

Strategic report - Macedonia

5 November 2010

Area (km ²)	25.333
Population (in mio)	2,1
GDP per capita	3.344 € (2009)
President	Gjorge Ivanov
Prime minister	Nikola Gruevski



IMF offered open credit line

Important news

The International Monetary Fund (IMF) has offered Macedonia an unconditional open line of credit in the amount of EUR 400 million at the interest rate of 1.3% p.a. This is a new form of flexible financial instrument with low interest rate that does not include the IMF's requirements for rigorous measures, for instance downsizing personnel, salary cuts and strict supervision by the Monetary Fund. The instrument is intended solely for countries that need fresh capital for capital investments, repayment of obligations to the private sector, etc., but refuse to borrow funds for that purpose on the domestic market by issuing government bonds. These funds will go to counties that according to the IMF's estimate pursue a healthy economic policy. If Macedonia opts for a credit line, the funds would be used for implementing the government policy on capital investments in infrastructure, health care and education, budget and repayment of external debt.

IMF has offered a new form of financial instrument

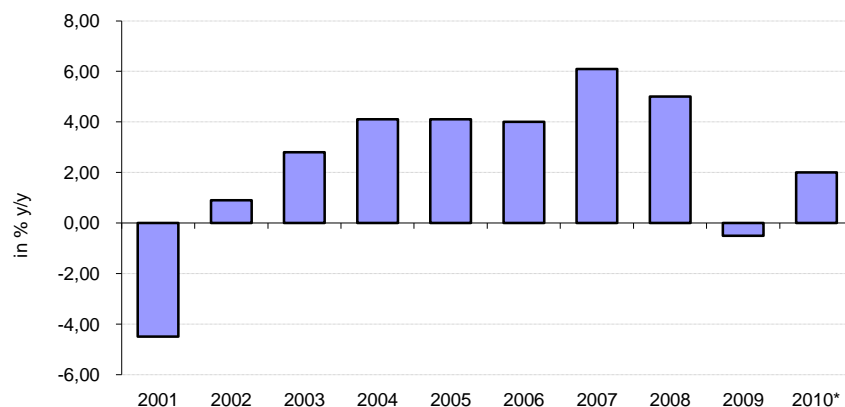
It is ever clearer that Macedonia will become involved in the South Stream gas pipeline, said the Minister of Finance Zoran Stavreski after the meeting with the representatives of the Russian energy giant Gazprom. In his opinion, the latest talks have brought them a step closer to project realisation. He stressed that it was necessary to complete the project's cost efficiency analysis and prepare the documentation necessary for including Macedonia in the gas pipeline project. If an intergovernmental agreement is signed with Russia, it will become clear whether a section of the gas pipeline will be covered by Russia's clearing debt to Macedonia in the amount of USD 60 million.

Macroeconomic indicators

In the last quarter of 2009 the economy again recorded growth of 1.2% (y-o-y), which was followed by a decrease of -1.1% (y-o-y) in the first quarter of this year. The main reason was a decline in domestic consumption and a considerable drop in investments. The uncertain economic environment in the country, accompanied by smaller inflow of foreign direct investments and decreased government spending, is the chief reason for lower investment activity in the first quarter. Negative changes on the labour market, lower growth in disposable income and reduced credit activity were reflected in smaller household consumption contributing to decreased growth in the first quarter. In the second quarter the economic growth slightly picked up owing to higher export demand, reaching 0.4% (y-o-y). Further on we can expect a negative trend in domestic demand as well as decreased personal consumption, however, with less distinct decrease than in the first half of the year. Labour market trends, household expectations and related investment and export activity will represent the main growth factors in the second half of the year, with export playing the lead role in recovery.

Investments and export activity will be the main drivers of economic growth in the second half of the year

Picture 1 Gross domestic product



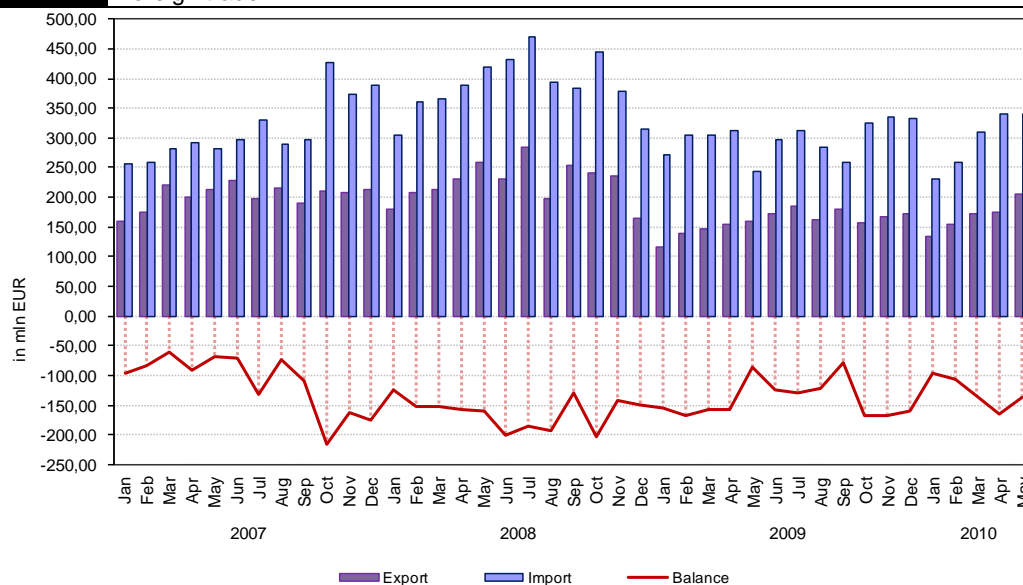
Source: NBRM

The inflow of foreign capital depends on the speed of recovery of European economies and partner countries

According to the Central Bank of Montenegro the investment activity in the first half of 2010 was at the last year's level. Thus, the volume of **foreign direct investments** stood at EUR 116.5 million in the first six months or 0.9% below the respective last year's figure – EUR 117.6 million. The speed of recovery of European economy, the EU partner countries and the euro area countries determines the expectations for the future, mainly for the second half of 2010 and 2011. If recovery is slower than expected and negative trends continue, the consequence will be smaller foreign demand and the resulting reduction in exports and inflow of foreign capital. On the other hand, given the data about export growth in the first six months and under the assumption of this trend continuing also in the second half of the year, this could positively influence the investment decisions of companies. It would thus lead to higher inflow of foreign direct investments, resulting in increased gross investments.

Preliminary data show that the **foreign trade** balance was EUR -858.6 million in the first seven months of the year. In this period, the country imported goods worth EUR 2,143 million and exported EUR 1,285 million worth of goods. At the annual level export rose by 19.2% and import by 4.3%; import/export ratio was 59.9%. The bulk was exported to the EU Member States (61.8%), followed by the Western Balkans (31.1%), while import was the highest from the EU Member States (52.8%) and developing countries (28.3%). Major international trade partners of Macedonia in this period were Germany, Greece, Italy, Serbia and Russia. The main export products were metal and steel products and clothes, while the predominant imported products were crude oil, motor vehicles and electricity.

Picture 2 Foreign trade



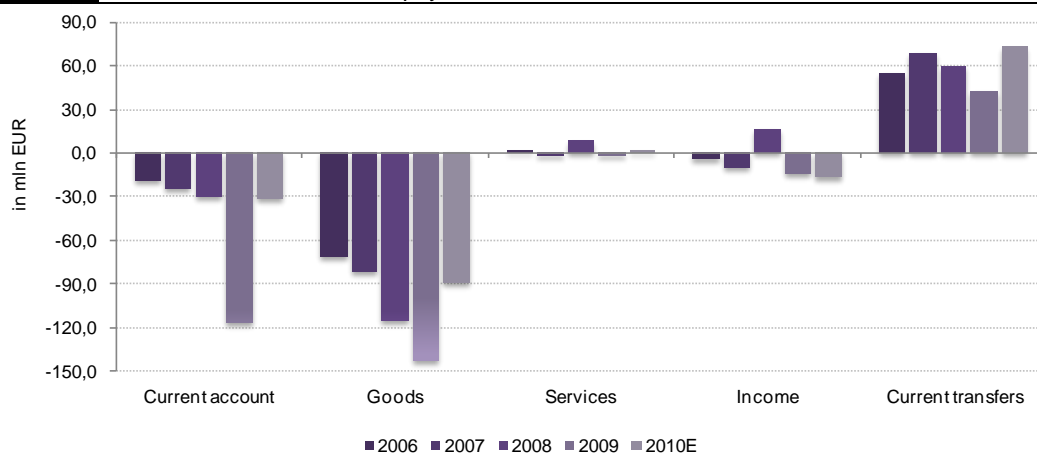
Source: State Statistical Office of RM

The improvement of the current account

In the first six months **the current account of the balance of payments** recorded a deficit of EUR 118.9 million, which is more than 70% better compared to the respective period last year, when the deficit was EUR 445.7 million. The current account balance improved chiefly

because of inflows of private transfers, which were compared to last year EUR 219.5 million or 60% higher, and lower deficit in goods balance (down by EUR 97.4 million).

Picture 3 Current account balance of payments

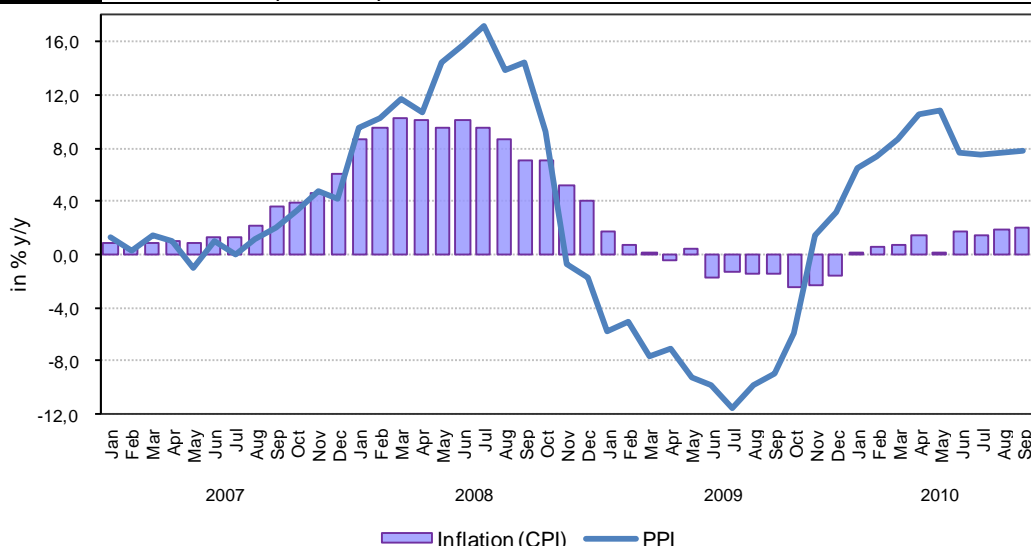


Source: NBRM

In the first eight months of this year budget revenues were EUR 1,409 million, having increased by 3.7% at the annual level, while expenditure totalled EUR 1,496 million, having risen by 2.3%. **Budget deficit** amounted to EUR -87.7 million or 1.2% of GDP. The largest portion of revenues came from taxes and contributions, i.e. EUR 1,185 million, followed by non-tax income (EUR 187.3 million). On the other hand, the largest share in expenditure was accounted for by transfers, i.e. EUR 916.9 million, of which EUR 685.7 million of social transfers. This year, the deficit is planned at about EUR 170 million or 2.5% of GDP. **Total public debt** at the end of July stood at EUR 2,328 million (33.7% of GDP), of which internal public debt was EUR 880.9 million and external public debt EUR 1,447.9 million. Since the end of last year total public debt grew by almost 10%.

Deflation was recorded in the second half of the year, whereas this year **consumer prices increased** again, which is reflected both in monthly and annual data. In the first eight months the annual inflation rate averaged 1%. Moderate price increase in this period is the consequence of growth of controlled prices at the start of the year and global energy price movements. Until the end of this year, consumer prices are expected to continue growing at a moderate pace, chiefly on account of increase in food prices and potential indirect effects of the increase in energy prices. Inflation projected for 2010 is 1.5%. On the other hand, growth was recorded also in **producer prices**. While they were declining throughout last year – with the exception of November and December – they started rising again this year. The highest growth was seen in April and May, i.e. 10.5% and 10.9% respectively. The main reason for this growth was the increase in energy prices and manufactured products' prices. In the past three months, producer prices rose on average at a rate of 7.6%, predominantly due to the increase in energy prices, which in August increased by 16.8%, and manufactured products, which grew by 3.8%.

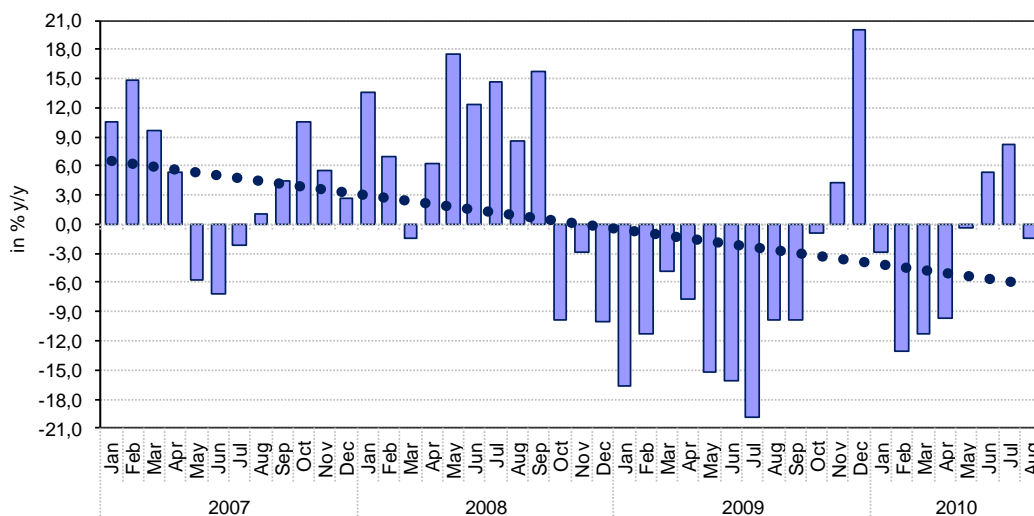
Picture 4 Consumer and producer price index



Source: State Statistical Office of RM

June witnessed the first increase in **industrial production** this year, namely by 5.4% (y-o-y). Growth continued in July, reaching 8.3%, whereas in August manufacturing again shrank by -1.5%. The June and July growth was influenced mainly by the rise in production volume, supply of electricity, gas and water. The rise was 49.7% and 35.1% in June and July respectively. Industrial production index was in the first eight months 3% lower than in the same period in 2009.

Picture 5 Industrial production



Source: State Statistical Office of RM

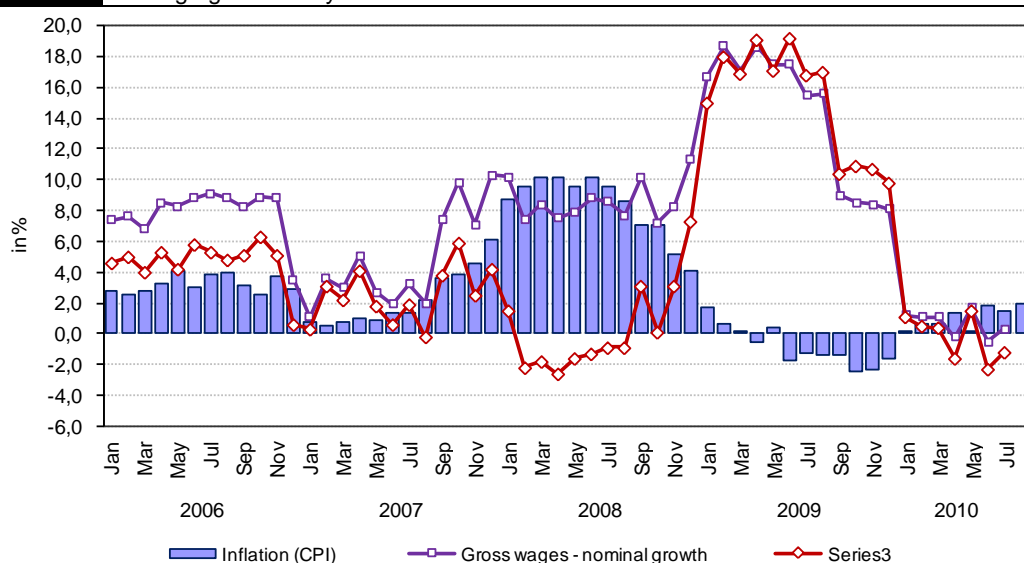
The unemployment rate and average gross salary remain at the last year level

While the **unemployment rate** last year slightly dropped compared to previous years, it rose again in the first quarter of this year to 33.5% (309,651 unemployed persons), thus reaching the 2008 level. The number of employed persons was in the first quarter 0.4% lower than the year before, whereas the number of unemployed was 2.9% higher. According to official data this is the first decrease in the number of employed persons since the last quarter of 2005 and the first increase in the number of unemployed persons since the first quarter of 2007.

This year, specifically in the first seven months, **average gross salary** per employee was MKD 30,023 (EUR 490), matching the 2009 level (KMD 29,922), however, this year nominal salary growth was much lower than last year. January recorded the highest nominal rise in salaries, i.e. 1.2%, whereas in July salaries grew by merely 0.3%. Weak monthly growth in June was mostly due to the salary increase in fisheries (23.3% y/y) and production (4.4% y/y). In July, the highest salary in the corporate sector was recorded in air transport with MKD

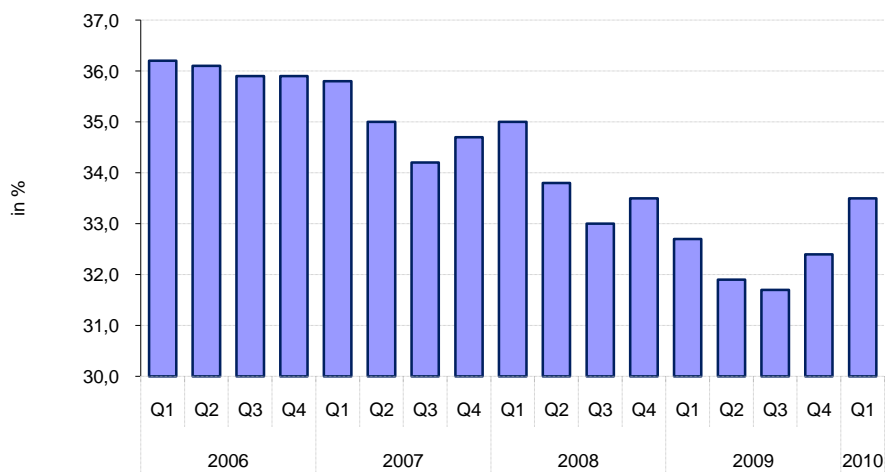
73,892 (EUR 1,200), which is nearly 2.5-times the average gross salary in the entire economy (MKD 29,827).

Picture 6 Average gross salary



Source: State Statistical Office of RM

Picture 7 Unemployment rate



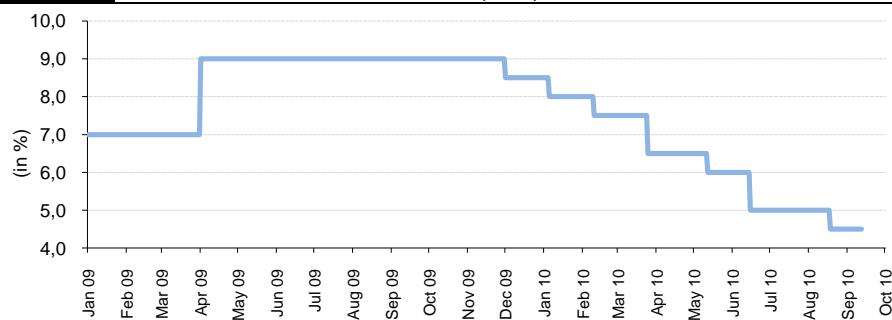
Source:

Banking system and Central bank regulations

The continuity of favorable trends in the foreign exchange market affects the benchmark interest rate

On 15 June the **NBRM** reduced the reference interest rate to 5.0%. According to the NBRM, the repeated reduction was influenced by continuing favourable trends on the foreign exchange market, making the environment still rather favourable for pursuing the monetary policy. If the financial and monetary system further stabilised, it would be possible to introduce measures for decreasing mandatory foreign-exchange reserves. In the second half of August, specifically on 18 August 2010, **the reference interest rate** on central bank bills decreased by 0.5 percentage point from 5% to 4.5%. The main purpose of repeated reduction is to diversify the banking sector and thus bring about an improvement in the Macedonian economy. With the aim of making the monetary policy less stringent, the reduction in reference interest rate continues this year.

Picture 8 Reference interest rate of NBRM (in %)



Source: NBRM

The risk in the banking sectors is still present

By reducing the reference interest rate, the manoeuvring area for reducing commercial interest rates of commercial banks increased. Consequently, interest rates on loans have decreased, the terms and conditions for refinancing of the existing loans have become more favourable and the interest rates on deposits have decreased. The reduction in the reference interest rate was thus followed by the reduction in interest rates on corporate and retail loans and deposits.

Macedonia, which between 10 and 12 May organised a series of meetings with the investors from Europe regarding the issue of new Eurobond scheduled for the second half of the year, announced that it was temporarily withdrawing from the issue. Bond issue will depend mainly on the situation on the international financial market and the need for financing budget deficit.

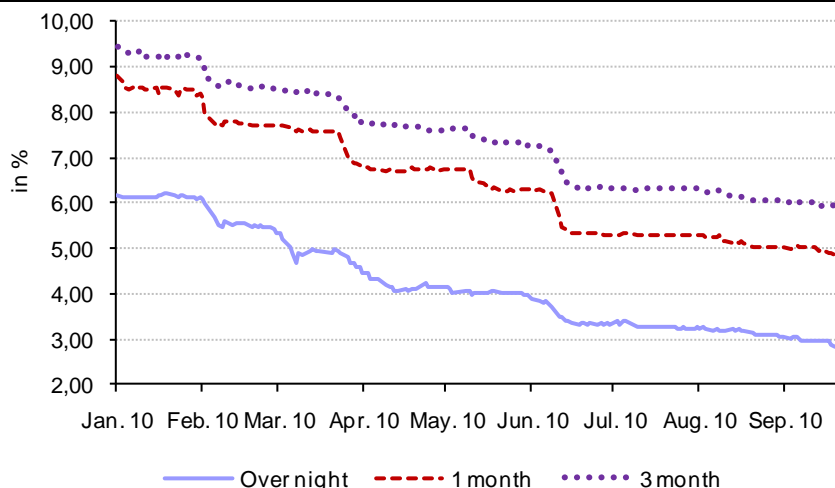
Money and Capital Market

Expansionary credit policy is expected in the rest of the year

The stability of the macroeconomic environment, increasing of deposits and higher expectations in the banking and private sector are the main factors enabling the increase in loans in the first eight months of this year. Together with good economic prospects, monetary measures had a positive influence on intensified credit activity of banks reflected in increased loans to corporate clients and households, and lower interest rates. Thus, in the first eight months of 2010, banks granted more than EUR 6 billion of loans to the corporate sector. In the first quarter loans increased by 1.4% (1.8% in the fourth quarter of 2009) whereas at the annual level, the increase was prominent especially since April. In August, loan growth rate was 7.1% or 1.1 percentage points more than in July (6%) and 1.3 percentage points more than in June (5.8%). New loans comprised an equal share of loans in Macedonian denars, which grew by 5.1% at the annual level, and loans in foreign currency, which rose by 14.1%. According to the analysis by sector, household and corporate loans in August grew by 3.7% and 9.4% respectively at the annual level. Given the current trends in sources of funding of the credit activity and other, alternative forms of financial assets, analysts project that the credit activity of banks will continue growing at an expected 8% annual rate.

Along with the decrease in the reference interest rate of the NBRM, the interbank reference interest rates also declined. Thus, the interbank reference interest rate on overnight deposits – **MKDONIA** has been decreasing since the start of this year. After reaching the daily peak of 6.20% at the end of January this year, it experienced a downward trend and in June reached the lowest point ever at 3.23%, while the March and December 2009 figures were 4.45% and 6.05% respectively. At the end of September, it was even lower, having fallen to 2.40%. Parallel to the decrease in reference interest rate of the NBRM in the second half of the year was the decrease in interbank reference interest rate **SKIBOR**, where a greater decrease was seen in longer maturities. From the start of the year until the end of September, Skibor for 1-month maturity decreased by 395 b.p. to 4.86% and for 3-month maturity by 360 b.p. to 5.84%, whereas Skibor for the shortest O/N maturity fell by 338 b.p. to 2.81%.

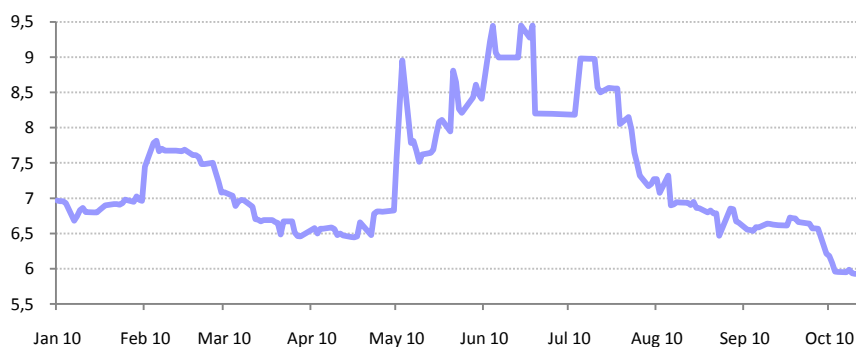
Picture 9 Movement of the bank interbank interest rate - Skibor



Source: NBRM

This year, the Ministry of Finance organised in total 14 auctions of government securities in the first ten months, through which the Government borrowed more than MKD 20 billion. As regards the issue of the new Eurobond, the Government decided to wait for more favourable circumstances because of the existing situation on financial markets. The movement in the bond coincides with the movement in bonds of other countries as well as the movement in the Macedonian reference interest rate. Since the end of April until the second half of June, the return on bond rose from 6.4% to 9.3%, which can be attributed to the debt crisis in Europe, when the return on all government bonds of lower quality shot up owing to the distrust crisis. Over the next few months the situation stabilised and the return on the said Macedonian bond lowered back to normal.

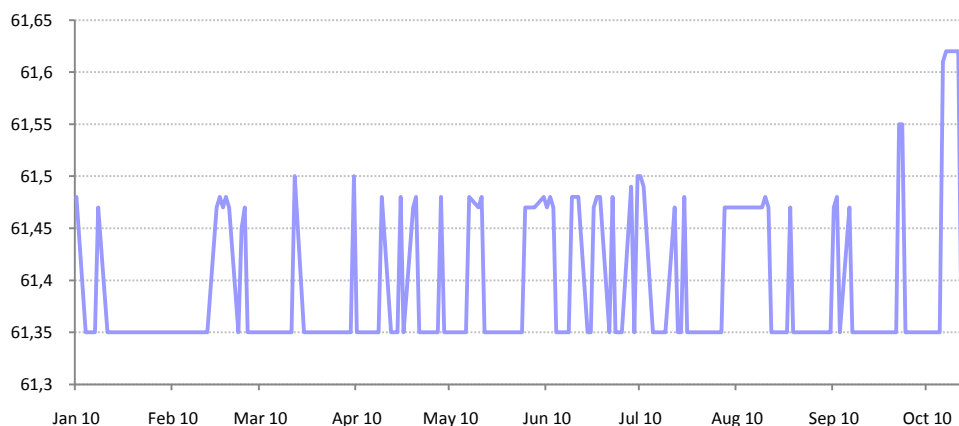
Picture 10 Yield of Macedonian government Eurobond in 2010



Source: Thomson Reuters

The EUR/MKD exchange rate in the third quarter ranged between 61.35 and 61.50, whereas in the second half of September and the first half of October it exceeded 61.50, possibly as a result of settling some carry-trade instruments, as the interest rate gap between the euro and the Macedonian denar has been narrowing. The other reason could be the fact that in the third quarter the outflow of foreign exchange is usually grater than the inflow.

Picture 11 EUR/MKD movement in 2010



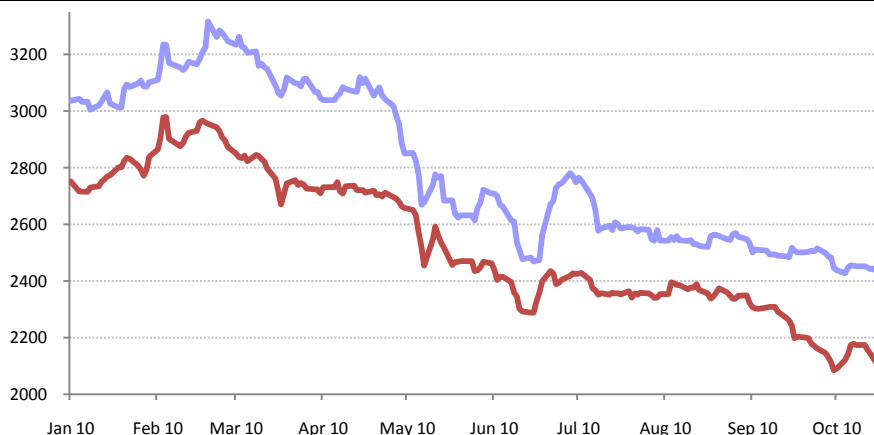
Source: Thomson Reuters

During the crisis, the interest for investment in securities decreased

At present, there is a lull on the Macedonian Stock Exchange, predominantly because of the crisis particularly felt this year by domestic companies. Various experts and bankers believe that the stock exchanges will need longer to recover as initially anticipated. High returns are in the past, the investors will have to be content with smaller returns and identify new opportunities and possibilities, in the long run mainly in stable companies which have been underestimated during the crisis. One of the potential opportunities is the reduction of interest rates on savings deposits. At the time of the crisis, relatively high interest on savings attracted citizens to deposit funds with banks, as a result of which securities investments attracted less interest. The decrease in interest rates will bring about also a decrease in interest on savings deposits, so that money will flow to other places. The analysts think there are two scenarios possible as regards the Macedonian Stock Exchange: the takeover of the stock exchange by some large foreign stock exchange or integration among stock exchanges in the region. Ivan Steriev, Executive Director of the Macedonian Stock Exchange, is of the opinion that stock exchanges in the region share the same fate and face similar problems.

There were indications of slight increase in stock exchange indexes at the start of the year, however, in mid February the stock exchange indexes started dropping again. The downward trend continued throughout the second and third quarter with a slight increase in both indexes in the second half of June. At the end of September the MBID index fell below 2,500 points, whereas the MBI10 went even lower. In the first half of October the MBID was 2,446.97 points and the MBI10 2,156.66 points. This year the bulk of trading was again in blue-chip domestic stocks, including that of Komercijalna Bank AD Skopje, Alkaloid AD Skopje, Granit AD Skopje, Makpetrol.

Picture 12 The movement of stock indices on Macedonian Stock Exchange



Source: Thomson Reuters

Credit rating and macroeconomic indicators of Macedonia

Table 1 Credit ratings

	S & P	Moody's	Fitch	Main disadvantage
Macedonia	BB	-	BB+	The mounting pressure on the domestic currency and the still high current account deficit of balance of payments..
	Stable (21.9.2009)	-	Negative (21.5.2009)	

Table 2 Data and forecast of macroeconomic indicators

Macedonia		Government			BMI			IMF		
Indicators	2009	2010E	2011F	2012F	2010E	2011F	2012F	2010E	2011F	2012F
GDP – real growth (in %)	-0,5	1,5	3,5	5,0	1,2	3,8	4,0	2,0	5,0	5,0
GDP per capita (in €)	3.287	3.412	3.595	3.862	3.012	3.270	3.679	/	/	/
Inflation - dec/dec (in %)	-1,6	/	/	/	2,5	4,0	4,5	2,0	3,0	3,0
Inflation - average (in %)	-0,8	2,0	2,0	2,5	0,5	3,2	4,2	0,8	3,0	3,0
FDI (in % GDP)	2,7	3,7	4,7	6,4	/	/	/	5,3	5,3	5,3
Primanjkljaj TRPB (in % GDP)	-7,2	-6,2	-7,5	-9,5	-5,0	-4,6	-4,0	-8,2	-7,3	-6,2
Budget balance (in mio €)	-178	-171	-181	-157	/	/	/	/	/	/
Budget balance (in % GDP)	-2,6	-2,4	-2,4	-2,0	-2,7	-2,7	-2,3	-2,5	-2,0	-1,5
Unemployment – ILO	32,2	30,8	29,4	27,8	40,0	35,0	32,0	/	/	/
Public debt - in % GDP	32,1	31,3	33,5	34,3	/	/	/	/	/	/

Table 3 Main macroeconomic indicators

Macedonia	Real GDP	Industrial production	Inflation	Cene pri proizvodnjah	Gross wages - nominal growth	Unemployment	Current account	Foreign trade	
<i>12- month average index (in %, I-XII / I-XII)</i>							<i>S^a in mln EUR</i>		
2001	-4,50		5,50	2,02	-0,40	30,90	-273,60	-591,17	
2002	0,90	-5,30	1,80	-0,90	6,40	31,90	-340,90	-766,33	
2003	2,80	4,70	1,20	-0,30	4,90	36,70	-169,78	-673,70	
2004	4,10	-2,20	-0,40	0,90	4,10	37,20	-361,82	-926,39	
2005	4,10	7,00	0,50	3,20	2,70	37,30	-122,45	-1.002,53	
2006	3,90	2,50	3,20	4,50	8,00	36,00	-23,37	-1.072,00	
2007	5,90	3,70	2,30	1,60	4,80	34,90	-421,16	-1.296,20	
2008	4,80	5,50	8,30	10,30	8,70	33,80	-853,32	-2.054,20	
2009	-0,70	-7,70	-0,80	-6,50	14,10	32,20	-483,25	-1.642,60	
<i>Annual index (v % y/y)</i>							<i>S^a in mln EUR</i>		
2009	Jan	-16,70	1,70	-5,80	16,70		-116,56	-154,15	
	Feb		-11,30	0,70	-5,10	18,70		-95,27	-166,68
	Mar	-0,60	-4,80	0,20	-7,60	17,10	32,70	-133,74	-157,13
	Apr		-7,70	-0,50	-7,10	18,60		-68,20	-156,01
	May		-15,30	0,40	-9,30	17,50		-11,02	-85,89
	Jun	-1,20	-16,20	-1,70	-9,90	17,50	31,90	-20,91	-124,67
	Jul		-19,80	-1,30	-11,50	15,50		24,83	-129,22
	Avg		-9,90	-1,40	-9,80	15,60		20,92	-121,79
	Sep	-1,40	-9,80	-1,40	-9,00	9,00	31,70	56,70	-79,22
	Oct		-1,00	-2,40	-5,90	8,50		-41,12	-166,31
	Nov		4,30	-2,30	1,40	8,40		-70,18	-167,58
	Dec	1,20	20,00	-1,60	3,20	8,10	32,40	-28,70	-160,08
2010	Jan		-2,90	0,10	6,50	1,20		-41,86	-95,95
	Feb		-13,10	0,60	7,40	1,10		-18,69	-105,40
	Mar	-1,10	-11,20	0,70	8,70	1,10	33,5*	-13,53	-135,54
	Apr		-9,60	1,40	10,50	-0,20		-38,93	-165,48
	May		-0,40	0,20	10,90	1,70		-4,70	-135,86
	Jun	0,40	5,40	1,80	7,60	-0,50		-1,27	-137,04
	Jul		8,30	1,50	7,50	0,30			-122,07
	Avg		-1,50	1,90	7,70				-149,08
	Sep			2,00	7,80				

Source: NBRM, State Statistical Office of RM

Disclaimer

This publication was prepared by NLB d.d., which is regulated by Securities Market Agency i.e. Agencija za trg vrednostnih papirjev, Poljanski nasip 6, 1000 Ljubljana, Slovenia, and The Bank of Slovenia i.e. Banka Slovenije, Slovenska 35, 1505 Ljubljana, Slovenia. The publication was prepared with a sole purpose to improve the knowledge on financial instruments and the capital market in Slovenia and it provides general information only. Neither the information nor any opinion expressed in this publication constitutes an offer, or an invitation to make an offer, to buy or sell any financial instrument or other investment or type of investment, related to financial instruments mentioned in the publication. This publication is not intended to provide personal investment advice as defined by Article 8 of Market in Financial Instruments Act (Official gazette of the RS No. 67/07, 100/07 and 69/08 – am.; further referred as: ZTFI) and it does not take into account the specific investment objectives, financial situation and the particular needs of any specific person who may receive this publication.

While the information contained in this publication was obtained from sources, which the authors believe to be reliable, no representations are made as to the accuracy or completeness of the information contained in this publication. The Information contained in this publication does not represent insider information as defined by Article 373 of ZTFI. The factual data in this publication are clearly separated from any opinions, projections, forecasts or estimates that constitute the current judgement of the author. All such opinions, projections, forecasts or estimates are subject to change without notice. In addition, such opinions, estimates and projections of the financial analyst do not necessarily reflect the opinions of NLB d.d. NLB d.d. has no obligation to update, modify or amend this publication or to otherwise notify a reader thereof in the event that any matter stated herein, or any opinion, projection, forecast or estimate set forth herein, changes or subsequently becomes inaccurate. This publication has been prepared and presented in accordance with conscientious and fair rules of conduct. NLB d.d. and the author of this publication assume no liability for any decision, or the consequences of any decision made on the basis of or in connection with the opinions or information contained in this publication.

Systematic and non-systematic risks are present at trading with securities. Non-systematic risks are those related to specifics of each financial instrument, and do not have influence to the whole financial market and are independent of moves on the financial instruments market. The effect of non-systematic risk can be eliminated by diversification. Systematic risk is the risk, related to the factors which influence the whole financial market and which consequently influence the whole value of the investor's portfolio. We recommend that any corporate body or natural person interested in investing into financial instruments should consult well-qualified professional financial experts and thus obtain additional information.

NLB d.d., any legal person related to NLB d.d., any natural person working for NLB d.d., or any other relevant person involved in the production of this publication, may own any of the financial instruments mentioned in this publication or any other financial instruments related to the financial instruments mentioned in this publication or financial instruments related to the issuers mentioned in this publication. NLB d.d. may have performed services regarding financial instruments and/or other investment banking services on the behalf of the subject issuers in the past. NLB d.d. may also seek to do business with the subject issuers in the future, meaning that NLB d.d. may also perform services regarding financial instruments and/or other investment banking services on the behalf of the subject issuers in the future.

For additional disclosures pertaining to recommendations or estimates (made in accordance to investment research, as defined by Article 378 of ZTFI) made on financial instruments, mentioned in this publication, and/or their issuers, please see the most recently published company reports, which are available on our web page (www.nlb.si). For rating definition and other general disclosures regarding investment research, please see the document Rating Definitions, General Disclosures and Disclaimer, which is available on our web page (www.nlb.si). For additional information regarding rules and procedures that NLB d.d. has established in order to effectively identify and manage conflicts of interest arising from investment research, including information barriers (otherwise known as Chinese Walls), please see the document Conflict of Interest Management Policy in Provision of Investment Services and Transactions in NLB d.d., which is available on our web page (www.nlb.si).

All prices are those current at the end of the trading session on the stated date unless otherwise indicated. Data on the prices of financial instruments and financial indexes, mentioned in this publication, are sourced from the web pages of Ljubljana Stock Exchange, Bloomberg and other vendors.

This publication has been prepared for the use of clients of NLB d.d. in Slovenia and may not be reproduced, distributed or published by any person for any reason without prior written consent of NLB d.d.

Author:

Rok Gabrovsek
(+386 1) 476 50 83
Rok.Gabrovsek@nlb.si



NLB d.d.
Področje finančnih trgov in zakladništva NLB Skupine
Oddelek za analize
Čopova 3
SI-1000 Ljubljana
T: +386 1 476 52 07
F: +386 1 476 50 65