THE REPUBLIC OF MACEDONIA

€150,000,000 4.625 per cent. Notes due 2015

ISSUE PRICE: 99.467 PER CENT.

The issue price of the 4.625 per cent. Notes due 2015 (the "Notes") of the Republic of Macedonia (the "Republic" or "Macedonia") is 99.467 per cent. of their principal amount.

Unless previously redeemed or cancelled, the Notes will be redeemed at their principal amount on 8 December, 2015.

The Notes will bear interest from, and including, 8 December, 2005 at the rate of 4.625 per cent. per annum payable annually in arrear on 8 December in each year commencing on 8 December, 2006. Payments on the Notes will be made in Euro without deduction for, or on account of, taxes imposed or levied by Macedonia to the extent described under "Terms and Conditions of the Notes – Taxation".

Application has been made to the Financial Services Authority in its capacity as competent authority under the Financial Services and Markets Act 2000 (the "**UK Listing Authority**" and the "**FSMA**" respectively) for the Notes to be admitted to the official list of the UK Listing Authority (the "**Official List**") and to the London Stock Exchange plc (the "**London Stock Exchange**") for the Notes to be admitted to trading on the London Stock Exchange's Gilt Edged and Fixed Interest Regulated Market.

The Notes have not been, and will not be, registered under the United States Securities Act of 1933, as amended (the "**Securities Act**"). The Notes are being offered outside the United States by the Manager (as defined herein) in accordance with Regulation S under the Securities Act ("**Regulation S**"), and may not be offered or sold within the United States or to U.S. persons, except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act.

An investment in the Notes involves a high degree of risk. See "Risk Factors" beginning on page 5.

The Notes will be in registered form and in denominations of €50,000 and integral multiples of €1,000 in excess thereof. The Notes will be represented by beneficial interests in a global note (the "**Global Note**") in registered form, without interest coupons, which will be registered in the name of Citivic Nominees Limited, as nominee for, and shall be deposited on or around 8 December, 2005 (the "**Closing Date**") with Citibank N.A., London as common depositary for, and in respect of interests held through, Euroclear Bank S.A./N.V., as operator of the Euroclear System ("**Euroclear**") and Clearstream Banking, *société anonyme* ("**Clearstream, Luxembourg**"). Beneficial interests in the Global Note will be shown on, and transfers thereof will be effected only through, records maintained by Euroclear and Clearstream, Luxembourg and their participants. Except as described herein, certificates will not be issued for beneficial interests in the Global Note.

Citigroup

This Prospectus is dated 7 December, 2005

The Republic has confirmed to the Manager named under "Subscription and Sale" below that this Prospectus contains all information regarding the Republic and the Notes which is (in the context of the issue of the Notes) material; such information is true and accurate in all material respects and is not misleading in any material respect; the Republic has confirmed that any opinions, predictions or intentions expressed in this Prospectus on the part of the Republic are honestly held or made and are not misleading in any material respect; the Republic has confirmed that this Prospectus does not omit to state any material fact necessary to make such respective information, opinions, predictions or intentions (in such context) not misleading in any material respect; and the Republic has confirmed that all reasonable and proper enquiries have been made by the Republic to ascertain and to verify the foregoing. The Republic accepts responsibility for the information contained in this Prospectus. To the best knowledge of the Republic (having taken all reasonable care to ensure that such is the case) the information contained in this Prospectus is in accordance with the facts and does not omit anything likely to affect the import of such information.

The Republic has not authorised the making or provision of any representation or information regarding the Republic or the Notes other than as contained in this Prospectus. Any other representation or information should not be relied upon as having been authorised by the Republic or the Manager. Each person contemplating making an investment in the Notes must make its own investigation and analysis of the creditworthiness of the Republic and its own determination of the suitability of any such investment, with particular reference to its own investment objectives and experience, and any other factors which may be relevant to it in connection with such investment.

Neither the delivery of this Prospectus nor the offering, sale or delivery of any Note shall in any circumstances create any implication that there has been no adverse change, or event reasonably likely to involve any adverse change, in the condition (financial or otherwise) of the Republic since the date of this Prospectus.

This Prospectus does not constitute an offer of, or an invitation to subscribe for or purchase, any Notes.

The distribution of this Prospectus and the offering, sale and delivery of the Notes in certain jurisdictions may be restricted by law. Persons into whose possession this Prospectus comes are required by the Republic and the Manager to inform themselves about and to observe any such restrictions. For a description of certain restrictions on offers, sales and deliveries of the Notes and on the distribution of this Prospectus and other offering material relating to the Notes, see ''Subscription and Sale''.

In particular, the Notes have not been and will not be registered under the Securities Act. Subject to certain exceptions, the Notes may not be offered or sold in the United States or to U.S. persons.

Prospective purchasers of the Notes should consult their tax advisers as to the consequences under the tax laws of the country of which they are resident for tax purposes and the tax laws of Macedonia of acquiring, holding and disposing of the Notes and receiving payments of principal, interest and/or other amounts under the Notes.

In this Prospectus, unless otherwise specified, references to "**Euro**", "**EUR**" or "**€**" are to the single currency introduced at the start of the third stage of European Economic and Monetary Union pursuant to the Treaty establishing the European Community, as amended, references to "**$**", "**USD**" and "**US dollars**" are to United States Dollars and references to "**denars**" and "**MKD**" are to Macedonian Denars.

The National Bank of the Republic of Macedonia's (the "**NBRM**") foreign exchange rate for US dollars on 24 November 2005 was 51.9862 MKD = USD 1.00 and the National Bank of Macedonia's foreign exchange rate for Euro on 24 November 2005 was 61.2189 = EUR 1.00.

In this Prospectus, unless otherwise stated, all annual information, including budgetary information relating to the Republic, is based upon calendar years. The GDP and expenditure numbers relating to the Republic in this Prospectus are based on constant prices unless otherwise stated. Comparison of statistical information calculated in accordance with different methodologies may not be possible. Information for year 2004 and the first half of 2005 is preliminary. In addition, references to the EU and EU members at a particular point in time or date are references to the EU comprising those countries that were members of the EU at that particular point in time or on such date.

Certain figures included in this Prospectus have been subject to rounding adjustments. Accordingly, figures shown for the same category presented in different tables may vary slightly and figures shown as totals in certain tables may not be an arithmetic aggregation of the figures which precede them.

In connection with the issue of the Notes, Citigroup Global Markets Limited or any person acting for it (the "Stabilising Manager") may over-allot Notes (provided that the aggregate principal amount of Notes allotted does not exceed 105% of the initial offer size) or effect transactions with a view to supporting the market price of the Notes at a higher level than that which might otherwise prevail. However, there is no assurance that the Stabilising Manager (or persons acting on behalf of the Stabilising Manager) will undertake such stabilisation action. Any stabilisation action may begin on or after the date on which adequate public disclosure of the terms of the offer of the Notes is made and, if begun, may be ended at any time, but it must end no later than the earlier of 30 days after the issue date of the Notes and 60 days after the date of the allotment of the Notes.

Such stabilising shall be in full compliance with applicable laws, regulations and rules.

Some of the statements contained in this Prospectus constitute forward-looking statements. Statements that are not historical facts, including statements about the Republic's beliefs and expectations, are forward-looking statements. These statements are based on current plans, objectives, assumptions, estimates and projections. Therefore, undue reliance should not be placed on them. Forward-looking statements speak only as of the date that they are made and the Republic undertakes no obligation to update publicly any of them in light of new information or future events. Forward-looking statements involve inherent risks and uncertainties. The Republic cautions that a number of important factors could cause actual results to differ materially from those contained in any forward-looking statement. Forward-looking statements include, but are not limited to: (i) plans with respect to implementation of economic policy, including privatisations, and the pace of economic and legal reforms; (ii) expectations about EU and NATO accession; (iii) expectations about the behaviour of the economy if certain economic policies are implemented; (iv) the outlook for inflation, exchange rates, interest rates, foreign investment, trade and fiscal accounts; and (v) estimates of external debt repayment and debt service.

CONTENTS

RISK FACTORS

The following are certain risk factors relating to the Republic and an investment in the Notes about which prospective holders of Notes should be aware. These risk factors are not intended to be exhaustive and prospective holders of Notes should carefully read this Prospectus in its entirety and should consider carefully the information set forth below before making an investment in the Notes.

General

Investors in emerging markets such as Macedonia should be aware that these markets are subject to greater risks than more developed markets, including in some cases significant legal, economic and political risks. In addition, as Macedonia has a relatively small and open economy, adverse political or economic developments in other countries in the Balkan region, the rest of Central and Eastern Europe and other emerging markets or in the European Union (the "EU") could have a significant negative impact on, among other things, Macedonia's GDP, foreign trade and economy in general. Investors should exercise particular care in evaluating the risks involved and must decide for themselves whether, in light of those risks, an investment is appropriate. Generally investment in emerging markets is more suitable for sophisticated investors who fully appreciate the significance of the risks involved. Investors should also note that a feature of emerging markets is that they are subject to rapid change and the information contained in this document may become outdated relatively quickly.

Political Risks

EU Accession

One of the key strategic priorities of the government of Macedonia is accession to the EU. Since signing the Stabilisation and Association Agreement with the EU in 2001, Macedonia has pursued policies and enacted legislative reforms aimed at strengthening its government institutions and satisfying the criteria for accession. In March 2004 Macedonia formally submitted its application for membership in the EU. On 9 November 2005, Macedonia received an *avis* (opinion) on its membership application from the European Commission. The *avis* is generally positive and as a result, the government anticipates that the European Council will grant Macedonia candidate status by December this year.

Should Macedonia be awarded candidate status, a wide range of further electoral, judicial, administrative and economic reforms to align Macedonia's laws and government practices with those of the EU will be required before formal accession negotiations can begin. The *avis* received by Macedonia on its application for EU membership highlights the importance of Macedonia continuing to implement structural reforms necessary for the creation in Macedonia of a robust market economy capable of withstanding the competitive pressures of a single market. The *avis* also highlights the need for Macedonia to make further efforts in the fields of electoral procedure, police reform, judiciary reform and the fight against corruption. Currently a broad political and social consensus exists in Macedonia that accession to the EU is in the national interest. However, no assurance can be given that all the reforms required by the EU as a condition for accession will be successfully enacted and implemented by Macedonia.

The recent "no" votes in the French and Dutch referenda on the EU's proposed constitutional treaty and public concerns expressed by politicians in some EU member states regarding the prospects for and implications of Turkish accession highlight an increased political sensitivity in some EU member states regarding the current policy of EU enlargement. Although Macedonia believes that there exists a continuing impetus for enlargement with the recent start of accession negotiations between the EU and Turkey and Croatia as well as the recent start of negotiations on a Stabilisation and Association Agreement between the EU and Serbia and Montenegro, there can be no assurance that political developments within the EU will not delay the commencement or conclusion of accession negotiations with Macedonia.

Ohrid Framework Agreement

Since 2001 there has existed in Macedonia a political and social consensus supportive of the implementation of the Ohrid Framework Agreement which ended the conflict between ethnic Albanians and Macedonians in that year. The government has secured parliamentary approval for all of the constitutional and legislative reforms mandated by the Framework Agreement, which reforms were largely aimed at ensuring protection of the rights of ethnic minorities in Macedonia. Notwithstanding these successes, certain tensions remain in Macedonia between ethnic Macedonian and ethnic Albanian communities.

Regional relationships

Macedonia has made substantial efforts in recent years to strengthen and stabilize its relations with neighbouring countries. These efforts have focused on improving the conditions for economic relations by reducing or eliminating tariff and non-tariff barriers, as well as on the development of cultural and political ties. Nevertheless, some issues remain which could contribute to instability in the region or adversely impact certain bilateral relationships. In particular, the resolution of the international status of Kosovo is currently under consideration by the UN, Serbia and the political authorities in Kosovo. It is possible that the resolution of the international status of Kosovo could give rise to tensions which could impact Macedonia and the region.

Discussions continue with Greece regarding the constitutional name of Macedonia, although trade with Greece has been strong in recent years and relations are generally considered to have stabilized.

Economic Risks

The Macedonian economy, though in the midst of a largely successful transition from a centrally planned to a market-based model, continues to suffer from persistent high levels of unemployment, high real interest rates, lack of foreign direct investment and moderate levels of real GDP growth. Macedonia's economy is largely dependent on external trade, leaving it vulnerable to economic trends in the EU and its other major trading partners as well as contributing to large trade and current account deficits. Although Macedonia currently maintains low budget deficits, low inflation and a stable currency, the future success of its economy will largely depend on the successful implementation of a broad range of structural economic reforms, particularly in the labour market. There can be no assurance that the current political consensus as to the importance of these reforms will be maintained, or that the reforms will be implemented successfully. Due to the openness of the Macedonian economy, external shocks (including energy prices) may have a substantial impact on future economic growth.

Trading Market

While application has been made to list the Notes on the London Stock Exchange there can be no assurance that an active trading market in the Notes will rapidly develop or, if one does develop, that it will be maintained. If an active trading market in the Notes does not develop or is not maintained, the market price and liquidity of the Notes may be adversely affected. It is expected that that market for the Notes will be influenced by economic and political conditions in Macedonia and, to varying degrees, in the Balkan region, in the EU and in other emerging markets generally.

Statistics

Statistical data appearing in this Prospectus has been extracted or compiled from the records, statistics and other official public sources of information in Macedonia, and have not been independently checked or verified by the Manager. In recent years there have been significant steps taken in Macedonia to improve the accuracy and reliability of official statistics and to conform statistical methodology to international standards. However, it is inevitable in the case of a transition economy like Macedonia's in which there is substantial amount of unofficial or unreported "grey market" economic activity that statistical data may not accurately reflect current or historic levels of, and trends in, economic activity. Accordingly, statistical data set forth in this Prospectus may in the future be subject to revision.

TERMS AND CONDITIONS OF THE NOTES

The Conditions set forth below are the terms and conditions of the Notes, subject to amendments, that will be endorsed on each Note

The €150,000,000 4.625% Notes due 8 December, 2015 (the "Notes", which expression includes any further Notes issued pursuant to Condition 13 and forming a single series therewith) of the Republic of Macedonia (the "Republic", "Macedonia" or the "Issuer") were authorised by the Republic, acting through the President of the government of the Republic of Macedonia. A fiscal and paying agency agreement to be dated 8 December, 2005 (the "Fiscal and Paying Agency Agreement") has been entered into in relation to the Notes between Macedonia and Citibank N.A., London in its capacity as registrar (the "Registrar"), as transfer agent (the "Transfer Agent"), as fiscal agent (the "Fiscal Agent") and principal paying agent (the "Principal Paying Agent").

In these Conditions, "Registrar", "Transfer Agent", "Fiscal Agent" and "Principal Paying Agent" shall include any successors appointed from time to time in accordance with the provisions of the Fiscal and Paying Agency Agreement, and any reference to an "Agent" or "Agents" shall mean any or all (as applicable) of such persons.

Certain provisions of these conditions are summaries of the Fiscal and Paying Agency Agreement. The Fiscal and Paying Agency Agreement includes the form of the Notes. Copies of the Fiscal and Paying Agency Agreement are available for inspection during usual business hours at the principal office of the Fiscal Agent (presently at Citigroup Centre, Canada Square, Canary Wharf, London E14 5LB, England) and at the specified offices of each of the other Agents. The holders of Notes are bound by and are deemed to have full notice of the provisions of the Fiscal and Paying Agency Agreement.

References to "Conditions" are, unless the context otherwise requires, to the numbered paragraphs of these terms and conditions.

1. Form and Denomination

The Notes are in registered form in denominations of €50,000 and integral multiples of €1,000 in excess thereof. The Notes will be represented by beneficial interests in a global note (the "Global Note") in registered form without interest coupons.

The Global Note will be exchangeable for notes in definitive, fully registered, form ("Definitive Notes") without coupons, in the circumstances specified in the Global Note.

2. Status

The Notes constitute direct, general, unconditional, (subject as provided in Condition 4) unsecured and unsubordinated obligations of Macedonia and the full faith and credit of Macedonia is pledged for the due and punctual payment of principal of, and interest on, the Notes and for the performance of all obligations of Macedonia with respect to the Notes. The Notes shall at all times rank *pari passu* among themselves and at least *pari passu* in right of payment with all other present and future unsecured and unsubordinated indebtedness of Macedonia.

3. Register, Title and Transfer

(a) Register

The Registrar will maintain a register (the "Register") in respect of the Notes in accordance with the provisions of the Fiscal and Paying Agency Agreement. In these Conditions, the "Holder" of a Note means the person in whose name such Note is for the time being registered in the Register (or, in the case of a joint holding, the first named thereof) and "Noteholder" shall be construed accordingly. A certificate (each a "Note Certificate") will be issued to each Noteholder in respect of its registered holding or holdings of Notes only in certain limited circumstances. Each such Note Certificate will be numbered serially with an identifying number which will be recorded in the Register.

(b) Title

Title to the Notes will pass by and upon registration in the Register. Each Noteholder shall (except as otherwise required by law) be treated as the absolute owner of such Notes for all purposes (whether or not it is overdue and regardless of any notice of ownership, trust or any other interest therein, any writing on the Note Certificate relating thereto (other than the endorsed form of transfer) or any notice of any previous loss or theft of such Note Certificate) and no person shall be liable for so treating such Holder.

(c) Transfers

Subject to paragraphs (f) and (g) below, a Note may be transferred in whole or in part in an authorised denomination upon surrender of the relevant Note Certificate, with the endorsed form of transfer duly completed, at the specified office of the Registrar or the Transfer Agent, together with such evidence as the Registrar or, as the case may be, such Transfer Agent may reasonably require to prove the title of the transferor and the authority of the persons who have executed the transfer form (the "Transfer Form"); provided, however, that a Note may not be transferred unless the principal amount of Notes transferred and (where not all of the Notes held by a Holder are being transferred) the principal amount of the balance of Notes not transferred are authorised denominations. Where not all the Notes represented by the surrendered Note Certificate are the subject of the transfer, a new Note Certificate in respect of the balance of the Notes will be issued to the transferor.

(d) Registration and delivery of Note Certificates

Subject to paragraphs (e) and (f) below, within five Business Days (as defined below) of the surrender of a Note Certificate in accordance with paragraph (c) above, the Registrar will register the transfer in question and deliver a new Note Certificate of the same aggregate principal amount as the Notes transferred to each relevant Holder at its specified office or (as the case may be) the specified office of the Transfer Agent or (at the request and risk of any such relevant Holder) by uninsured first class mail (airmail if overseas) to the address specified for the purpose by such relevant Holder. In this paragraph, "Business Day" means a day on which commercial banks are open for business (including dealings in foreign currencies) in the city where the Registrar or (as the case may be) the Transfer Agent has its specified office.

Where some but not all the Notes in respect of which a Note Certificate is issued are to be transferred, a new Note Certificate in respect of the Notes not so transferred will, within five Business Days of the surrender of the original Note Certificate in accordance with paragraph (c) above, be mailed by uninsured first class mail (airmail if overseas) at the request of the Holder of the Notes not so transferred to the address of such Holder appearing on the Register.

(e) No charge

Registration or transfer of a Note will be effected without charge by or on behalf of the Issuer, the Registrar or the Transfer Agent but against payment by the Holder of such indemnity as the Registrar or (as the case may be) such Transfer Agent may require in respect of any tax or other duty or governmental charge of whatsoever nature which may be levied or imposed in connection with such registration or transfer.

(f) Closed periods

Noteholders may not require transfers to be registered during the period beginning on the 15th calendar day before the due date for any payment of principal or interest in respect of such Notes.

(g) Regulations concerning transfers and registration

All transfers of Notes and entries on the Register are subject to the detailed regulations concerning the transfer of Notes scheduled to the Fiscal and Paying Agency Agreement. The regulations may be changed by the Issuer with the prior written approval of the Registrar. A copy of the current regulations will be mailed (free of charge) by the Registrar to any Noteholder who requests in writing a copy of such regulations.

4. Negative Pledge and Other Covenants

(a) Negative Pledge

So long as any Note remains outstanding (as defined in the Fiscal and Paying Agency Agreement) Macedonia shall not create, incur, assume or permit to arise or subsist any Lien (as defined below), (other than a Permitted Lien (as defined below)), upon the whole or any part of its existing or future assets or revenues to secure any Public External Indebtedness (as defined below) of Macedonia or any other Person (as defined below), or any Guarantee (as defined below) in respect thereof unless, at the same time or prior thereto, Macedonia's obligations under the Notes are secured equally and rateably therewith or have the benefit of such other arrangement as may be approved by an Extraordinary Resolution (as defined in the Fiscal and Paying Agency Agreement) of the Noteholders.

(b) Other Covenants

So long as any Note remains outstanding:

(i) either Macedonia or an Agency (as defined below) or any of Macedonia's Monetary Authorities (as defined below) shall continue to exercise full ownership, power and control over the International Monetary Assets (as defined below) as they exist from time to time; and

(ii) Macedonia shall duly obtain and maintain in full force and effect all governmental approvals (including any exchange control and transfer approvals) which may be necessary under the laws of Macedonia for the execution and delivery by it of, and performance of its obligations under, the Notes and the Fiscal and Paying Agency Agreement and duly take all necessary governmental and administrative action in Macedonia in order to perform or comply with all or any of its obligations under the Notes and the Fiscal and Paying Agency Agreement (including, without limitation, to make all payments to be made under the Notes as required by these Conditions and the Fiscal and Paying Agency Agreement).

(c) Certain Definitions

For the purposes of these Conditions:

"Agency" means any political sub-division, regional government, ministry, department, authority or statutory corporation of Macedonia or the government thereof (whether or not such statutory corporation is autonomous) and any corporation or other entity (but not any commercial corporation or other commercial entity except, in each case, to the extent that any International Monetary Assets are owned, controlled, held or administered thereby) which is directly or indirectly controlled (whether by reason of whole or partial ownership, control over voting or other relevant decision making power to direct management, the composition of management or otherwise) by Macedonia or the government thereof or one or more Agencies (including, without limitation, the Ministry of Finance, Council of Ministers or the National Bank (as defined below)).

"External Indebtedness" means all obligations, and Guarantees (as defined below) in respect of obligations, for money borrowed or raised (whether or not evidenced by bonds, debentures, notes or other similar instruments) denominated or payable, or which at the option of the relevant creditor or holder thereof may be payable, in a currency other than the lawful currency of Macedonia.

"Guarantee" means any guarantee of or indemnity in respect of indebtedness or other like obligation.

"International Monetary Assets" means all Macedonia's official holdings of gold and all Macedonia's and Macedonia's Monetary Authorities' holdings of (i) Special Drawing Rights, (ii) Reserve Positions in the Fund and (iii) Foreign Exchange, and the terms "Special Drawing Rights", "Reserve Positions in the Fund" and "Foreign Exchange" have, as to the types of assets included, the meanings given to them in the publication of the International Monetary Fund ("IMF") entitled "International Financial Statistics" or such other meanings as shall be formally adopted by the IMF from time to time.

"Lien" means lien, pledge, hypothecation, mortgage, security interest, charge or any other encumbrance or arrangement having a similar legal and economic effect including, without limitation, anything analogous to any of the foregoing under the laws of any jurisdiction.

"Macedonia's Monetary Authorities" means the National Bank and, to the extent that they perform monetary authorities' functions, currency boards, exchange stabilisation funds and treasuries.

"National Bank" means the National Bank of the Republic of Macedonia.

"Permitted Lien" means:

(i) any Lien upon property to secure Public External Indebtedness incurred for the purpose of financing the acquisition of such property and any renewal and extension of such Lien which is limited to the original property covered thereby and which secures any renewal or extension of the original secured financing, provided that the principal amount of the Public External Indebtedness secured thereby is not increased;

(ii) any Lien existing on property at the time of its acquisition (and not created in contemplation of such acquisition) to secure Public External Indebtedness and any renewal and extension of such Lien which is limited to the original property covered thereby and which secures any renewal or extension of the original secured financing, provided that the principal amount of the Public External Indebtedness secured thereby is not increased ;

(iii) any Lien securing Public External Indebtedness in existence on 5 December, 2005 or any Lien arising out of an exchange of collateral permitted by the terms of such Public External Indebtedness and the renewal or extension of such Lien which is limited to the original property covered thereby and which secures any renewal or extension of the original secured financing, provided that the principal amount of the Public External Indebtedness secured thereby is not increased;

(iv) any Lien securing Public External Indebtedness or any Guarantee of Public External Indebtedness incurred for the purpose of financing all or part of the costs of the acquisition, construction or development of a project (including any renewal or extension thereof provided that the principal amount secured by any such additional encumbrance does not exceed the principal amount outstanding and secured by the original encumbrance), provided that (a) the holders of such Public External Indebtedness or Guarantee expressly agree to limit their recourse to the assets and revenues (including insurance proceeds) of such project as the principal source of repayment of such Public External Indebtedness and (b) the property over which such Lien is granted consists solely of such assets and revenues or revenues or claims which arise from the operation, failure to meet specifications, exploitation, sale or loss of, or failure to complete, or damage to, such properties;

(v) any Lien on any assets securing Public External Indebtedness which arises pursuant to any order or attachment, distraint or similar legal process arising in connection with court proceedings so long as the execution or other enforcement thereof is effectively stayed and the claims secured thereby are being contested in good faith by appropriate proceedings; and

(vi) any Lien arising by operation of law, provided that such Lien is not created or permitted to be created by the Republic to secure any Public External Indebtedness.

"Person" means any individual, company, corporation, firm, partnership, joint venture, association, unincorporated organization, trust or any other juridical entity, including, without limitation, a state or agency of a state (including the Ministry of Finance and Council of Ministers) or other entity (including the National Bank), whether or not having separate legal personality.

"Public External Indebtedness" means External Indebtedness which (i) is in the form of, or represented by, bonds, notes, or other securities or any Guarantees thereof and (ii) is, or is capable of being, quoted, listed or ordinarily purchased and sold on any stock exchange, automated trading system or over the-counter or on any other securities market.

5. Interest

Each Note bears interest on its principal amount from and including 8 December, 2005 the ("Issue Date") at the rate of 4.625% per annum. Interest is payable annually in arrear on 8 December in each year commencing on 8 December, 2005 (each an "Interest Payment Date") until maturity. Interest due on an Interest Payment Date will accrue during the immediately preceding Interest Period (as defined below) and will be paid subject to and in accordance with the provisions of Condition 7.

Each Note will cease to bear interest from the due date for redemption unless, after surrender of such Note, payment of principal is improperly withheld or refused, in which case it will continue to bear interest at the rate specified above (after as well as before judgment) until whichever is the earlier of (a) the day on which all sums due in respect of such Note up to that day are received by or on behalf of the relevant holder of Notes and (b) the day which is seven days after notice has been given to the holders of Notes that the Fiscal Agent has received all sums due in respect of the Notes up to such seventh day (except to the extent that there is any failure in the subsequent payment to the relevant holders under these Conditions).

Where interest is to be calculated in respect of a period which is equal to or shorter than an Interest Period, the day-count fraction applied to calculate the amount of interest payable in respect of each Note shall be the number of days in the relevant period, from and including the date from which interest begins to accrue, but excluding the date on which it falls due, divided by the number of days in the Interest Period in which the relevant period falls (including the first such day but excluding the last) and rounding the resulting figure to the nearest cent (half a cent being rounded upwards). Each period beginning on (and including) the Issue Date or any Interest Payment Date and ending on (but excluding) the next Interest Payment Date is herein called an "Interest Period".

6. Redemption, Purchase and Cancellation

(a) Final Redemption

Unless previously redeemed, or purchased and cancelled, the Notes will be redeemed at their principal amount on 8 December, 2015, subject as provided in Condition 7.

(b) No other Redemption

The Issuer shall not be entitled to redeem the Notes other than as provided in paragraph (a) above.

(c) Purchase and Cancellation

Macedonia and its Agencies may at any time purchase Notes in the open market or otherwise at any price. Any Notes so purchased may be cancelled or held and resold. Any Notes so purchased, while held by or on behalf of Macedonia or any Agency, shall not entitle the holder to vote at any meeting of holders of Notes and shall not be deemed to be outstanding for the purposes of calculating quorums at meetings of holders of Notes. Any Notes so cancelled will not be reissued.

7. Payments

(a) Method of Payment

Payments of principal and interest in respect of the Notes will be made by euro cheque drawn on a bank in London and mailed to the Holder by uninsured first class mail (airmail if overseas), at the address appearing in the Register at the opening of business on the relevant Record Date (as defined below) or, upon application by a Noteholder to the specified office of the Principal Paying Agent not later than the 15th day before the due date for any such payment, by transfer to a euro account maintained by the payee with a bank in London.

(b) Payments Subject to Fiscal Laws

All payments in respect of the Notes are subject in all cases to any applicable fiscal or other laws and regulations of Macedonia, but without prejudice to the provisions of Condition 8.

(c) No Commissions

No commission or expenses shall be charged to the Noteholders in respect of any payments of principal or interest in respect of the Notes.

(d) Payments on business days

Where payment is to be made by transfer to a euro account, payment instructions (for value the due date, or, if the due date is not a business day, for value the next succeeding business day) will be initiated and, where payment is to be made by a euro cheque, the cheque will be mailed on the due date for payment. A Noteholder shall not be entitled to any interest or other payment in respect of any delay in payment resulting from (A) the due date for a payment not being a business day or (B) a cheque mailed in accordance with this Condition 6 arriving after the due date for payment or being lost in the mail.

(e) Partial payments

If a Paying Agent makes a partial payment in respect of any Note, the Registrar shall procure that the amount and date of such payment are noted on the Register.

(f) Record date

Payment in respect of a Note will be made to the person shown as the Holder in the Register at the opening of business in the place of the Registrar's specified office on the 15th day before the due date for such payment (the "Record Date").

"Business Day" in respect of the Notes means a day on which banks are open for business and carrying out transactions in euro in the country in which the Fiscal Agent has its specified office, and is a day on which the Trans-European Automated Real-Time Gross Settlement Express Transfer System ("TARGET") is operating.

(g) Agents

The Issuer has initially appointed the Fiscal Agent, the Principal Paying Agent, the Registrar and the Transfer Agent named above. The Issuer may at any time vary or terminate the appointment of any such Agent and appoint another Agent or additional or other Agents outside the United States, provided that, it will at all times, and while any Note is outstanding, maintain one or more Paying Agents having a specified office in Europe for payments on Notes. As long as the Notes remain outstanding, the Issuer has also agreed that, pursuant to the European Council Directive 2003/48/EC or any other Directive implementing the conclusions of the EU Council of Ministers (the "ECOFIN Council") meeting of 26-27 November 2000 or any law implementing or complying with, or introduced in order to conform to, such Directive, the Issuer will, to the extent possible as a matter of law, ensure that it maintains a Paying Agent in a European Union member state that will not be obliged to withhold or deduct tax pursuant to any European Union Directive on the taxation of savings implementing such conclusions.

Notice of any such termination or appointment and of any change in the specified office of any Agent will be given in accordance with Condition 14.

8. Taxation

All payments of principal and interest in respect of the Notes by Macedonia shall be made free and clear of, and without withholding or deduction for, any taxes, duties, assessments or governmental charges of whatever nature imposed, levied, collected, withheld or assessed by Macedonia or any regional or local subdivision or any authority thereof or therein having power to tax (together "Taxes"), unless such withholding or deduction is required by law. In that event, Macedonia shall pay such additional amounts as will result in the receipt by the holders of Notes of such amounts as would have been received by them had no such withholding or deduction been required, except that no such additional amounts shall be payable in respect of any Note:

(a) to a holder, or to a third party on behalf of a holder, if such holder is liable to such Taxes in respect of such Note by reason of having some connection with Macedonia other than the mere holding of such Note; or

(b) if the Note is surrendered for payment more than 30 days after the Relevant Date (as defined below), except to the extent that the holder would have been entitled to such additional amounts on surrender of such Note for payment on the last day of such period of 30 days.

(c) where any withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to the European Council Directive 2003/48/EC or any other Directive implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000 on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to, such Directive, or

(d) presented for payment by or on behalf of a holder who would have been able to avoid such withholding or deduction by presenting the relevant Note to another Paying Agent in a member state of the European Union.

For the purpose of these Conditions, "Relevant Date" means whichever is the later of (i) the date on which such payment first becomes due and (ii) if the full amount payable has not been received by the Fiscal Agent on or prior to such due date, the date on which (the full amount plus any accrued interest having been so received) notice to that effect has been given to the holders of Notes.

Any reference in these Conditions to payments of principal or interest in respect of the Notes shall be deemed to include any additional amounts which may be payable under this Condition 8.

9. Events of Default

If any of the following events occurs and is continuing:

(a) Non-payment

Macedonia fails to pay any principal on any of the Notes within seven days of the due date for payment or any interest or additional amounts on any of the Notes within 15 days of the due date for payment; or

(b) Breach of other obligations

Macedonia does not perform or comply with any one or more of its other obligations under the Notes, which default is incapable of remedy or, if capable of remedy, is not remedied within 30 days after notice of such default has been given to Macedonia at the specified office of the Fiscal Agent by any holder of Notes; or

(c) Cross-default

(i) the holders of any Public External Indebtedness of Macedonia accelerate such Public External Indebtedness or declare such Public External Indebtedness to be due and payable, or required to be prepaid (other than by a regularly scheduled required payment), prior to the originally stated maturity thereof; or

(ii) Macedonia fails to pay in full any principal of, or interest on, any Public External Indebtedness when due (after expiration of any originally applicable grace period) or any Guarantee of any Public External Indebtedness given by Macedonia shall not be honoured when due and called upon (after the expiration of any originally applicable grace period);

provided that the aggregate amount of the relevant Public External Indebtedness or Guarantee in respect of which one or more of the events mentioned above in this paragraph (c) shall have occurred equals or exceeds €20,000,000 or its equivalent in other currencies; or

(d) Moratorium

Macedonia shall suspend payment of, or admit its inability to pay, its Public External Indebtedness or any part thereof or declare a general moratorium on or in respect of its Public External Indebtedness or any part thereof, or anything analogous to the foregoing shall occur; or

(e) Unlawfulness or Invalidity

The validity of the Notes is contested by Macedonia or Macedonia shall deny any of its obligations under the Notes or it is or becomes unlawful for Macedonia to perform or comply with all or any of its obligations set out in the Notes or any of such obligations shall be or become unenforceable or invalid; or

(f) IMF

Macedonia ceases to be a member of the IMF or shall cease to be eligible to use the general resources of the IMF;

then the Fiscal Agent shall, upon receipt of written requests to Macedonia at the specified office of the Fiscal Agent from holders of not less than 25% in aggregate outstanding principal amount of the Notes, declare the Notes due and payable, in each case at their principal amount together with accrued interest, without further formality. Upon such declaration by the Fiscal Agent, the Fiscal Agent shall give notice thereof in the manner provided in the Fiscal and Paying Agency Agreement to Macedonia and to the holders of the Notes in accordance with Condition 14. After any such declaration by the Fiscal Agent, if all amounts then due with respect to the Notes are paid (other than amounts due solely because of such declaration) and all other defaults with respect to the Notes are cured, such declaration may be annulled and rescinded by holders of not less than 50% in aggregate outstanding principal amount of the Notes (the "Required Percentage") by written notice thereof to Macedonia at the specified office of the Fiscal Agent or by the passing of a resolution by the holders of not less than the Required Percentage.

10. Prescription

Claims in respect of principal and interest will become void unless made within a period of 10 years in the case of principal and five years in the case of interest from the appropriate Relevant Date.

11. Replacement of Notes

If any Note Certificate is lost, stolen, mutilated, defaced or destroyed it may be replaced at the specified office of the Registrar or the Transfer Agent, subject to all applicable laws and stock exchange requirements, upon payment by the claimant of the expenses incurred in connection with such replacement and on such terms as to evidence, security, indemnity and otherwise as Macedonia may reasonably require. Mutilated or defaced Note Certificates must be surrendered before replacements will be issued.

12. Meetings of Noteholders and Modification

(a) Meetings of Noteholders

The Fiscal and Paying Agency Agreement contains provisions for convening meetings of Noteholders to consider matters affecting their interests, including the sanctioning by Extraordinary Resolution of a modification of any of these Conditions (having been approved by the Issuer) or any provisions of the Fiscal and Paying Agency Agreement. Such a meeting may be convened by Noteholders holding not less than 10 per cent. in principal amount of the Notes for the time being outstanding. The quorum for any meeting convened to consider an Extraordinary Resolution will be two or more persons holding or representing a clear majority in principal amount of the Notes for the time being outstanding, or at any adjourned meeting two or more persons being or representing Noteholders whatever the principal amount of the Notes held or represented; provided however, that any proposals relating to a Reserved Matter may only be sanctioned by an Extraordinary Resolution passed at a meeting of Noteholders at which two or more persons holding or representing not less than 75 per cent. in principal amount of the Notes for the time being outstanding, or at any adjourned meeting, 25 per cent. in principal amount of the Notes for the time being outstanding, form a quorum. Any Extraordinary Resolution duly passed shall be binding on Noteholders (whether or not they were present at the meeting at which such resolution was passed).

The holders of a Global Note will be treated as being two persons for the purposes of any quorum requirements of a meeting of Noteholders and, at any such meeting, as having one vote in respect of each €1,000 in principal amount of Notes for which the relevant Global Note may be exchanged.

(b) Extraordinary Resolution: In these Conditions "Extraordinary Resolution" means:

(i) in relation to any Reserved Matter:

(A) a resolution passed at a meeting of Noteholders duly convened and held in accordance with the Fiscal and Paying Agency Agreement by a majority consisting of not less than 75 per cent. of the outstanding principal amount of the Notes for the time being outstanding; or

(B) a resolution in writing signed by or on behalf of holders of not less than 75 per cent. of the outstanding principal amount of the Notes for the time being outstanding.

(ii) in relation to any other matter:

(A) a resolution passed at a meeting of Noteholders duly convened and held in accordance with the Fiscal and Paying Agency Agreement by a majority consisting of not less than 66.67 per cent. of the outstanding principal amount of the Notes for the time being outstanding; or

(B) a resolution in writing signed by or on behalf of holders of not less than 66.67 per cent. of the outstanding principal amount of the Notes for the time being outstanding.

(c) Reserved Matter: In these Conditions "Reserved Matter" means any proposal to:

(i) change any date, or the method of determining the date, fixed for payment of principal or interest in respect of the Notes, to reduce the amount of principal or interest payable on any date in respect of the Notes or to alter the method of calculating the amount of any payment in respect of the Notes on redemption or maturity or the date for any such payment;

(ii) effect the exchange or substitution of the Notes for, or the conversion of the Notes into, shares, bonds or other obligations or securities of the Issuer or any other person or body corporate formed or to be formed;

(iii) reduce or cancel the principal amount of the Notes;

(iv) vary the currency or place of payment in which any payment in respect of the Notes is to be made;

(v) amend the status of Notes under Condition 2 (Status);

(vi) amend the obligation of the Issuer to pay additional amounts under Condition 8 (Taxation);

(vii) amend the Events of Default set out in Condition 9 (Events of Default);

(viii) amend the law governing the Notes, the courts to the jurisdiction to which the Issuer has submitted in the Notes, the Issuer's obligation to maintain an agent for service of process in England or the Issuer's waiver of immunity, in respect of actions or proceedings brought by any Noteholder set out in Condition 16 (Governing Law and Jurisdiction);

(ix) modify the provisions contained in the Fiscal and Paying Agency Agreement concerning the quorum required at any meeting of the Noteholders or any adjournment thereof or concerning the majority required to pass an Extraordinary Resolution or the percentage of votes required for the taking of any action;

(x) change the definition of "Extraordinary Resolution" or "outstanding" in the Conditions and/or Fiscal and Paying Agent Agreement;

(xi) instruct any Noteholder or committee appointed on behalf of all Noteholders pursuant to Condition 12(d) (Meetings of Noteholders; Noteholders' Representative Committee) to withdraw, settle or compromise any proceeding or claim being asserted pursuant to Condition 9 (Events of Default);

(xii) confer upon any committee appointed pursuant to Condition 12(d) (Meetings of Noteholders; Noteholders' Representative Committee) any powers or discretions which the Noteholders could themselves exercise by Extraordinary Resolution; or

(xiii) amend this definition.

(d) Noteholders' Representative Committee

(i) Appointment: The Noteholders may, by a resolution passed at a meeting of Noteholders duly convened and held in accordance with the Fiscal and Paying Agency Agreement by a majority of at least 50 per cent. in aggregate principal amount of the Notes then outstanding, or by notice in writing to the Issuer (with a copy to the Fiscal Agent) signed by or on behalf of the holders of at least 50 per cent. in aggregate principal amount of the Notes then outstanding, appoint any persons as a committee to represent the interests of the Noteholders if any of the following events shall have occurred:

(A) an Event of Default;

(B) any event or circumstance which would, with the giving of notice, lapse of time, the issuing of a certificate and/or fulfillment of any other requirement provided for in Condition 9 (Events of Default) become an Event of Default; or

(C) any public announcement by the Issuer, to the effect that the Issuer is seeking or intends to seek a restructuring of the Notes (whether by amendment, exchange offer or otherwise);

provided, however, that no such appointment shall be effective if the holders of more than 25 per cent. of the aggregate principal amount of the outstanding Notes have either (A) objected to such appointment by notice in writing to the Issuer (with a copy to the Fiscal Agent) during a specified period following notice of the appointment being given (if such notice of appointment is made by notice in writing to the Issuer) where such specified period shall be either 30 days or such other longer or shorter period as the committee may, acting in good faith, determine to be appropriate in the circumstances, or (B) voted against such resolution at a meeting of Noteholders duly convened and held in accordance with the Fiscal and Paying Agency Agreement. Such committee shall if appointed by notice in writing to the Issuer, give notice of its appointment to all Noteholders in accordance with Condition 14 (Notices) as soon as practicable after the notice is delivered to the Issuer.

(ii) Powers: Such committee in its discretion may, among other things, (i) engage legal advisers and financial advisers to assist it in representing the interests of the Noteholders, (ii) adopt such rules as it considers appropriate regarding its proceedings and (iii) enter into discussions with the Issuer and/or other creditors of the Issuer. The Issuer shall pay any reasonably incurred fees and expenses of any such committee (including, without limitation, the fees and expenses of the committee's legal advisers and financial advisers, if any) within 30 days of the delivery to the Issuer of a reasonably detailed invoice and supporting documentation.

(e) Outstanding Notes

For the purposes of (i) ascertaining the right to attend and vote at any meeting of Noteholders and (ii) Condition 9 (Events of Default), Condition 12(f) (Meetings of Noteholders; Modification) and Schedule 3 (Provisions for Meetings of Noteholders) to the Fiscal and Paying Agency Agreement, those Notes (if any) which are for the time being held by or on behalf of Macedonia or any Agency shall (unless and until ceasing to be so held) be deemed not to remain outstanding.

(f) Modification

The Fiscal Agent may agree, without the consent of the Noteholders, to any modification of any of the provisions of the Fiscal and Paying Agency Agreement which is in its opinion of a formal, minor or technical nature or is made to correct a manifest error. Any such modification shall be binding on the Noteholders and, if the Fiscal Agent so requires, such modification shall be notified to the Noteholders as soon as practicable.

13. Further Issues

Macedonia may from time to time, without notice to or the consent of the holders of Notes, create and issue further notes having the same terms and conditions as the Notes in all respects (or in all respects save for the date for and amount of the first payment of interest thereon) so as to form a single series with the Notes.

14. Notices

All notices to Noteholders may be delivered in person or sent by mail or facsimile transmission or telex to them at their respective addresses, facsimile or telex numbers reflected in the Register. Any such notice shall be deemed to have been given, in the case of a letter delivered by hand, at the time of delivery, in the case of a letter sent by mail, at the time of dispatch or, in the case of a telex, on receipt of an answerback confirmation by the sender, except that, so long as the rules of the London Stock Exchange plc so require, notices must be published in a leading daily newspaper of general circulation in London, which is expected to be the *Financial Times*. Such notices will be deemed to have been given on the date of such publication, and if published in such newspaper on different dates, on the date of the first such publication.

15. Currency Indemnity

The euro is the sole currency of account and payment for all sums payable by Macedonia under or in connection with the Notes, including damages. Any amount received or recovered in a currency other than the euro (whether as a result of, or of the enforcement of, a judgment or order of a court of any jurisdiction or otherwise) by any holders of Notes in respect of any sum expressed to be due to it from Macedonia shall only constitute a discharge to Macedonia to the extent of the euro amount which the recipient is able to purchase with the amount so received or recovered in that other currency on the date of that receipt or recovery (or, if it is not practicable to make that purchase on that date, on the first date on which it is practicable to do so). If that euro amount is less than the euro amount expressed to be due to the recipient under any Note, Macedonia shall indemnify such recipient against any loss sustained by it as a result. In any event, Macedonia shall indemnify the recipient against the cost of making any such purchase. These indemnities constitute separate and independent obligations from Macedonia's other obligations, shall give rise to a separate and independent cause of action, shall apply irrespective of any indulgence granted by any holders of Notes and shall continue in full force and effect despite any judgment, order, claim or proof for a liquidated amount in respect of any sum due under any Note or any judgment or order.

16. Governing Law and Jurisdiction

(a) Governing Law

The Fiscal and Paying Agency Agreement and the Notes are governed by and shall be construed in accordance with English law.

(b) Jurisdiction

(i) Subject only to Condition 16(b)(ii), the courts of England are to have exclusive jurisdiction to settle any disputes which may arise out of or in connection with the Notes and accordingly any legal action or proceedings arising out of or in connection with the Notes ("Proceedings") may be brought only in such courts. The Issuer irrevocably submits to the exclusive jurisdiction of such courts and waives any objection to Proceedings in such courts whether on the ground of venue or on the ground that the Proceedings have been brought in an inconvenient forum.

(ii) However, the provisions of Condition 16(b)(i) are made for the benefit of each of the Noteholders and shall not limit the right of any of them to take Proceedings in any other court of competent jurisdiction nor shall the taking of Proceedings in one or more jurisdictions preclude the taking of Proceedings in any other jurisdiction (whether concurrently or not).

(c) Agent for Service of Process

The Issuer has in the Fiscal and Paying Agency Agreement irrevocably appointed the Ambassador of the Republic of Macedonia to the Court of St. James's from time to time of Suite 2.1 and 2.2, Bucking Court, 75-83 Buckingham Gate, London, SW1E 6PE, United Kingdom as its authorised agent in England to receive service of process in any Proceedings in England based on any of the Notes. If for any reason the Issuer does not have such an agent in England, it will promptly appoint a substitute process agent and notify the Noteholders of such appointment. Nothing herein shall affect the right to serve process in any other manner permitted by law.

(d) Consent to Proceedings

Subject to Condition 16(e) below, the Issuer has irrevocably and generally consented in respect of any Proceedings anywhere to the giving of any relief or the issue of any process in connection with those Proceedings including, without limitation, the making, enforcement or execution against any assets whatsoever (irrespective of their use or intended use) of any order or judgment which may be made or given in those Proceedings.

(e) Waiver of State Immunity

To the extent that Macedonia or any of its revenues, assets or properties shall be entitled to any immunity from suit, from the jurisdiction of any such court, from attachment in aid of execution of judgment, from execution of a judgment or from any other legal or judicial process or remedy, and to the extent that in any such jurisdiction there shall be attributed such an immunity, Macedonia irrevocably waives such immunity to the fullest extent permitted by the laws of such jurisdiction. Such waiver of immunities constitutes only a limited and specific waiver by the Issuer for the purposes of the Notes and under no circumstances shall it be construed as a general waiver by the Issuer or a waiver with respect to proceedings unrelated to the Notes. The Issuer does not waive any immunity in respect of (a) present or future "premises of the mission" as defined in the Vienna Convention on Diplomatic Regulations signed in 1961, (ii) "consular premises" as defined in the Vienna Convention on Consular Relations signed in 1963, (iii) any other property or assets used solely for official state purposes in the Republic of Macedonia or elsewhere, (iv) military property or military assets of the Republic of Macedonia related thereto, or (v) the natural resources and objects of historical and artistic heritage as referred to in Article 56 of the Constitution of the Republic of Macedonia.

17. Rights of Third Parties

No person who is not a Noteholder has any right under the Contracts (Rights of Third Parties) Act 1999 to enforce any of the Terms and Conditions of the Notes.

FORM OF NOTES AND TRANSFER RESTRICTIONS

The following information relates to the form, transfer and delivery of the Notes. Capitalised terms used but not defined herein have the meanings provided in the section entitled "Terms and Conditions of the Notes".

1. Form of Notes

All Notes will be in registered form, without interest coupons attached and will be offered and sold outside the United States in reliance on Regulation S. The Notes will be represented by interests in a Global Note, in fully registered form, without interest coupons attached, which will be deposited on or about the Closing Date with Citibank N.A., London, as common depositary for, and registered in the name of, Citivic Nominees Limited as nominee for such common depositary in respect of interests held through Euroclear and Clearstream, Luxembourg. A beneficial interest in the Global Note may at all times be held only through Euroclear and Clearstream, Luxembourg.

For so long and the Notes are represented by the Global Note, Noteholders may not require transfers to be registered during the period beginning on the fifteenth calendar day before the due date for any payment of principal or interest in respect of such Notes.

2. Exchange of Interests in the Global Note for Note Certificates

Registration of title to Notes represented by the Global Note in a name other than the nominee of the common depositary for Euroclear and Clearstream, Luxembourg will not be permitted unless (a) Euroclear or Clearstream, Luxembourg is closed for business for a continuous period of 14 days (other than by reason of holidays statutory or otherwise) or announces an intention permanently to cease business or does in fact so do and no alternative clearing system satisfactory to the Registrar is available or (b) following a failure to pay principal in respect of any Note at maturity or upon acceleration of any Note, and the Registrar has received a request from the registered holder of the Global Note requesting the exchange of the Global Note for individual note certificates (the "Note Certificates").

In such circumstances, the Global Note shall be exchanged in full for Note Certificates and the Republic will, at the cost of the Republic (and against such indemnity as the Registrar or any relevant Transfer Agent may require in respect of any tax or other duty of whatever nature which may be levied or imposed in connection with such exchange), cause sufficient Note Certificates to be executed and delivered to the Registrar for completion, authentication and dispatch to the relevant Noteholders. A person having an interest in the Global Note must provide the Registrar with a written order containing instructions and such other information as the Republic and the Registrar may require to complete, execute and deliver such Note Certificates.

The holder of a Note may transfer such Note in accordance with the provision of Condition 3 of the Terms and Conditions of the Notes (see "*Terms and Conditions of the Notes – Register, Title and Transfers*"). Note Certificates may not be eligible for trading in the Euroclear and Clearstream, Luxembourg systems.

The Registrar will not register the transfer of or exchange of interests in a Global Note for Note Certificates for a period of 15 calendar days ending on the due date for payment of principal or interest.

3. Euroclear and Clearstream, Luxembourg Arrangements

So long as Euroclear or Clearstream, Luxembourg or the nominee of their common depositary is the registered holder of the Global Note, Euroclear, Clearstream, Luxembourg or such nominee, as the case may be, will be considered the sole owner or holder of the Notes represented by such Global Note for all purposes under the Fiscal and Paying Agency Agreement and the Notes. Payments of principal, interest and additional amounts, if any, in respect of the Global Note will be made to Euroclear, Clearstream, Luxembourg or such nominee, as the case may be, as the registered holder thereof.

Distributions of principal and interest with respect to book-entry interests in the Notes held through Euroclear or Clearstream, Luxembourg will be credited, to the extent received by Euroclear or Clearstream, Luxembourg from the Principal Paying Agent, to the cash accounts of Euroclear or Clearstream, Luxembourg customers in accordance with the relevant systems's rules and procedures.

Interest on the Notes (other than interest on redemption) will be paid to the holder shown on the Register on the third business day before the due date for such payment so long as the Notes are represented by the Global Note, and on the fifteenth date before the due date for such payment if the Notes are in the form of Note Certificates (the "Record Date"). Trading in the Global Note will therefore be net of accrued interest from the relevant Record Date to the relevant interest payment date.

The holdings of book-entry interests in the Notes through Euroclear or Clearstream, Luxembourg will be reflected in the book-entry accounts of each such institution. As necessary, the Registrar will adjust the Register to reflect the amounts of Notes held through Euroclear and Clearstream, Luxembourg respectively. Beneficial ownership of Notes will be held though financial institutions as direct and indirect participants in Euroclear and Clearstream, Luxembourg.

Interests in the Global Note will be in uncertificated book-entry form.

4. Secondary Market Trading in Relation to the Global Note

Secondary market sales of book-entry interests in the Notes held through Euroclear or Clearstream, Luxembourg will be conducted in accordance with the normal rules and operating procedures of Euroclear and Clearstream, Luxembourg and will be settled using the procedures applicable to conventional eurobonds.

5. Notices

So long as the Global Note is held on behalf of Euroclear and Clearstream, Luxembourg or any other clearing system (an "Alternative Clearing System"), notices to holders of Notes represented by a beneficial interest in the Global Note may be given by delivery of the relevant notice to Euroclear or Clearstream, Luxembourg or, as the case may be, the Alternative Clearing System; except that, so long as the Notes are listed on the London Stock Exchange plc and the rules of the London Stock Exchange plc so require, notices will also be published in a leading newspaper having general circulation in London (which is expected to be the *Financial Times*) or, if such publication is not practicable, in an English language newspaper having general circulation in London.

USE OF PROCEEDS

The net proceeds of the issue of the Notes, expected to amount to €148,863,000, after deduction of the combined management, underwriting and selling commission, will be used by the Republic to repay external indebtedness, including but not limited to an expected early redemption of outstanding Capitalisation Bonds due 2012, and increase foreign exchange reserves.

REPUBLIC OF MACEDONIA

Area and Population

The Republic of Macedonia (the "Republic" or "Macedonia") lies in south eastern Europe and covers an area of 25,713 square kilometres. Macedonia is bordered by four countries: Serbia and Montenegro to the North, Bulgaria to the East, Greece to the South and Albania to the West. Macedonia is 80% mountainous, rising at its highest point at Mt. Korab, with an elevation of 2,764 metres. Running North to South, the Vardar River crosses through the centre of Macedonia, connecting the country, through Greece, with the ports of the Aegean Sea. Macedonia has a moderate continental climate with four distinct seasons.

The population of Macedonia is approximately 2.02 million of which approximately 500,000 people live in Skopje, the political, administrative and commercial centre of Macedonia. After Skopje, the largest cities are Bitola, Kumanovo, Prilep and Tetovo, with populations ranging between 50,000 to 100,000 people. Ethnic Macedonians comprise an estimated 64.2% of the population, with ethnic Albanians – 25.2%, Turks – 3.9%, Rhomas – 2.7%, Serbs – 1.8%, Bosniaks – 0.8%, Vlachs – 0.5% and other ethnic groups. Ethnic Macedonians are generally Christian Orthodox and ethnic Albanians are generally Muslim. Catholics comprise the next largest religious group. The official language is Macedonian. Additional languages spoken in Macedonia include Albanian, Turkish, Rhomas, Serbian, Vlach and other languages.

History

The name "Macedonia" comes from the territory encompassing the ancient kingdom of Macedon, which included, along with current day Macedonia, some parts of present day Greece, southwestern Bulgaria and Albania. The ancient kingdom of Macedon reached its pinnacle during the reign of Alexander III, also known as "Alexander the Great" (356-323 BC), who increased Macedon's influence through Asia Minor, the Levant, Egypt, Mesopotamia, Persia and some parts of India. Macedon gradually declined after the death of Alexander the Great in 323 BC and was conquered by the Romans in 168 BC and was annexed to the Roman empire in 148 BC.

After the fall of the Western Roman Empire, the territory of Macedonia came under control of the Byzantine Empire in the 6th and 7th centuries. During this time period, large numbers of Slavic people came to and settled in the Balkan region. By the end of the 14th century, the Ottoman Empire gained control over Macedonia and continued to rule Macedonia for more than 500 years. During this period, political and cultural customs were heavily influenced by the Ottoman Turks.

In the late 19th century, as Greece, Bulgaria and Serbia began to compete for control over the territory of Macedonia, a number of nationalist movements emerged and challenged the Ottoman Empire. In the most well known uprising in August 1903, Macedonian revolutionaries liberated the town of Krushevo from the

Ottomans and briefly established the Krushevo Republic. The uprising was quickly put down by Ottoman forces. In 1912, a combined force of Bulgaria, Serbia and Greece defeated the Ottoman Empire in the First Balkan War and forced the Ottomans to leave Macedonia and surrounding regions. Shortly thereafter, Bulgaria, Serbia and Greece fought against each other in the Second Balkan War in an attempt to divide Macedonia. The Treaty of Bucharest officially ended this conflict in 1913 and the territory of Macedonia was partitioned among these countries. Following the First World War, present day Macedonia was incorporated into the newly formed Kingdom of Serbs, Croats and Slovenes (later known as the Kingdom of Yugoslavia) as part of the Province of Vardar.

During World War II, Macedonia was occupied by Bulgaria and Italy. Harsh rule by the occupying forces encouraged many Macedonians to support the resistance movement led by the partisans and Marshall Tito, who became Yugoslavia's president when the war ended. Following World War II, Macedonia became a constituent republic (federal unit) of the Socialist Federal Republic of Yugoslavia and remained a republic with the name Republic of Macedonia until the dissolution of the federation.

Recent History

1989 to 2001

As authoritarian regimes collapsed across central and eastern Europe in the late 1980s and early 1990s, Macedonia, like other republics that constituted Yugoslavia, declared its independence in November 1991. The first government was formed in early 1991 following elections held before independence, which enabled citizens to cast their vote on the structure of the first democratically elected Assembly. Macedonia held a national referendum in September 1991 to establish a sovereign state based on a parliamentary democracy. After the referendum was approved by the Macedonian people, Macedonia adopted a new constitution on 17 November 1991. The first government was led by Prime Minister Nikola Kljusev. Kiro Gligorov became the first President of an independent Macedonia. Under the Macedonian constitution, President Gligorov was only permitted to serve for two terms in office. Former Deputy Foreign Minister Boris Trajkovski succeeded President Gligorov in November 1999. During this period, Macedonia was the only country whose succession from the former Yugoslavia was not marred by ethnic conflict. Although some tensions between ethnic Albanians and Macedonians remained following independence, there was at first no open conflict between these ethnic groups comparable to the ethnic strife experienced by other countries in the region at that time. Conflict occurred in February 2001, as ethnic Albanians, influenced by the Kosovo crises, carried out attacks against Macedonian government forces in the region near the Kosovo border. The hostilities spread to some parts of northern and western Macedonia, and the ruling coalition government in Macedonia responded by forming a grand coalition including major opposition parties in 2001 to prevent an escalation of the crisis.

In an effort to end this conflict, the President of Macedonia and the leaders of major political parties, supported by the EU and the United States, signed the Ohrid Framework Agreement (the "Framework Agreement") in August 2001, which called for the implementation of political, constitutional and administrative reforms to improve rights for minority groups in Macedonia. These reforms were adopted by the Macedonian Assembly in November 2001, and included, among others, the decentralisation of power from the Macedonian government to local municipalities, the creation of new municipal borders within Macedonia, the granting of equal status to the Albanian as well as other languages in areas where the ethnic communities exceed a certain percentage of the population and an expanded role for ethnic minority communities in public institutions.

2002 to date

Following the adoption of the Framework Agreement, parliamentary elections were held in September 2002 with a Social Democratic Union of Macedonia ("SDSM") led coalition winning half of the seats in the Assembly. Branko Crvenkovski was elected Prime Minister in a coalition which included the ethnic Albanian Democratic Union for Integration ("DUI") Party and the Liberal Democratic Party ("LDP"). Following the death of President Trajkovski, Branko Crvenkovski (former Prime Minister) was elected as President of the Republic of Macedonia and the Assembly confirmed Hari Kostov, former Interior Minister, as Prime

Minister. Prime Minister Kostov resigned in November 2004 and former Defence Minister Vlado Buckovski was confirmed by the Assembly in December 2004 as Prime Minister, maintaining the coalition with the DUI and the LDP. The Macedonian government under Prime Minister Buckovski has continued to focus on integrating Macedonia into the international community, having entered into a number of bilateral agreements with countries in the region, including agreements on investment, free trade, double taxation and others, become a member of numerous regional and international organisations, and increased cooperation with the EU and the United States (see "*International Relations*" below).

In November 2004, a referendum was held at the instigation of opposition Macedonian parties to retain the old municipal borders in existence before the Framework Agreement. The majority of the Macedonian population rejected the referendum, supporting the government's call to continue to implement the Framework Agreement. The implementation of the principles of the Framework Agreement and their acceptance by the Macedonian public is considered by the government to be crucial for Macedonia's aspirations to become a member of the EU and to increase stability in the region.

Political System

The President

The President of the Republic is the head of state, elected by majority vote in direct elections, for a term of five years. No person may serve more than two terms as President. The current President is Branko Crvenkovski, who was elected on 28 April 2004. The next presidential elections will be in 2009. The President represents Macedonia at home and abroad, is the commander in chief of the armed forces and is the President of the Security Council of Macedonia. In the event that the Assembly is not able to sit, the President possesses the power to declare a state of war and may also appoint or dismiss the government or individual officials.

The President may negotiate international agreements on behalf of Macedonia, appoint and recall Macedonian ambassadors and envoys and receive letters of credence and letters of recall from foreign diplomatic representatives. The President gives the mandate to form a government to the nominated Assembly candidate, appoints three members of the country's Security Council, proposes candidates for the Council of Inter Ethnic Relations, nominates two judges for the Constitutional Court and two members of the State Judicial Council of the Republic (the "Judicial Council"), and performs other duties defined by the constitution.

Government

The government of Macedonia consists of the Prime Minister as the head of the government and other ministers who are the members of the government (currently 18 ministers, out of which four are ministers without portfolio). The government is elected by an absolute majority vote in the Assembly, known as the *Sobranie*. The Prime Minister and the government's programme are approved by an absolute majority vote of the Assembly. The current Prime Minister, Vlado Buckovski, was confirmed by the Assembly in December 2004. The ministers comprising the government are proposed by the Prime Minister and elected and discharged by the Assembly. The government is responsible for proposing legislation to the Assembly.

The Assembly

The unicameral Assembly is the country's legislative body. The Assembly sits in Skopje and its powers include amending the constitution, passing laws and resolutions and ratifying international agreements. The Assembly is comprised of 120 members, all of whom are elected by a proportional system in 6 constituencies. All members of the Assembly serve four year terms. Assembly elections were held most recently on 15 September 2002. The next election will be in 2006.

The Judicial System

The Macedonian judiciary system consists of a Constitutional Court, a Supreme Court, 27 Courts of First Instance, three Courts of Appeal and the Judicial Council.

Judicial power is independent and is exercised in compliance with the constitution, domestic legislation and ratified international agreements. Judges are proposed by the Judicial Council and are then appointed by the Assembly for unlimited terms.

The Constitutional Court of Macedonia is an independent body responsible for the protection of constitutional and legal rights and for resolving legal disputes between the three branches of government. The Constitutional Court also decides whether the President has violated the constitution. The Assembly appoints the nine judges of the Constitutional Court, of which, two judges are nominated by the Judicial Council, two judges are nominated by the President and five judges are nominated by the Assembly. Judges of the Constitutional Court serve for one nine year term.

The Supreme Court is the highest court in the country and is responsible for equal administration of laws by all courts. Its members are appointed by the Assembly for unlimited terms.

The Judicial Council is comprised of seven members appointed by the Assembly, of which, two members are nominated by the President and five members are nominated by the Assembly. The members are appointed for a period of six years, with the right to one re-election. It governs the ethical conduct of judges, proposes to the Assembly the election or dismissal of judges and evaluates their work. It also nominates two judges to the Constitutional Court.

Local Government

Macedonia is divided into 84 municipalities and the city of Skopje. Municipalities are autonomous, democratically manage local affairs and set the rates of certain limited local taxes. The Macedonian constitution grants all municipalities the same fundamental rights.

In accordance with the Law on Local Government, all municipalities have equal authority and responsibilities. The municipalities can make decisions within the determined competence and adopted laws. Municipalities are governed by representative bodies, whose members are elected for four year terms. Decisions of municipalities may only be overruled if they conflict with the constitution or national legislation. The most recent municipal elections were held in April 2005.

Overview of Current Political Situation

Political Parties

Twenty six political parties participated in the September 2002 elections for the Assembly. The main political parties are the following: the SDSM; Internal Macedonian Revolutionary Organisation – Democratic Party for Macedonian National Unity (“VMRO DPMNE”); DUI; LDP; Democratic Party of Albanians (“DPA”); Liberal Party (“LP”); Party for Democratic Prosperity (“PDP”); Internal Macedonian Revolutionary Organisation – People’s Party (“VMRO NP”); National Democratic Party (“NDP”); and Socialist Party (“SP”).

Presidential Elections

The first president of the Republic of Macedonia, Mr. Kiro Gligorov, was elected in 1992. Mr. Gligorov was elected for another term of five years in the 1994 presidential election, with over 52.6% of the vote. On 14 November 1999, Boris Trajkovski from VMRO DPMNE became the new Macedonian President after receiving 52.4% of the vote in the second round of the presidential elections. On 26 February 2004, President Trajkovski tragically died in a plane crash in Bosnia. Presidential elections were held on 14 April and 28 April 2004 with then Prime Minister Branko Crvenkovski winning the second round of the presidential election with 60.5% of the vote. The main opposition candidate won 36.2% of the vote, and the remainder were spoiled ballots. Mr. Crvenkovski is considered a pro Western politician intent on integrating Macedonia into the international community. He favours the full implementation of the Framework Agreement and is a strong proponent of Macedonia’s accession to the EU.

Assembly Elections

The most recent election of representatives for the Assembly was held on 15 September 2002. The following table sets out the percentage breakdown of the vote in that election and each party's number of seats in the Assembly as of end of October 2005.

Party	Seats	Per-centage
The Social Democratic Union of Macedonia	44	36.7%
Democratic Union for Integration	15	12.5%
Internal Macedonian Revolutionary Organisation – People's Party	12	10.0%
Liberal – Democratic Party	11	9.2%
Internal Macedonian Revolutionary Organisation – Democratic Party for Macedonian National Unity	10	8.3%
Democratic Party of Albanians	7	5.8%
Liberal Party	6	5.0%
Agrarian Peoples Party of Macedonia	3	2.5%
Party for Democratic Prosperity	2	1.7%
Democratic Party of Turks of Macedonia	2	1.7%
National Democratic Party	1	0.8%
Socialist Party	1	0.8%
Democratic Party of the Serbs in Macedonia	1	0.8%
Democratic League of Bosniaks in Macedonia	1	0.8%
The Union of Rhomas of Macedonia	1	0.8%
New Democratic Forces	1	0.8%
Party for Movement of Turks in Macedonia	1	0.8%
Independent MP	1	0.8%
Total	120	100.00%

Source: The Assembly of Macedonia (Sobranie)

International Relations

General

Macedonia has established diplomatic relations with 155 countries and attaches importance to further developing relations with international organisations. Macedonia became a member of the United Nations ("UN") in April 1993 and is currently a member of 138 other international and regional organisations, including the International Monetary Fund ("IMF"), the International Bank for Reconstruction and Development ("IBRD" or "World Bank"), the European Bank for Reconstruction and Development ("EBRD"), Council of Europe Development Bank ("CEB") and the Organisation for Security and Cooperation in Europe ("OSCE"), Council of Europe and Central European Initiative. Macedonia also became a member of the World Trade Organisation ("WTO") in April 2003.

European Union Accession

Accession to the EU is a strategic priority of the Macedonian government. Macedonia established diplomatic relations with the EU in 1995 and signed a Cooperation Agreement with the EU in 1996. Negotiations with the EU commenced in March 2000 with the aim to conclude the Stabilisation and Association Agreement ("SAA"). In April 2001, Macedonia signed the SAA with the EU, thus becoming the first country in the region to sign such an agreement and thereby making its initial step towards attaining membership in the EU. In March 2004, Macedonia formally submitted its Application for Membership to the EU. The SAA came into force in April 2004. In June 2004, the EU launched the European Partnership with the Republic of Macedonia. The European Partnership lists short and medium term priorities for Macedonia's preparations for further integration in the EU, and serves as a checklist against which to measure progress. Macedonia responded to the European Partnership by preparing a plan with a timetable and details of how it intends to address the European Partnership's priorities. These priorities have been selected on the basis of whether it is realistic to expect Macedonia can complete them or take then substantially forward over the next years.

As part of this progression toward EU membership, Macedonia has been working closely with the EU to develop and strengthen its institutions in order to meet accession requirements. The Stabilisation and Association Process ("SAP") agreed with the EU on 1 April 2001, called for implementing the Framework Agreement, implementing all the obligations of the SAA, decentralising public administration, enacting judicial reforms, strengthening laws against organised crime, improving the police force, as well as other reforms. In its SAP Annual Reports, the EU noted that while Macedonia has made progress in implementing these reforms, it still needs to accelerate current reforms and implement additional reforms. In the interim, the Macedonian government has continued to work towards EU accession and maintains a constant dialogue with the EU to ensure it is meeting EU expectations.

Macedonia received a generally positive *avis* (opinion) on its membership application from the European Commission on 9 November 2005. The *avis* acknowledged that Macedonia is a functioning democracy with stable political institutions, and that the successful implementation of the legislative agenda of the Framework Agreement has contributed to major political and security improvements in the country. The *avis* also noted the important steps that have been taken by Macedonia toward the establishment of a functioning market economy, particularly in aligning its legislation with EU rules in the area of the internal market and trade. However, the *avis* also highlighted the importance of Macedonia continuing to implement structural reforms necessary for the creation of a robust market economy capable of withstanding the competitive pressures of a single market. In particular, in order to achieve higher economic growth and competitiveness, the *avis* suggested that the business climate in Macedonia could be improved to make the country more attractive for domestic and foreign investors. The *avis* also stated that Macedonia must make further efforts in the fields of electoral procedure, police reform, judiciary reform and the fight against corruption. The *avis* recommended that once Macedonia reaches a sufficient degree of compliance with the membership criteria, negotiations for accession to the EU should be opened. In light of the *avis*, the government anticipates that the European Council will grant Macedonia EU candidate status by the end of this year.

In its efforts to accelerate the transition process, the EU provides financial support for reforms in the Republic through its Poland and Hungary Assistance for Reconstruction of Economy ("PHARE"), Community Assistance for Reconstruction, Development and Stability ("CARDS") and the Community Programmes (pre-accession instruments financed by the EU to assist applicant countries of central and eastern Europe in their preparations for accession to the EU), with an allocation of approximately EUR40 million on an annual basis. These allocations are in form of grants and have been provided at approximately the same level every year since 1996.

The recent "no" votes in the French and Dutch referenda on the EU Constitutional Treaty may signify a change in sentiment among certain EU member states toward continued enlargement of the EU. A major cause of concern behind the "no" votes was the perception that enlarging the EU may lead to increased competition for jobs and investment and thus have a negative effect on European economic growth.

Nevertheless, in light of the new impulse for further enlargement of the EU on the basis of the recent start of negotiations between the European Council and Turkey and Croatia, the Republic of Macedonia remains optimistic with regard to its accession prospects. The start of accession negotiations with Turkey and Croatia, as well as the recent start of negotiations for signing a Stabilisation and Association Agreement between the EU and Serbia and Montenegro, are decisions that may be considered as a positive signal for the EU perception of the whole region, including the Republic of Macedonia.

NATO Accession

Membership in the North Atlantic Treaty Organisation ("NATO") is another of Macedonia's foreign policy priorities. Since its independence in 1991, Macedonia has worked to broaden its ties with NATO. Macedonia is an active participant in NATO's Partnership for Peace. Under the NATO Membership Action Plan, Macedonia has launched a major effort to reform and reconstruct its armed forces to build and sustain a modern, professional defence force. Macedonia is acting as a *de facto* NATO ally and fully supports the efforts of the international community in the fight against terrorism and in preserving the security and stability in south eastern Europe. Macedonia also contributes troops to peace-keeping operations.

Macedonia, together with Albania and Croatia, formed the Adriatic Group with United States support. The main objective of the group is to cooperate on military and defence issues in order to promote regional stability and enhance the prospects for NATO membership of the member states.

Relationship with the United States

The United States and Macedonia have had very good relations since Macedonia's independence in 1991. During the Kosovo crisis in 1999, Macedonia played a key role in facilitating US and international relief efforts by accepting hundreds of thousands of refugees, serving as a launching pad for humanitarian operations and functioning as a conduit for humanitarian assistance programmes and logistics for Kosovo.

In 2004 the United States recognised Macedonia under its constitutional name.

Macedonia and the United States enjoy a cooperative partnership on a number of issues, including political, economic, cultural, military and social issues. Through the Agency for International Development ("USAID") the United States has invested over USD400 million in Macedonia since 1993. Presently, over 30 projects worth more than USD35 million a year are currently being implemented.

The United States supports Macedonia's efforts to build a democratic society and to implement the Framework Agreement and has contributed and pledged on its own, and through international organisations a significant part of the aid which had been used to offset the financial impact of the flow of refugees from the Kosovo crisis and stabilise ethnic relations in Macedonia. In addition, USAID has developed programmes in Macedonia to promote economic growth, support democratic institutions and help build Macedonia's fledging market economy. The US Treasury Department is also assisting the Macedonian Ministry of Finance with programmes aimed at improving its strategic planning and public expenditure management.

Regional cooperation

Macedonia's regional policy focuses on multilateral and bilateral cooperation with many countries. In general, Macedonia's relations with neighbouring countries such as Bulgaria, Serbia and Montenegro and Albania have improved in recent years as political, cultural and economic ties have grown. With regard to economic cooperation, Macedonia has concluded bilateral free trade agreements with nine countries, and one international organisation and two multilateral free trade agreements. Bilateral free trade agreements have been concluded with Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Romania, Serbia and Montenegro, Moldova, Turkey, Ukraine and the United Nations Mission in Kosovo. On the multilateral level, Macedonia is implementing free trade agreements with the member states of the European Free Trade Association ("EFTA") and a trade agreement under the SAA with the EU. These agreements provide preferential treatment of custom duties on industrial and agricultural products during a transitional period until a free trade area has been established.

Macedonia has entered into a number of other bilateral agreements with countries in the region, including agreements on protection of investment and double taxation.

Macedonia also participates in a number of regional forums such as the South Eastern Europe Cooperation Process, which strive to develop and maintain strong bilateral and regional cooperation in political, economic, infrastructural, cultural and humanitarian spheres.

Macedonia entered into a succession agreement in 2001 with the other five former republics of Yugoslavia. This succession agreement, which was ratified by Macedonia in 2004, provides a framework for resolving all remaining succession issues, including as to the allocation of assets and liabilities of the former Yugoslavia, and will further serve to increase cooperation and understanding among the former republics of Yugoslavia. So far, many of the issues treated under the succession agreement have been successfully resolved among the parties.

Relations with Greece

Macedonia's relations with Greece have improved in recent years despite the ongoing dispute between Macedonia and Greece over the constitutional name of Macedonia used in international organisations. In February 1994, Greece imposed a trade embargo on Macedonia as a result of the dispute regarding the name Macedonia and other issues. Greece and Macedonia signed an Interim Accord under the auspices of the UN in October 1995, paving the way for better relations.

Since then, the two countries have continued political dialogue and extended bilateral relations to promote peace and stability in the region. Macedonia and Greece opened Liaison Offices in Skopje and Athens during 1996, after the signing of the Interim Accord. Macedonia opened a consular office in Thessaloniki in October 2004, and Greece opened a similar office in Bitola in October 2005. Greece is one of the largest foreign investors in Macedonia. Macedonia and Greece have also worked together to resolve lingering ethnic conflicts in the region. Talks between the two countries on resolving differences over the use of the constitutional name of Macedonia are currently ongoing.

Relationship with International Organisations

International Monetary Fund

Since 1994, Macedonia has received assistance from the IMF in the form of stand-by arrangements and other types of financing facilities, including the Systematic Transformation Facility ("STF"), Enhanced Structural Adjustment Facility ("ESAF"), Compensatory and Contingency Financing Facility ("CCFF"), Poverty Reduction and Growth Facility ("PRGF") and Extended Fund Facility ("EFF"). The IMF has historically worked closely with the government of Macedonia to foster macroeconomic stability and encourage structural reform so as to increase the pace of economic growth. In August 2005, the IMF approved a three year stand by arrangement for Macedonia in the aggregate amount of special drawing rights ("SDR") 51.7 million (USD75.8 million equivalent) to support the country's economic programme, and approved an extension to the obligations schedule of the country's repayments to the IMF in a total amount of USD7.9 million. The approval of the arrangement enables Macedonia to draw SDR10.5 million (USD15.4 million equivalent) immediately. The government has stated it does not intend to make any further drawings under the arrangement if expected proceeds from privatisation are realised, and accordingly intends to treat the arrangement as precautionary.

The main objective of the stand-by arrangement is to accelerate the weak economic growth of the Republic of Macedonia and to increase employment. The economic programme underwritten by the IMF is designed to sustain macroeconomic stability, to strengthen domestic and international credibility of the country, to increase the confidence of investors in Macedonia and to improve external competitiveness. The ambitious programme includes a series of structural reforms, such as reforms in the labour market, business environment and public sector, and fiscal reforms (including comprehensive reform of tax administration) as well as health care, financial sector and judicial reforms. The arrangement provides for quantitative and structural performance criteria, which are required to be met and which may affect future disbursements, and for quantitative and structural benchmarks and indicative targets, which indicate Macedonia's general progress. These criteria and benchmarks are typically set on a quarterly or annual basis and are periodically reviewed. The structural performance criteria for 2005 under the stand-by arrangement currently include:

- the Public Revenue Office to design a new organisational chart and to fill identified positions required to implement payroll tax reform;
- the Assembly to enact a 2006 budget that is in line with the programme;
- the government to submit a new Banking Law to the Assembly; and
- the largest public health-care institutions to prepare 2006 budgets, approved by Ministry of Health.

Quantitative performance criteria and indicative targets include the following: floor for net international reserves of the National Bank of Republic of Macedonia ("NBRM"), floor for central government fiscal balance, ceiling on net domestic credit to the central government from the NBRM, ceiling on central government's total domestic arrears, ceiling on new non concessional medium term and long term external debt contracted or guaranteed by the central government or the NBRM with original maturities of more then one year, ceiling on short term external debt of the central government or the NBRM with maturities of up to one year, including guarantees for such debt.

The main macroeconomic targets for 2005 and 2006 under the stand-by arrangement are the following: real GDP growth of 3.8% and 4%, inflation rate of 1.2% and 1.8%, central government deficit of 0.8% and 0.6% of GDP and official gross reserves to cover 3.6 and 4 months of imports, respectively.

World Bank

Since 1993, Macedonia has received assistance from the World Bank in the form of bank financing targeted to specific projects and reforms. The World Bank has historically worked to maintain macroeconomic stability and develop a sound financial sector in Macedonia. Commitments from the World Bank to Macedonia have totalled USD655 million from 1993 through 2005.

With the intention to maintain continuity of the reform process, the government of Macedonia has recently adopted and begun implementing a three year, medium-term programme of comprehensive structural and social reforms. This reform programme will be supported by the World Bank through Programmatic Development Policy Loans ("PDPL").

The PDPL arrangement is an instrument of support for the government's medium term policy and the structural reforms Macedonia will undertake to strengthen economic development and prepare for accession to the EU. The PDPL arrangement will support the key structural and institutional reforms across several sectors of the Macedonian economy.

The objective of the PDPL will be promotion of economic growth and job creation in Macedonia. According to the World Bank's requirements, each year the reform programme will be adjusted and further developed, based on changes and lessons learned from programme implementation during the previous year. The areas of reform to be covered by the PDPL arrangements will be based on two main pillars:

Pillar I: Improving Investment Climate:

- Judicial reform;
- Labour market reform;
- Strengthening financial sector intermediation and financial sector supervision; and
- Increasing the competitiveness of the business sector.

Pillar II: Strengthening Governance and Efficiency:

- Improvement of public sector management;
- Health sector reform; and
- Decentralisation.

Approval of the first PDPL arrangement by the World Bank Board of Directors was obtained on 27 October 2005, allocating to Macedonia EUR24.4 million (USD30 million) to be disbursed in 2005.

Other International Financial Institutions

The EBRD, together with the European Investment Bank ("EIB") and the EU, plays a crucial role in financing transport and energy projects as well as the small- and medium-sized enterprise ("SME") sector directly or through intermediary banks, with a particular focus on regional, municipal and environmental infrastructure. In the light of all challenges that Macedonia faces, the EBRD also invests in the private sector, including the financial sector and local export oriented companies showing good corporate governance. To date the EBRD has invested in Macedonia approximately EUR373.5 million in the form of credits and equity investments.

Legal Proceedings

An arbitral proceeding was commenced on 8 March 2004 against the government of Macedonia before the International Arbitration Court in Paris, France by EL.P.ET Balkaniki S.A., a Greek company. The claimant is seeking damages in the amount of approximately $58 million arising under contractual documentation agreed in connection with the sale by Macedonia to EL.P.ET Blakaniki S.A. of a 54.4% interest in the OKTA crude oil refinery in Skopje in 1999. Macedonia is contesting the claim. The judgment in the arbitral proceeding is expected by July 2006.

THE MACEDONIAN ECONOMY

BACKGROUND

During the last decade and a half, Macedonia has endured a difficult period of economic reform, aimed at building a market based economy. Following declaration of its independence in late 1991, Macedonia faced significant economic challenges as it commenced its transition from a centrally planned to a market economy and as a result of regional and internal conflicts. The collapse of the former Yugoslavia eliminated benefits Macedonia enjoyed from key protected trade markets and substantial transfer payments from the central Yugoslav government. Additional obstacles to growth included the unallocated external debt of the former Yugoslavia assumed by Macedonia, as well as the deficits of the pension and other funds in the health and social sectors. These conditions in the initial years following independence led to macroeconomic instability, manifested through a sharp contraction of GDP, high unemployment and hyper inflation. The economy was also hurt by a trade embargo imposed by Greece in February 1994 and other external factors including the war in Bosnia, international sanctions imposed on Serbia (Macedonia's largest trading partner at the time) and the crisis in Kosovo. However, in spite of these difficulties, Macedonia experienced five years of economic expansion during the period from 1996 to 2000, realising real GDP growth at an average rate of 3% per annum, compared to the negative average rate of 4.7% per annum for the period from 1991 to 1995. The improved economic performance reflected the government's commitment to economic reform, free trade and regional cooperation. During this period, the government began introducing changes in the main elements of the economic system, including liberalisation of the market, privatisation of ownership and restructuring of industries and companies.

This growth period was halted with the 2001 ethnic Albanian insurgency within Macedonia. The Macedonian economy contracted in 2001, recording a 4.5% fall in GDP. This was due largely to decreased trade, intermittent border closures and investor uncertainty. On 12 March 2002, an international donors conference, organised by the World Bank and the European Commission, was held in Brussels, where Macedonia received USD310 million in the form of loans and grants. The funding was aimed to assist Macedonia in financing its projected budget deficit and to its implementation of the Framework Agreement and projects related to economic reform measures. In 2002, growth continued to lag, with a rise in GDP of only 0.9%. In 2003, the economy accelerated and realised GDP growth of 2.8% and a low inflation rate of 1.2%. These improved macroeconomic indicators were accompanied by a notable reduction of the central budget deficit from 3.0% to 1.0% of GDP in 2002 and 2003, respectively, and were supported by a disciplined monetary policy. Although concerns from the 2001 conflict linger, the Framework Agreement is being implemented and Macedonia's political and security situation has stabilised, allowing the government to refocus on domestic reforms aimed at stimulating economic growth and increasing levels of foreign investment.

In 2004 the country faced another series of challenges, including the death of President Trajkovski, resulting in early presidential elections, an ongoing debate over Framework Agreement decentralisation legislation and a referendum on new municipal boundaries. Macroeconomic performance and trends in 2004 include the following:

- Macedonia ended 2004 with 2.9% real GDP growth. The growth in GDP was mainly attributable to the services (particularly construction) and agricultural sectors, which outweighed a decline in industrial production.

- For 2004, Macedonia experienced deflation, as measured by the Consumer Price Index ("CPI"), of 0.4%. This was largely due to downward movements in the price of agriculture and food products, which contribute the highest share to the CPI.

- In 2004 the trade deficit was approximately 21% of GDP, compared to 18.4% in 2003. At the 2004 year end the current account deficit was 7.7% of GDP, compared to 3.3% of GDP in 2003.

Current economic developments

In the first half of 2005, the trends in the real economy were in line with the government's targets. In the first six months of the year, industrial production grew 9.3% compared to the same period in 2004. This growth was attributable to strong performance in several sectors, mainly the steel industry, chemical industry, textile industry, industry for construction materials and electricity production. At the same time, deflation tendencies were offset by higher oil prices, increased excise taxes on tobacco and higher prices of postal and telecommunication services. Average inflation, based on the CPI, for the first six months of 2005 was 0.2%. In this period total exports of goods increased by 34.7% and imports increased by 17.5% as compared to the same period in 2004. As a result of these developments, 3.7% GDP growth was realised in the first half of 2005 compared to the same period in 2004.

Programme for reform

The current Macedonian government has been implementing a wide ranging programme for reform with the aim to achieve accelerated and sustainable economic growth as well as EU membership. The government has stated that the key objectives of its legislative programme are to:

- increase the medium term economic growth rate, mainly by intensifying structural reforms, including implementing pension system reform, public sector reform, judiciary reform and financial system reform;
- reduce the unemployment rate as well as the level of poverty; and
- improve the business climate and create conditions for integration into the EU, including labour market reform, judicial reform and other measures to reduce obstacles to investment and improve corporate governance.

The medium term structural reform programme being implemented by Macedonia in the next three years is supported by both the IMF's new three year stand by arrangement and the World Bank successive PDPLs. The implementation of these arrangements will support the key structural and institutional reform programme across several sectors of the Macedonian economy.

GDP

The following table sets out certain information about Macedonia's GDP for the periods indicated.

	2001	2002	2003	2004(1)	2005(2)
Nominal GDP at current prices (MKD millions)	233,841	243,970	251,486	257,744	270,618
Real GDP (USD millions)(3)	3,437	3,769	4,631	5,216	6,005
Real GDP (% change)	(4.5)	0.9	2.8	2.9	3.8
Real GDP per capita (USD)	1,830	1,859	2,243	2,567	2,713

(1) Estimate based on preliminary data

(2) Projection

(3) Based on average exchange rate for the period.

Source: State Statistical Office

GDP by sectors

The following table sets forth the composition of real GDP by sector for the periods indicated. The data in the table below is calculated using constant prices of production for 1997.

	2000	2001	2002	2003	2004	2005[1]
			(MKD millions)			
Agriculture	21,488	19,168	18,779	19,686	20,553	10,349
year-on-year change %		(10.8)	(2.0)	4.8	4.4	2.4
Industry	51,122	48,787	48,390	50,845	49,754	25,207
year-on-year change %		(4.6)	(0.8)	5.1	(2.1)	9.0
Construction	12,037	10,300	10,364	11,741	12,766	5,095
year-on-year change %		(14.4)	0.6	13.3	8.7	(9.2)
Wholesale and retail trade	22,696	22,506	23,725	24,146	25,927	13,258
year-on-year change %		(0.8)	5.4	1.8	7.4	7.3
Hotels and restaurants	3,345	3,149	3,726	4,085	4,300	2,068
year-on-year change %		(5.9)	16.7	9.6	5.3	4.3
Transport and communication	18,282	16,761	16,467	16,539	17,405	8,790
year-on-year change %		(8.3)	(1.8)	0.4	5.2	6.2
Financial Services	27,215	27,783	26,758	25,787	26,421	13,307
year-on-year change %		2.1	(3.7)	(3.6)	2.5	0.5
Public administration and defense	28,546	27,876	28,843	30,262	30,812	15,577
year-on-year change %		(2.3)	3.5	4.9	1.8	0.4
Minus: Imputed banking services	5,023	4,493	4,576	4,522	4,574	2,294
year-on-year change %		(10.6)	1.8	(1.2)	1.1	0.2
Value added	179,470	171,545	172,191	177,935	183,081	91,293
year-on-year change %		(4.4)	0.4	3.3	2.9	3.7
Indirect taxes	30,275	28,737	29,675	29,841	30,707	15,313
		(5.1)	3.3	0.6	2.9	3.7
GDP	209,777	200,284	201,992	207,686	213,697	106,606
year-on-year change %		(4.5)	0.9	2.8	2.9	3.7

(1) January–June. Real growth rates displayed related to the same period in 2004.

Source: State Statistical Office

The share of services (which include all categories in the above table except agriculture, industry, and imputed banking services) accounts for 54.3% of GDP during the period from January-June 2005. During the period from 2001 to 2002, the share of agriculture in GDP has stayed at the same level of approximately 9.5% of GDP. Also, the share of industry was relatively stable at approximately 24% of GDP.

Strong growth in agriculture and services, in particular in the construction sector, in 2004 outweighed the decline in industrial production. The agricultural sector expanded by 4.4% in real terms, following on from the real growth of 4.8% year on year in 2003. Continued public spending on infrastructure projects contributed to the growth in the construction sector to post real annual growth of 8.7% in 2004; however, this represented a deceleration from the 13.3% growth in real terms recorded in the sector in 2003. Wholesale and retail trade growth surged to 7.4% in real terms up from 1.8% in real terms in 2003 helped by the continued expansion of private sector credit. Excluding the industry sector, the real growth in all other sectors was 4.5% in 2004. A decline in industrial production which began in the last quarter of 2003 and continued in the first quarter of 2004 adversely affected the Macedonian economy. The temporary shutdown of several key industrial facilities in the first half of 2004 (especially several large mines and industrial facilities in Skopje), contributed to the decline in industrial production.

The re-opening of certain of these facilities in the second half of 2004 offset part of these adverse effects. Industrial production declined by 2.1% in real terms for the full year in 2004.

GDP by expenditure components

The following table sets forth the percentage contribution to GDP of expenditure components for the periods indicated.

	2000	2001	2002	2003
	Share in GDP (In %)(1)			
Gross Domestic Product	100.0	100.0	100.0	100.0
Final consumption	92.6	94.8	99.5	97.0
Household final consumption	74.4	70.0	77.1	76.3
General government final consumption	18.2	24.8	22.4	20.7
Gross capital formation	22.3	19.1	20.6	20.0
Gross fixed capital formation	16.2	14.8	16.6	16.7
Changes in inventories	6.0	4.2	4.0	3.2
Export of goods and services	48.6	42.7	38.0	37.9
Export of goods	36.8	33.6	29.5	29.3
Export of services	8.8	7.1	6.7	7.0
Non-resident purchases	3.0	2.0	1.8	1.5
Import of goods and services	63.5	56.6	58.2	54.8
Import of goods	56.1	48.9	50.9	47.7
Import of services	7.5	7.7	7.3	7.1
Net export	(14.9)	(13.9)	(20.1)	(17.0)

(1) Calculated using current prices, no data for 2004 or 2005 is available on the basis of current prices.

Source: State Statistical Office.

In 2001, there was a significant decline in Macedonian economic activity as a result of the security crisis created by the ethnic Albanian insurgency within Macedonia. This led to a large reduction of gross capital formation, contributing to a GDP decline of 4.5%. During 2002 there was increased economic activity in the country, largely driven by substantial increases in gross capital formation and household final consumption. However, there was a further decline in exports, which resulted in a negative contribution to GDP. Significant fiscal consolidation in 2003 was the main reason for the decline in the final and government consumption as a percentage of GDP. The budget deficit declined from 3.0% of GDP in 2002 to 1.0% of GDP in 2003. Lower government expenditures in public investments had a negative impact on GDP. A substantial increase in net exports was a principal contributor to GDP growth in 2003.

Inflation

The following table sets forth the average Consumer Price Index information for the periods indicated.

	2001	2002	2003	2004	2005(1)
Consumer price inflation%	5.5	1.8	1.2	(0.4)	0.2

(1) January-June

Source: State Statistical Office

During the early stages of the transition process, Macedonia experienced hyper-inflation, peaking at 128% in 1994. Inflation fell in subsequent years, reaching 0.7% in 1999. In 2000 and 2001, inflation rose 5.8% and 5.5%, respectively, due to the introduction of VAT. It subsequently declined and in 2004 Macedonia recorded a negative rate of inflation of 0.4%. This was largely due to lower food prices, which were partially offset by the impact of high international oil prices. This trend continued throughout the first half of 2005, with a

2.1% year on year decline in food prices contributing to keep the annual consumer price inflation close to zero.

The continuous, gradual liberalisation of imports, including the process of further reduction of the average weighted customs rates (initiated by the accession of Macedonia into the WTO and implementation of the SAA), has also contributed to keeping inflation at very low levels.

Key components of the economy

Industry

The traditional industrial sectors in the Macedonian economy have been steel and iron, textiles and clothing, chemicals, food processing and tobacco.

Industrial output in Macedonia has declined over the last decade. The main reasons for this fall in output are inadequate foreign direct investment, loss of traditional markets (especially in the other former Yugoslav republics) following independence, lack of cooperation and links with other commercial partners in the world, obsolete technology, import dependency and the failure to keep apace with global technological trends.

The following table sets forth information about industrial production for the periods indicated.

	1999	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**[(1)]
	index of industrial production (in %)						
Industrial output[(2)]	97.4	103.5	96.9	94.7	104.5	97.9	109.3

(1) January-June

(2) The index of industrial production represents the percentage of industrial production compared to the previous year.

Source: State Statistical Office

During the period from 1991 to 1995, there was a low level of utilisation of industrial capacity due to the poor economic climate, which was further exacerbated by the sanctions imposed by the United Nations towards Serbia and Montenegro and the trade sanctions imposed by Greece on Macedonia. This made it difficult for certain industries dependent on imports, such as textiles and steel, to continue production.

Industrial consolidation and reversal of the negative trend of industrial output occurred during 1996 to 1998. However, this growth period was short lived, with a reduction of industrial output in 1999 due to further regional conflict. Conditions improved in 2000, but in 2001 the Albanian insurgency severely impacted industrial production. The economy suffered significant damages, and industry incurred losses of approximately USD322 million relating to cancelled contracts, increased insurance costs, additional security costs and higher transportation costs, among other things. Industrial output continued to suffer the consequences in 2002, with a high number of contracts with foreign counterparts, mostly in the textile sector, cancelled. In 2003, industrial production increased by 4.5%. During the first half of 2004, industrial output declined 0.7% compared to the same period in the previous year. In the second half of the year decline was even more significant at 3.5%. Output has improved in 2005, and during the first six months of 2005, industrial production increased by 9.3% compared to the same period in previous year. Generators of growth are principally steel, textile, chemical and construction material industries and electricity production.

Textiles and Clothing

Textiles and clothing is an important industrial sector, accounting for 5.2% of total employment for 2003.

The textile sector has faced a number of difficulties. Obsolete technology is still in use, which means the industry is not able to compete effectively in the global markets. Furthermore, there has been strong competition from neighbouring countries and Asian markets. The textile industry is also import dependent.

Recent government efforts to support the industry include:

- undertaking measures and activities to offset the negative effects in the textile industry caused by the ten year transition period under the WTO Agreement on Textiles and Clothing and the increased competition from Chinese textiles in the EU and US markets, which are also the main export markets for Macedonian textiles;
- preparing a Textile Industry Development Strategy, to define the guidelines for restructuring the sector;
- establishing a Textile Design Centre for training personnel in textile engineering and designing and establishing an accredited laboratory for testing textile products; and
- making legislative changes to create a favourable environment for attraction of foreign direct investment in the textile industry, including new customs and labour laws.

Metals and Mining

Metallurgy production accounted for 18.4% of total industry output, of which mining contributed 2.0% and production of basic metals contributed 16.4%, in 2003 and 2004. Starting from 2005, the State Statistical Office prepares statistical data based on value added instead of volume of production. For comparative purposes, the industrial production index based on this new methodology was produced for 2004 data. According to this new methodology, the share of basic metals in the total index of industrial production is 6%, while the share of mining is 0.1%.

During the 2000 to 2003 period exports of basic metals accounted for 22% of total exports of Macedonia. Germany, Italy, France, Switzerland, Serbia and Montenegro and Croatia were the main destinations of these exports.

The principal challenges facing this sector include:

- facing increasing international competition;
- developing down-stream industries; and
- increasing the value-added from the steel and metallurgy production related industries.

To improve the situation in this industry, the Ministry of Economy has taken a number of measures in the restructuring and privatisation process, including its commitment to restructure and prepare 30 companies in the sector for privatisation or sale to strategic investors, or for closure.

Agriculture

Agriculture accounted for 12.2% of total employment for 2003. The agri-food sector, which includes both primary agricultural production and the food processing industry, is currently estimated to represent 15% of GDP.

The EU and Serbia and Montenegro are currently the major trade partners in respect of agricultural and food processing products, together accounting for 70% of Macedonian exports and 40% of Macedonian imports in 2004.

Agriculture in 2005 is expected to achieve a growth rate of approximately 2.1%. The sustainable and stable development in the agricultural sector is in line with the 2005 Annual Programme on Agriculture Development and Promotion. This programme encompasses measures and activities to increase efficiency, profitability and competitiveness of Macedonia's agricultural products. In addition, the development of this sector has been assisted by the International Fund for Agricultural Development via existing credit lines (South Eastern Rural Region Rehabilitation Project and Agricultural Financial Services Project known as IFAD 1 and IFAD 2 projects). In addition, the government has adopted a strategy for harmonising policies in the agricultural sector with the EU Common Agricultural Policy.

Construction

Construction accounted for 7.0% of total employment for 2004. The construction sector grew 8.7% in real terms in 2004, mainly due to public sector investment in infrastructure and roads and a higher number of overseas construction projects taken on by Macedonian companies. The sector is expected to decline by approximately 3%, as a consequence of delays in certain substantial public financed construction projects. Among the more significant construction projects ongoing in 2005 are the Skopje bypass and other road projects, activities related to Matka 2 hydro power plant, several projects in the area of water supply, as well as repair of damaged transport infrastructure.

Communications

In line with global trends, the Macedonian telecommunications market is developing rapidly, particularly in the mobile segment. There is currently one incumbent fixed-line operator and two mobile carriers in Macedonia.

The new Law on Electronic Communication, which was entered into force in mid 2005, provides a stable and consistent regulation of the communication sector. It is harmonised with the EU requirements, thus enabling full liberalisation of the market with the aim of attracting investments by domestic and foreign operators. Macedonia expects further expansion of the telecommunications sector, including the addition of a third mobile carrier and a second land line operator. The government expects to sell the remaining 47% stake of Macedonian Telecommunication in the first half of 2006.

Tourism

According to customs controls, approximately 165,300 foreigners visited Macedonia in 2004, which is an increase of 4.8% over 2003. Tourists from EU countries accounted for approximately 45% of total visitors.

The tourism sector is expected to grow approximately 4% in 2005 compared to the previous year. Government policies contributing to growth include:

- enhancing the general tourist promotion activities of the country, especially on important foreign tourist markets (such as The Netherlands and Russia) and towards foreign tour operators;
- determining tourist localities for management under concession, together with provision of appropriate information on the available investments in all tourist areas; and
- stimulating entrepreneurship and competitiveness by upgrading the quality of tourist services via training in tourism management and marketing.

Energy

Macedonia's energy demand totals approximately 30,000 million kWh per year and is increasing annually at a rate of approximately 4%. Energy sources comprise electricity (56%), oil derivatives (32%) and renewables (12%). Macedonia imports all of its oil and gas supply. Macedonia does not have any nuclear energy production capacity.

Macedonia expects its medium and long term supply will be met with domestic lignite reserves, imported gas, renewable resources such as hydro electricity and electricity imports.

Electricity

The following table shows Macedonia's electricity production, imports, exports and consumption for the periods indicated.

Year	Production	Import	Export	Consumption
		10^3kWh		
1992	5,910	430	290	6,050
1993	6,175	477	25	6,627
1994	5,456	247	153	5,550
1995	5,667	184	60	5,791
1996	6,153	95	60	6,248
1997	6,211	164	85	6,290
1998	6,492	121	138	6,475
1999	6,330	210	–	6,540
2000	6,403	287	182	6,508
2001	5,759	439	29	6,169
2002	5,593	774	–	6,367
2003	6,272	1,081	–	7,353
2004	6,209	1,231	–	7,440

Source: Ministry of Economy

Historically, the quantity of exports and imports was relatively small compared to the overall production and consumption. Since 2001, the growth of demand could not be met by domestic production and imports have become increasingly important.

The decline in 2001 arose as a result of the internal conflict. In 2004, approximately 85% of total electricity consumption in Macedonia was supplied from its own production, with the remaining demand met by imports. The percentage of consumption met by imports is expected to rise further in 2005 and 2006. Growth in electricity consumption since 1999 was mainly due to the increased demand of direct industrial users.

Macedonia has a total installed power generation capacity of 1,485 MW, out of which, 1,000 MW is thermal power generation. Coal fired thermal power plant generation accounts for approximately 800 MW, which generates approximately 5 billion kWh/year, out of the total of 6 billion kWh of annual electricity production. The coal for the thermal power plant operation is obtained domestically and is a low calorie lignite grade.

The process of restructuring of the Electric Power Company of Macedonia ("ESM") commenced in 2004 and was completed by September 2005. As part of the government's programme to liberalise the electricity market, the restructuring resulted in unbundling of the vertically integrated ESM into three legally separated enterprises. The Macedonian Electricity (Transmission) System Operator ("MEPSO") will remain in government ownership and control, and will be responsible for transmitting electricity and managing the high voltage transmission network, operating the electricity central despatching system and implementing the market operations, providing electricity supply for the regulated wholesale customers and providing ancillary services. Electricity generation is conducted by the joint stock company "Electric Power Plants of Macedonia" ("ELEM"), while distribution and supply is conducted by the joint stock company "ESM", which is currently preparing for privatisation. The privatisation process of ESM (distribution and supply) is expected to be completed by March 2006. The privatisation of ELEM, the electricity generation company, is planned subsequent to 2006.

Macedonia is also looking to develop hydro-electricity as the most readily available renewable energy source. Approximately 20 development sites have been targeted for immediate development, the majority of which are currently in the feasibility stage. The government plans to develop this resource through concessional funding agreements, foreign direct investment, joint ventures, donations and other forms of non-credit funding. The installed hydropower generation currently represents one third of the overall electricity production capacity, providing approximately 1 billion kWh or one sixth of Macedonia's current electricity production.

It is estimated that approximately 40% of the available and accessible hydropower is not currently utilised. Most of the large Hydro Power Plants ("HPPs") suitable for development require significant investments, and are planned to be offered to private investors under concession schemes, and operated as independent power producers. Additionally, approximately 200 small and micro HPP sites exist that are suitable for development.

The existing legal and regulatory framework related to hydropower concession and power purchase agreements is currently under review to reform to common international criteria and best practices.

The use of other renewable energy resources such as wind, solar or biomass is being investigated.

Oil and Gas

Macedonia does not have any oil fields. There is one crude oil refinery in Skopje. Oil is transported via the Thessalonica-Skopje pipeline with a length of 212 km. The refinery has total capacity of 2,500,000 MTA, and produces heavy oil (mazut), leaded and unleaded gasolines, diesel fuel and heating fuel, and LPG. The annual refined crude oil production ranges from approximately 1 million to 1.2 million tons a year, depending on internal demand. Refined crude oil is also available for export, mainly to the southern parts of Serbia and Kosovo.

Macedonia also has a gas pipeline system extending to the capital Skopje, with a length of 98 km, and a total capacity of 800 million m^3 per year. Currently only 12% of its total capacity is utilised. Macedonia aims to utilise the excess gas supply capacity at a combined heat and power plant in Skopje, for gasification of urban areas or parts of the city including the outskirts in Skopje and along the gas transportation corridor, which is also expected to be extended to the south and west parts of Macedonia. There are no immediate plans or funding to build the pipeline extension, but it forms part of the overall energy policy set by government. Macedonia expects any pipeline extension would be funded by private capital or other similar means.

Public Investment Programme

Independence and the transition to a market based economy have confronted Macedonia with a challenging economic environment, ageing infrastructure and a low level of foreign direct investment, resulting in a significant decline in public sector investments. Seeking to address this position, the government established medium and long term public sector development policies to optimise existing capacities, modernise public infrastructure and stimulate investment in reconstruction and development activities.

The current three year Public Investment Programme ("PIP") embodies the medium term public investment policy. The PIP consists of 98 investment projects requiring a total financial commitment of EUR1,247.9 million. Of this total, EUR321.3 million in projects were undertaken in 2004, and several other projects amounting to an estimated EUR174.7 million are expected to be implemented beyond 2007 to allow for the completion of the decentralisation process, resulting in a total estimate of EUR752 million to be expended in the period from 2005 to 2007.

Moreover, 87.8% of PIP financing will be allocated for economy infrastructure development, with the remaining 12.2% directed towards non-economy infrastructure, including education and science, health, culture and sport, social welfare, and public administration.

In 2005, approximately 27.4% of PIP financing has been directed to the energy sector, 27.2% for transport and 9.7 % for water resources. The remaining 35% has been directed to communal services, environmental protection and education and science, health, culture and sport, social welfare, and state administration.

The following table sets forth the expected PIP sources of funding for the periods indicated.

	2005	2006	2007	Total
		(EUR millions)		
Total	**283.6**	**265.0**	**203.5**	**752.0**[1]
Foreign Credit	109.2	106.3	81.4	296.8
Foreign Grant	71.1	49.0	22.3	142.4
Central Budget	39.2	40.8	33.4	113.4
Own participation[2]	21.4	20.5	9.3	51.2
Funds[3]	42.7	48.5	57.1	148.3

(1) The calculations were made according to the average euro exchange rate of the NBRM for 2004 (EUR1=MKD61.3377)

(2) Funds provided by the public enterprises

(3) This refers to the Regional and National Road Fund, the Health Insurance Fund and certain other government funds.

Source: PIP programme 2005-2007

Grey Economy

Part of the economic activity in Macedonia takes place in the informal sector, or "grey market" economy. The grey market is thought to encompass a range or economic sectors, especially agriculture and tourism. It is estimated that this informal sector could account for approximately 25% - 35% of GDP and between approximately 30% - 40% of the working population (according to World Bank research). The government is introducing measures aimed to reduce this unrecorded element of the economy, including requiring enterprise record keeping of transactions and strengthening oversight powers of local authorities.

Employment and Wages

Without taking account of employment in the grey economy, Macedonia has a relatively low official employment rate (employed workers as a percentage of the total working age population) when compared with other central European countries. Approximately 32.8% of Macedonia's working age population (ages 15 – 80) were employed in 2004.

During the initial stages of the transition to a market based economy, the official employment rate was 49% in 1991 and dropped to 38.1% in 1997, largely due to significant restructuring of state owned enterprises. Employees at bankrupt state owned enterprises were laid off, whilst employees from privatised companies were put on forced leave schemes or alternatively chose to retire early. In addition, a small number left the labour market and became inactive, while the majority registered as unemployed. The cumulative impact of these effects resulted in a significant decrease in employment during this period. Low labour participation rates and high unemployment continue to act as significant constraints on improving economic growth.

The following table sets forth labour market data for the end of the periods indicated.

Labour Market	2001	2002	2003	2004	2005[1]
Working age population (ages 15-80)	1,554,420	1,566,954	1,579,450	1,594,557	1,606,833
Registered employed	599,308	561,341	545,108	522,995	552,797
Registered unemployed	263,196	263,483	315,868	309,286	330,724
Employment rate	38.6%	35.8%	34.5%	32.8%	34.4%
Unemployment rate (Labour Force Survey)..........................	30.5%	31.9%	36.7%	37.2%	37.4%
Employment by ownership: Public	49.1%	47.6%	45.6%	43.3%	40.4%
Private........	50.9%	52.4%	54.4%	56.7%	59.6%

(1) January-June

Source: Labour Force Survey (LFS), based on International Labour Organisation ("ILO") methodology and definitions. According to ILO definitions set by Eurostat, "employment rate" equals the number of employed persons divided by the working age population, and "unemployment rate" equals number of unemployed persons divided by the active population (total number of employed and unemployed persons).

Survey data indicates that for the year ending 2004, the number of unemployed fell by 2.1% to approximately 309,286. However, the number of those in employment fell by 4% compared with 2003. As a consequence, for the year ending 2004, the annual unemployment rate rose to 37.2% compared to 36.7% in 2003.

As of May 2005 inclusive, number of beneficiaries of unemployment benefit was 43,968, while 252,768 persons used health insurance through the Employment Agency. It is the government's view that a substantial number of the registered unemployed are working in the unofficial sector and it is common for people to register as unemployed to secure constitutionally protected healthcare benefits. Seeking to address this issue, the government is in the process of determining an alternative basis for state health insurance. In addition, the government has undertaken a survey of registered unemployed at their re-registration, asking them whether their incentive to register as unemployed is solely the provision of free health care. To date, more than 60,000 registered unemployed declared that their reason of registering as unemployed with the Employment Agency is to obtain state funded health care benefits.

Employment by Sector

The following table sets forth the registered employment by sector for the periods indicated.

Sectors of Activity[(1)]	2001	2002	2003	2004	2005[(2)]
Agriculture, hunting and forestry	149,163	133,581	119,951	87,608	125,840
Fishing	303	715	181	442	354
Minerals and stone mining	9,314	6,937	2,498	2,813	2,619
Manufacturing	149,223	132,405	131,307	116,300	120,636
Electricity, gas and water supply	16,508	14,769	15,176	15,784	13,932
Construction	35,620	32,806	35,874	36,493	37,401
Wholesale and retail, repair of motor vehicles, motorcycles and articles for personal use and for households	66,653	64,265	62,507	74,218	73,275
Hotels and restaurants	12,438	11,230	12,766	12,672	12,410
Transport, storage and communications	33,180	32,595	30,642	30,785	32,669
Financial intermediation	8,776	8,422	7,093	7,703	6,758
Real estate, renting and business activities	10,432	11,953	10,811	13,529	14,127
Public administration and defence, compulsory social security	33,937	32,956	34,744	39,700	35,786
Education	26,990	33,700	32,027	33,635	30,029
Health and social work	26,907	26,226	30,233	29,914	29,236
Other activities of communal, cultural, general and personal	18,567	17,521	17,760	19,654	16,822
Private households with employees	–	319	–	156	261
Exterritorial organisations and bodies	1,296	945	1,537	1,589	642
Total	599,307	561,345	545,107	522,995	552,797

(1) For the years 2001 to 2003, statistics are as of the end of April because the Labour Force Survey was conducted once a year, in April. Starting from 2005, statistics are calculated as an annual average based on quarterly data. 2004 was the first year of quarterly reporting.

(2) January-June

Source: LFS

Average Monthly Wages

The government sets wages in the public sector. Wage adjustments in the public sector are decided by the government after consultation with the unions and employers' organisations. In 2005, the minimum wage level in the public sector is MKD5,064 net, per month, slightly more than 40% of the average net wage in the economy. Wages in the private sector are determined at an enterprise level, subject to any limits set in collective bargaining arguments. Collective bargaining agreements are applicable to certain sectors of the economy, but only to enterprises which are members of the collective organisations. Collective bargaining agreements generally provide for minimum wages. There are currently no minimum wage requirements set by law for the private sector.

The following table sets forth information on average monthly net wages for the periods indicated.

Wages	2001	2002	2003	2004	2005[(1)]
Average net wages in MKD	10,558	11,282	11,828	12,297	12,466
Net wages, nominal annual growth %	3.5	6.9	4.8	4.0	2.0
Net wages, real annual growth %	1.9	5.0	3.6	4.4	1.9

(1) January-August

Source: State Statistical Office

Average monthly net wages have increased by 2.0% year on year in nominal terms in January-July 2005, and by 1.9% in real terms. There are no arrears in the wages paid to public sector employees.

The following table sets forth the average net wages per sector for the periods indicated.

Sectors of Activity	**2001**	**2002**	**2003**	**2004**	**2005**[(1)]
			(MKD)		
Agriculture, hunting and forestry	9,400	9,432	9,993	9,692	9,878
Fishing	8,215	7,956	7,231	10,259	12,902
Minerals and stone mining	11,096	12,840	13,238	13,826	14,532
Manufacturing	9,577	9,944	10,028	10,486	10,139
Electricity, gas and water supply	14,215	14,580	15,041	15,410	15,885
Construction	8,056	8,318	8,760	9,353	9,720
Wholesale and retail, repair of motor vehicles, motorcycles and articles for personal use and for households	10,583	10,758	11,842	12,279	12,836
Hotels and restaurants	8,792	8,832	9,321	10,420	10,680
Transport, storage and communications	13,055	14,305	14,683	15,116	15,788
Financial intermediation	21,051	22,281	23,515	25,209	25,997
Real estate, renting and business activities	13,239	13,723	14,205	13,436	13,509
Public administration and defence, compulsory social security	10,481	11,606	12,911	13,636	15,004
Education	9,632	10,844	11,544	11,606	11,659
Health and social work	10,115	11,024	11,865	12,042	12,138
Other activities of communal, cultural, general and personal	11,038	11,743	12,025	12,204	12,234
Total	10,592	11,279	11,824	12,293	12,466

(1) January-August

Source: State Statistical Office

Labour market reform has been identified as a key component in the process of improvement of the business climate in Macedonia. These reforms will be complemented by additional measures that impact on the labour market. The new Law on Labour Relations aims to increase labour market flexibility by reducing restrictions on short-term and part-time contracts and overtime work, simplifying the procedures for mass lay offs, providing greater flexibility on working hours and encouraging employment by supporting entrepreneurship.

The following table sets forth the government expenditure on unemployment benefits for the periods indicated.

Unemployment Benefits	**2001**	**2002**	**2003**	**2004**	**2005**[(1)] **Budget**
			(MKD millions)		
Pecuniary allowances to the employees	1,612	2,250	2,373	2,677	2,610
Pension insurance	1,037	1,451	1,536	1,734	1,696
Health insurance	1,369	1,763	1,849	1,998	2,080
Other (retraining, employed disabled persons, employment creation law)	113	175	222	679	828
Total	4,131	5,639	5,980	7,088	7,214

(1) January-August

Source: State Statistical Office

Pensions

Under the current legislation, the retirement ages of men and women are 64 and 62 respectively. Approximately 25.5% of the population is aged 60 and over, and the ratio is expected to increase in future years. Until the commencement of the second pillar pension system, 21.2% of each worker's salary goes to the state pension fund, which is a pay-as-you-go system.

Pension system reform scheduled to commence in January 2006 will introduce a two pillar pension system, whereby a proportion of each worker's salary which was previously deposited in the state pension fund will instead be contributed to a privately-managed pension fund chosen by the worker. The basic objectives of the reforms are the following:

- insuring short and long term solvency of the Pension and Disability Insurance Fund of Macedonia;
- maximising benefits and minimising risk for pensioners;
- guaranteeing pension security for all generations; and
- strengthening public confidence in the pension system.

In 2004, the Agency for Supervision of Fully Funded Pension Insurance ("MAPAS") was established as an agency for the supervision of pension companies. The pension law sets limits on the asset allocation of the private funds.

Two financial institutions have been licensed to establish private pension funds relating to the second pillar of the new pension system. Workers newly employed since 1 January 2003 will be required to contribute 7% of their salary to a private fund, and 14.2% to the existing state pension fund. Officials estimate approximately 66,000 persons should participate in the new private scheme by the beginning of 2006. All other employees may elect to participate in the two-pillar system, but are not required to do so.

Health

The Macedonian health system comprises the dominant public health sector and the fast growing private health sector. The public health sector employs around 24,000 people and is financed via the Health Insurance Fund, managed by the government with expenditures financed from the mandatory contributions by employees.

Recently, a process of re-defining public health functions has been initiated to coincide with the establishment of the new private health schemes. In addition, privatisation of certain activities, such as pharmacy, dentistry and primary healthcare will further stimulate growth in this sector.

The primary objective of these collective reforms is to achieve greater transparency, efficiency and better management in the public health sector. To this end, the government has concluded arrangements with the World Bank and the IMF to support implementation of these reforms. The reform process is expected to take three years.

Environment

The Republic of Macedonia takes an active part in international efforts aimed at solving global environmental pollution and degradation and has achieved significant progress in international cooperation in the area of the environment, on bilateral, regional, European and global levels. In this context, the Republic of Macedonia is a signatory to a large number of multilateral environmental agreements.

Macedonia's environmental regulation is currently undergoing significant development to harmonise laws and regulations with EU and international standards. The *avis* recently received from the European Commission on Macedonia's application for membership in the EU highlights the need for substantial additional investment and strengthening of administrative capacity for the enforcement of environmental legislation.

As part of those efforts, in 2004 the Ministry of Environment and Physical Planning has completed the drafting and enactment of the legislation relating to ambient air quality, waste management and nature protection (the Law on Ambient Air Quality, Law on Waste Management and Law on Nature Protection, respectively).

Price Liberalisation

Price liberalisation has been essential to Macedonia's transition to a market based economy, adherence to the SAA and membership in the WTO. Since 1992, production and turnover prices in Macedonia have been mainly established according to prevailing market conditions. However, certain products and services existed within the market with little or no competition, which required a transitional period to implement price liberalisation.

By March 2005, only a small number of goods and services remained under governmental pricing regulation. These goods and services are typically confined to utility companies which provide water, energy and sanitation services, and to companies operating in the transportation sector, post office services and obligatory insurance of motor vehicles.

The prices of energy and telecommunication services in Macedonia are regulated by independent regulatory bodies.

Privatisation

By the end of 2004, Macedonia had completed the privatisation of 1,696 enterprises, with an estimated book value of EUR2.326 billion. More than 95% of enterprises subject to privatisation have been privatised. Due to the fact that the privatisation process has been substantially completed, in March 2005 the Privatisation Agency was terminated, and its obligations and responsibilities were transferred to the Ministry of Finance, the Ministry of Economy and the Pension and Disability Insurance Fund. The Ministry of Economy is charged with completing the privatisation to the remaining 80 state-owned enterprises. Most of these companies have not been privatised due to ongoing bankruptcy procedures or due to significant liabilities held by these enterprises that need to be restructured or discharged before they can be sold. Acquiring land ownership is still a right of the residents of Macedonia only.

The following table shows the most significant privatisations that have occurred to date.

Enterprise	Investor	Country of Origin	Activity	USD millions[1]	%
Makedonski telekomunikacii	Matav	Hungary	Telecommunication	310.0	53.0
Stopanska banka Skopje......	National Bank of Greece (65%), EBRD (10%), IFC (10%)	Greece, EBRD, IFC	Banking	46.4	85.0
Pivara Skopje	Balkanbrew Holding LTD	Greece	Beer	34.0	51.0
OKTA Skopje.....................	Hellenic Petroleum	Greece	Oil Refinery	32.0	54.0
Usje Skopje	Titan, Holderbank Financiere Glaris	Greece, Switzerland	Cement	30.0	94.0
Ladna valalnica Skopje	Balcan steel Liechtenstein	Lihtenstajn	Ferrous metallurgy	21.0	33.5
ADOR Makedonija	QBE Inter.Insurance LTD London	Great Britain	Insurance	14.8	55.0
Lek, Skopje	Lek, Ljubljana	Slovenia	Pharmaceutical	14.5	100.0
Zito Luks Skopje	Elbisko SA Atika	Greece	Bread and pastry	14.0	51.9
Makstil Skopje	Duferco Skop Investment LTD	Lihtenstajn	Ferrous metallurgy	11.5	54.0

(1) Representing investment size.

Source: Ministry of Economy

The first major privatisation was the sale of 53% of the shares in Makedonski telekomunikacii (Macedonian Telecommunications) to the Hungarian telecommunications company, MATAV, in 2001.

The privatisation in the electricity sector is a key component of the liberalisation of the electricity market. See "Key Components of the Economy – *Energy*" above. The Macedonian government intends to sell the electricity supply and distribution network in the first quarter of 2006, with the sale of the generating capacity to follow thereafter.

Public Enterprise Macedonian Railways is also subject to privatisation as part of the reform in the railway sector. This is planned to be done in two phases. The first phase aims to improve the financial viability, productivity, and efficiency of railway operations and to prepare it for substantial private sector involvement in the operation and management of the transport and infrastructure entities. The second phase of the restructuring will focus on privatising the Macedonia Railway Transport operation company and outsourcing infrastructure maintenance (with infrastructure remaining under state ownership).

BALANCE OF PAYMENTS AND FOREIGN TRADE

Balance of Payments ("BOP")

The following table shows Macedonia's balance of payments for the periods indicated.

	2001	2002	2003	2004	2005[1]
			(USD millions)		
I. CURRENT ACCOUNT	**(243.61)**	**(357.81)**	**(149.05)**	**(414.82)**	**(115.57)**
Goods, net	**(526.38)**	**(804.34)**	**(847.92)**	**(1,112.08)**	(515.48)
Exports, f.o.b.	1,155.43	1,112.15	1,362.65	1,672.43	988.68
Imports, f.o.b.[2]	(1,681.81)	(1,916.49)	(2,210.57)	(2,784.51)	**(1,504.15)**
Services, net	**19.16**	**22.13**	**10.24**	**54.39**	**(20.51)**
Income, net	**40.71**	**29.78**	**31.56**	**39.23**	(21.36)
Interest, net	33.50	18.64	31.15	26.22	**(16.15)**
Current Transfers, net	**342.65**	**498.44**	**740.67**	**790.88**	**441.78**
Official	49.01	100.50	103.98	70.07	26.96
Private	293.64	397.95	636.69	720.81	414.82
II. CAPITAL AND FINANCIAL ACCOUNT	**241.21**	**376.87**	**174.67**	**407.02**	**148.23**
Capital Account, net	**1.30**	**8.26**	**6.69**	**4.61**	**(0.16)**
Capital transfers, net	3.64	9.92	6.60	4.61	(0.16)
Official	3.64	9.92	0.00	0.00	0.00
Other	0.00	0.00	6.60	4.61	(0.16)
Acquisition/disposal of non produced, non-financial assets	(2.34)	(1.66)	(0.09)	0.00	0.00
Financial Account, net	**239.91**	**368.61**	**181.36**	**411.63**	**148.39**
Direct Investment, net	440.66	77.72	95.99	155.85	69.79
Portfolio Investment, net	0.36	0.35	3.39	14.82	21.25
Other Investment, net	124.11	159.98	132.94	260.42	100.31
Trade credits, net	60.23	83.10	72.90	170.05	27.47
Loans, net	107.18	8.19	42.97	59.82	75.67
Currency and deposits, net	21.27	44.69	2.91	3.66	(16.54)
Monetary Authorities, net	82.56	68.79	17.77	26.44	(0.41)
Commercial Banks, net	(272.39)	112.17	(54.59)	(105.08)	(39.33)
Individuals, net	376.23	(136.27)	39.73	74.97	23.20
Other, net	22.02	24.00	14.16	34.22	13.71
Gross official reserves (=increase)[3]	(77.00)	130.57	50.96	19.47	(42.96)
III ERRORS AND OMISSIONS	**2.39**	**(19.07)**	**(25.61)**	**7.81**	**(32.66)**

(1) January–June

(2) Imports data are on fob basis in accordance with IMF V Balance of Payments Manual.

(3) Excluding monetary gold and exchange rate differences.

Source: NBRM

Current account

Like in other transition countries, the need to restructure the economy and accelerate economic growth, accompanied with low level of domestic savings, has resulted in substantial deficits in the current account of the balance of payments of Macedonia.

Since independence, the current account has continuously run a deficit, stemming mainly from the negative trade balance. The trade deficit has steadily increased from USD526 million in 2001 to USD1,112 million in 2004 reflecting the following factors: increased imports as a result of restarting several import dependant industrial companies following their privatisation; the security crisis in 2001 and the post-crisis period (a duration of several months after the end of the conflict), causing a temporary decline in the export of Macedonian products in 2002, as well as the on-going process of trade liberalisation. The current account deficit increased from USD244 million in 2001 to USD358 million in 2002. Due to the considerable improvement in the balance of transfers which finance two thirds of the trade deficit, the deficit was reduced to USD149 million in 2003. The improvement in the balance of transfers was partly due to improvements in methodology for calculating such transfers. In 2004, in addition to the strengthening of export activity, lower custom duties after the WTO accession and higher oil prices increased the demand for imports and further widened the current account deficit to USD415 million.

In the first six months of 2005, the performance of the external sector considerably improved. According to data published by the NBRM, in the first half of the year the current account deficit equalled USD115.6 million, substantially lower compared to the same period of the previous year. The improvement resulted from significant export activity, primarily in the export of iron and steel, oil products, agricultural products, beverages and tobacco, doubling the growth rate of exports relative to imports.

The favourable trends in the external sector are expected by the government to continue in the foreseeable future, barring external shocks. The increased value added in the exports sector are a result of the structural reforms and the positive effects from five industrial clusters in which Macedonia considers that it has an actual or potential competitive advantage. These five clusters comprise wine, meat and dairy products, textiles, tourism and IT. Thus a gradual improvement of the current account deficit is expected.

Historically, financing of the current account deficit has been through long term borrowing, non-debt deficit financing (principally transfer) payments and trade credits. Current account deficit financing in the future is expected to be carried out via long term borrowing and by non-debt deficit financing, increasingly in the form of foreign direct investment. The government anticipates a higher inflow of foreign investments with the planned privatisations in the energy sector as well as in other sectors of the economy and with the improvement of the business climate in the country.

Capital and financial account

Macedonia's financial account increased in 2004 to 7.7% of GDP compared to 4% of GDP in 2003 primarily due to an increase in commercial credits and net foreign direct and net portfolio investments. The increase in commercial credits was due to increased foreign trade activity, resulting in higher lending to domestic importers. In 2004, trade (commercial) credits stood at USD170 million, and financed 15.2% of the trade deficit, compared with 8.6% in 2003.

The foreign and portfolio investments totalled 3.2% of GDP in 2004, financing 37.6% of the current account deficit.

Official international reserves

The following table sets forth the official international reserves of Macedonia for the periods indicated.

	2001	**2002**	**2003**	**2004**	**2005**(1)
			(USD millions)		
International Reserves(2)	775	725	893	975	980
In months of the current year's imports	4.8	4	4.2	3.6	3.4

(1) January–July

(2) Includes gold reserves.

Source: NBRM

Under the IMF arrangement, for 2005 year end, the NBRM is to maintain international reserves equal to the level of 3.6 months import coverage of the following year's imports. With the privatisation of the ESM distribution and supply network in 2006, the government anticipates this level should increase to 4 months coverage.

Foreign Trade

The priority of Macedonia's trade policy is the creation of conditions for increasing exports of products with higher value added, and attracting foreign investments in the export oriented sector that will create a sustainable export position of Macedonian producers in the longer term. At the same time the government aims to ensure greater access of Macedonian products on the international market. Macedonia has concluded free trade agreements with 9 countries, thus ensuring free access to a market of 174 million people. The market would be further increased by Macedonia becoming a member state of the EU, one of the strategic priorities of the government.

Exports performance

Macedonia has had a foreign trade deficit since 1994, which reached a record high of 21.1% of GDP in 2004. The restarting of a large steel factory in the second half of 2004, higher oil import prices, the higher import cost of products for reprocessing and machinery pushed imports higher in 2004. However, as part of the imports pertained to products that were reprocessed and than exported abroad, the positive impact on the export side lagged behind. In the first half of 2005 the expectations materialised and exports increased by 35% compared to the same period in the previous year. The increase was mainly due to the high level of exports of iron and steel, oil products, tobacco and beverages, together contributing to a decline in the trade deficit to USD515 million.

However, the challenge for restructuring the Macedonian export sector remains. The traditionally high trade deficit (18.2% of GDP, on average, for the period 1996-2004) results from the import dependent industries (with low value added) and high concentration of exports (two products, iron and steel and textiles, account for 50% of the total exports).

Composition of trade

The following tables show the composition of imports and exports for the periods indicated.

Imports(1)

Groups of Products(2)	**2001**	**2002**	**2003**	**2004**	**2005**(3)
			(*Shares in %*)		
Transactions and products (*further processed goods*)	**24.3**	**20.0**	**19.6**	**11.6**	**0.1**
Machinery and transport equipment	**16.7**	**20.4**	**18.8**	**18.8**	**17.6**
Road Vehicles	3.7	6.6	4.4	6.3	4.9
Products classified by material	**12.2**	**13.3**	**14.4**	**24.0**	**30.6**
Textile yarns , etc.	1.4	1.2	1.2	3.6	9.9
Iron and steel	2.1	2.2	3.3	10.3	11.3
Mineral fuels, lubricants, etc.	**13.8**	**13.2**	**14.0**	**13.0**	**17.7**
Oil and oil derivatives	11.4	10.3	11.2	10.2	13.0
Electricity	0.6	1.4	1.0	1.3	2.8
Animal and vegetable oils and fats	**0.9**	**1.0**	**1.1**	**1.0**	**0.9**
Food Products	**11.5**	**12.4**	**11.8**	**11.6**	**10.7**
Meat and meat products	3.6	3.6	3.0	3.0	2.6
Cereals and cereals preparations	1.8	2.3	2.0	2.3	2.0
Beverages and tobacco	**1.1**	**0.9**	**1.0**	**0.9**	**1.0**
Chemical products	**10.2**	**10.6**	**11.1**	**10.5**	**10.5**
Medical and pharmaceutical products	2.7	2.8	3.0	2.7	2.4
Various ready made products	**6.5**	**5.7**	**5.6**	**5.9**	**7.9**
Raw materials other than fuel	**2.8**	**2.5**	**2.6**	**2.7**	**3.0**
Total Imports	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

(1) Import data prepared by the State Statistical Office are on a CIF basis, whereas the import statistics in the Balance of Payment data prepared by the NBRM are on an FOB basis.

(2) Standard International Trade Classification

(3) January–July

Source: State Statistical Office

Groups of Products[1]	2001	2002	2003	2004	2005[2]
			(USD millions)		
Transactions and products					
(*further processed goods*)	**412**	**400**	**452**	**337**	**1.1**
Machinery and transport equipment	**283**	**408**	**434**	**546**	**321**
Road Vehicles	62	131	100	184	91
Products classified by material	**207**	**265**	**333**	**696**	**557**
Textile yarns , etc.	23	25	27	106	182
Iron and steel	35	45	76	299	187
Mineral fuels, lubricants, etc.	**234**	**263**	**323**	**377**	**322**
Oil and oil derivatives	193	206	259	296	274
Electricity	10	28	23	39	43
Animal and vegetables oils and fats	**16**	**20**	**25**	**30**	**16**
Food Products	**194**	**247**	**271**	**337**	**196**
Meat and meat products	62	71	70	86	48
Cereals and cereals preparations	31	46	47	66	34
Beverages and tobacco	18	18	24	28	16
Chemical products	**172**	**212**	**255**	**304**	**194**
Medical and pharmaceutical products	46	56	69	78	42
Various ready made products	**110**	**113**	**129**	**171**	**145**
Raw materials other than fuel	**47**	**50**	**60**	**77**	**54**
Total Imports	**1,693**	**1,996**	**2,306**	**2,903**	**1,822**

(1) Standard International Trade Classification
(2) January-July

Source: State Statistical Office

Exports[1]

Groups of products[2]	2001	2002	2003	2004	2005[3]
			(*Share in %*)		
Products classified by material	**32.2**	**28.3**	**29.1**	**32.6**	**36.3**
Iron and steel	16.9	14.0	18.4	24.2	31.3
Non ferrous metals	6.3	5.6	3.0	0.4	2.3
Various ready made products	**32.5**	**34.9**	**34.6**	**34.1**	**29.1**
Clothing	27.7	30.0	30.1	29.2	24.3
Footwear	3.2	3.2	3.0	3.0	2.6
Beverages and tobacco	**10.6**	**11.3**	**10.0**	**7.6**	**8.2**
Beverages	4.0	4.4	4.1	3.3	3.2
Tobacco and products thereof	6.5	6.8	5.9	4.4	4.5
Machinery & transport equipment	**6.6**	**6.7**	**5.9**	**5.9**	**4.9**
Electrical equipment, spare parts	4.0	3.8	3.2	3.0	2.4
Food products	**5.6**	**6.7**	**6.7**	**7.5**	**7.4**
Fruits and vegetables	2.6	3.2	3.1	3.8	3.5
Chemical products	**5.2**	**6.2**	**5.1**	**4.8**	**4.3**
Raw materials other than oil	**3.2**	**3.2**	**2.9**	**2.6**	**2.9**
Mineral fuels, lubricants, etc.	**3.7**	**2.2**	**5.4**	**4.7**	**6.8**
Oil and oil derivatives	3.7	2.2	5.2	4.5	6.4
Animal and vegetable fats and oils	**0.2**	**0.2**	**0.1**	**0.0**	**0.1**
Special transactions and commodities	**0.2**	**0.3**	**0.2**	**0.2**	**0.0**
Total Exports	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

(1) Export data prepared by the State Statistical Office are on a CIF basis, whereas the export statistics in the Balance of Payments data prepared by the NBRM are on a FOB basis.
(2) Standard International Trade Classification
(3) January-July

Source: State Statistical Office

Groups of products[(1)]	2001	2002	2003	2004	2005[(2)]
			(USD millions)		
Products classified by material	**373**	**316**	**398**	**546**	**425**
Iron and steel	196	156	251	405	345
Non ferrous metals	36	35	37	44	27
Various ready made products	**376**	**389**	**472**	**569**	**341**
Clothing	321	334	411	488	290
Footwear	37	36	41	50	36
Beverages and tobacco	**122**	**125**	**137**	**128**	**96**
Beverages	46	49	56	55	37
Tobacco and products thereof	75	76	81	73	59
Machinery & transport equipment	**77**	**75**	**81**	**99**	**58**
Electrical equipment, spare parts	47	42	44	49	27
Food products	**65**	**75**	**92**	**126**	**87**
Fruits and vegetables	30	36	42	63	41
Chemical products	**61**	**69**	**70**	**80**	**51**
Raw materials other than oil	**37**	**35**	**40**	**44**	**34**
Mineral fuels, lubricants, etc.	**43**	**25**	**74**	**78**	**80**
Oil and oil derivatives	42	25	71	75	77
Animal and vegetable fats and oils	**2**	**3**	**0.8**	**0.8**	**1**
Special transactions and commodities n.e.s.	**2**	**4**	**3**	**3**	**1**
Total Exports	**1,158**	**1,116**	**1,367**	**1,673**	**1,173**

(1) Standard International Trade Classification.
(2) January-July

Source: State Statistical Office

Direction of trade

The following table sets out the direction of imports and exports for the periods indicated.

Export and import of goods with the significant trade partners[(1)]	2000		2001		2002		2003		2004[(2)]	
	(USD millions)	*% share*	*(USD millions)*	*% share*	*(USD millions)*	*% share*	*(USD millions)*	*% share*	*(USD millions)*	*% share*
Export	**1,323**	**100.0**	**1,158**	**100.0**	**1,116**	**100.0**	**1,367**	**100.0**	**1,673**	**100.0**
Germany	257	19.4	239	20.6	234	21.0	279	20.4	316	18.9
Serbia and Montenegro	335	25.3	267	23.1	246	22.0	275	20.1	348	20.8
Greece	84	6.4	101	8.7	117	10.5	180	13.2	229	13.7
Italy	91	6.9	91	7.9	82	7.3	95	6.9	134	8.0
Russia	10	0.8	14	1.2	14	1.3	14	1.0	20	1.2
USA	165	12.5	99	8.5	77	6.9	73	5.3	72	4.3
Slovenia	26	2.0	21	1.8	22	2.0	21	1.5	27	1.6
Bulgaria	27	2.0	21	1.8	22	20	26	19	52	3.1
Croatia	48	3.6	58	5.0	59	5.3	66	4.8	80	4.8
Netherlands	36	2.7	45	3.9	45	4.0	47	3.4	47	2.8
Others	244	19.4	202	17.4	198	17.7	291	21.3	348	20.8
Import	**2,094**	**100.0**	**1,688**	**100.0**	**1,995**	**100.0**	**2,306**	**100.0**	**2,903**	**100.0**
Germany	253	12.1	215	12.7	285	14.3	305	13.2	366	12.6
Serbia and Montenegro	190	9.1	158	9.4	185	9.3	213	9.2	243	8.4
Greece	202	9.6	185	11.0	238	11.9	306	13.3	281	9.7
Italy	111	5.3	108	6.4	119	6.0	123	5.3	168	5.8
Russia	192	9.2	140	8.3	125	6.3	179	7.8	252	8.7
USA	83	4.0	52	3.1	59	3.0	57	2.5	48	1.7
Slovenia	144	6.9	119	7.1	130	6.5	139	6.0	140	4.8
Bulgaria	98	4.7	103	6.1	128	6.4	149	6.5	208	7.2
Croatia	58	2.8	46	2.7	55	2.5	64	2.8	65	2.2
Netherlands	45	2.1	46	2.7	52	2.6	50	2.2	57	2.0
Others	718	34.3	516	30.6	619	31	721	31.3	1.1	37

(1) Export and import data prepared by the State Statistical Office are based on a CIF basis whereas the export and import statistics in the Balance of Payments data prepared by the NBRM are on a FOB basis.
(2) Preliminary data

Source: State Statistical Office

The three traditional trading partners of Macedonia are Germany, Serbia and Montenegro and Greece, the average share of which in the total foreign trade during the period from 2000 to 2004 totalled 40.5%. The EU represented an average share of 46.1% during this same period, increasing from 40% in 2000 to 50.5% in 2004. The traditional connections with the economies of the former Yugoslav republics makes this group of countries the second most important region with an average share in total foreign trade of 22.5% in the 2000-2004 period. The countries of central and eastern Europe have a share of 16.4% on average in the analysed period due to Macedonia's dependence on raw material resources such as oil, iron ore and steel, mainly imported from Russia and Ukraine.

Foreign Direct Investment

Foreign direct investment has remained at relatively low levels in Macedonia since independence. This is due to both non economic factors, such as political instability and security concerns in the region and (in 2001) in Macedonia itself, and economic factors, including the small size of the market, frequent regulatory changes, cumbersome administrative procedures and the effect of market globalisation and international industrial competition. Nevertheless, increasing the level of foreign direct investment remains an important priority for the government, not only because of the continuing need to finance the large current account deficits but also because of the positive impact such investments would have on domestic business practices.

From 1994-2000, aggregate foreign direct investment in Macedonia totalled USD409.8 million. The first substantial foreign direct investments in the country occurred in 2001 following the privatisation of several large public sector companies, including a stake in the telecommunications company. In 2002, however, this trend took a downturn due to the deteriorated economic environment owing in part to the unstable political and security situation that arose in 2001. Foreign direct investments amounted to USD96.3 million in 2003 and USD157 million in 2004.

Foreign Direct Investment in GDP

During the period from 2001 to 2004, the share of foreign direct investment in GDP ranged from 12.8% in 2001 to 2.1% in 2003.

The following table shows the breakdown of foreign direct investment as a percentage of GDP for the periods indicated.

	2001	**2002**	**2003**	**2004**	**2005(1)**
Annual FDI(2) (USD million)	441.5	77.8	96.3	157.0	70.0
% of GDP	12.8	2.1	2.1	2.9	n/a
Cumulative FDI(2) (USD million)	851.3	929.1	1,025.4	1,182.4	1,252.4
% of GDP	24.8	24.7	22.1	22.1	n/a

(1) January-June

(2) This data represents the difference between total (gross) FDI in Macedonia and return investment. The Balance of Payments data for FDI represents the difference between FDI in Macedonia (minus return investment) and FDI of Macedonia abroad as net data.

Source: NBRM

Historically, foreign direct investment was largely through the process of privatisation, with relatively few investments made to start up new enterprises. For the period from 1995-2002, privatisation foreign direct investment amounted to USD583.7 million. Since 2001, greenfield investments have taken on an increasingly important role. The government believes increased levels of foreign direct investment, and in particular, greenfield investments, will be crucial for the sustained growth of Macedonia and to finance future current account deficits.

Foreign Direct Investment by Country

During the period 1997 - 2004, the ten largest investing countries in Macedonia were Hungary, Greece, Netherlands, Cyprus, Switzerland, Great Britain, Germany, Slovenia, Austria and the United States.

The following table shows the breakdown of the share of cumulative foreign direct investment by country of origin in the total FDI for the periods indicated.

Cumulative Investment in Macedonia - by country[1]

	1997-2005[2]
	(USD millions)
Hungary	322.7
Greece	269.4
Netherlands	103.3
Cyprus	82.2
Switzerland	62.8
Great Britain	41.7
Slovenia	41.0
Germany	40.1
Austria	34.7
Italy	30.0
Other[3]	205.5
Total	1,233.4

(1) For FDI reporting by country, gross FDI data is used.

(2) January-June

(3) This includes: United Arab Emirates, Albania, Netherlands Antilles, Australia, Bosnia and Herzegovina, Belgium, Bulgaria, Brazil, Bahamas, Botswana, Canada, China, Czech, Denmark, Spain, France, Hong Kong, Croatia, Indonesia, Ireland, Israel, Iran, Japan, Cayman Iceland, Liechtenstein, Luxembourg, Latvia, Republic of Moldova, Marshall Islands, Malta, Panama, Philippines, Pakistan, Poland, Romania, Russia, Sweden, Slovakia, San Marino, Syria, Thailand, Turkey, Taiwan, Ukraine, United States of America, saint Vincent and Grenadines, British Virgin Island, USA Virgin Islands, Yemen, Serbia and Monte Negro.

Source NBRM

Foreign Direct Investment by Activity

Analysing foreign direct investment by activity, from 1997 to 2004, the largest portion of foreign direct investments were made in the services sector, production, mining and extraction, and construction.

The following table sets forth the foreign direct investment by sector of economic activity for the periods indicated.

Activity[1]	1998	1999	2000	2001	2002	2003	2004	2005[2]
	(*USD millions*)							
Agriculture, hunting and fishing	0.1	0.0	0.0	2.3	0.4	1.6	6.0	0.4
Mining and extraction	0.0	0.4	9.6	2.2	0.3	0.0	5.8	16.7
Production	100.2	23.0	34.7	37.7	27.2	15.6	54.2	24.2
Electricity	0.0	0.0	0.0	0.0	0.0	0.8	2.6	0.0
Construction	0.2	0.3	18.9	12.3	4.0	0.1	0.1	0.0
Total services:	26.2	8.0	113.2	363.6	48.4	80.7	93.4	33.1
– Trade and repair	5.1	2.2	3.5	5.2	7.0	4.7	8.5	13.9
– Hotels and restaurants	0.0	0.0	0.1	1.3	1.6	7.2	6.6	2.3
– Transportation and communications	0.9	0.9	2.4	337.4	10.3	32.5	62.8	0.7
– Financial intermediation	19.8	3.6	104.7	11.2	24.8	30.5	9.4	12.6
– Real estate and business operations	0.3	(1.2)	2.4	8.5	1.9	4.4	5.9	0.6
– Other services	0.1	0.0	0.1	0.1	2.8	1.4	0.2	3.0
Not allocated	1.3	1.2	2.1	27.0	1.2	0.0	0.4	0.3
Private purchase and sale of real estate	0.0	0.0	0.0	0.0	0.2	0.5	0.8	0.7
Total	**128.0**	**32.8**	**178.5**	**445.1**	**81.7**	**99.3**	**163.1**	**75.5**

(1) For FDI reporting by activity, gross FDI data is used.

(2) January-June

Source: NBRM

PUBLIC FINANCE

General Information

The central government budget is the primary fiscal record that details the revenues and expenditures of government institutions, extra budgetary funds and municipalities, herein referred to as budget users. The central government budget does not include the state owned enterprises, which are not financed through the state budget.

Pursuant to the Budget Law, the payment of debt (domestic and foreign debtors are treated equally) is a guaranteed expenditure, that is given priority over wages and allowances. Any increase in revenues may be directed towards debt reduction without the requirement to produce a supplementary budget.

Methodology

Unless otherwise indicated, all data in this section are presented for comparison purposes in accordance with the methodology of the IMF (as set forth in the Manual of Governance Finance Statistics, IMF 1986) ("GFS").

From 2005, in accordance with the agreement with the IMF, for reporting purposes, the authorities changed the coverage of the term "central government". From 2005, the term "central government" will cover: Central Government Budget as defined in the Annual Budget Document (including Special Revenue Accounts), Employment Agency, Health Insurance Fund, Pension and Disability Insurance Fund, Regional and National Road Fund and agencies and institutions that are currently treated by the Ministry of Finance as part of government.

For the year 2005, the Ministry of Finance prepared two sets of budgetary data. The set "Budget 2005", is the budget compiled in late 2004 and approved by the Assembly in December 2005. The second set, "Revised Budget 2005", is based upon additional information obtained during the course of 2005. In this Prospectus, we present revised data compiled by the Ministry of Finance in the light of data available as of July 2005.

Central Government Budget

In 2002 and 2003 Macedonia recorded budget deficits of 3.0% of GDP and 1.0% of GDP, respectively. In 2004, Macedonia recorded a budget surplus of MKD371 million, or 0.1% of GDP.

In 2004, the government achieved lower than expected revenues. This was largely due to a lower collection of direct taxes together with a systematic reduction in custom revenues as a result of further trade liberalisation. However, lower capital expenditures resulted in a central budget surplus of 0.1% of GDP at year end 2004. In 2005, Macedonia has continued to implement a disciplined fiscal policy restricting budgetary expenditures and expects that the budget deficit will not exceed 0.8% of projected GDP.

The budget deficit in 2005 is expected to be financed from foreign sources (foreign donations and credits), domestic sources (short term treasury bills) and a minimum withdrawal of government deposits from the NBRM. This method of deficit financing is aimed at providing non-inflationary financing of public expenditure in 2005.

The following table sets forth the central government budget for the periods indicated in accordance with GFS Manual, IMF 1986 (excluding the extra-budgetary funds due to the unavailability of data that conforms with GFS methodology).

	2002	2003	2004	Budget 2005	Revised Budget 2005
	(MKD millions)				
TOTAL REVENUES	**58,160**	**53,881**	**56,982**	**56,502**	**59,905**
Tax revenues	**54,389**	**49,163**	**52,526**	**52,321**	**53,318**
Personal Income tax	7,513	7,502	7,707	7,931	8,231
Profit tax	2,624	3,271	2,361	2,571	2,572
VAT	20,521	21,175	25,757	25,623	26,325
Excises	10,715	10,564	10,335	10,965	10,757
Import Duties	6,336	6,140	5,815	4,731	4,867
Other taxes	340	476	548	500	567
Tax on Financial Transactions	6,336	31	–	–	–
Utility Taxes	4	4	4	–	–
Non tax revenues	**3,170**	**4,163**	**3,855**	**3,561**	**5,151**
Profit of public financial institutions	1,057	1,807	1,595	1,661	3,261
National Bank Profit	34	–	27	–	10
Bank Rehabilitation Agency	98	325	300	341	341
Other Property Income	267	108	72	60	90
Interest on Deposits	658	243	18	70	70
Telecom Profit	–	1,131	1,178	1,190	2,750
Administrative Taxes and Charges	1,092	1,369	1,463	1,390	1,390
Other Administrative Taxes	205	370	257	300	300
Other Non taxes Revenues	816	618	540	210	200
Capital Revenues	**601**	**555**	**600**	**620**	**620**
Flats	431	461	370	420	420
Land and Other	170	94	230	200	200
Foreign Donations	–	–	–	–	**816**
TOTAL EXPENDITURES	**65,503**	**56,432**	**56,611**	**59,206**	**60,825**
Current Expenditures	**51,591**	**50,984**	**51,726**	**53,467**	**53,563**
Wages and allowances	18,338	20,234	20,944	21,757	21,862
Reserves	–	–	138	190	190
Goods and services	8,715	6,914	6,694	7,162	7,310
Transfers to extra budgetary funds	20,576	21,105	21,840	13,254	13,125
Pension and Disability Insurance Fund	6,538	7,305	8,054	7,705	7,587
Employment Agency	4,111	4,360	5,438	5,494	5,494
Health Insurance Fund	–	–	–	55	44
Other Transfers[1]	3,404	3,264	3,056	0	0
Refugees	391	259	272	100	100
Structural Reforms	1,387	1,659	732	634	383
Public Administration Reforms	442	528	527	657	600
Transfers to Local government	–	–	–	813	813
Interest	3,401	2,443	2,052	2,499	2,335
Domestic	1,179	950	930	1,430	1,224
Foreign	2,222	1,493	1,123	1,069	1,111
Guarantees	561	288	58	–	–
Subsidies	–	–	–	2,452	2,891
Public enterprises	–	–	–	30	188
Non government organisations	–	–	–	123	123
Other subsidies	–	–	–	2,299	2,580
Social benefits	–	–	–	3,950	3,953
Social assistance	–	–	–	2,860	2,860
Child allowances	–	–	–	490	490
Assistance for disabled veterans	–	–	–	446	446
Other social assistance	–	–	–	139	142
Assistances for ill people	–	–	–	15	15
Capital Expenditures	**8,636**	**5,037**	**4,886**	**5,739**	**7,262**
Fixed Assets	2,718	1,737	2,187	3,428	3,431
Capital Transfers	2,476	2,796	2,368	1,919	3,349
Commodity Reserves	418	–	–	350	350
International Financial Institutions	22	18	18	42	132
Telecom Projects	3,002	486	313	–	–
Crisis Related Expenses	**5,276**	**412**	–	–	–

	2002	2003	2004	Budget 2005	Revised Budget 2005
	(MKD millions)				
BUDGET BALANCE	**(7,343)**	**(2,551)**	**371**	**(2,704)**	**(920)**
Financing	**7,343**	**2,551**	**(371)**	**2,704**	**920**
Inflow	13,430	10,585	6,761	10,037	17,222
Bond C	–	–	–	140	127
Privatisation	5,177	4,673	459	500	500
Succession proceeds	–	–	–	401	397
Foreign Donations	2,641	2,560	1,044	816	–
Capitalisation	–	–	–	–	–
Foreign Loans	1,584	3,773	2,081	2,636	12,969
Deposits	4,029	422	1,268	3,044	–
BIS	–	–	1,909	–	–
Domestic Borrowing	–	–	–	2,500	3,229
Outflow	6,087	8,034	7,132	7,333	16,302
Repayment of Principal	6,087	8,034	7,132	7,333	7,191
Foreign	3,602	3,682	2,932	2,919	2,791
Domestic	2,485	4,352	4,201	4,414	4,400
Purchase of Bonds	–	–	–	–	–
Increasing Deposits	–	–	–	–	9,111
Total revenues(2)	–	–	–	66,539	77,127
Total expenditure(2)	–	–	–	66,539	77,127

(1) Other transfers from 2005 are presented in separate expenditures items below (subsidies; social benefits; and transfer to HIF)

(2) Inclusive of financing.

Source: Ministry of Finance

The principal budgetary expenditures are for social benefits, education, security and defence, general public services and debt service payments.

The following table shows the principal components of public expenditure as a percentage of the total for the periods indicated.

Budget expenditure by functional classifications

Code	Description	Budget 2005		Revised Budget 2005	
		(MKD millions)	*%*	*(MKD millions)*	*%*
701	**General Public Services**	**5,876**	**8.8**	**5,958**	**7.7**
702	**Defence**	**5,895**	**8.9**	**5,856**	**7.6**
703	**Public Order and Safety**	**8,434**	**12.7**	**8,609**	**11.2**
704	**Economic Affairs**	**15,917**	**23.9**	**26,352**	**34.2**
	General economic, commercial and labour related affairs	1,232	1.9	1,469	1.9
	Agriculture, forestry, fishing and hunting	1,484	2.2	1,471	1.9
	Fuel and Energy	51	0.1	53	0.1
	Mining, craftsmanship and construction	207	0.3	212	0.3
	Transportation	443	0.7	497	0.6
	Communication	0	0.0	0	0.0
	Other industries	131	0.2	65	0.1
	Other economic affairs(1)	12,369	18.6	22,585	29.3
705	**Environment protection**	**397**	**0.6**	**392**	**0.5**
706	**Housing and community amenities**	**863**	**1.3**	**802**	**1.0**
707	**Health**	**631**	**0.9**	**647**	**0.8**
708	**Recreation, Culture and Religion**	**1,447**	**2.2**	**1,455**	**1.9**
709	**Education**	**9,913**	**14.9**	**10,013**	**13.0**
710	**Social Protection**	**17,158**	**25.8**	**17,035**	**22.1**
	TOTAL	**66,539**	**100.00%**	**77.27**	**100.00%**

(1) This includes administrative activities relating to general and sectoral economic issues which do not fall within the other categories listed.

Source: Ministry of Finance

Budget process

Under the Budget Law, budgetary institutions are required to submit their budgetary requests to the Ministry of Finance by the end of August in each year. The central budget is submitted to the Assembly for approval on 15 November prior to the beginning of the fiscal year and for implementation on 1 January. The central budget has been submitted on time every year since 1991.

Should the proposed central budget not be adopted by the Assembly before the beginning of a new fiscal year, a temporary financial procedure is triggered whereby monthly budgets are produced based on an average of the first three months of the preceding fiscal year. Since 1991, this has occurred two times. The government is to be dissolved if the central budget cannot be agreed by 31 March. To date this has not occurred. A similar process also occurs at the municipal level.

For every expenditure that requires a new source of revenues, and in situations where the approved planned revenues can not be realised within 5% variation, an additional supplementary budget document must be approved by the Assembly.

Budgetary reform

In connection with its IMF and World Bank arrangements, Macedonia has introduced a number of fiscal reforms to strengthen the budget planning and execution process. In this regard, the 2006 central budget will be implemented under the recently adopted Law on Budgets which provides a detailed framework for the identification of budget priorities and establishes a set timeframe to which budget users must adhere. This new budget framework, to which the Ministry of Finance largely adhered in preparing the 2005 budget, requires the Ministry of Finance to prepare a three year fiscal strategy that details the direction of fiscal policy and estimated revenues and appropriations for that period. This fiscal strategy is to be adopted by the Assembly by May in each fiscal year. On the basis of the adopted fiscal strategy, the Ministry of Finance must no later than 15 June submit to budget users a budget circular which provides instructions and guidance on completing budget requests relating to the basic budget, donation budget, loan budget and the budget of self financing activities. In addition, budget users must also submit a three year strategic plan, a summary of goals and initiatives and their budgetary requirements. Budget users are to submit this information to the Ministry of Finance by 15 August.

Once this data has been compiled and reviewed by the Ministry of Finance, levels of revenue and appropriation are determined and the draft budget is submitted to the Assembly no later than 15 November for debate. The budget is to be approved by the Assembly by 31 December. Similar procedures to the previous regime occur should the budget encounter difficulties passing through the Assembly, with the exception that the budget for the first three months of the preceding fiscal year is to be averaged to determine the temporary financial budget.

In the previous years there was a trend of underperformance of capital expenditures during the first half of the year and significant spending in the last quarter of the year. The Law on Budget Execution addresses this issue by requiring 30% of budget allocations to be utilised during the first half of the year. Budgetary allowances not utilised during this period are redirected to the Ministry of Finance for further reallocation.

Taxation

The taxation system in Macedonia is in the process of transition to compatibility with EU standards to encourage foreign investment. The current tax system comprises of direct taxation in the form of personal income tax (rates of 15%, 18% and 24%), profit tax (rate of 15%) and property tax (rates from 0.1% up to 0.2%). Indirect taxation exists in the form of value added tax (rates of 5% and 18%) and excise duties (specific, proportional and combined excise) according to the type of the excise goods.

The collection of taxation is undergoing a period of reform whereby the collection of social contributions, income tax and other forms of government revenue will occur centrally in a "one stop shop". This reform is expected to improve the collection of payments and the accuracy of submitted information.

Employers who engage persons, who were registered as unemployed for at least one year, are also encouraged to use these incentives.

Extra budgetary funds

Macedonia has four principal extra budgetary funds: the Pension and Disability Insurance Fund ("PDF"), Employment Agency, ("EA") Health Insurance Fund, ("HIF") and Regional and National Road Fund ("RNRF"). All of these funds generally maintain balance of budgets except for the RNFR. This is due to the borrowing of the RNFR and the repayment of its debt obligations. From 2004 all of these funds are included in the single treasury account which is monitored by the Treasury Department of the Ministry of Finance.

Total projected revenues and expenditures for the extra budgetary funds in 2005 are MKD56,727 million.

The following table sets forth the total revenues and expenditures of the extra budgetary funds for the periods indicated.

	2002	2003	2004	Budget 2005	Revised Budget 2005
			(MKD millions)		
Total Revenues	**49,311**	**52,957**	**56,273**	**57,397**	**56,727**
PDF	25,809	28,203	29,467	29,966	29,544
HIF	14,062	14,699	14,888	15,724	15,703
EA	6,006	6,386	7,640	7,457	7,277
RNRF	3,434	3,669	4,278	4,250	4,203
Total Expenditures	**49,134**	**52,317**	**55,411**	**57,397**	**56,727**
PDF	25,880	27,764	29,117	29,966	29,544
HIF	13,971	14,698	14,724	15,724	15,703
EA	5,855	6,193	7,307	7,457	7,277
RNFR	3,428	3,662	4,263	4,250	4,203

Source: Extra-budgetary Funds

Pension and Disability Insurance Fund

The PDF is responsible for providing pensions to retired persons. In 2004, its principal sources of revenue were contributions from employees, accounting for 61.2% of revenues and 28.8% comprising the central budget transfers.

The largest expenditure of PDF is for pension payments, accounting for 86.2%, followed by funding of health care of pensioners, accounting for 11.5%.

Employment Agency

The EA is responsible for providing benefits to the unemployed. In 2004, the principal sources of revenues were transfers from the central budget, accounting for 81% of revenues, 17% were contributions and 2% comprising the remainder. The largest expenditures of the EA in 2004, is for the payment of unemployment benefits, accounting for 36.5%, followed by funding of health insurance of unemployed persons, accounting for 27.3% and the funding of pension insurance of beneficiaries of unemployment benefits, accounting for 23.7%.

Health Insurance Fund

The HIF is responsible for healthcare and maintaining health care facilities. In 2004, the HIF's principal source of revenues were:

- Contributions from employees (59%);
- Transfers from the PDF (22%);
- Transfers from the EA (13%); and
- Others (6%).

The largest expenditures of the HIF include primary healthcare expenses, specialist and consultative healthcare, hospital treatments and allowances.

Regional and National Road Fund

The RNRF is responsible for funding the investments in, and maintenance of, the arterial and regional roads. In 2004, the principal revenue sources of the RNRF were :

- Transfers from the central budget (37.6%);
- Annual fee for motor vehicles subject to registration (19.9%);
- Pay-toll for use of motorway (17.3%);
- Pay-toll for use by foreign motor vehicles (1.8%) (this fee represents each foreign motor vehicle crossing the Macedonian border); and
- Foreign financing related to infrastructure projects (22.9%).

Municipalities

The Law on Local Financing was adopted in September 2004. This law sets the framework for financial monitoring of the transfer of competences from the central to local governments. The actual transfer of competencies is done under separate legislation. This transfer will be coupled with the transfer of certain revenue raising capacities to the municipalities. The completion of this process is expected to occur in July 2007, when the transitional provisions restricting domestic and international borrowing of municipalities are to be lifted, thereby providing them with greater financial independence.

Under the Law of Local Financing, municipal financing will be carried out to a greater extent from sources independent from the central budget. New fiscal competencies of the municipalities will also enable them to control the level of property taxes and utility fees.

Notwithstanding their broadened revenue raising powers, under the new regime municipalities will receive the benefit of certain finance grants from central budget revenues from value added tax, earmarked grants, capital grants and grants for delegated authorities. Value added tax revenues will be provided in the amount of 3% from the total collected value added tax, realised in the previous fiscal year. These tax revenues are distributed proportionally with 13% earmarked according to the number of dwellings, 27% according to the municipality's proportion of the total size of Macedonia and 60% according to the municipality's proportion of the total population. From July 2007, earmarked grants will be provided to finance specific activities, by project, by institution and by programme. Prior to this, earmarked grants were only provided for culture, child care and education. Capital grants will be provided to finance investment projects. Block grants will be provided to finance areas of culture, social protection, childcare, education and health care. Grants will also be provided to finance the authorities delegated from government administration bodies to the municipalities.

The transfer of certain revenue raising activities to the municipalities is expected to have an effect on the level of taxes. For example, in 2004, the revenue collected by the central government for property taxes was approximately MKD1 billion.

The supplementary budget in 2005 includes a planned increase of MKD813 million in municipal budgets from 1 July 2005. Out of these funds, MKD379 million are VAT revenues and the municipalities will decide independently how such funds will be spent. The remainder comprises earmarked grants from the central budget which are intended to finance projects in education, culture, child care and homes for the elderly of MKD434 million. The municipalities obtained MKD500 million as capital grants for current and investment maintenance of roads from the RNRF. The Ministry of Transport and Communications also provided funds in the amount of MKD150 million to finance miscellaneous infrastructure projects related to water supply.

MONETARY AND FINANCIAL SYSTEM

The National Bank of the Republic of Macedonia

The NBRM was established in 1946 and until April 1992 it was part of the system of the National Bank of Yugoslavia. From April 1992, the NBRM started to perform all central bank functions as the central bank of Macedonia. The primary objective of the NBRM is to maintain the price stability. The NBRM is responsible for establishing and implementing monetary policy and exchange rate policy, regulating the liquidity of the banking system, holding and managing foreign reserves, and supervising the banking sector, among others.

The NBRM's governing body is the National Bank Council headed by the Governor of the NBRM. The National Bank Council consists of, apart from the Governor, three Vice Governors and six external members. The Governor of the NBRM is appointed and dismissed by the Assembly, upon proposal of the President, for a seven year term of office, with the possibility of a consecutive appointment. The Vice Governors are appointed by the Assembly upon proposal of the Governor, for a seven year term of office, with the possibility of a consecutive appointment. External members of the National Bank Council are appointed by the Assembly upon a proposal from the President for a seven year term of office and are not eligible for consecutive appointments.

The legal status of the NBRM and its role as an independent central bank is guaranteed by Macedonia's constitution and reinforced by the Law of the National Bank of the Republic of Macedonia (the "NBRM law"). The NBRM law formally sets out the role of the NBRM and confers its authority to operate independently. Despite this autonomy to facilitate optimal management at monetary policy, the NBRM must consult with the Macedonian government on the following measures: any increase in the NBRM's statutory capital, management in the country's foreign reserves, and any balance of payment matters.

In practice, the NBRM regularly consults with the Ministry of Finance to enable the continuous and smooth implementation of legal regulations within the banking and financial sectors. In this regard, the Minister of Finance may attend NBRM meetings and participate in discussions, but may not vote on matters before the NBRM.

Monetary policy

Under the NBRM law, the main objective of the NBRM is to maintain price stability. Given this, the monetary policy of the NBRM has been based on targeting the nominal MKD exchange rate against the Deutsche Mark since October 1995 (and against the Euro since 2002). In addition, the NBRM uses a combination of variables as operational targets which include the reserves maintained by the banking system and the money market interest rates to influence movements on the foreign exchange market. The application of the exchange rate targeting has been very successful and the exchange rate of the MKD has been largely stable, except for a one devaluation of 15.5% in 1997.

Denars per 1 unit of foreign currency

	2000	**2001**	**2002**	**2003**	**2004**	**2005**(1)
			(MKD)			
Average exchange rates						
EUR 1	60.79	60.96	61.07	61.29	61.31	61.30
USD 1	65.33	69.17	58.60	49.05	45.07	50.86

(1) January-June

Source: NBRM

Monetary Instruments

The monetary instruments currently used by the NBRM include (i) establishing reserve requirements for banks and savings institutions, (ii) conducting open market operations, including auctions of central bank bills and (iii) extending lombard credits.

Reserve requirements

The reserve requirement in MKD is a standard monetary policy instrument of the NBRM. All banks in Macedonia are currently required to allocate to the account of the NBRM 10% of the deposits which are included in the basis for calculating the reserve requirement, while for savings institutions this ratio equals 2.5%.

Open market operations

The basic monetary policy instrument of the NBRM is the central bank bill ("CB bill"). This instrument helps the NBRM to manage and absorb excess liquidity in the banking system, which has been a characteristic of the banking system since mid 1999. CB bills are issued in auctions held twice a week (Wednesday and Friday). CB bills are short term discounted papers. The CB bills auctions can be held in form of a "volume tender", or in form of an "interest rate tender".

Lombard credit

The lombard credit is a short term collateralised credit from the NBRM available to banks facing a lack of liquidity at the end of a business day. The CB bills and the Treasury bills of Macedonia are used as collateral for granting a lombard credit. From October 2005, lombard credit may also be extended through repo operations with CB bills and Treasury bills.

The interest rate on the lombard credit equals 13%, representing a ceiling for the market interest rate. The level was established in November 2004. The structural excess liquidity in the banking system and scope for liquidity management through the average maintenance of the reserve requirement, limit the banks, need to utilise this form of credit. In 2004, the lombard credit was used only four times, and only once in the first quarter of 2005.

Interest rates

The NBRM influences monetary policy through open market operations, setting of interest rates on CB bills, and lombard credits. During the third and fourth quarters of 2004, NBRM gradually increased the interest rate of the CB bills to 10% for 28-day CB bills. This change was a reaction to the anticipated pressures of foreign exchange demand. However, positive developments in the real and external sector in the period January-September 2005, in addition to favourable movements in the financial markets, lead to the introduction of the interest rate tenders of CB bills, since 26 October 2005. The most recent weighted interest rate is 8.9%.

Despite the increase in interest rates on CB bills during 2004, a downward trend of the banks' interest rates was registered. The nominal weighted lending interest rate on short-term MKD credits (with a maturity of up to one year) in 2004 was 12.5% on average compared to 16.0% in 2003. The average nominal weighted deposit interest rate on three-month MKD deposits of the banks decreased by 1.4 percentage points in 2004 to 6.5%. The decline in the interest rates charged by banks, notwithstanding the NBRM's increases in interest rates on CB bills, was partially due to the perception that the changes in the NBRM's monetary policy were temporary. In addition, the growing competitiveness and thus higher efficiency of the banking sector, as well as the determination of the banks to keep financially reliable customers with whom they have developed good business terms contributed to the declining trend in interest rates.

Money supply

The key monetary aggregates monitored by the NBRM are M1 (currency in circulation, and demand deposits) and M2 (M1, sight deposits and time deposits with a maturity of up to one year). However, the NBRM also monitors the broadest monetary aggregate, M4 (M2, restricted deposits and long term time deposits).

The M1 registered a moderate annual increase of 0.8% for 2004 with MKD27.6 billion in supply at year end. The M2 registered higher levels of annual growth of 16.8% for the same period primarily due to the widening deposit base of the banks, with MKD88.9 billion at year end. The M4 registered an annual increase of 16.1% in 2004 totalling MKD93.9 billion at year end.

The increase in the money supply was caused by continued economic growth prompting an increase in savings in the form of bank deposits. Further broadening of the banks' deposit base in 2004 and 2005 was recorded, which indicates the further strengthening of the confidence of the banking sector and increased propensity of the population to save, which is expected to generate positive effects on the Macedonian economy.

The following table sets forth the breakdown of monetary supply for the periods indicated.

	2001	2002	2003	2004	2005[(1)]
			(MKD millions)		
Money (M1)	25,322	26,214	27,376	27,595	27,425
Currency in circulation	14,134	14,136	14,177	14,162	13,385
Demand deposits	11,188	12,078	13,199	13,433	14,040
Money (M2)	69,784	63,663	76,131	88,886	94,564
Sight deposits	2,378	3,618	4,883	5,143	5,221
Time deposits	67,406	60,045	71,248	83,743	89,343
Money (M4)	77,237	68,436	80,916	93,947	99,436
Growth limited deposits	1,832	734	631	901	1,153
Long term deposits	75,405	67,702	80,285	93,046	98,283

(1) January-August

Source: NBRM

The Macedonian banking system

According to the NBRM law and the Banking Law, the NBRM is the sole supervisory authority responsible for licensing and supervision of banks and savings institutions in Macedonia.

Macedonia's banking system consists of two major segments, banks and savings institutions. As of 30 June 2005, 20 banks and 15 savings institutions operated in Macedonia. Savings institutions have marginal role with share of 1.4% of total assets of the banking system.

Macedonia's banking system is universal in nature as specified by the Banking Law. Of the total number of banks as at 30 June 2005, 15 banks were licensed to perform domestic and international financial activities. This licence requires an initial capitalisation of EUR9 million and enables the performance of activities such as payment operations abroad, international money transfer and guarantees and the safekeeping and managing of securities and precious metal objects. Four banks are also licensed to perform only domestic financial activities. This licence requires an initial capitalisation of EUR3.5 million and enables the performance of such domestic operations as acceptance of money deposits from natural persons, issuance of credit cards, leasing safes and the sale of short-term securities for its account or for the account of a client. The Macedonian Bank for Reconstruction and Development Promotion AD Skopje is the only state owned bank and was established and performs specific financial activities pursuant to a special law, but does not accept deposits. On 5 May 2005, the founding and operating license of one bank was revoked by the NBRM due to detected irregularities in the bank's operating and solvency position. Shortly thereafter, the bank entered into bankruptcy proceedings.

To assist management and performance analysis of Macedonia's banking system, banks have been classified into three groups according to the size of their assets:

- large banks (3 banks, the assets of each of which exceed MKD15 billion);
- medium size banks (10 banks, the assets of each of which range from MKD2 billion to MKD15 billion); and
- small size banks (7 banks, the assets of each of which are below MKD2 billion).

Large banks are the most important segment in Macedonia as of 30 June 2005, accounting for:

- 69.2% of the total credit activity;
- 68.1% of the total assets;
- 76.2% of the total deposit base;
- 43.9% of the total capital; and

16 banks have foreign investors and 8 of the banks are more than 50% owned by foreign investors.

Banking system performance

Confidence in the banking system has led to increase in bank deposits. As at 31 December 2004, the ratio of the total deposits to GDP was 31.1% compared to 29.9% in 2001. Total assets of banks as of 30 June 2005 was approximately MKD132 billion, which is an increase of 12.1% compared to 31 December 2004. In the first six months of 2005, banks increased lending as a result of increases in bank deposits. Lending increased to MKD63 billion as at 30 June 2005, or a 9.9% increase compared to 31 December 2004. Total credit exposure of the banking system as at 31 December 2004 was MKD119.2 billion, which is a 14.3% increase over 31 December 2003. The upward trend has continued in 2005, with total credit exposure of MKD130.5 billion as at 30 June 2005.

Capital requirement

The aggregate capital adequacy ratio of the banking system was 23.0% on 31 December, 2004, which is 2.8 percentage points lower compared to the end of 2003. On 30 June 2005, the capital adequacy ratio remained almost unchanged and equalled 23.1%. On 30 June 2005, the lowest capital adequacy ratio was registered in the group of large banks (14.9%), compared to the capital adequacy ratio at the group of small size banks (52.5%). The high capital adequacy ratio of the small size banks is largely due to their low volume of banking activities, particularly a low deposit base and lending activity. As at 30 June 2005, all banks in Macedonia met the required capital adequacy ratio.

The NBRM conducts off site monitoring of banks on a continuous basis and full scope on site examinations and reviews are conducted in a 18 month cycles.

Reforms

The Macedonian government is currently considering a number of changes to the Banking Law which will enable harmonisation of Macedonian banking regulations with the EU directives and further compliance with Basle standards. The changes include streamlining banking procedures, enhancing "fit and proper" requirements for shareholders and board members, increasing oversight powers of NBRM, establishing a legal framework for market risk, allowing banks to invest more in financial institutions, raising the threshold for minimum capital requirements to establish a bank and increasing the powers of the NBRM when dealing with weak banks. In addition, the scope of banking services will be expanded to include additional financial activities such as trading with monetary gold and intermediation in the sale of insurance policies. The amendments are expected to be implemented in 2006.

Capital Markets

In order to promote the transition to a market based economy, the Macedonian government has focused on establishing a stable capital market, which would in turn facilitate the economic development of Macedonian enterprises.

Unlike some capital markets in emerging economies, where the activities of the capital markets started prior to any legislative framework being adopted, legislation was adopted in 1993 to provide for the foundation of the first institutions to support the development of the capital markets. This approach contributed to a stable market without any significant turbulence.

Macedonian Securities and Exchange Commission

Macedonian Securities and Exchange Commission ("MSEC") was established after independence on 19 June 1992 by a Decision of Government made in accordance with the Securities Law of the former Yugoslavia. The MSEC is an autonomous legal entity that regulates and supervises all participants within the Macedonian securities market and has been a regular member of the International Organisation of Security Commissions ("IOSCO") since 1994. The MSEC is also responsible for the efficient operation of the securities market, protection of investor rights and promotion of confidence within the securities market. It is in charge of the implementation of the Securities Law, Investment Funds Law and the Company Takeover Law.

The MSEC is comprised of a president and six members who serve seven year terms. The Commissioners are appointed and dismissed by the Assembly, at a request of the government of Macedonia. The independence of the MSEC is ensured by the amendments of the Securities Law of 2003.

The Macedonian Stock Exchange

The Macedonian Stock Exchange ("MSE") was founded in 13 September 1995, and commenced trading on 28 March 1996 as a central marketplace for trading in securities and the first organised stock exchange in the history of Macedonia.

MSE currently has 15 members consisting of 9 brokerage houses and 6 banks. All MSE members must be licensed for trading in securities by the MSEC. Only brokers authorised by the MSE members may trade in securities at MSE. According to the Securities Law, the initial share capital of each MSE member must be at least EUR75,000 and the liquid assets must be EUR15,000. In order to conduct asset management and investment advising, apart from acting as an agent, the initial share capital of the MSE member must be at least EUR150,000 and the liquid assets must be EUR30,000. The MSE member may obtain a full license as broker dealer (including performing the activities of underwriting and acting as a dealer), if it has at least EUR500,000 share capital, and liquid assets of more than EUR50,000.

Starting from 20 June 2001 (with the new amendments to the Securities Law), MSE started to operate on a for profit basis, with a founding capital of EUR500,000. MSE shareholders may be any legal and private domestic and foreign entity. Shareholdings per entity is limited to 10% of the outstanding shares of MSE.

MSE has two market segments – the official market and unofficial market.

All trades conducted on the MSE are automatically transmitted to the Central Securities Depositary ("CSD") immediately after the end of each trading session. Initial clearing (identification of buyers/sellers, quantity of securities and prices) is done by the MSE BEST (Bourse Electronic System for Trading) system. The rest of the clearing process and settlement is completed by the CSD. Rolling settlement is implemented based on DVP (delivery versus payment) principle. The settlement period is maximum of T+3 for all securities.

The securities register of CSD is the only legally valid evidence of issuance and ownership of securities. The rights and obligations of securities commence from the moment they are registered in the CSD. CSD is also responsible for the settlement of trades concluded on the MSE, based on the delivery versus payment principle.

All joint stock companies must maintain their share registries at the CSD. By the end of 2004, the CSD maintained share registry records for 780 companies. Since 2001, all securities issued in Macedonia have been dematerialised.

As of 31 July 2005 the MSE has 57 companies listed with a market capitalisation of around EUR440 million and a total market capitalisation of around EUR1.1 billion.

Another important event that contributed to increasing the liquidity on the MSE was the listing of government bonds issued to compensate persons with foreign currency deposit accounts before Macedonia's independence in 2000. As of July 2005 five government bonds were listed on the MSE official market. The market capitalisation of these bonds as at 31 December 2004 was EUR347 million .

The MSE is still in the development phase, with relatively low turnover and low liquidity. In 2004, cumulative turnover in the secondary market increased to MKD2.75 billion or EUR44.6 million (excluding 107 block transactions that totalled MKD5.2 billion or EUR84.2 million) which was an increase at 19.2% from the preceding year. These results positively impacted the official exchange index (the "MBI-10"), which increased by 14.7% in 2004 compared to 2003 year end. From the beginning of 2005 to 31 July 2005, the MBI-10 index increased by 89.3%.

The first half of 2005 evidenced significant growth for the Macedonian securities market both in liquidity and in turnover. The total turnover in the first half of 2005 on the secondary market reached MKD3.14 billion (or EUR51.2 million) (excluding 34 block transactions that totalled MKD1.16 billion or EUR18.9 million).

Insurance Sector

Legislation

The main legal framework that regulates the establishment, operation, supervision and liquidation of the insurance companies as well as the insurance brokerage companies in Macedonia is the Insurance Supervision Law.

In order to improve the system of compulsory insurance in the country and to further harmonise domestic legislation in the field of automobile third party liability insurance with the EU directives (especially the IV Motor Directive), a new law on compulsory insurance in traffic was adopted by the Assembly in October 2005.

Insurance Supervision and Market

According to the Insurance Supervision Law, the Ministry of Finance is the responsible authority for supervision of insurance companies as well as insurance brokerage companies. This is carried out by the Insurance System and Insurance Supervision Unit. Further enhancement of the insurance supervision function has been planned for the period 2006-2008. Initiatives include the establishment and operative functioning of an independent insurance supervision authority in accordance with the principles and standards of the International Association of Insurance Supervisors, competence strengthening through permanent professional training and continuous education of employees for carrying out the normative and supervisory function, further development of the system for collection and processing insurance data, creation of an early warning system and other measures to strengthen the insurance supervision.

There are currently 10 insurance companies operating in the market. Only one of them is licensed and registered for conducting life insurance business, one insurance company is licensed for non-life insurance and active reinsurance and the other eight insurance companies are licensed for conducting solely non-life insurance activities. The foreign participation in the insurance companies is 61.7%, with three insurance companies wholly owned by foreign companies at the end of 2004. The total assets of the insurance companies, according to the non audited financial reports of the insurance companies, increased by 5.8% from MKD12,236 million at the end of 2003, to MKD12,942 million at the end of 2004. The total capital (including reserves) of the insurance companies at the end of 2004 was MKD2,616 million, which represents a 13.9% increase from 2003. This increase of the capital is principally due to the entry of two newly established companies in 2004. The gross written insurance premiums at the end of 2004 were MKD5,171 million, which represented an increase of about 4.9% over 2003. Only 2.4% of the gross written premium was realised in the life insurance business. The contributions of gross written premiums to GDP in 2004 was 1.9%, which represented a decrease from 2003 of about 0.1%. The market participation of the three largest insurance companies measured by share in the gross written premiums, decreased from 92.8% in 2003, to 82.6% in 2004.

At 30 June 2005, there were 4 insurance brokerage companies operating as insurance intermediaries on the insurance market, established solely with domestic capital.

INDEBTEDNESS

Public debt comprises external public debt and domestic public debt.

External public debt includes external government debt, external NBRM debt, external public enterprise and external municipalities' debt to multilateral, bilateral and private creditors. Domestic public debt includes debt from domestically issued structural bonds, treasury securities, and CB bills, domestic municipal debt and domestic public enterprise debt. According to the newly adopted Public Debt Law the debt of the NBRM is not regarded as public debt, so in the following section NBRM debt has been excluded from the data.

Total public debt stood at EUR1,723 million and EUR1,824 million at 31 December 2004 and at 31 July 2005, respectively. As a percentage of total public debt, external public debt accounted for 65% and domestic public debt accounted for 35% at 31 July 2005. This ratio has been broadly unchanged since the year 2000. External public debt is issued outside of Macedonia and is denominated mostly in euros (35%) and US dollars (35%), Domestic debt is debt issued inside Macedonia and is denominated in euros (83%) and MKD (17%). The total public debt to GDP ratio fell from 52.9% in 2000 to 41.2 % as at 31 July 2005.

As at 31 July, 2005, 16% of total public debt had a term to maturity of over 30 years, 22% had a term to maturity of 15 to 20 years, 51% had a term to maturity of 10 to 15 years, 2% had a term to maturity of 20 25 years and 8 % had a term to maturity of less than 10 years. The average maturity of the total public debt as at 31 July 2005 was 13.7 years.

External public debt was EUR1,194 million at 31 July 2005, or 27% of GDP. Domestic public debt was EUR630 million at 31 July 2005, or 14% of GDP. Both these ratios were broadly unchanged by comparison the previous six month period. Yields at auction on domestic government securities in July 2005 averaged 10.4% for 3-month bills, 10.6% for 6-month bills and 11.8% for 12-month bills. Macedonia's indebtedness remains low in comparison with other central and eastern European countries. Generally, debt indicators have improved in the last four years. The ratio of total public debt to exports remained flat at 111.2 % at 31 July 2005 as compared with 112% at 31 December 2001.

The Macedonian government also guarantees loans of certain Macedonian companies in Macedonia and abroad.

The following table shows public debt, both in millions of euro and as a percentage of GDP, for the periods indicated.

Public Debt

	2000	2001	2002	2003	2004	2005(1)
			(EUR millions, except for percentages)			
Total Public Debt	2,051.0	1,996.0	1,829.0	1,717.0	1,722.7	1,824.0
% of GDP	52.9	52.0	45.9	41.9	40.9	41.2
External Public Debt	1,340.1	1,314.6	1,203.0	1,124.2	1,132.1	1,194.2
% of GDP	34.6	34.2	30.1	27.5	26.9	27.1
Domestic Public Debt	711.7	681.6	627.0	593.6	589.6	630.1
% of GDP	18.3	17.7	15.7	14.5	14.0	14.1

(1) January-July

Source Ministry of Finance and NBRM

Since 2000 total public debt as a percentage of GDP has declined. This favourable trend reflects moderate fiscal deficits, significant privatisation revenues, and modest but consistent economic growth, except for 2001.

The Ministry of Finance manages Macedonia's public debt and according to the Public Debt Law is obliged by the end of 2005 to prepare the first medium term Public Debt Management Strategy which will cover the years 2006 to 2008.

External Public Debt

The following table shows total external public debt at the end of the periods indicated.

	2000	2001	2002	2003	2004	2005[1]
			(EUR millions)			
External Public Debt	1,427.7	1,394.0	1,267.6	1,178.9	1,178.1	1,228.0
Multilateral Creditors	543.3	585.8	596.9	617.9	659.6	731.33
IBRD	128.7	134.3	125.0	122.7	137.8	173.9
CEDB	7.5	6.4	13.9	13.9	16.9	20.0
EIB	70.1	82.2	95.7	91.2	103.8	112.1
IFAD	3.3	4.6	50	5.4	7.9	10.9
IDA	268.6	289.6	283.8	286.4	285.3	290.6
EBRD	11.1	8.9	6.4	8.3	17.8	33.8
EUROFIMA	14.1	9.7	5.1	0.0	0.0	0.0
EU	40.0	50.0	62.0	90.0	90.0	90.0
Bilateral Creditors	338.9	308.7	248.2	192.7	161.9	148.9
1995 Rescheduling[2]	255.3	217.8	175.1	135.0	111.7	94.6
Non-rescheduled debt[2]	11.4	10.1	8.7	7.6	6.6	6.6
2000 Rescheduling[2]	20.7	35.8	27.5	14.4	7.0	0.0
Newly concluded credits	51.6	45.0	36.8	35.7	36.5	47.7
Private creditors	271.6	297.4	243.8	194.9	171.2	163.5
London Club	271.6	296.9	243.5	194.7	171.2	163.5
Other private creditors	0.0	0.5	0.3	0.2	0.0	0.0
NBRM Debt	87.7	80.3	64.7	54.7	46.0	36.9
IMF	87.7	80.3	64.7	54.7	46.0	36.9
Public Enterprises Debt	186.2	121.8	114.0	118.7	139.4	147.5
IBRD	3.3	6.7	14.6	22.1	26.6	26.4
EUROFIMA	3.9	6.2	6.4	6.1	6.1	6.1
EIB	4.1	3.1	2.3	1.5	5.0	10.5
EBRD	49.1	29.0	9.6	8.2	7.2	12.0
IFC	48.4	0.0	0.0	0.0	0.0	0.0
Bilateral creditors	8.6	5.8	14.8	14.0	18.8	16.7
Other private creditors	68.9	71.0	66.4	66.8	75.7	75.7
Government guaranteed debt	128.6	119.1	124.5	126.2	134.6	166.0

(1) Projection, excluding any anticipated proceeds from the issue of the Notes.

(2) Paris club of creditors debt. Macedonia is currently in discussions with Italy and Croatia regarding the status and resolution of an unreconciled claim in the amount of approximately EUR 5.0 million (inclusive of interest) arising out of a Yugoslavia-era credit extended by Italy. This amount is not reflected in the debt table.

Source: Ministry of Finance and NBRM

Debt from multilateral creditors is the largest proportion of external public debt, constituting 64% of external public debt at 31 July 2005. The principal multilateral creditors are the International Development Agency ("IDA") and the World Bank to which Macedonia owed EUR303.5 million and EUR185.5 million, respectively, as at 31 July 2005. In 2004, as a result of new borrowing, the relative share of debt to multilateral creditors was higher than in 2003. Debt to London Club creditors fell from the year 2000 to 31 July 2005, as a result of principal repayments. For the same reason debt to Paris Club creditors fell over the same period. Public enterprise debt increased from 2001 to 31 July 2005, due to higher borrowing.

External Public Debt by Type of Currency

The following table shows external public debt by currency (as a percentage of total external public debt) as at 31 July 2005.

Currency	**As at 31 July 2005**
EUR	35%
USD	35%
SDR[1]	29%
Other[2]	1%

(1) Special drawing rights

(2) Other currencies include Japanese Yen, Swedish Krona, Danish Krona, Swiss Franc and Sterling

Source: Ministry of Finance and NBRM

As at 31 July 2005, USD denominated debt (35 %) was at a significant level, approximately the same level as in recent years. As the denar is informally pegged to the euro, depreciations of the US dollar relative to the euro reduces the debt and debt servicing requirements expressed in denar. Because most of Macedonia's revenues from exports are in euro, the potential benefits from US dollar depreciation are significant.

External Public Debt by Type of Interest Rate

53% of the external public debt is floating interest rate and the remainder is fixed rate.

Debt Service on External Public Debt

Debt service (principal and interest payments) on external public debt fell from EUR128.0 million in 2003 to EUR108.4 million in 2004 largely as a result of lower stock of debt and depreciation of the US dollar relative to the euro. The external public debt service ratio decreased to 8% of exports in 2004 from 11% in 2003. By the end of 2009, annual payments on the external public debt service are expected to increase to approximately EUR149.9 million.

The following table shows historical and projected external public debt payments for the periods indicated. The projected payments in 2005 and beyond are for external public debt outstanding as at 31 July 2005. The table does not include provisions for refinancing existing external public debt as it matures and assumes interest and exchange rates as at 31 July 2005 are maintained.

External Public Debt Payments for 1999-2009

Period	**Principal payments**	**Interest payments**	**Total amount**
		(EUR millions)	
1999	47.0	39.3	86.4
2000	75.6	58.5	134.1
2001	79.0	54.8	133.8
2002	75.3	44.3	119.6
2003	91.0	37.0	128.0
2004	79.0	29.4	108.4
2005	69.2	32.9	102.1
2006	87.0	37.0	124.0
2007	94.9	36.6	131.6
2008	100.1	36.4	136.5
2009	114.6	35.2	149.9

Source: NBRM

Debt Payment Record

Since independence, Macedonia has agreed with creditors a restructuring of the debt incurred during the existence of Yugoslavia. Restructuring agreements were reached with the Paris and London clubs of creditors in 1995 and 1997, respectively, and with the IMF and World Bank in 1994.

Further debt rescheduling and reduction arrangements were also reached in 1996 and 2000 with its Paris Club creditors. Since 2000, Macedonia has not been in default on any of its public debt whether external or domestic, and there are currently no arrears. See "Relationship with Creditors" below.

Domestic Public Debt

Domestic public debt was issued for the first time in 1996, not to finance the budget deficit but to resolve certain structural problems that occurred after the independence of the country. Bonds were issued: (i) to compensate individuals who held foreign currency deposits in Macedonia before independence; (ii) as compensation for property nationalised on behalf of the state in the period from 1945 to 1990; and (iii) for the rehabilitation and privatisation of the banking system.

Domestic public debt of the Republic of Macedonia comprises the following: structural bonds, treasury bills, municipal debt and debt of the public enterprises.

In addition to this debt, the government extended guarantees to Macedonian companies for credit from Macedonian commercial banks.

As of 31 July 2005 the Republic of Macedonia has issued five structural bonds: (a) bonds issued for rehabilitation of Stopanska Banka AD Skopje; (b) bonds issued to the NBRM to compensate it for its financial support of banks during the banking rehabilitation process; (c) Stopanska Banka Privatisation Bond; (d) bonds for old foreign currency deposits (issued as compensation to all individuals who held foreign currency deposits in Macedonia in banks before the independence); and (e) denationalisation bonds (issued as compensation for the property nationalised on behalf of the state in the period from 1945 to 1990). Four issues of denationalisation bonds have taken place since 2002, and a further two issues (in the aggregate amount of EUR120 million) are expected before 2008.

The average maturity of the domestic public debt as at July 2005 was 4.3 years.

The following sets forth the different categories of total domestic public debt for the periods indicated.

	2000	2001	2002	2003	2004
			(EUR millions)		
Domestic Public Debt (total excl guarantees)	**711.7**	**681.6**	**626.9**	**593.6**	**590.1**
Structural Bonds	711.7	681.6	626.9	593.6	557.9
Treasury Bills	0.0	0.0	0.0	0.0	31.1
Municipal Debt[(1)]	n/a	n/a	n/a	n/a	n/a
Public Enterprise Debt	n/a	n/a	n/a	n/a	n/a
Government Guaranteed Debt[(2)]	n/a	n/a	n/a	n/a	1.1

(1) Data on municipal and public enterprise domestic debt are not available due to the lack of obligation for reporting until the adoption of the Public Debt Law (2005)

(2) The total exposure of Macedonia under government guaranteed debt is not available.

Source: Ministry of Finance

The following table shows the structural bonds by types and conditions under which they were issued

Purpose for which bonds are issued	Amount issued	Issue currency and settlement	Year of issuance	Year of repayment of the I instalment	Year of repayment of the last instalment	Deadline for repayment per years	Interest rate	Date of principal repayment	Date of interest repayment	Debt stock 31st July 2005	Trading price of the MSX as of 31st July 2005
Stopanska Banka Re-habilitation Bonds	MKD6 billion	MKD	1996	1996	2010	15	discount rate of the Central Bank (currently 6.5%)	1 April	each month	26.6	not traded
Bond for selective credits	MKD 1,039 billion	MKD	1996	–	2020	25	interest free	–		17.0	not traded
Bond for old foreign exchange saving	EUR 546.5	Euro denominated, MKD settled	2000	1 April 2002	1 October 2011	10	2% annually	1 April & 1 October	1 April & 1 October	332.0	74.5
Stopanska Banka Privatisation Bond	EUR 120.1 million	Euro denominated, MKD settled	2001	31 31 March 2002	December 2014	+ 1 14	EURIBOR 31 June, percentage point	31 March, 31 June, 30 Sept. & 31 December	31 March, 30 Sept. & 31 December	81.5	not traded
First issue of denationali-sation bonds	EUR2.5 million	Euro denominated, MKD settled	2002	1 June 2003	1 June 2012	10	2% annually	1 June 2003	1 June 2003	0.9	69
Second issue of denationali-sation bonds	EUR39.5 million	Euro denominated, MKD settled	2003	1 June 2004	1 June 2013	10	2% annually	1 June 2004	1 June 2004	25.0	68
Third issue of denationali-sation bonds	EUR47 million	Euro denominated, MKD settled	2004	1 June 2005	1 June 2014	10	2% annually	1 June 2005	1 June 2005	31.9	65.3
Fourth issue of denationali-sation bonds	EUR58 million	Euro denominated, MKD settled	2005	1 June 2006	1 June 2015	10	2% annually	1 June 2006	1 June 2006	55.1	63.5
TOTAL										**570.0**	

Source: Ministry of Finance

Since 2004, the Ministry of Finance has implemented the strategy for developing the domestic government securities market, initially issuing treasury bills. Although some of the structural bonds are tradable they were not designed as conventional market instruments. To date the Ministry has issued 3, 6 and 12 month treasury bills and by the end of 2005 is planning to introduce a 2 year treasury bond (all are MKD denominated). In this way, the Ministry is gradually extending the yield curve of the government securities and reducing the refinancing risk. The medium term strategy of the Ministry of Finance is steadily to increase its reliance on the domestic capital market to satisfy its financing needs.

Relationship with Creditors

London Club

Macedonia issued Capitalisation Bonds due 2012 to its London Club creditors in March 1997. The current outstanding principal is EUR163.5 million. Principal and interest payments are made on the bonds on a semi annual basis over an 11 year period which commenced on January 2002 with a progressive interest rate. Interest on the bonds is LIBOR plus 13/16 of one percent. The interest rate for the current interest period is 3.65%. The Capitalisation Bonds are listed on the Luxemburg Stock Exchange. Macedonia has the right to redeem any or all of the bonds on any interest payment date, at a redemption price of par plus accrued and unpaid interest through the redemption date.

Paris Club

Macedonia agreed to the restructuring of certain of its official debt to Paris Club creditors in 1995, 1996 and 2000. This Paris Club debt amounts EUR111.4 million, but its structure according the original currency of the debt comprises: USD70.3 million, EUR43.5 million, SEK3.8 million, JPY103.7 million, GPB0.7 million, DKK5.3 million and CHF10.2 million. The debt to the Paris Club creditors includes as well as rescheduled debt, non rescheduled debt towards Germany. The overall debt towards the Paris Club, except for the non-rescheduled debt towards Germany, is repaid on semi annual basis. The precise conditions for debt repayment differs for each Paris Club creditor but is based on market interest rates in the relevant currency.

Relationship with international financial institutions and multilateral donors

Macedonia's receipt of funds from international financial institutions and multilateral donors continues to be closely related to the implementation of economic policy reforms recommended by the IMF and World Bank, among others. Macedonia is current on its debt service to all international financial institutions.

International Monetary Fund

Since 1994, Macedonia has received assistance from the IMF in the form of three stand by agreements, one STF, one ESAF arrangement, one CCFF arrangement, one EFF arrangement and one PRGF arrangement. The IMF has historically worked closely with the government of Macedonia to encourage structural reform to increase the pace of economic growth.

World Bank

Since 1993, Macedonia has received assistance from the World Bank (International Bank for Reconstruction and Development and International Development Association) in the form of bank financing targeted to specific projects and reforms. The World Bank has historically worked to maintain macroeconomic stability and develop a sound financial sector in Macedonia. Commitments from the World Bank (IBRD and IDA) to Macedonia have totaled USD655 million from 1993 through 2005. As at 31 July 2005, the total outstanding debt to the World Bank was EUR489.0 million (including EUR185.50 million owed to the IBRD and EUR303.45 million owed to the IDA), representing 30.5% of the total external public debt.

European Bank for Reconstruction and Development

Macedonia became a member of the EBRD in 1993. As at May 2005, the EBRD had approved 26 projects in Macedonia with a total value of EUR844.1 million. The EBRD is especially active in the private sector with 17 approved projects. In the public sector, the EBRD has financed nine projects in the area of telecommunications, energy, transport, civil aviation and local infrastructure.

European Investment Bank

The active cooperation between the EIB and Macedonia began 1998 when the EIB, for the first time, awarded credit to the government of Macedonia as a sovereign borrower. The first road project, financed with a loan in the amount of EUR70 million, was successfully completed in 2004.

Private Foreign Debt

The private foreign debt includes foreign debt of the banking sector and the remaining private sector.

The total private foreign debt as of 31 July 2005 was EUR416.8 million, out of which the banking sector accounted for 21.4%, while the remaining private sector accounted for 78.6%. According to the maturity structure, 89.5% is long term foreign private debt and 10.5% is short term foreign private debt. The private foreign debt shows significant increase from 2000 as a result of the increased liberalisation of foreign credit according to the Foreign Exchange Law (2001).

TAXATION

The following is a summary of certain Macedonian tax consequences resulting from the purchase, ownership and disposition of the notes and is not intended to reflect the individual tax position of any beneficial owner. This summary is based upon the laws, regulations, rulings and decisions now in effect, all of which are subject to change.

Persons considering the purchase of the notes should consult their own tax advisers concerning the application of Macedonian tax laws to their particular situations as well as any consequences of the purchase, ownership and disposition of the notes arising under the laws of any other taxing jurisdiction.

Macedonian Taxation

Non-resident Holders

A non-resident holder of a Note will not be subject to Macedonian taxes on receipt from the republic of amounts payable in respect of principal or interest on the Notes.

A non-resident holder generally should not be subject to any Macedonian taxes in respect of gains or other income realised on the sale or other disposition of the Notes outside the Republic.

A non-resident holder which is a legal person or organisation should not be subject to withholding tax on any gain on sale or other disposal of the Notes even if payment is received from a source in the Republic.

Resident Holders

A holder of a Note who is a physical or legal person resident in the Republic is subject to all applicable Macedonian taxes.

EU Taxation of Savings Directive

On 1 July 2005 a new EU Directive regarding the taxation of savings income payments came into effect. The directive obliges a Member State to provide to the tax authorities of another member State details of payments of interest or other similar income payments made by a person within its jurisdiction for the immediate benefit of an individual or to certain non-corporate entities resident in that other Member State (or for certain payments secured for their benefit). However, Austria, Belgium and Luxembourg have opted out of the reporting requirements and are instead applying a special withholding tax for a transitional period in relation to such payments of interest, deducting tax at rates rising over time to 35 per cent. This transitional period commenced on 1 July 2005 and will terminate at the end of the first fiscal year following agreement by certain non-EU countries to the exchange of information relating to such payments.

Also with effect from 1 July 2005, a number of non-EU countries and certain dependent or associated territories of Member States have adopted similar measures (either provision of information or transitional withholding) in relation to payments of interest or other similar income payments made by a person in that jurisdiction for the immediate benefit of an individual or to certain non-corporate entities in any Member State. The Member States have entered into reciprocal provision of information or transitional special withholding tax arrangements with certain of those dependent or associated territories. These apply in the same way to payments by persons in any Member State to individuals or certain non-corporate residents of those territories.

Prospective investors resident in a Member State of the European Union should consult their own legal or tax advisers regarding the consequences of the directive in their particular circumstances.

SUBSCRIPTION AND SALE

Citigroup Global Markets Limited (the "**Manager**") has, in a subscription agreement dated 5 December, 2005 (the "**Subscription Agreement**") and made between the Republic and the Manager upon the terms and subject to the conditions contained therein, agreed to subscribe and pay for the Notes at their issue price of 99.467 per cent. of their principal amount plus any accrued interest in respect thereof and less a combined management, underwriting and selling commission of 0.225 per cent. of their principal amount. The Manager is entitled in certain circumstances to be released and discharged from its obligations under the Subscription Agreement prior to the closing of the issue of the Notes.

United States

The Notes have not been and will not be registered under the Securities Act and may not be offered or sold within the United States except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act. The Manager has represented, warranted and undertaken to the Republic that is has not offered or sold, and will not offer or sell, any Notes except in accordance with Rule 903 of Regulation S under the Securities Act.

United Kingdom

The Manager has represented, warranted and undertaken that:

(a) it has only communicated or caused to be communicated and will only communicate or cause to be communicated an invitation or inducement to engage in investment activity (within the meaning of Section 21 of the FSMA) received by it in connection with the issue or sale of the Notes in circumstances in which Section 21(1) of the FSMA does not apply to the Republic; and

(b) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the Notes in, from or otherwise involving the United Kingdom.

Italy

The offering of the Notes has not been registered with the Commissione Nazionale per la Società e la Borsa ("CONSOB") (the Italian securities exchange commission) pursuant to the Italian securities legislation and, accordingly, the Notes cannot be offered, sold or distributed nor any copies of the Prospectus or any other document relating to the Notes can be distributed in the Republic of Italy ("Italy") in a solicitation to the public at large (sollecitazione all'investimento) within the meaning of Article 1, paragraph 1, letter (t) of Legislative Decree no. 58 of 24 February 1998, unless an exemption applies. Accordingly, the Notes in Italy:

(a) shall only be offered or sold to professional investors (operatori qualificati), as defined in Article 31, second paragraph of CONSOB Regulation No 11522 of 1 July 1998 (the "Regulation No 11522"), as amended, and effected in compliance with the terms and procedures provided therein; or

(b) shall only be offered or sold in circumstances which are exempted from the rules of solicitation of investments pursuant to Article 100 of Legislative Decree No 58 of 24 February 1998 (the "Financial Services Act") and Article 33, first paragraph, of CONSOB Regulation No 11971 of 14 May 1999,

but, in any case, cannot be offered, sold and/or delivered, either in the primary or in the secondary market, to individuals in Italy, and in any event, the offer or sale of the Notes in Italy shall be effected in accordance with all relevant Italian securities, tax and exchange control and other applicable laws and regulations.

Moreover and subject to the foregoing, the Notes may not be offered, sold or delivered and neither the Prospectus nor any other material relating to the Notes may be distributed or made available in Italy unless such offer, sale or delivery of Notes or distribution or availability of copies of the Prospectus or any other material relating to the Notes in the Italy is:

(a) made by investment firms, banks or financial intermediaries permitted to conduct such activities in Italy in accordance with the Financial Services Act, Legislative Decree No 385 of 1 September, 1993 (the "Italian Banking Act"), the Regulation No 11522 and any other applicable laws and regulations;

(b) in compliance with Article 129 of the Italian Banking Act and the implementing instructions of the Bank of Italy, pursuant to which the issue, trading or placement of securities (e.g., Notes) in Italy is subject to prior and subsequent notification to the Bank of Italy, unless an exemption, depending *inter alia* on the amount of the issue and the characteristics of the securities, applies, and

(c) in compliance with any other applicable requirement or limitation which may be imposed from time to time by CONSOB or the Bank of Italy.

Insofar as the requirements above are based on laws which are superceded at any time pursuant to the implementation of the Prospectus Directive, such requirements shall be replaced by the applicable requirements under the Prospectus Directive.

The Republic of Macedonia

The Manager has represented, warranted and undertaken that it has not offered or sold and will not offer or sell the Notes to any person in the Republic of Macedonia other than to certain institutions who are authorised in the Republic of Macedonia within the meaning of the Foreign Exchange Law.

General

No action has been or will be taken in any jurisdiction by the Republic or the Manager that would, or is intended to, permit a public offering of the Notes, or possession or distribution of this Prospectus or any other offering material, in any country or jurisdiction where action for that purpose is required. Persons into whose hands this Prospectus comes are required by the Republic and the Manager to comply with all applicable laws and regulations in each country or jurisdiction in which they purchase, offer, sell or deliver Notes or have in their possession, distribute or publish this Prospectus or any other offering material relating to the Notes, in all cases at their own expense.

GENERAL INFORMATION

1. Authorisation

The creation and issue of the Notes has been authorised by Macedonia, acting through the President of the government of the Republic of Macedonia.

2. Litigation

Except as disclosed on page 32 of this Prospectus, the Republic is not and has not been involved in any governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the Republic is aware) during the previous 12 months which may have, or have had in the recent past, a significant effect on the Republic's financial position.

3. Significant Change

Save as disclosed on pages 58-59, 49 and 51-53 of this Prospectus, there has been no significant change in relation to the public finances, balance of payments and trade, respectively, of the Republic since the fiscal year ended 31 December 2004.

4. Documents available for inspection

For so long as any of the Notes are outstanding, copies of the following documents may be inspected (and in the case of (a), obtainable) during normal business hours at the Specified Office of each Paying Agent:

(a) this Prospectus;

(b) the Subscription Agreement;

(c) the Fiscal and Paying Agency Agreement;

(d) the Budget of the Republic for the current fiscal year; and

(e) budgetary review bulletins for the last 2 fiscal years.

5. Enforceability of Judgments

Enforceability of Judgments

Under Macedonian law, a final judgment in a civil proceeding rendered by a court outside the Republic will be enforced on territory of the Republic without re-examination of the merits if such judgment meets the prerequisites for recognition prescribed by Macedonian law.

A final judgment will meet the presumptions for recognition if (i) the defendant had an opportunity to appear and be heard in connection with the original proceeding; (ii) Macedonian courts did not have exclusive jurisdiction over the subject matter of the original proceeding; (iii) there are no pending legal proceedings before or a final judgment of a Macedonian court involving the same factual circumstances; and (iv) enforcement of the judgment does not violate public order of Macedonia.

A final judgment will not be recognised if there is no formal or factual reciprocity in recognition of final judgments between the Republic and the state where the final judgment was rendered. The existence of this reciprocity is assumed, unless proven otherwise, and no such proof otherwise exists in the case of judgments rendered in the United Kingdom.

6. Macedonian Taxation

There are no Macedonian withholding taxes levied on payments of principal or interest in respect of the Notes paid to foreign tax residents.

7. European Directive on the Taxation of Savings

Under EC Council Directive 2003/48/EC on the taxation of savings income, each Member State is required to provide to the tax authorities of another Member State details of payments of interest or other similar income paid by a person within its jurisdiction to, or collected by such a person for, an individual resident in that other Member State; however, for a transitional period, Austria, Belgium and Luxembourg may instead apply a withholding system in relation to such payments, deducting tax at rates rising over time to 35 per cent. The transitional period is to terminate at the end of the first full fiscal year following agreement by certain non-EU countries to the exchange of information relating to such payments.

Also with effect from July 1, 2005, a number of non-EU countries, and certain dependent or associated territories of certain Member States, have agreed to adopt similar measures (either provision of information or transitional withholding) in relation to payments made by a person within its jurisdiction to, or collected by such a person for, an individual resident in a Member State. In addition, the Member States have entered into reciprocal provision of information or transitional withholding arrangements with certain of those dependent or associated territories in relation to payments made by a person in a Member State to, or collected by such a person for, an individual resident in one of those territories.

8. Interested Persons

No person involved in the offering of the Notes (the "**Offering**") has any interest in the Offering which is material to the Offering.

Delivery of Notes

The Notes have been accepted for clearance through Euroclear and Clearstream, Luxembourg. The ISIN is XS0238022445 and the common code is 023802244.

THE REPUBLIC

Ministry of Finance of
the Republic of Macedonia
14, Dame Gruev Street
Skopje 1000
Republic of Macedonia

FISCAL AGENT

Citibank N.A.
21st floor, Citigroup Centre
Canada Square, Canary Wharf
London
E14 5LB

PRINCIPAL PAYING AGENT

Citibank N.A.
21st floor, Citigroup Centre
Canada Square, Canary Wharf
London
E14 5LB

REGISTRAR AND TRANSFER AGENT

Citibank N.A.
21st floor, Citigroup Centre
Canada Square, Canary Wharf
London
E14 5LB

LEGAL ADVISERS

To the Republic as to English Law:

White & Case
5 Old Broad Street
London EC2N 1DW

To the Republic as to Macedonian law:

The Ministry of Justice of
the Republic of Macedonia
9 Dimitrija Chupovski Street
Skopje 1000
Republic of Macedonia

To the Manager as to English law:

Latham & Watkins
99 Bishopsgate
London EC2M 3XF

To the Manager as to Macedonian law:

Law Office Polenak
Orce Nikolov 98
1000 Skoyge, Macedonia

printed by **eprint*financial*.com**
tel: + 44 (0) 20 7613 1800 document number 3362