



Report on the public debt of the Republic of Macedonia for the first half of 2007

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Skopje, August 2007

1. Significant activities in the first half of 2007

- **Public debt reduction** – Total public debt in the Republic of Macedonia in the first half of 2007 declined by EUR 156.2 million, i.e. by 8.5% in relation to GDP and is 30.7%. External public debt in December 2006 amounted to EUR 1,180.6 million and constantly declines, so at end-June 2007 it amounted to EUR 1,012.8 million, i.e. it declined by 14.2%. Domestic public debt in December 2006 amounted to EUR 651.2 million and by end-June 2007 it grew by EUR 11.6 million, i.e. by 1.8%, due to the issue of the sixth denationalisation bond and the growth of net issues of treasury bills for monetary purposes.

General government debt also significantly declined by EUR 156.1 million and as of June 2007 it amounted to EUR 1,517.5 million compared to December 2006 when it amounted to EUR 1,673.6 million. In relation to GDP, government debt declined by 5.6 percentage points and as of June it was only 27.8% which is significantly lower than the Maastricht criteria, according to which general government debt must not exceed 60% of GDP.

The ratio between domestic and external debt improved and as of June 2007, the share of the domestic public debt in the total public debt was 39.6 %, while the share of external debt was 60.4%. In December 2006 this ratio was 35.6% and 61.3%, respectively. This improvement in the ratio between the domestic and external debt is due above all to the increase in the share of treasury bills for monetary purposes, due to the constant increase of net issues of continuous government securities, as well as early repayment of external public debt.

From the aspect of **interest structure**, favourable changes also occurred with regard to the total public debt. In fact, by pursuing the objective of the strategy to increase the part of the debt with fixed interest rate, in the period January-June 2007 the external public debt with fixed interest rate grew by around 6 percentage points, which is a result of the buyback of the debt towards the London Club of Creditors, the World Bank and the IMF, where variable interest rate credits prevailed. At the same time, within the domestic public debt, fixed interest rate debt declined as a result of the issuance of treasury bills for monetary purposes, treated as variable interest rate debt (due to their 3-month maturity period).

Positive changes also occurred in the **currency structure** of public debt, which aims at meeting the objectives of the Public Debt Management Strategy, to the end of increasing the part of the public debt denominated in domestic currency and the debt denominated in EUR. Thus, as a result of the buyback and the increased volume of issues of government securities and treasury bills for monetary purposes, in June 2007, the debt denominated in EUR and Denars, compared to 2006, grew by 1.9 percentage points, i.e. by 3.4 percentage points respectively, and at the same time, as a result, public debt denominated in US dollars declined by 6.4 percentage points.

Despite the gradual reduction of the **maturity structure** of the general government debt in the past years, in the first half of 2007 the average time to maturity of the general government debt grew from 6.85 years in December 2006 to 7.11 years in June 2007. This, above all is a result of the buyback of the credits with shorter maturities in this period. The domestic debt shows slight decline in maturity period resulting from the gradual amortisation of structural bonds, the redemption of the continuous bond no.2 in 2005, issued with 5-year maturity and the redemption of the bond for rehabilitation of Stopanska Banka AD Skopje (it falls due until 2010) and the small number of issues of long-term continuous government securities.

- **Early redemption of the debt towards the Paris Club of Creditors** - In order to reduce interest costs to the Budget of the Republic of Macedonia and to use the high level of resources from the foreign currency deposit of the Ministry of Finance, and under the multilateral agreement signed in Paris on January 24, 2007 with 13 member states of the Paris Club, the Republic of Macedonia, in the period January 31 – April 30, 2007 made early redemption of the overall debt towards the Paris Club of Creditors in the amount of EUR 77 million at nominal value and without additional penalties or fees. The objectives for this operation are the following:

- public debt portfolio restructuring aimed at reduction of the external public debt in non-Euro currencies.
 - reduction of the variable interest rate debt, as well as making interest savings in the 2007 Budget of the Republic of Macedonia in the amount of EUR 2.5 million, and interest savings will be made until 2011 in the total amount of EUR 9.8 million.
- By April 30, 2007, twelve agreements were signed with the member states of the Paris Club of Creditors and payments were made thereunder. The overall operation is expected to be completed with the signing of the new bilateral agreement with Italy.
- In July 2007, the Republic of Macedonia will sign a bilateral agreement for consolidation and repayment of certain debts with Italy. This is mainly a debt of Macedonian enterprises which used credits from Italy through banks from other countries from the former SFRY within the Paris Club of Creditors.

The Republic of Macedonia was the first country from former SFRY countries which in 1998, within the Paris Club of Creditors regulated the debt inherited from former SFRY towards Italy. Still, in the following period, an additional debt occurred which had not been covered with the 1998 agreement. In order to regulate these debts, both sides started negotiations, setting the conditions and the manner of regulating the debt towards Italy.

The Agreement sets rescheduling of the debt in the amount of EUR 6.785.821,75 and US\$ 1,194,779,5 and full redemption along with other debts towards Italy for which agreement had already been agreed upon within the Club of Creditors. In addition, the debt treated as development assistance in the amount of US\$ 1.800.833,65 was agreed not to be repaid, but rather to be converted into projects of social and development nature, i.e. the project, „Computers for primary schools“, or, as an alternative, to the following projects:

 - Project for modernization of the Customs Administration - procurement of mobile X-ray system for inspection of large vehicles and containers
 - Subsidizing of hiring of single parents, handicapped persons and orphans;
 - Rehabilitation of the landslide in Ramnina in Veles

The agreement is expected to be ratified by the Parliament of the Republic of Macedonia during the third quarter of 2007, followed by full redemption of the Italian debt by the Republic of Macedonia in the total amount of around EUR 10 million.
 - **Early redemption of the bond for rehabilitation of Stopanska Banka AD Skopje**– On April 1, 2007, the Ministry of Finance made early redemption of the bond for rehabilitation of Stopanska Banka AD Skopje at nominal value in the amount of Denar 1,302.5 million. The early redemption for the period April 2007 – March 2010 would result in total saving on the basis of interest costs in the amount of Denar 205.66 million. Taking into account that this bond was issued for structural purposes, this redemption operation would improve the characteristics of the total public debt portfolio so as to reduced the share of the debt issued under non-market conditions and improve the image of the Republic of Macedonia with the credit rating agencies.
 - **Issuance of the sixth issue of the denationaliation bonds**- Pursuant to the Law on Issuance of Denationalisation Bonds in the Republic of Macedonia (Official Gazette of the Republic of Macedonia, no. 37/02), the sixth denationalisation bond in the amount of EUR 18 million was issued on March 1, 2007 (according to the issued prospectus). Terms and conditions for the issuance of this bond are identical as for the first five issues, i.e. 10-year maturity period and 2% fixed interest rate. The first instalment of this bond falls due on June 1, 2008, and it is listed on the Macedonian Stock Exchange AD Skopje as from March 14, 2007.
 - **Buyback of the debt towards the International Bank for Reconstruction and Development completed**- on April 4, 2007 the Government has approved the realization of a buyback of the debt towards IBRD in the amount of EUR 96.1 million. The objective of this buyback is further improvement of the structure of the debt portfolio and its exposure to interest and currency

risks. Also for this operation, interest savings are planned in the amount of EUR 2.7 million in 2007 only, and savings continue to be realized until 2021 in the total amount of EUR 32.7 million, of which the Road Fund only would realize interest savings of EUR 9.6 million. On the basis of the analyses of the savings in net present value, the effect of the buyback is EUR 3.1 million.

On June 11, 2007 the Ministry of Finance made successful buyback.

From the aspect of the **interest costs** directly affecting the Budget of the Republic of Macedonia, the early redeemed credits are with unfavourable (high) variable interest rates. The average weighted interest rate for all 6 loans is 5.6%. This interest rate is higher than the current interest rates at which the Republic of Macedonia could borrow on the foreign markets (6-month LIBOR for euros, increased by 0.5 percentage points margin, which is approximately 4.5%).

From the aspect of the **currency structure**, most of the redeemed credits have been concluded and are being repaid in non-euro currencies (78% of the credits are US\$-denominated) which is contrary to the objectives in the medium-term Public Debt Management Strategy, whereby one of the basic objectives is increase of the debt in euros within the external public debt. The trends in the EUR-US\$ exchange rate is in favour of this redemption since the Ministry of Finance used the weak position of the dollar and made cheaper redemption of US\$-denominated debt with deposit in euros.

- Early repayment of the debt towards the **International Monetary Fund**- on May 23, 2007 the National Bank of the Republic of Macedonia made full early repayment of the liabilities of the Republic of Macedonia under concessional and non-concessional loans towards the IMF in the total amount of SDR 29.19 million (i.e. EUR 32.8 million). According to the initial repayment plans, the maturity period of the loans was until 2010. Total interest savings until 2010 were EUR 1.7 million.
Early repayment of the debt towards the IMF reflects the stronger external position of the Republic of Macedonia, which contributed to greater rating of the Republic of Macedonia in the credit rating agencies and interest savings and reduction of the variable interest rate debt and non-euro debt.
- **Buyback of part of the debt towards the European Investment Bank announce** - the Ministry of Finance, upon the previous analyses proposed to the Government to realize the buyback also of part of the credits towards the EIB, which the Government accepted. These are two credits in the amount of EUR 6.9 million, inherited from the former SFRY, having unfavourable conditions, i.e. high interest rates (fixed interest rates in the amount of 7.65% and 9.5%) and unfavorable currency structure. The redemption will be made on August 15, 2007.
- **Issue of continuous government securities** – during the first half of 2007 twelve issues of 3-month treasury bills were made, six issues of 6-month treasury bills and three issues of 12-month treasury bills. In addition to the issue of short-term government securities two issues were made of 2-year government bonds and one issue of 3year government bond. Interest rates on 3-month government securities slightly declined in this period, with certain variations in certain auctions.
Thus, in January, the average interest rate reached was 6.5%, and the next month it declined to 6.37%. In the next two months there was slight increase by 0,05 percentage points, and after this period, in the next two months, the interest rates declined to 6,16%, i.e. 5,41%, respectively.

Interest rates on 6-month GS declined in January compared to the previous month from 7,02% to 6,76%, followed by slight growth and in February they reached 6,78%, i.e. 6,96% in March, followed again by a decline in June to 5,49%. Interest rates at the auctions of 12-months GS significantly declined in the auctions held in this period. Thus, at the auctions in January and

March, interest rates reached were 8,79% and 8,37% respectively, while at the auction in June, the interest rate declined to 5,81%. Auctions of 2-year government bonds show certain decline in interest rates, whereby the average interest rate at the auction in February was 8,87% and shows decline compared to the October 2006 auction, when it was 9,33%. The average interest rate reached at the next auction in May was 5,73%. According to the announced calendar of auctions, in June an issue of 3-year bond was announced, but it was not realized due to technical difficulties.

Trading on the secondary market in this period of the year grew compared to the previous period both in volume and in number of transactions. There were 23 transactions in treasury bills on the over the counter market with total nominal amount of Denar 501.260.000, with average price of 98,6587 and average yield to maturity of 6,05%. Total of 96 transactions in government bonds were made in the past six months with total nominal amount of Denar 621.810.000 with average price of 99,385 and average yield to maturity of 8,798%.

The eurobond the Republic of Macedonia issued on December 8, 2005 is also traded on the international market. Chart 25 shows the trading prices for the eurobond on the secondary market. As one can notice that in January 2007, the trading is made at relatively high prices followed by a period of decline. This declining trend, especially in June and July was also observed last year and can be observed as a period in which trading on the international market declines in general. In the next period, greater interest is expected in the eurobond as a result of a number of activities undertaken by the Republic of Macedonia to attract foreign investors, contributing to higher trading prices. Also the chart shows approximation of the eurobond price spread to the international benchmark (10-year mid-term spread) showing a declining risk for investment in the eurobond, i.e. that this security is very attractive on the international market and hence, should the Republic of Macedonia decide to reappear on the international capital market, it would enable borrowing with lower interest rates.

- **The Board of Directors of the World Bank approved the second PDPL arrangement** in the amount of US\$ 23,3 million and after the enactment of the Law on Borrowing of the Republic of Macedonia in the Parliament, funds are expected to be disbursed during 2007. The objective of this credit is to promote economic development and job creation via reforms for improvement of the investment climate and reforms for strengthening of the public sector efficiency. Health sector, business environment and judiciary reforms projects are implemented with the assistance of the PDPL 2 project.
- This half of the year is characterized by poor realization of the **disbursements** on the basis of external borrowings of only 35% of the planned, i.e. of the planned EUR 97,8 million only EUR 34,2 million have been disbursed. This low percentage of realization of projects financed with foreign credits carries additional costs on the basis of commitment fees that burden the budget of the Republic of Macedonia.
- In the first half of 2007 additional **improvement was made of the characteristics of the public debt portfolio**, and thus realization of the targets set in the Public Debt Management Strategy (2007-2009).

Targets*	Parameters of the debt portfolio as of December 2006	Parameters of the debt portfolio as of June 2007	Targets for the period 2007-2009
Ratio between total public debt and GDP	35,1%	28,2%	37%-40%

Ministry of finance
Public Debt Management Department

Targets*	Parameters of the debt portfolio as of December 2006	Parameters of the debt portfolio as of June 2007	Targets for the period 2007-2009
Ratio between general government debt and GDP	31,9%	25,3%	34%-37%**
Ratio between total guaranteed debt and GDP	2,8%	2,6%	3.7%-4.1%
Ratio between external and domestic debt	external debt-67,3% domestic debt-32,7%	external debt-65,7% domestic debt-34,3%	external debt-65% domestic debt-35%
Ratio between the debt with fixed and variable interest rate	debt with fixed rate-62,1% debt with variable rate-37,9%	debt with fixed rate-67,1% debt with variable rate-32,9%	debt with fixed rate-70-80% debt with variable rate-20-30%
Ratio between domestic currency debt and foreign currency debt	domestic currency debt-7,6%	domestic currency debt-7,4%	domestic currency debt- 15-20%
Stock of guaranteed public debt	144,7 million EUR	144,8 million EUR	220 million EUR

*When monitoring the realization of the targets and presentation of data, the national methodology was used, according to which central bank debt is not part of the total public debt, and it also excludes treasury bills for monetary purposes. While the data in the remaining part of the report are shown also according to the national methodology, but including the debt on the basis of treasury bills for monetary purposes (since despite the fact that they are issued for monetary policy purposes, primary issuer is the Ministry of Finance).

** According to the program of the Government of the Republic of Macedonia (2006-2010) government debt should not exceed 35% of GDP.

2. Stock of public debt

Table 1

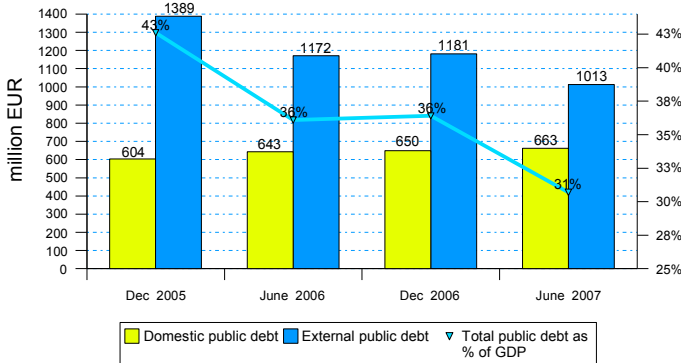
in million EUR	DEC- 2005	JUN- 2006	DEC-2006	JUN-2007
External public debt	1.388,5	1.171,8	1.180,6	1.012,8
General public debt	1.245,4	1.037,7	1.025,2	857,0
Central government debt (consolidated)	1.245,4	1.037,7	1.025,2	857,0
Central government debt	1.208,0	999,5	981,9	823,1
Public funds	37,4	38,2	43,3	33,9
Municipalities	0,0	0,0	0,0	0,0
Central Bank	52,7	47,8	42,4	0,0
Public enterprises	143,2	134,1	155,4	155,8
Domestic public debt	603,7	642,7	651,2	662,9
General public debt	603,7	641,2	648,4	660,5
Central government debt	603,5	641,0	648,2	660,5
Structural bond	533,5	512,0	479,7	430,9
Bond for rehabilitation of Stopanska banka	26,6	21,3	21,3	0,0
Bond for selective credits	17,0	17,0	17,0	17,0
Bond for privatization of Stopanska banka	77,2	73,0	68,7	66,5
Bond for old foreign exchange savings	306,5	280,9	254,9	229,4
Denationalization bond (I, II, III, IV, V and VI issue)	106,2	119,9	117,8	118,0
Continuous government securities	70,0	129,0	168,6	229,6
Out of which treasury bills for monetary purpose	0,0	43,6	75,9	134,1
Municipalities	0,2	0,2	0,2	0,0
Central bank	146,7	110,6	155,3	247,7
Public enterprises	N/A	1,5	2,8	2,4
TOTAL PUBLIC DEBT -PUBLIC DEBT LAW	1.992,2	1.814,5	1.831,8	1.675,7
GDP	4.653,6	5.003,4	5.003,4	5.462,7
Average export	1.640,4	1.913,5	1.913,5	2.122,4
External public debt as % of total public debt	69,7	64,6	64,4	60,4
Domestic public debt as % of total public debt	30,3	35,4	35,6	39,6
Total public debt as % of GDP	42,8	36,3	36,6	30,7
Total public debt as % of average export	121,4	94,8	95,7	79,0
General government debt	1.849,0	1.678,7	1.673,6	1.517,5
External debt of the general government as % of the total general government debt	67,4	61,8	61,3	56,5
Domestic debt of the general government as % of the total general government debt	32,6	38,2	38,7	43,5
General government debt as % of average GDP	39,7	33,6	33,4	27,8
General government debt as % of average export	112,7	87,7	87,5	71,5
Foreign currency denominated debt of the general government as % of the total general government debt	93,8	90,0	87,6	83,8
Interest payment of general government debt as % of total revenues of the general government	2,6	3,1	3,0	4,0
TOTAL PUBLIC DEBT according to the GFS methodology	2.191,6	1.972,9	2.029,5	1.923,4
External debt as % of total public debt	65,8	61,8	60,3	52,7
Domestic debt as % of total public debt	34,2	38,2	39,7	47,3
Total public debt as % of GDP	47,1	39,4	40,6	35,2
Total public debt as % of average export	133,6	103,1	106,1	90,6

Source: Ministry of Finance and NBRM

* according to the GFS methodology, in addition to the general government debt and the debt of the public enterprises, central bank debt is also included.

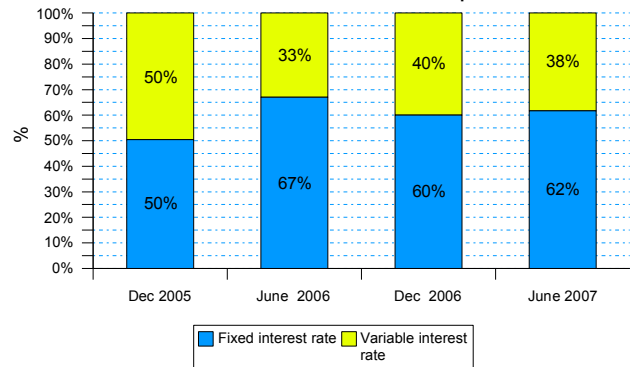
2.1. Public debt structure

Chart 1
Domestic and external debt



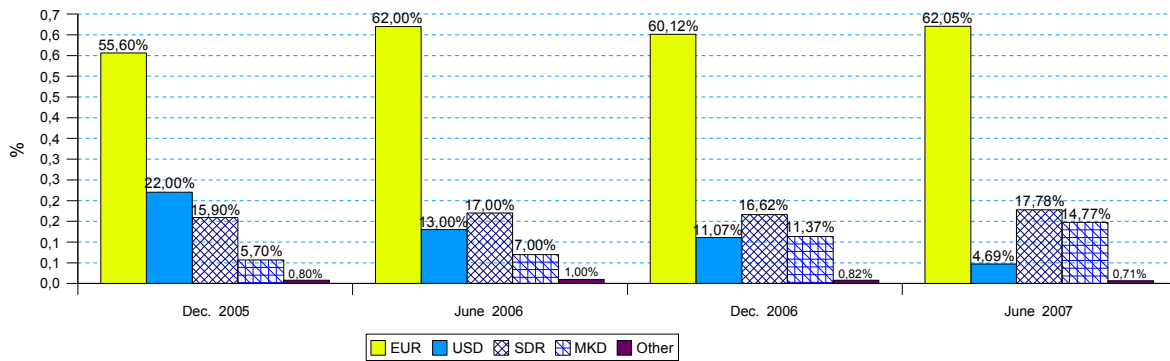
Source: Ministry of Finance and NBRM

Chart 2
Interest rate structure of the total public debt



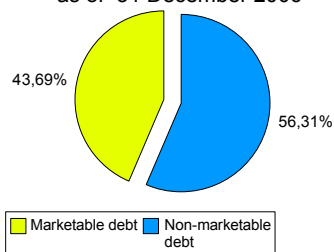
Source: Ministry of Finance and NBRM

Chart 3 Currency structure of the total public debt



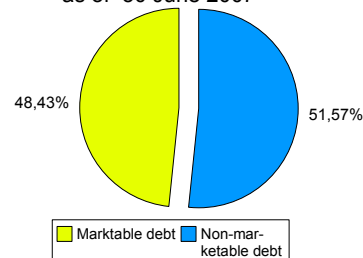
Source: Ministry of Finance and NBRM

Chart 4
Marketable and non-marketable public debt
as of 31 December 2006

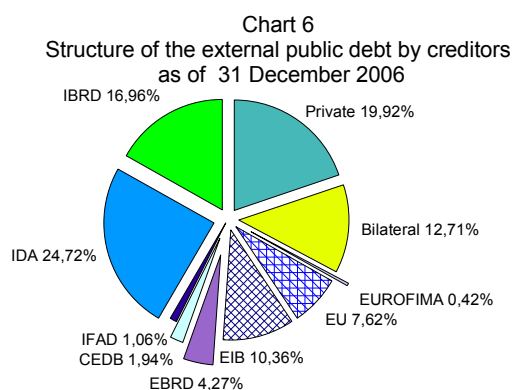


Source: Ministry of Finance and NBRM

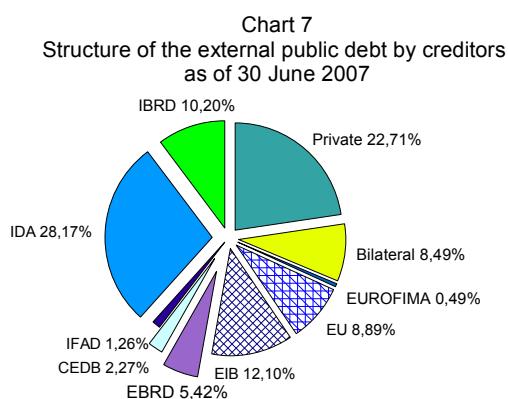
Chart 5
Marketable and non-marketable public debt
as of 30 June 2007



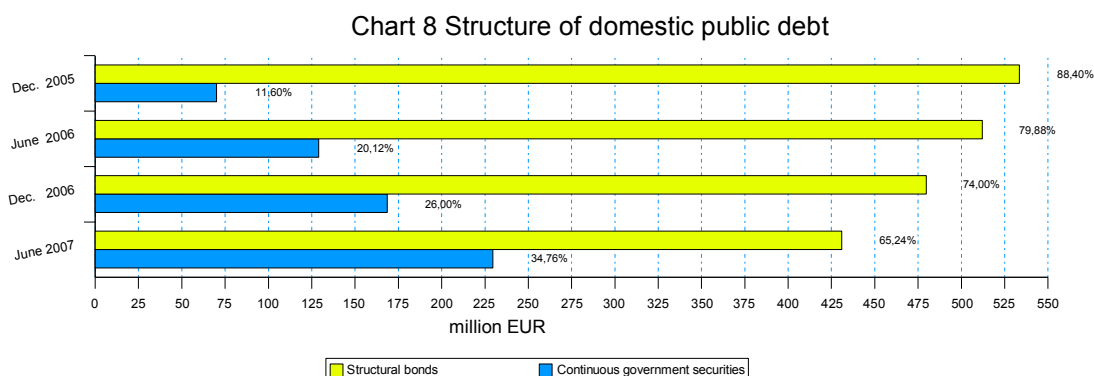
Source: Ministry of Finance and NBRM



Source: Ministry of Finance and NBRM



Source: Ministry of Finance and NBRM



Source: Ministry of Finance and NBRM

2.2 Risk indicators of the public debt portfolio

Table 2

	Average time to maturity-ATM (in years)			
	31.12.05	30.06.06	31.12.2006	30.06.2007
Domestic debt	3,71	3,55	3,03	2,99
External debt	9,51	9,24	8,98	9,6
Total debt	7,38	7,16	6,85	7,11

Source: MoF

Table 3

	Average time to refixing-ATR (in years)			
	31.12.05	30.06.06	31.12.06	30.06.07
Domestic debt	3,07	3,00	2,57	2,50
External debt	7,18	6,20	7,12	7,92
Total debt	5,67	5,13	5,46	5,82

Source: MoF

Table 4

	Duration of domestic debt (in years)			
	31.12.05	30.06.06	31.12.2006	30.06.2007
Structural bonds	2,81	2,83	2,92	2,45
Continuous government securities	0,94	0,88	0,55	0,62
Total domestic debt	2,63	2,59	2,52	2,12

Source: MoF

3. Funds disbursed on the basis of external and domestic borrowing

Disbursements on the basis of external borrowing

Table 5

	In million EUR	JUL-DEC 2005	JAN-JUN 2006	JUL-DEC 2006	JAN-JUN 2007	JAN-JUN 2007 proj.	Realization of disbursement in % of projected- Jan.- June 2007**
Public sector		56,5	23,5	62,8	34,25	97,8	35,0%
General Government		55,4	19,4	29,3	24,1	70,4	34,2%
Multilateral creditors		52,4	14,6	22,4	14,0	48,5	28,9%
IBRD		27,8	3,3	4,4	2,9	27,9	10,4%
CEDB		0,0	1,7	0,0	0,0	1,5	0,0%
EIB		11,8	0,0	5,0	5,0	6,1	82,0%
IDA		2,7	2,8	1,3	0,0	0,0	-
EBRD		9,2	6,1	10,1	5,5	12,3	44,5%
EU		0,0	0,0	0,0	0,0	0,0	-
IFAD		0,9	0,7	1,6	0,6	0,7	92,4%
Bilateral creditors		3,0	4,8	6,9	8,5	22,0	38,8%
Private creditors		0,0	0,0	0,0	1,6	0,0	-
Public enterprises		1,1	4,1	33,4	10,1	27,4	37,0%
Multilateral creditors		1,1	4,1	12,4	3,3	17,6	18,7%
IBRD		0,1	0,1	1,2	2,2	4,5	49,7%
EIB		1,0	4,0	3,5	0,0	0,5	0,0%
CEDB		0,0	0,0	5,0	0,0	3,0	0,0%
EBRD		0,1	0,0	2,8	1,0	9,6	11,0%
Bilateral creditors		0,0	0,0	0,0	6,7	9,8	67,7%
Private creditors		0,0	0,0	21,0	0,2	0,0	-

Source: Ministry of Finance and NBRM

*Percentage of realization of disbursements in 2006 was 62%.

**In the period January – June, 2007 there is significant decline in the percentage of realization of the disbursements (35%) compared to the period January – June 2006, when it was 38%.

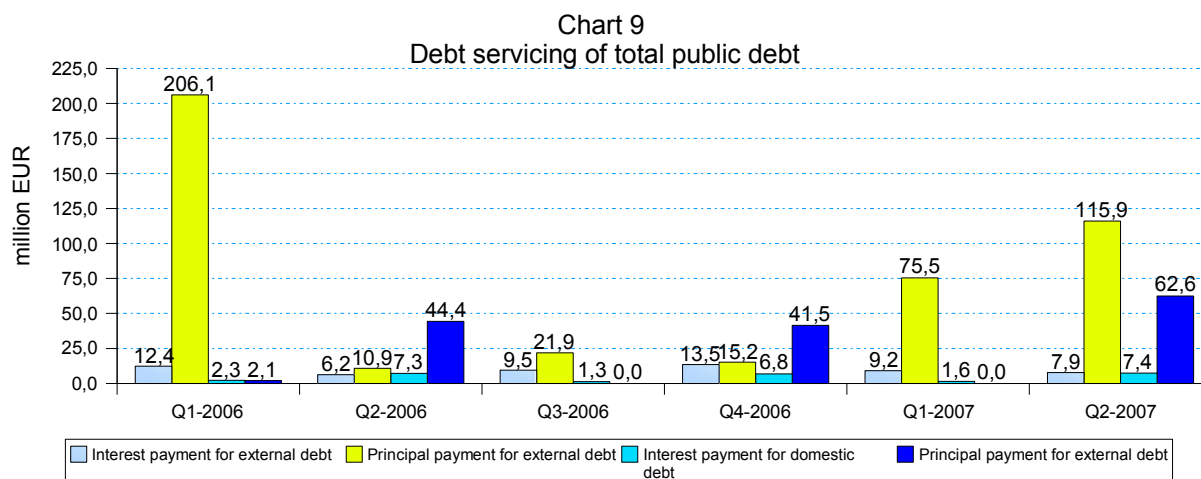
Net issue of continuous government securities and structural bonds

Table 6

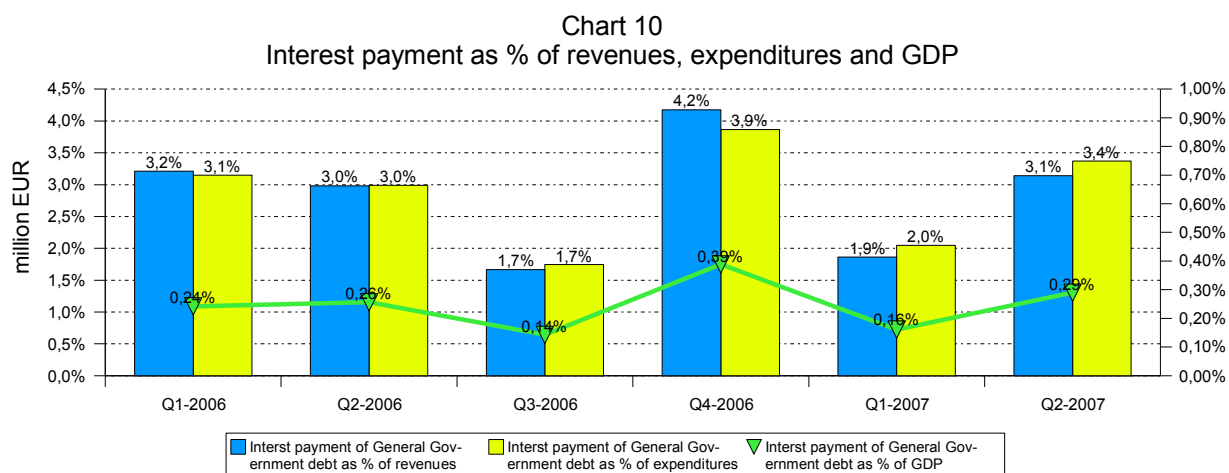
	In million EUR	Jan-07	Feb-07	March-07	April-07	May-07	June-07	Total Jan.- June 2007
Net issue of government securities		-5,08	7,65	30,36	19,68	14,40	8,17	32,93
1 3-month GS		-7,79	4,35	12,75	14,58	13,60	12,54	9,30
2 6-month GS		0,79	-0,78	1,77	1,58	0,80	-3,13	1,78
3 12-month GS		1,92		0,60			-1,24	2,52
4 2-year government bond			4,08				0,24	4,08
5 3-year government bond					3,52			0,00
6 6-th issue of denationalization bond				15,24				15,24

Source: Ministry of Finance

4. Servicing the total public debt

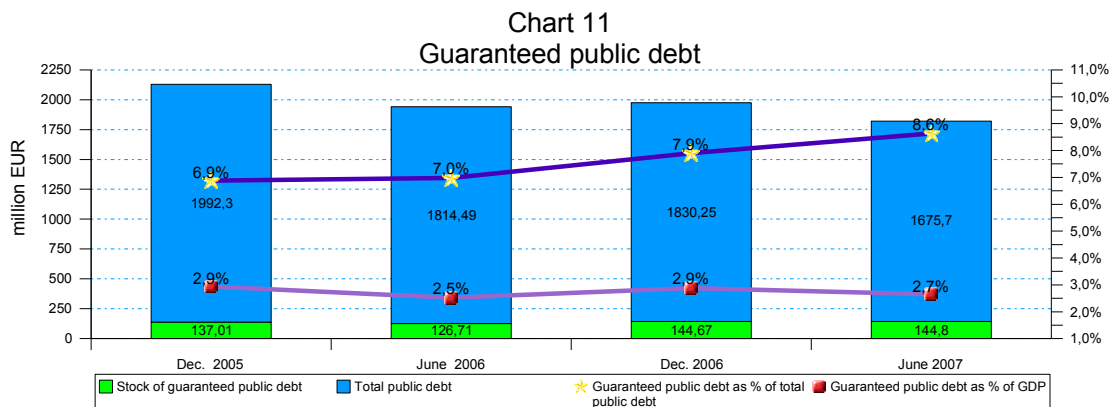


Source: Ministry of Finance and NBRM



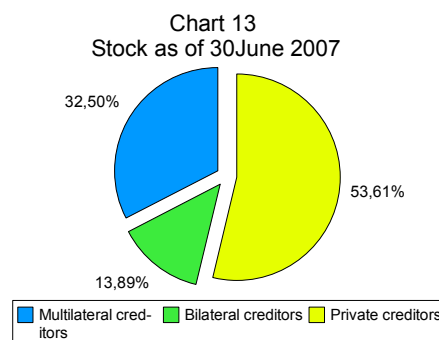
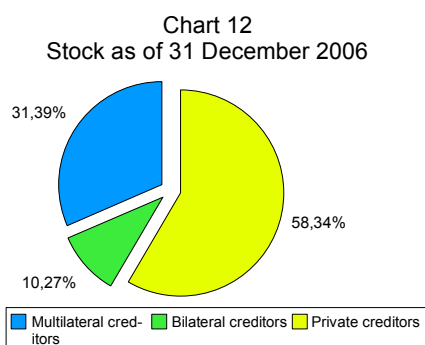
Source: Ministry of Finance and NBRM

5. Guaranteed public debt



Source: Ministry of Finance and NBRM

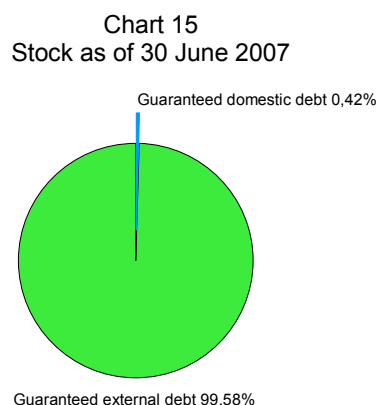
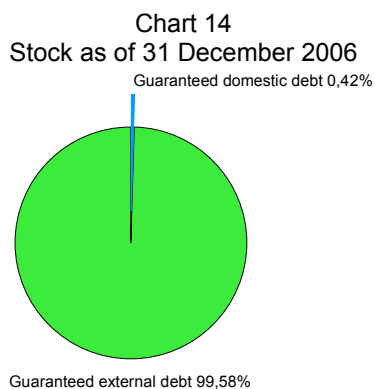
Guaranteed public debt by creditors



Source: Ministry of Finance and NBRM

Source: Ministry of Finance and NBRM

Guaranteed domestic and external public debt

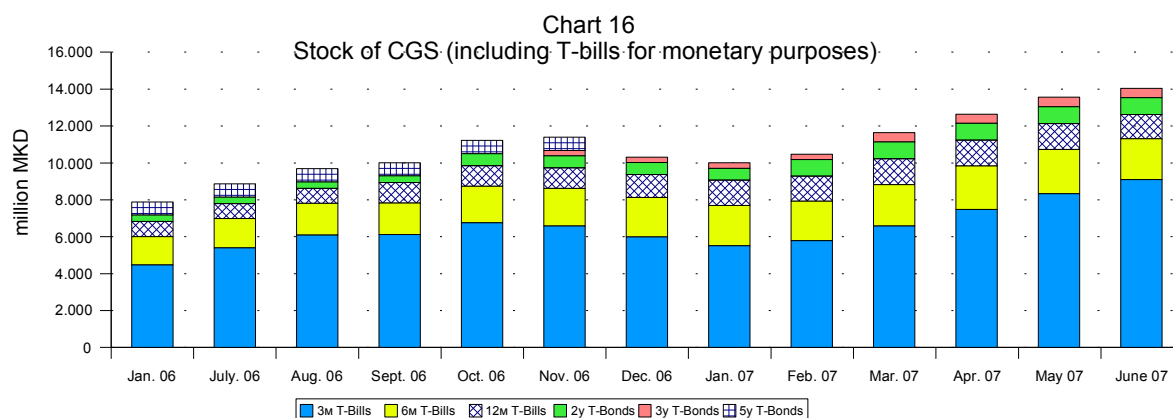


Source: Ministry of Finance and NBRM

Source: Ministry of Finance and NBRM

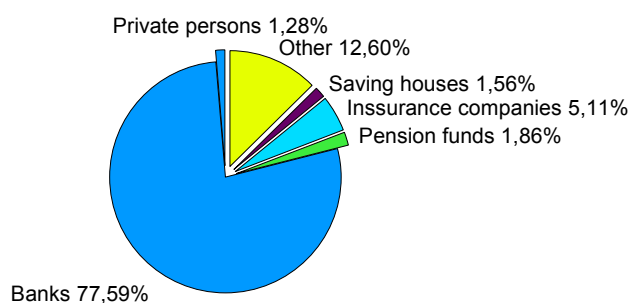
6. Primary government securities market

Auctions of government securities in the period January – June 2007



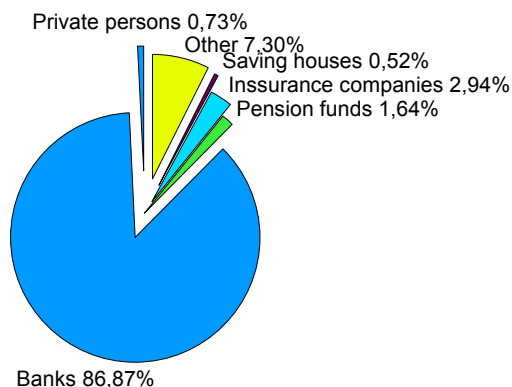
Source: Ministry of Finance

Chart 17
Ownership structure of CGS as of December 2006

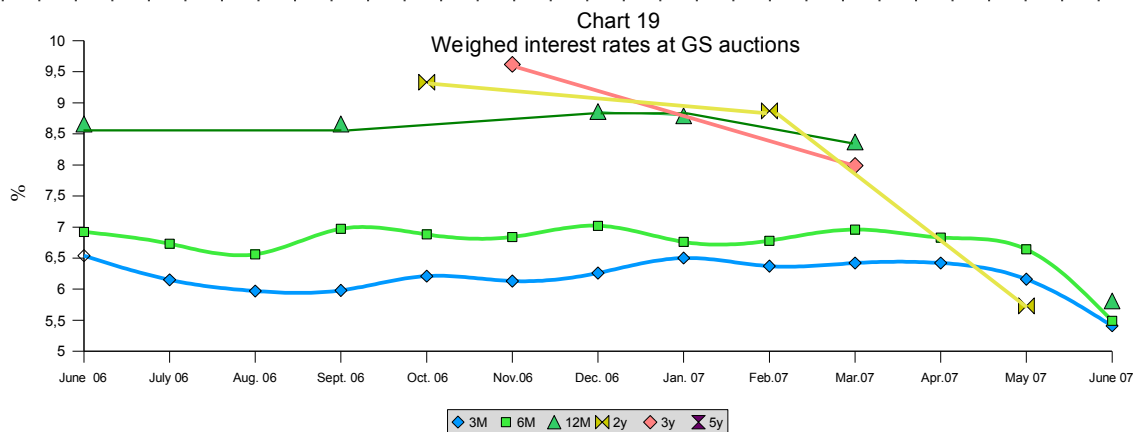


Source: Ministry of Finance

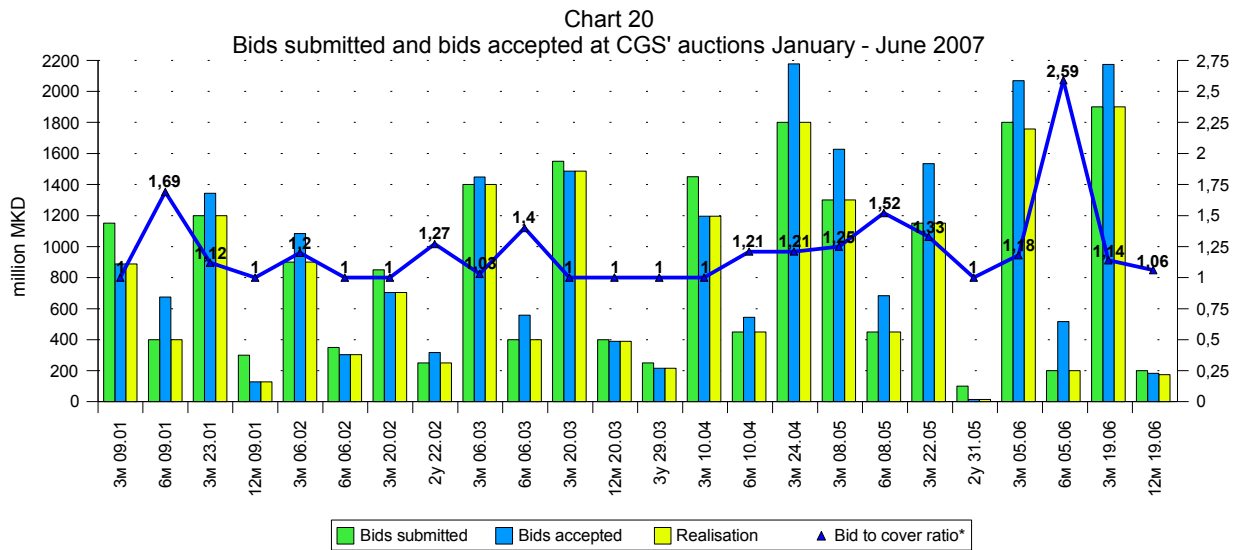
Chart 18
Ownership structure of CGS as of June 2007



Source: Ministry of Finance



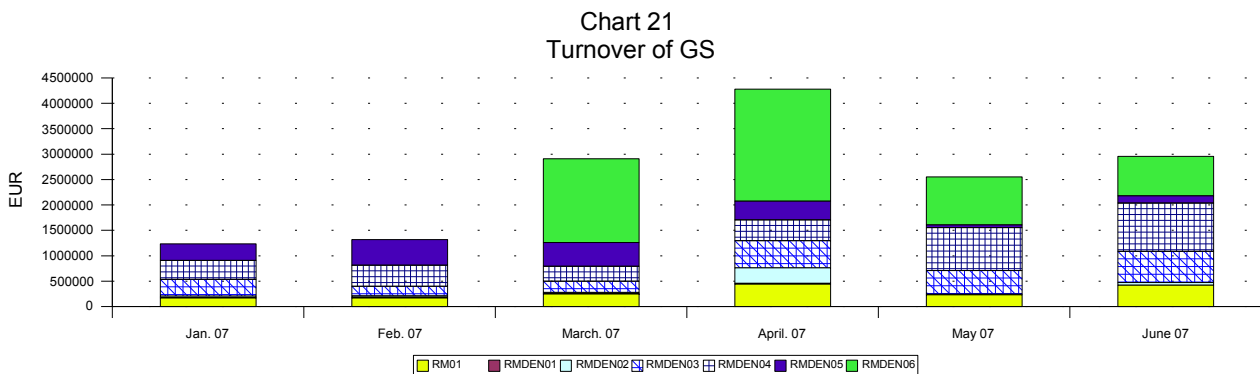
Source: Ministry of Finance



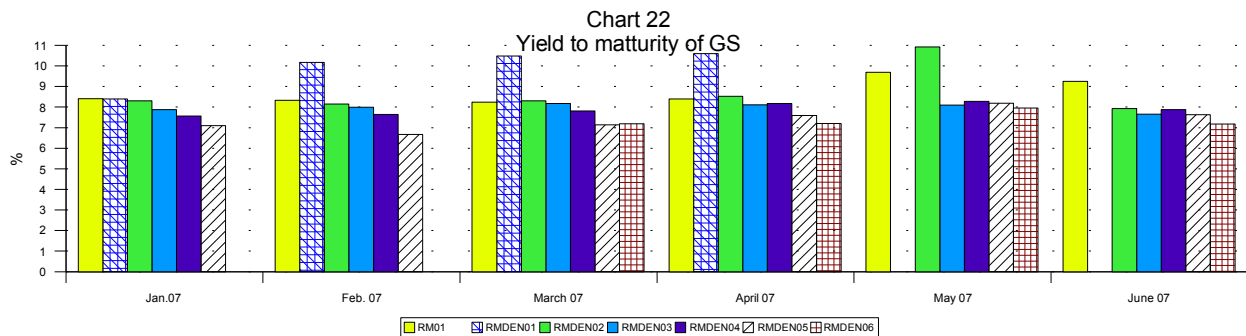
Source: Ministry of Finance
*Bid-to-cover ratio – showing the coverage of the realization with demand

7. Secondary government securities market

7.1 Macedonian Stock Exchange



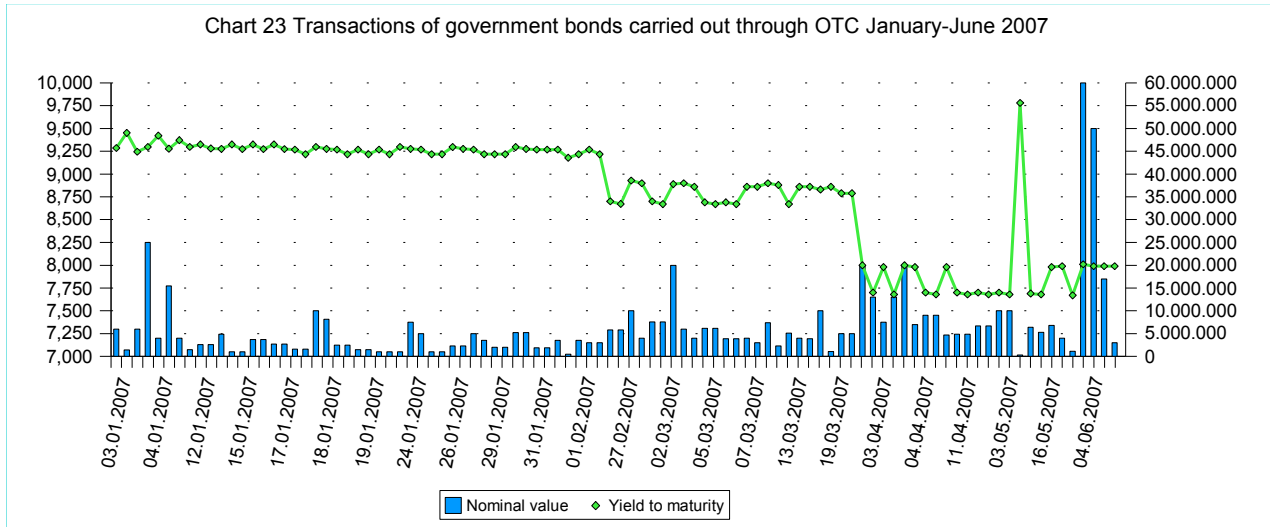
Source: Ministry of Finance and Macedonian Stock Exchange



Source: Ministry of Finance

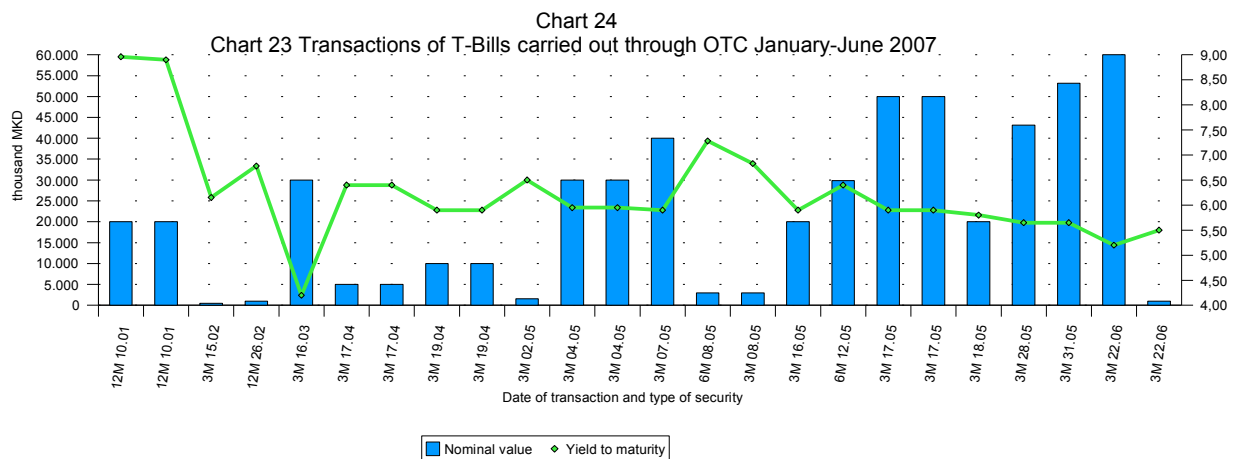
7.2 Over-the-counter market

Chart 23 Transactions of government bonds carried out through OTC January-June 2007



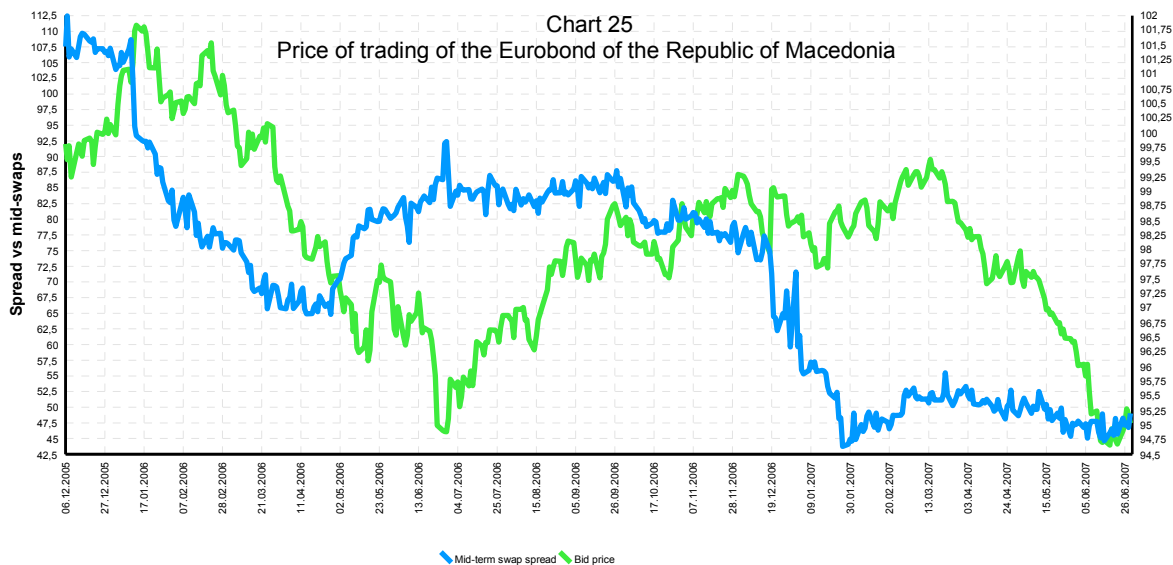
Source: Ministry of Finance

Chart 24 Transactions of T-Bills carried out through OTC January-June 2007



Source: Ministry of Finance

7.3 International capital market



Source CityGroup

Prepared by:
Ministry of Finance
Public Debt Management Department

8. Conclusion

The Ministry of Finance proposed the Government of Macedonia to adopt the Report on Public Debt of the Republic of Macedonia for the first half of 2007.