 2004. During January 2004, the NBRM paid the amount of MKD 1.018.258 thousand in respect of these guarantees and recorded a receivable from the bankrupt bank. This receivable has been disputed by the bankruptcy trustee and therefore the NBRM has made provision for the whole amount as of 31 December 2003 (see also note 41).

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

3 FOREIGN EXCHANGE DEPOSITS (Continued)

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

	Sight deposits	*Term deposits*	*Subordinated loan*	*Total*
At 31 December 2001	150.414	3.163	345.858	499.435
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
At 31 December 2002	211.720	149.082	292.990	653.792
FX valuation	-	47.739	(47.739)	-
Release of provisions	(86.226)	-	-	(86.226)
Charge for the year	122.733	674.286	-	797.019
At 31 December 2003	248.227	871.107	245.251	1.364.585

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

	2003	*2002*
International financial institutions	**15.525.999**	27.234.436
Central banks	**16.912.593**	9.480.171
Commercial banks	**6.982.215**	3.925.784
Subtotal	**39.420.807**	40.640.391
Provisions	**(1.364.585)**	(653.792)
Total	**38.056.222**	39.986.599

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

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

	2003	*2002*
Europe	**27.856.192**	31.886.302
Other	**11.564.615**	8.754.089
Subtotal	**39.420.807**	40.640.391
Provisions	**(1.364.585)**	(653.792)
Total	**38.056.222**	39.986.599

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.

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

4 GOLD

Gold is analyzed as follows:

	2003	*2002*
Gold in NBRM vault	**49.543**	67.892
Gold deposits	**1.769.038**	3.911.752
Total	**1.818.581**	3.979.644

Total gold reserves of NBRM as of 31 December 2003 consisted of 88.857,553 fine troy ounces (2002: 198.149,970 fine troy ounces) at a market value of USD 417,25 (MKD 20.466) per fine troy ounce (2002: USD 342,75 or MKD 20.084 per fine troy ounce). Gold deposits of 86.436,935 fine troy ounces are held at two correspondent banks as non-interest bearing sight deposits (2002: gold deposits of 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 0,40% per annum). The decrease of the quantity of gold during 2003 is a result of a swap of 108.327,680 fine troy ounces.

5 FOREIGN CURRENCIES

Foreign currencies comprise convertible foreign currencies held in the vault of NBRM.

6 SPECIAL DRAWING RIGHTS (SDR) HOLDINGS

NBRM keeps a SDR-denominated current account with IMF for processing and settling transactions with IMF. This current account earns interest at the so-called basic rate of IMF, which is obtained weekly as a weighted average of selected rates of 3-month money-market instruments of five countries whose currencies constitute the SDR valuation basket. During 2003, the basic rate ranged between 1,99% and 2,41%, per annum (2002: 2,4% to 2,9% per annum).

7 FOREIGN SECURITIES

Foreign securities are analyzed as follows:

	2003	*2002*
Held to maturity:		
2,625% semi-annual Treasury note denominated in USD, maturing November 2006	**147.151**	-
3,5% annual government note denominated in EUR, maturing October 2008	**90.780**	-
4,75% semi-annual BIS bond denominated in GBP, maturing March 2007	**261.055**	-
Available-for-sale:		
Fixed-income foreign government bonds	**3.785.144**	-
Other fixed-income securities	**-**	427.495
Other foreign securities	**39.177**	39.953
Total	**4.323.307**	467.448

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

7 FOREIGN SECURITIES (Continued)

Fixed-income foreign government bonds, maturing between 2005 and 2008 bear fixed annual and semi-annual coupons ranging between 2% and 6% per annum.

Fixed-income securities comprise securities issued by the Bank for International Settlement (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. 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 SDR 5.000 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

Receivables from Government are analyzed as follows:

	2003	*2002*
Receivable from the Government related to repayment of foreign debt (Note 21)	**75.317**	246.962
Receivable related to SDR allocation liability (Note 30)	**610.698**	667.490
Total	**686.015**	914.452

The receivable from the Government related to repayment of foreign debt represents an outstanding balance based on a financial arrangement originating from 1994 when the outstanding arrears of the Government towards the International Bank for Reconstruction and Development ("IBRD") were settled by withdrawal of a single trance of a loan granted by the IMF known as Systemic Transformation Facility 1 (STF - 1). The receivable of MKD 75.317 thousand has been fully recovered during 2004. NBRM charges the government the same interest rate incurred on the borrowing from IMF, which is the basic rate of IMF (see note 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 30).

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

9 RECEIVABLES FROM GOVERNMENT (Continued)

Pursuant to the IMF Statute, ratified by the Parliament of the Republic of Macedonia, and the related Law on the Legal Succession of the Republic of Macedonia in the Membership of the IMF, NBRM acts as a fiscal agent of the Republic of Macedonia, and as a depository of IMF in the Republic of Macedonia. In this capacity, NBRM records the membership quota in IMF of the Republic of Macedonia, and also Accounts No.1, and No.2 with IMF. The balances of these three accounts, which are stated on a net basis in the financial statements, are MKD 5.312.502 thousand, MKD 13.315 thousand, and MKD 156 thousand, respectively (2002: MKD 5.875.874 thousand, MKD 14.727 thousand, and MKD 173 thousand, respectively).

10 GOVERNMENT SECURITIES HELD TO MATURITY

Government securities are analyzed as follows:

	2003	*2002*
Bond issued for rehabilitation and restructuring of one commercial bank	**629.732**	610.612
Other Bonds issued by the Bank Rehabilitation Agency	**2.149.094**	2.456.107
Total	**2.778.826**	3.066.719

Government securities held to maturity represent Bonds issued by the Bank Rehabilitation Agency on behalf of the Republic of Macedonia, based on the provisions of the 1995 Law on Rehabilitation and Restructuring of Part of Banks in the Republic of Macedonia.

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

The other Bonds issued by the Bank Rehabilitation Agency 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 2003 was 10,7% until March 2003, 8% until 15 April 2003 and 6,5% per annum thereafter (2002: 10,7% per annum).

11 RECEIVABLE FROM THE GOVERNMENT RELATED TO REPAYMENT OF FOREIGN DEBT

For the purpose of eliminating the negative monetary effects caused by large foreign funds necessary to repay foreign debts of the Republic of Macedonia, starting from 1995 the receivable from the Government related to repayment of foreign debt from the foreign reserves was recorded on the so-called External account of the Government for payments abroad. The Government settled these receivables, i.e. liabilities, from foreign funds obtained from new foreign borrowings and donations for balance of payment support, funds from succession of the former Yugoslavia, funds from privatization and etc. The balance on this account reflects the amount of unpaid foreign liabilities of the Government. During June 2003, the balance of this account was closed with other foreign deposits of the Government (Budget) account of the Republic of Macedonia and from funds of the so-called fund for support of the monetary policy of the Government (see note 25).

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

12 LOANS TO BANKS

Loans to banks are analyzed as follows:

	2003	*2002*
Long-term loans from the conversion of selective loans in:		
1993	**29.431**	38.287
1996	**24.253**	24.253
Long-term loans from other conversions	**69**	262
Total	**53.753**	62.802

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

13 OVERDUE RECEIVABLE FROM BANKS

Overdue receivable from banks are analyzed as follows:

	2003	*2002*
Overdue deposit auctions	**9.268**	9.268
Provisions	**(6.825)**	(6.825)
Total	**2.443**	2.443

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

	Total
At 31 December 2001	153.775
Collected in cash	(30.980)
Foreclosed property	(120.352)
At 31 December 2003 and 2002	2.443

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

14 PREMISES AND EQUIPMENT

Premises and equipment are analyzed as follows:

	Buildings	*Furniture, equipment and vehicles*	*Works of art*	*Computer software*	*Construction in progress*	*Total assets for business purposes*	*Assets for employee amenities*	*Total fixed assets*
At 1 January 2003, net of accumulated depreciation	752.264	180.233	22.071	35.397	12.862	1.002.827	30.709	1.033.536
Additions	1.393	12.484	3.869	2.906	-	20.652	70	20.722
Transfers from construction in progress	-	42	-	-	(42)	-	-	-
Write-offs	-	(405)	(17)	-	-	(422)	(9)	(431)
Revaluation	-	13	-	11	-	24	-	24
Depreciation charge for the year	(11.034)	(42.499)	-	(10.636)	-	(64.169)	(1.763)	(65.932)
At 31 December 2003	742.623	149.868	25.923	27.678	12.820	958.912	29.007	987.919
At 1 January 2003								
Revalued amount	841.602	399.863	22.071	54.980	12.862	1.331.378	35.011	1.366.389
Accumulated depreciation	(89.338)	(219.630)	-	(19.583)	-	(328.551)	(4.302)	(332.853)
Net carrying amount	**752.264**	**180.233**	**22.071**	**35.397**	**12.862**	**1.002.827**	**30.709**	**1.033.536**
At 31 December 2003								
Revalued amount	842.995	404.396	25.923	57.898	12.820	1.344.032	35.072	1.379.104
Accumulated depreciation	(100.372)	(254.528)	-	(30.220)	-	(385.120)	(6.065)	(391.185)
Net carrying amount	**742.623**	**149.868**	**25.923**	**27.678**	**12.820**	**958.912**	**29.007**	**987.919**

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 were transferred from ZPP, they are currently used and maintained by NBRM, and NBRM has made capital improvements shown as construction in progress in the above schedule. 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.

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

15 INVENTORIES

Inventories are analyzed as follows:

	2003	*2002*
Jubilee coins	**66.910**	50.633
Other inventories	**26.506**	21.910
Total	**93.416**	72.543

Jubilee coins represent golden and silver coins which based on Government Decisions are produced to honor anniversaries deemed important for the country. At 31 December 2003, NBRM held 8.209 golden coins and 510 silver coins (2002: 5.854 golden coins and 476 silver coins). The jubilee coins held in the NBRM vault are intended for sale.

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

16 RECEIVABLES

Receivables are analyzed as follows:

	2003	*2002*
Income tax	**120.484**	110.451
Interest	**40.879**	24.043
Fees and commissions	**36.972**	23.014
Other	**12.423**	14.539
Total	**210.758**	172.047

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

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

17 OTHER ASSETS

Other assets are analyzed as follows:

	2003	*2002*
Reserve funds	**853.563**	716.888
Funds for employee amenities	**-**	138.772
Deferred tax asset (Note 42)	**-**	58.313
Accrued interest income from sight and term deposits	**15.392**	26.238
Accrued interest income from available-for-sale financial assts	**86.817**	-
Prepaid expenses for printing money	**68.129**	-
Assets with special purpose	**615**	615
Other	**10.333**	4.176
Total	**1.034.849**	945.002

Reserve funds represent cash equivalents of the General reserves (see note 32).

In accordance with its accounting practices, NBRM transfers from its giro account an amount equal to the retained earnings each year to the reserve fund account. These reserve funds cannot be used for purposes other than covering potential future losses of NBRM.

Funds for employee amenities were also allocated from the NBRM giro account and were intended to fund recreational and other needs of NBRM employees as required by the NBRM collective labor agreement.

For the purpose of complying with the requirements of the Law on the National Bank of the Republic of Macedonia, during 2003 the NBRM Council adopted a decision for canceling the employee amenities fund and transferring the balance to the capital account of NBRM and the general reserve fund account (see note 31). The cash accounts relating to these funds were also allocated accordingly.

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.

18 NARROW DEFINITION OF RESERVE MONEY

The narrow definition of reserve money is analyzed as follows:

	2003	*2002*
Currency in circularization	**15.011.282**	14.814.692
Banks' accounts	**3.234.523**	3.355.098
Total	**18.245.805**	18.169.790

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

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

19 RESERVE REQUIREMENTS OF BANKS

The reserve requirements of banks are analyzed as follows:

	2003	*2002*
Reserve requirements of saving houses in Denars	**6.565**	4.849
Reserve requirements of banks in foreign currencies	**2.769.856**	-
Total	**2.776.421**	4.849

Banks and saving houses are obligated to hold reserve requirements with NBRM, at percentages determined by the NBRM, in denars and in foreign currencies. The reserve requirement of banks in denars is fulfilled in part with the settlement accounts of banks held at NBRM and in part with the banks cash in vaults. Savings houses are required to hold the reserve requirements on a special account with NBRM.

NBRM pays remuneration on the amount of reserve requirement in denars based on the average holdings of each bank during the relevant period. For the part of the reserve requirement originating from cash in vaults, as well as any reserve holdings above the requirement determined by NBRM, no remuneration is paid. During 2003, the remuneration rate paid on the reserve requirement in denars was: 6% in the period January-March, 5% in the period April-October and 4% in the period November-December (2002: 9,52% in the period January-June, 7% in July and 6% from August thereafter).

During June 2003, a foreign currency reserve requirement was introduced. Banks are required to hold the foreign currency compulsory reserve on a special account with NBRM which amount is determined on a fixed basis. NBRM pays remuneration on the foreign reserve requirement of banks at an interest rate equivalent to the Deposit Standing Facility interest rate of ECB, which during 2003 amounted to 1% per annum.

20 NBRM BILLS

NBRM bills represent a monetary instrument designed to manage the overall liquidity by withdrawal of the excess liquidity from the banking system. The maturity of the NBRM bills is standardized on 28 days. Depending on the goals of the monetary policy, the maturity of the NBRM bills can be shorter. The bills are sold to banks through an auctioning process, either through interest rate tenders (banks auction for amounts they want to purchase and interest rates) or volume tenders (banks auction only with amounts they want to purchase, while the interest rate is pre-determined by the NBRM). During 2003, the NBRM bills were with pre-determined maturity of 28 days. Both types of auctions were applied during 2003: up to 11 April interest rate tenders, from 11 April to 22 October volume tenders, and from 22 October thereafter interest rate tenders (with a pre-determined maximum interest rate of 7%). During 2003, the interest rates on NBRM bills have declined, from 14,75% during January to 6,12% during November 2003, (2002: between 6,8 % and 16%).

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

21 FOREIGN LIABILITIES

Foreign liabilities represent the remaining portion of the borrowings that NBRM has withdrawn from IMF arising from the following arrangements:

	2003	*2002*
Systemic Transformation Facility - Part 1 (STF-1)	**75.317**	246.962
Systemic Transformation Facility - Part 2 (STF-2)	**225.951**	411.604
Enhanced Structural Adjustment Facility (ESAF)	**1.590.738**	2.100.899
Compensatory Contingency Financing Facility (CCFF)	**376.644**	960.563
Poverty Reduction and Growth Facility (PRGF)	**125.548**	137.223
Extended Fund Facility (EFF)	**83.698**	91.482
Stand-by	**874.646**	-
Total	**3.352.542**	3.948.733

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

CCFF is for a period of five years, including a three-year and three-month 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. The Stand-by loan is for a period of five years, including a grace period of three years and three months, with quarterly payments maturing between 2006 and 2008. ESAF and PRGF arrangements incur interest at fixed rates of 0,5% per annum. Other borrowing arrangements incurs interest at the basic rate of IMF (see note 6).

22 RESTRICTED DEPOSITS

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

23 DENAR DEPOSITS OF THE GOVERNMENT

Denar deposits of the government are analyzed as follows:

	2003	*2002*
Single treasury account (Budget)	**1.976.633**	2.557.165
Other denar accounts	**1.852.301**	462.528
Total	**3.828.934**	3.019.693

23 DENAR DEPOSITS OF THE GOVERNMENT (Continued)

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

The interest rate is renegotiated annually. During 2003, the interest rate was 3% per annum (2002: 5,5% per annum until 1 October 2002, and 3% per annum thereafter).

24 FOREIGN EXCHANGE DEPOSITS OF GOVERNMENT

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

During 2002 and up till 18 November 2003, NBRM paid interest on USD deposits at 70% of Federal Reserve System discount rate, amounting to rates between 0,5% and 0,9%, per annum and on EUR deposits at 70% of ECB refinancing tender rate, amounting to rates between 1,2% and 1,6%, per annum, with the exception of the special foreign exchange privatization deposit denominated in EUR amounting to MKD 6.698.477 thousand, which earns interest at the full amount of the above mentioned benchmark rates for EUR deposits.

Starting from 18 November 2003, NBRM does not pay any interest on these deposits.

25 FUND FOR SUPPORT OF THE MONETARY POLICY OF THE GOVERNMENT

For the purpose of coordinating monetary policy and regulating the exchange rate of the denar, starting from 1995, the Government maintains funds from the budget account in a special non-interest earning fund for support of the monetary policy of the Government. During June 2003, part of the fund for support of the monetary policy of the government was used for settling the receivables from the government for repaying foreign debt, and the remaining balance was transferred to the single treasury account (see also notes 11 and 23).

26 OTHER DEPOSITS

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

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

27 OTHER PAYABLES

Other payables are analyzed as follows:

	2003	*2002*
Interest payables	**37.070**	30.079
Payables from appropriation of net income	**26.993**	26.993
Liabilities from BNT bankruptcy	**9.873**	15.263
Payables arising from annuities received from sale of socially-owned flats	**2.882**	10.300
Income tax payable	**-**	9.983
Other payables	**999**	-
Total	**77.817**	92.618

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

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

With the appropriation of the liquidation pool of one commercial bank, which was declared bankrupt in 1995, NBRM acquired assets and liabilities in the amount of MKD 292.442 thousand for the purpose of compensating depositors of the bankrupt bank. In this respect, the amount of MKD 129.923 thousand was paid out until 31 December 2003 to meet claims by the bank depositors. The amount of MKD 9.873 thousand reflects the amount NBRM management believes that will be paid for the same purpose in the foreseeable future.

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

NBRM does not pay interest on either of these payables.

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

28 OTHER LIABILITIES

Other liabilities are analyzed as follows:

	2003	*2002*
Liabilities from servicing foreign borrowings of the Government (NBRM Apex unit)	**583.537**	746.206
Bank deposits related to swap operations	**193.113**	660.901
Temporarily confiscated foreign currencies	**144.834**	145.844
Equity payments pending operational license	**-**	122.142
Jubilee coins counterpart	**57.241**	50.633
Expected litigation outlays	**73.932**	30.779
IBRD special deposit	**15.412**	20.212
Accrued interest to IMF	**10.334**	19.107
Sundry payables	**12.646**	5.245
Other liabilities	**5.935**	3.546
Total	**1.096.984**	1.804.615

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

Bank deposits related to swap operations consist of foreign exchange deposits of domestic commercial banks which in accordance with local regulations are made available for intra-day swap operations (i.e. granting denar funds for bridging the timing gaps between inflows and outflows of denars during one working day trough the MIPS system). Starting from 18 November 2003, NBRM does not pay any interest on these funds (2002: paid interest on these funds amounting to 70% of the benchmark rates explained in note 24).

Temporarily confiscated foreign currencies represent foreign currency holdings of individuals that are confiscated for a variety of reasons and deposited with NBRM by the confiscating authority, until the court resolution of the dispute, when the foreign currencies are either returned to the original holder or conferred to the government. NBRM also maintains temporary deposited foreign currencies that are recorded on memo accounts. Those foreign currencies recorded off-balance sheet amount to MKD 100.050 thousand at 31 December 2003 (2002: MKD 101.788 thousand). NBRM does not pay interest on these funds.

Equity payments pending operational license include EUR 1 million deposit related to 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.

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

28 OTHER LIABILITIES (Continued)

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

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

29 COUNTER-ENTRIES IN NBRM ACCOUNTS

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

- counter-entries for local currency deposits and settlement accounts maintained in NBRM,
- stocks and monetary liabilities not related to any creditor for produced denar banknotes and coins, administrative forms and stamp duty that are also put in circulation by NBRM,
- other assets and liabilities accounts not related to any debtor and/or creditor, 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.

30 SDR ALLOCATION

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

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

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

31 CAPITAL

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

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

31 CAPITAL (Continued)

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

32 GENERAL RESERVES

As stipulated in the NBRM Law, 20% of NBRM annual net income after taxes is transferred to the general reserves until the level of initial NBRM capital is reached. These reserves can be used for covering future losses of NBRM.

33 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.

34 IFRS ADJUSTMENTS

This retained earnings account accumulates all changes to statutory profit and loss statements up to and including year 2003 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:

At 31 December 2000	-
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)
IFRS adjustments to the statutory profit and loss statement for 2002	(5.918)
At 31 December 2002	372.155
IFRS adjustments to the statutory profit and loss statement for 2003	762.970
At 31 December 2003	1.135.125

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

35 INTEREST INCOME

Interest income is analyzed as follows:

	Loans granted	*Deposits made*	*Securities purchased*	***Total 2003***	*Total 2002*
Government	494	-	180.057	**180.551**	277.869
Domestic banks	49.828	-	-	**49.828**	16.904
Foreign entities	-	679.599	187.515	**867.114**	1.427.427
Total 2003	**50.322**	**679.599**	**367.572**	**1.097.493**	1.722.200
Total 2002	17.772	1.418.858	285.570	1.722.200	

36 INTEREST EXPENSE

Interest expense is analyzed as follows:

	Loans received	*Deposits received*	*Securities issued*	***Total 2003***	*Total 2002*
Government	-	294.170	-	**294.170**	476.081
Domestic banks	-	133.438	347.539	**480.977**	743.158
Foreign entities	40.163	-	-	**40.163**	99.856
Total 2003	**40.163**	**427.608**	**347.539**	**815.310**	1.319.095
Total 2002	99.856	650.576	568.663	1.319.095	

37 FEE INCOME

Fee income is analyzed as follows:

	2003	*2002*
Fees from providing cash to commercial banks	**41.264**	36.518
Fees from domestic bank payments clearing (RTGS)	**28.510**	26.277
Fees from issued guarantees	**22.464**	38.615
Fees from sales of duty stamps	**14.772**	20.289
Fees from foreign exchange payments	**11.956**	50.760
Fees from Euro exchange for domestic banks	**-**	20.739
Other fees	**8.418**	8.263
Total	**127.384**	201.461

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

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

37 FEE INCOME (Continued)

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

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

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

Fees 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.

38 OTHER INCOME

Other income is analyzed as follows:

	2003	*2002*
Realized foreign exchange gains, net	**83.876**	56.908
Realized gains from available-for-sale securities	**46.809**	-
Collection of interest written off earlier	**-**	41.806
Fees from NBRM Apex operations (Note 28)	**11.699**	11.688
Dividend income from BIS (Note 7)	**6.794**	6.804
Revenues from jubilee coins	**8.865**	1.080
Other income	**17.580**	15.113
Cancelled liabilities	**33.589**	-
Total	**209.212**	133.399

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

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

38. OTHER INCOME (Continued)

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

39 FEE EXPENSE

Fee expense is analyzed as follows:

	2003	*2002*
Fees to foreign banks	**21.199**	19.666
Fees to domestic banks related to exchange operations	**2.516**	9.928
Other fees to domestic banks	**27**	5.805
Total	**23.742**	35.399

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

40 OTHER EXPENSE

Other expense is analyzed as follows:

	2003	*2002*
Services	**80.365**	74.743
Costs for production of banknotes and coins	**61.806**	31.926
Expected litigation outlays (note 28)	**43.153**	-
Materials	**28.140**	27.087
Other administrative expenses	**8.643**	11.257
Other expenses	**4.741**	4.279
Total	**226.848**	149.292

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.

41 PROVISION FOR POTENTIAL LOSSES, NET

Provisions for potential losses are analyzed as follows:

	2003	*2002*
Provisions charged against bank deposits for issued guarantees to a bankrupt bank	**797.019**	241.500
Reversal of provisions	**(86.226)**	(87.143)
Total	**710.793**	154.357

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

41 PROVISION FOR POTENTIAL LOSSES, NET (Continued)

The NBRM has issued guarantees during 2001 and 2002 by pledging foreign currency deposits as security for the borrowings of a local commercial bank that was put in bankruptcy procedure during March 2004. During January 2004, the NBRM paid the amount of MKD 1.018.258 thousand in respect of these guarantees and recorded a receivable from the bankrupt bank. This receivable has been disputed by the bankruptcy trustee and therefore the NBRM has made provision for the whole amount as of 31 December 2003 in respect of these guarantees. The NBRM is going to pursue the confirmation of its claim through a court procedure and is determined to collect the receivable from the sale of the assets of the bankrupt bank.

42 TAXATION

	2003	*2002*
Deferred asset:		
At 1 January	**58.313**	61.287
Movement for the year relating to income statement:		
Reversal of previous temporary differences	**-**	(2.974)
Write down of deferred tax asset	**(58.313)**	-
At 31 December	**-**	58.313

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

	2003	*2002*
Profit before taxation per income statement	**32.842**	47.988
Income tax at the statutory rate of 0% (2002: 15%)	**-**	7.198
Tax effects arising from:		
origination and reversal of timing differences	**-**	1.641
expenses that are not deductible for tax purposes	**-**	1.275
income that is not taxable for income tax purposes	**-**	-
Tax relief for fixed assets additions	**-**	(1.785)
Tax at effective income tax rate 0% (2002: 17.4%)	**-**	8.329
Effective tax rate	**0%**	17,4%
Current income tax expense	**-**	5.355
Deferred tax expense	**58.313**	2.974
	58.313	8.329

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

43 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 2003**:

	Up to 1 month	*1 to 3 months*	*3 months to 1 year*	*1 to 5 years*	*over 5 years*	*Total*
ASSETS						
Foreign assets	43.640.085	345.650	-	498.986	39.177	44.523.898
Receivable from the government	610.698	75.317	311.040	1.228.053	1.243.760	3.468.868
Receivable from banks	9.154	-	8.856	20.575	24.322	62.907
Other assets	1.154.777	41.108	45.459	-	1.085.598	2.326.942
Total assets	45.414.714	462.075	365.355	1.747.614	2.392.857	50.382.615
LIABILITIES						
Reserve money	25.401.441	-	-	-	-	25.401.441
Foreign liabilities	-	200.865	774.086	2.299.472	78.119	3.352.542
Restricted deposits	641.878	-	-	-	-	641.878
Deposits of the government	12.181.005	-	-	-	-	12.181.005
Other deposits	1.313.593	-	-	-	-	1.313.593
Other liabilities	1.687.327	-	-	-	39.106	1.726.433
SDR allocation liability	610.698	-	-	-	-	610.698
Capital and reserves	-	-	-	-	5.155.025	5.155.025
Total liabilities and capital	41.835.942	200.865	774.086	2.299.472	5.272.250	50.382.615
GAP ANALYSIS						
Gap per individual band	3.578.772	261.210	(408.731)	(551.858)	(2.879.393)	
Cumulative gap	3.578.772	3.839.982	3.431.251	2.879.393		

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

43 FINANCIAL INSTRUMENTS (Continued)

a) Liquidity risk (Continued)

The maturity profile of the assets and liabilities at 31 December 2002 was as follows:

	Up to 1 month	*1 to 3 months*	*3 months to 1 year*	*1 to 5 years*	*over 5 years*	*Total*
ASSETS						
Foreign assets	35.606.996	9.625.296	-	-	39.953	45.272.245
Receivable from the government	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	21.172.392	-	-	-	-	21.172.392
Foreign liabilities	-	511.536	728.870	2.507.812	200.515	3.948.733
Restricted deposits	553.383	-	-	-	-	553.383
Deposits of the government	17.312.147	-	-	-	-	17.312.147
Other deposits	1.035.931	-	-	-	-	1.035.931
Other liabilities	2.408.061	-	-	-	-	2.408.061
SDR allocation liability	667.490	-	-	-	-	667.490
Capital and reserves	-	-	-	-	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)	(1.099.674)	(5.760.773)	
Cumulative gap	(2.002.890)	7.193.191	6.860.447	5.760.773	-	

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

43 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, the exposure of the NBRM to interest rate risk is low and is in accordance with the principles of security and liquidity when managing foreign reserves.

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

	Interest-bearing items					*Non-interest*	
	Up to 1 month or at variable rate	*1 to 3 months*	*3 months to 1 year*	*1 to 5 years*	*over 5 years*	*bearing items*	*Total*
ASSETS							
Foreign assets	41.518.499	345.650	-	498.986	-	2.160.763	44.523.898
Receivable from the government	-	75.317	311.040	1.228.053	1.243.760	610.698	3.468.868
Receivable from banks	2.443	-	8.856	20.575	24.322	6.711	62.907
Other assets	-	-	-	-	-	2.326.942	2.326.942
Total assets	41.520.942	420.967	319.896	1.747.614	1.268.082	5.105.114	50.382.615
LIABILITIES							
Reserve money	9.603.156	-	-	-	-	15.798.285	25.401.441
Foreign liabilities	1.636.255	-	410.016	1.256.052	50.219	-	3.352.542
Restricted deposits	-	-	-	-	-	641.878	641.878
Deposits of the government	2.321.814	-	-	-	-	9.859.191	12.181.005
Other deposits	-	-	-	-		1.313.593	1.313.593
Other liabilities	-	-	-	-	-	1.726.433	1.726.433
SDR allocation liability	610.698	-	-	-	-	-	610.698
Capital and reserves	-	-	-	-	-	5.155.025	5.155.025
Total liabilities and capital	14.171.923	-	410.016	1.256.052	50.219	34.494.405	50.382.615
GAP ANALYSIS							
Gap per individual band	27.349.019	420.967	(90.120)	491.562	1.217.863	(29.389.291)	
Cumulative gap	27.349.019	27.769.986	27.679.866	28.171.428	29.389.291		

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

43 FINANCIAL INSTRUMENTS (Continued)

b) Interest rate risk (Continued)

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

	Interest-bearing items					*Non-interest*	
	Up to 1 month or at variable rate	*1 to 3 months*	*3 months to 1 year*	*1 to 5 years*	*over 5 years*	*bearing items*	*Total*
ASSETS							
Foreign assets	35.058.852	9.625.296	-	-	-	588.097	45.272.245
Receivable from the government	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	-	-	-	-	18.169.790	21.172.392
Foreign liabilities	1.710.611	72.448	289.782	1.721.118	154.774	-	3.948.733
Restricted deposits	-	-	-	-	-	553.383	553.383
Deposits of the government	10.720.429	-	-	-	-	6.591.718	17.312.147
Other deposits	-	-	-	-	-	1.035.931	1.035.931
Other liabilities	660.901	-	-	-	-	1.747.160	2.408.061
SDR allocation liability	667.490	-	-	-	-	-	667.490
Capital and reserves	-	-	-	-	-	8.266.970	8.266.970
Total liabilities and 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	21.006.164	9.552.848	(282.990)	(1.681.667)	480.353	(29.074.708)	
Cumulative gap	21.006.164	30.559.012	30.276.022	28.594.355	29.074.708		

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

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

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

	EUR	USD	SDR	other	MKD	Total
ASSETS						
Foreign assets	29.238.452	14.228.032	52.947	2.369.052	(1.364.585)	44.523.898
Receivable from the government	-	-	610.698	75.317	2.782.853	3.468.868
Receivable from banks	-	-	-	-	62.907	62.907
Other assets	94.280	3.006	1.031	4.923	2.223.702	2.326.942
Total assets	29.332.732	14.231.038	664.676	2.449.292	3.704.877	50.382.615
LIABILITIES						
Reserve money	2.769.856	-	-	-	22.631.585	25.401.441
Foreign liabilities	-	-	3.352.542	-	-	3.352.542
Restricted deposits	22.985	609.589	-	9.304	-	641.878
Deposits of the government	7.301.585	1.049.456	-	1.031	3.828.933	12.181.005
Other deposits	-	-	-	-	1.313.593	1.313.593
Other liabilities	914.903	5.099	9.281	7.862	789.288	1.726.433
SDR allocation liability	-	-	610.698	-	-	610.698
Capital and reserves	-	-	-	-	5.155.025	5.155.025
Total liabilities and capital	11.009.329	1.664.144	3.972.521	18.197	33.718.424	50.382.615
GAP ANALYSIS						
Gap per currency	18.323.403	12.566.894	(3.307.845)	2.431.095	(30.013.547)	

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

43 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 2002:

	EUR	USD	SDR	other	MKD	Total
ASSETS						
Foreign assets	27.010.470	12.136.781	358.302	6.420.484	(653.792)	45.272.245
Receivable from the government	-	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	-	-	-	-	21.172.392	21.172.392
Foreign liabilities	-	-	3.948.733	-	-	3.948.733
Restricted deposits	44.395	445.039	-	63.949	-	553.383
Deposits of the government	7.409.123	303.333	-	-	9.599.691	17.312.147
Other deposits	-	-	-	-	1.035.931	1.035.931
Other liabilities	1.577.201	112.786	-	14.021	704.053	2.408.061
SDR allocation liability	-	-	667.490	-	-	667.490
Capital and reserves	-	-	-	-	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	(3.343.469)	6.345.127	(36.085.471)	

NOTES TO THE FINANCIAL STATEMENTS all amounts in MKD'000

43 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:

	Deposits	*Securities*	***Total 2003***	*2002*
BIS Basle	15.525.999	261.055	**15.787.054**	30.714.487
Federal Reserve Bank of New York	11.285.915	351.513	**11.637.428**	8.708.892

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.

	31 December 2003			*31 December 2002*		
	Carrying value	***Fair value***	***Difference***	*Carrying value*	*Fair value*	*Difference*
Financial assets						
Non-interest earning government bond (Note 10)	**629.732**	**232.084**	**(397.648)**	610.612	238.791	(371.821)
Long-term loans to banks from conversion of selective loans (Note 12)	**53.753**	**37.851**	**(15.902)**	62.802	38.004	(24.798)
Investments held to maturity (note 7)	**498.986**	**502.959**	**3.973**	-	-	-
Net difference between			**(409.577)**			(396.619)

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 9,08% (2002: 8,90%) prevailing during the last two years. All of the above financial assets are carried at amortized cost. It is the NRBM intention to hold the assets until maturity and there is no intention to sell these financial instruments earlier should market conditions change. There is no need to reduce the carrying amount of the bond as all amounts due will be collected according to the contractual terms of the bond.

43 FINANCIAL INSTRUMENTS (Continued)

e) Fair value (Continued)

As explained in note 7, included under available-for-sale investments are BIS shares with a value of MKD 39.177 thousand (2002: MKD 39.953 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.

44 COMMITMENTS AND CONTINGENCIES

a) Capital commitment

NBRM has uncalled capital on its investment in BIS shares amounting to SDR 1.612.500 or MKD 117.530 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 2003, there were MKD 278.841 thousand of such guarantees outstanding. The outstanding guarantees at 31 December 2003 exclude the guarantees in respect of the borrowings of the bankrupt bank, for which full provision has been made as of 31 December 2003 (see notes 3 and 41). Effective 25 March 2003, the NBRM Council "Decision on Criteria and Conditions for Using Part of Foreign Reserves for Providing Guarantees to Banks Authorized for Foreign Operations" has been canceled.

c) Litigation

NBRM is defendant in a number of lawsuits, including one from a domestic bank in the amount of MKD 71 million, where the bank contests that NBRM has not duly performed its payment system function, by not executing the security instrument against a bank in administration. NBRM contests these claims and based on legal advise considers that no other material liabilities will be incurred, except for the amounts already provided for (see note 28).

d) Derivatives

NBRM had no derivatives as of 31 December 2003 (2002: nil).