FOREIGN DIRECT INVESTMENT IN MACEDONIA

Lindita Muaremi, PhD Candidate
Rigersa Konomi, PhD Candidate
Sindise Salihi, PhD Candidate

Abstract

Foreign Direct Investment is a very important component of the economic activity of a country. It is a vital resource for a county's economic and social development and prosperity. Through extensive literature, we find that FDI is one of the most important channels through which international funding results in economic benefits. In this article, we present Foreign Direct Investment in Macedonia and consider FDI as the locomotive of the country, since it is concentrated on important sectors of the economy of Macedonia. The effects of foreign direct investment (FDI) are recognized in theory, literature, and also in practice. The Republic of Macedonia as a country still faces economic reforms, and considers FDI as one of the relevant factors affecting the acceleration of the economic growth process. Next in this paper, we discussed the factors which make Macedonia an attractive location for foreign investors. Also, through literature, we recognized how the concept of economic freedom and the ease or difficulty of doing business is an important key in this country.

Keywords: FDI, GDP, Macedonia, regression

Introduction

All the countries are striving for rapid economic growth. Thus, as a result, they are inviting more and more investments by allowing foreign investors to invest in their country. Over the past three years, investment growth has moved faster than GDP growth, but it is difficult to say that Macedonia is making full use of its investment potential. In recent years, Macedonia is among the least developed countries of the region, marking the smallest attraction of FDI.

According to this issue, the main research question of this paper is:

How to attract foreign direct investment and how to make the best use of it?

In support of this question, we drew a hypothesis that foreign direct investment in Macedonia is an important factor for economic growth.

We defer to the next section of the paper on the issue of the econometrics of estimating the model and testing hypotheses.

The methodology will be based on secondary data that is provided by the Central Bank of Macedonia and the Macedonian Statistical Office for the period of 1999-2012.

Theoretical Viewpoint on FDI

The theory suggests the relation between FDI and growth. The World Investment Report also describes some econometric models for determining the impact of FDI on growth. Many studies points out that FDI and growth relationship depends on the internal factors of the recipient countries. Lee and Mansfield (1996) pointed out that these factors are trade policies, legislative environment, and law enforcement. Buckley (2002) presented that countries would benefit from FDI in their country, if there is high rate of savings, open trade regime, and high technological knowledge.

Surveying the literature on Central American, the impact of FDI is difficult to assess. The empirical evidence which is generating the positive effects in Gross domestic product (GDP) is ambiguous for micro and macro levels. Hanson (2001) indicates that there is weak evidence that FDI generates positive benefit for host countries. Lipsey (2002) shows that there is no stable variable in relation between the type of FDI and GDP or growth.

However, the following type of FDI presented by authors (Millar, and Chryssochoidis Clegg, 1997) affects the country's characteristics such as the levels of human capital and financial development. The first type includes those FDI used to provide input to specific factors of production, such as resources, technological knowledge, patents or a reputation held by a company in the host country. The second type includes FDI that presents an important role to gain access to cheaper factors of production, such as labor market, and the marketing possibilities. Research on this focus of FDI is attributed to Raymond Vernon in his theory of the product life-cycle. Hence, such FDI are encouraged by host governments when they implement policies in favor of exports and reduce them through taxes or the obtaining of various grants. A typical example of this is Macedonia, since it provides a minimized cost due to relatively lower wages. The third type of FDI relates to international companies increasing role in global business. This type of investment includes companies that compete internationally by undertaking a series of investments in the competing countries. This is realized through the organizational form of Joint Venture in order to gain access to the range of each other's products. This type of FDI is very common due to increased competition between similar products, research and development

achievements. The fourth type is related to FDI which is aimed at influencing customers of the host country. This type of FDI is viewed at ensuring all products and services for the customers of the host country in the same manner as they are offered to customers of the investor of the other country. This type often turns out to be almost impossible because of certain services offered, or they are unable to meet a certain kind of request. Consequently, the inability to trade some products and services in the host country has been a key factor in the growth of this type of FDI. We can mention the mobile phone companies in Macedonia as an example, which for a very short period of time have managed to provide the same mobile phone services in Macedonia as those in their home countries. The fifth type of FDI is related to the aspect of the analysis of diversified trade of regional integration. Hence, this type of FDI occurs when the host country presents advantages for foreign companies wanting to invest, in order to gain access to the host market. However, obstacles in the taxation system and trade, block these companies from exporting goods and services in these countries. When foreign companies consider this reasonable, they overcome these barriers by establishing their presence in the host country in order to gain a market share.

Subsequently, many research works has been done in this field, but it essential to have a closer look at the scenario of this country as far to the advantages and disadvantages of investing. Important to FDI are the causes and consequences of foreign capital in a country. As the investors are also getting their benefits, the host countries are getting advantages of FDI. Economic theories on this issue are different ranging from very extremist views to protect nationalism. Views such as FDI affect the identity of a country, ideas that they are an aspect of the economy, without which they cannot exist and therefore should be viewed positively.

However, FDI play a very important role in economic development, transfer of technologies, development of human resources, creation of new jobs, increase workers' wages, facilitating lifestyle, development of the productive sector of the host country, productivity growth, increasing exports and income from them, and funding the deficit in the balance of payments thus improving crediting in the host countries. In addition, FDI plays an important role in creating appropriate economic conditions for NATO membership.

The disadvantages of FDI are associated with the function and distribution of gains from foreign investments. One of the indirect disadvantages of FDI is that the less developed economic sectors of the host country are always inappropriate when the level of FDI has a negative effect. Hence, FDI involves high communication, travel, and other costs.

Linguistic and cultural differences that exist between the investors and the host country may also pose problems in the case of FDI. However, a disadvantage of FDI is that there is always the possibility of failure in the ownership of a company. This has often made many companies to approach FDI with high concern.

Sometimes, there is considerable volatility in a particular geographic region which causes much concern for foreign investors, i.e. political risk. The size of the market and the conditions of the host country might be other factors important for FDI. In cases where the host country is not strongly associated with the more advanced neighboring countries, this result in a challenge for the investors.

General Characteristics of Macedonia and their Relation to FDI

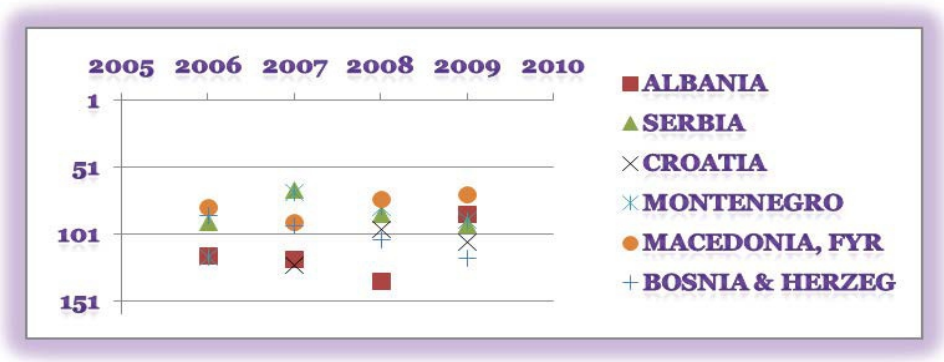
The Republic of Macedonia is a country that is located in southeastern Europe bordering in the east with Bulgaria, in the south with Greece, in the west with Albania, and in the north with Kosovo and Serbia. In the Organization of the United Nations, it is known as the Former Yugoslav Republic of Macedonia due to the name conflict with Greece and Bulgaria. The Republic of Macedonia is divided into 84 municipalities and the City of Skopje as a special municipality of the local government. Thus, Macedonia's climate is similar to the Mediterranean climate, hot dry summers and cold winters with heavy snowfall. Given the fact that Macedonia faces a very high rate of unemployment and a very low economic development, the role of FDI is crucial to the economic future of this country. The table below shows that Macedonia is among the top countries for the ease of doing business in just a few days. This period is precisely 3 days, which means that it is the top country in southeastern Europe with fewer days of doing business.

Table 1: Doing Business and days needed

Days			
Faster		**Slower**	
New Zealand	1	Loa PDR	100
Australia	2	Haiti	105
Macedonia	3	Brazil	120
Belgian	4	Venezuela	141
Albania	5	Congo	160
Canada	5	Suriname	694

Source: Doing Business 2010.

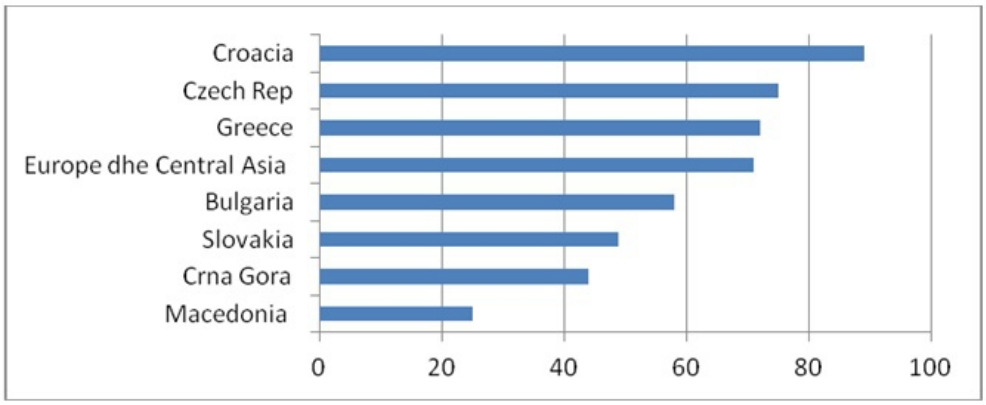
Chart No. 1: Ease of doing business in the Balkans



Source: Doing Business 2010.

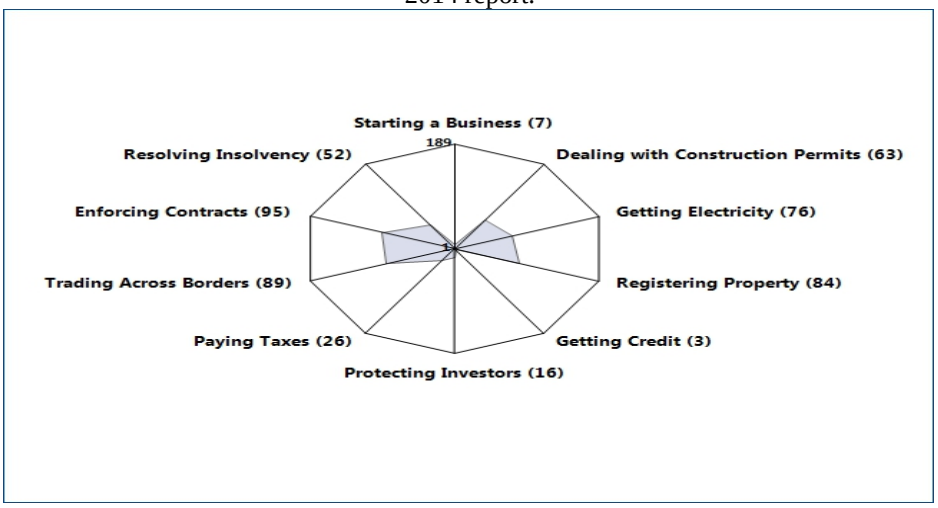
In 2014, the global ranking of countries according to the ease of doing business puts Macedonia in place 25 with a slightly lower performance from other years. Macedonia ranked in the first group of Western Balkan countries ahead of Bulgaria, Greece, and Croatia. Macedonia ranks best in terms of investor protection (16), obtaining loans (3), starting a business (7), and payment of taxes (26). However, its position is lower in the aspect of insolvent choice (52), treatment of building permits (63), obtaining electricity (76), and registration of property (84). Finally, it ranked lowest globally for cross-border trade (89), and contract forcing (95).

Chart no. 2: Classification of Macedonia according to the indicators of the ease of doing business in Macedonia and neighboring economies.



Source: World Bank and IFC Doing Business Report, 2014.

Chart no. 3: Classification of Macedonia under the main indicators of the Doing Business, 2014 report.



Source: World Bank and IFC Doing Business Report, 2014.

According to the report of "Doing Business 2012", the level of taxes paid on the rate of profit is 9.7%, where the figure is improved compared to a year ago. According to this report, the figure was 10.6% compared with the countries in the region. A company that operates in Macedonia has higher taxes that weigh over profit. The bigger part of the weight i.e. 27% goes to social and health contributions.

Table No. 2: Weight of taxes on profits %

	Doing Business in 2012	Doing Business in 2011
Bosnia	25	23
Albania	38,5	40,6
Croatia	32,3	32,5
Kosovo	15,4	16,5
Macedonia	9,7	10,6
Montenegro	22,3	26,6
Serbia	34	34

Source: "Doing Business" Report, The World Bank

Macedonia as a country of opportunity and with a potential for attracting foreign direct investment has experienced significant improvements in the direction of continuous economic growth. A sustainable economic growth and the creation of new jobs, provides a big opportunity for the growth of a business. From the table below, we can conclude that FDI have an upward trend in Macedonia. Also, it has an improvement of inflow values since 2005-2010. Referring to the data source from UNCTAD (2011), we see that Albania has a higher margin than Macedonia in 2010. Thus, it is

only 1,097 million dollars compared to 293 million dollars that Macedonia holds. Compared to 2010, Albania has a much more favorable position for tourism and for textiles. Hence, for this reason, it has a growth rate higher than Macedonia.

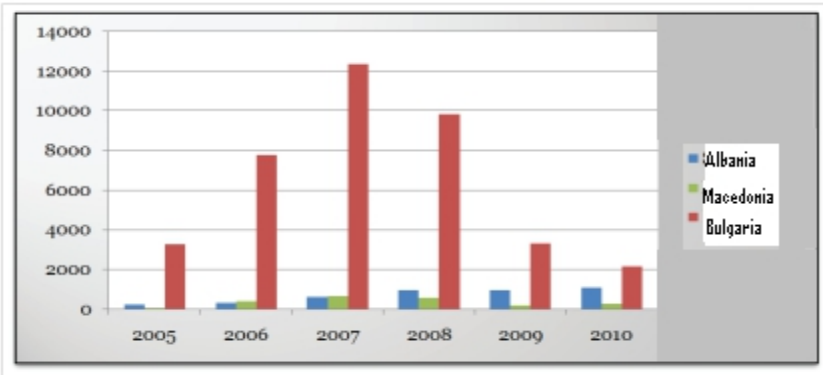
Macedonia as a country and neighboring Albania has a similar history even though FDI in Macedonia have been steadily increasing over the years. Although in 2007 and 2008, they have achieved a large increase, because of significant administrative obstacles, widespread corruption, and regulatory weaknesses in 2009 and 2010. They showed a threefold decrease compared to 2007. Hence, the Macedonian economy has had different rates of economic growth since the country's independence till today. The economic development has been characterized by different growth-reduction rates for the given period.

Table No. 3: Inflows of some East European countries in 2005-2010.

REGION	Flukset e IHD-ve në Europën Juglindore					
Europe North East	2005	2006	2007	2008	2009	2010
	4 877	9 875	12 837	12 601	7 824	4 125
Albania	264	325	656	988	979	1 097
Bosnia	613	766	2080	932	246	63
Croatia	1825	3473	5035	6179	2911	583
Montenegro	501	622	934	960	1527	760
Serbia	1577	4256	3439	2855	1959	1329
Macedonia	96	433	693	586	201	293

Source: UNCTAD (2011) (given in millions of dollars)

Chart no. 5: Absolute values of FDI in millions of dollars



Source: UNCTAD (2011)

As it can be seen from the table, foreign direct investments have a growing trend over the last 5 years. It has a greater growth rate from 2000 to 2001, where we have an increase of over 45% of the invested value from

2000 to 2001. However, the change in recent years has been in terms of obligations.

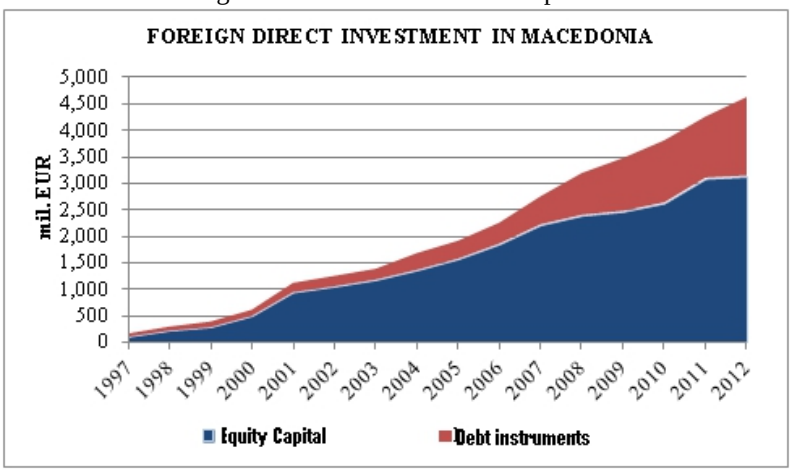
From 2010 to 2011, there has been a decrease in the value of liabilities. Later, this value has been "compensated" with an even greater increase in liabilities in 2012, which has in turn resulted in a relatively very small increase in the total value of foreign investment.

Table no. 4: Status of foreign direct investment in the Republic of Macedonia (in millions of Euros).

			Debt Instruments	
Years	**Total**	**Equity capital**	**Claims**	**Liabilities**
1	2=3-4+5	3	4	5
1997	141.22	102.88	12.13	50.48
1998	270.37	219.51	12.81	63.66
1999	359.90	284.26	15.70	91.28
2000	580.05	497.72	16.95	99.35
2001	1,039.15	946.28	40.84	133.72
2002	1,160.71	1,056.57	46.35	150.48
2003	1,292.14	1,181.98	47.98	158.14
2004	1,610.22	1,366.11	36.70	280.82
2005	1,768.97	1,579.62	74.54	263.89
2006	2,098.57	1,863.35	80.91	316.14
2007	2,545.17	2,226.62	106.11	424.66
2008	2,968.75	2,407.42	113.96	675.29
2009	3,141.38	2,481.27	169.96	830.07
2010	3,322.32	2,642.52	246.88	926.67
2011	3,695.01	3,110.17	284.53	869.37
2012	3,746.42	3,148.89	443.41	1,040.94

Source: Central Bank of Macedonia

Chart no. 6: Foreign Direct Investment in the Republic of Macedonia



Source: Central Bank of Macedonia

Distribution of FDI

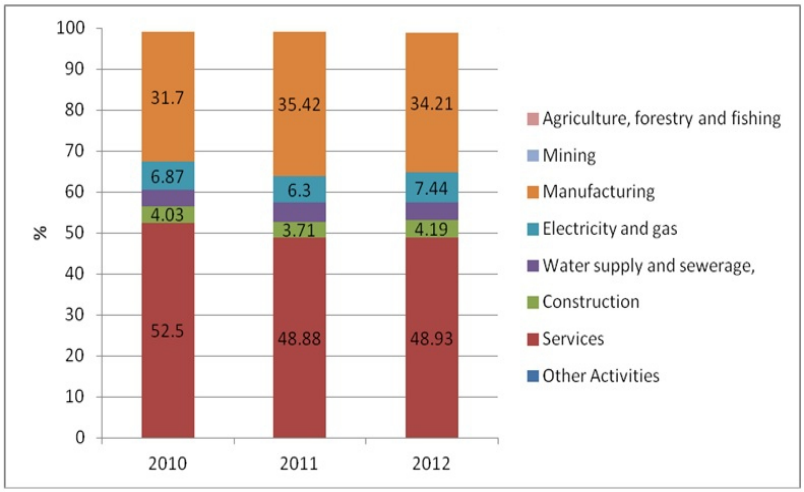
The Macedonian economy does not mainly depend only on one economic activity, although an activity may have greater perspective and potential than any other activity or sector. The year 2010 was the year with the largest number of new projects. Consequently, one can note a decline in the number of projects in 2011 and 2012 based on activities. One of the most invested sectors and activities is the service sector, particularly in relation to the financial sector and tourism. Another dominant and attractive activity to the foreign direct investments is agriculture.

Regarding the value of the projects, larger commitments appear in the services sector. It is the dominant sector with 52.5 percent in 2010 in the total FDI stock. This percentage dropped to 48.93 percent in 2012. During the three years, the stock of FDI for electricity and gas remained almost unchanged, although it marked changes in some other economic activities. The production of building materials increased in 2012, as well as the manufacturing sector compared with the year before. As a result of FDI, the financial services industry is also experiencing major changes.

The entry of foreign banks in recent years and the buying of local banks consolidated the banking system. By the end of 2010, foreign capital accounted to 73 percent of the total in the Macedonian banking system, while domestic capital was estimated to have declined. The biggest investors in the Macedonian banking sector with 100 percent foreign capital are: Alpha Bank Greece, Euro standard bank holding of the E.H.H. Eastern HEMISPHERE SA, Melide, and ProCredit Bank

Internationale Micro Investitionen AG (IMI). In general, foreign banks have had a positive influence in terms of efficiency, which expanded rapidly in developing the economy in recent years.

Chart no. 7: Foreign Direct Investment by main economic activity, 2012.

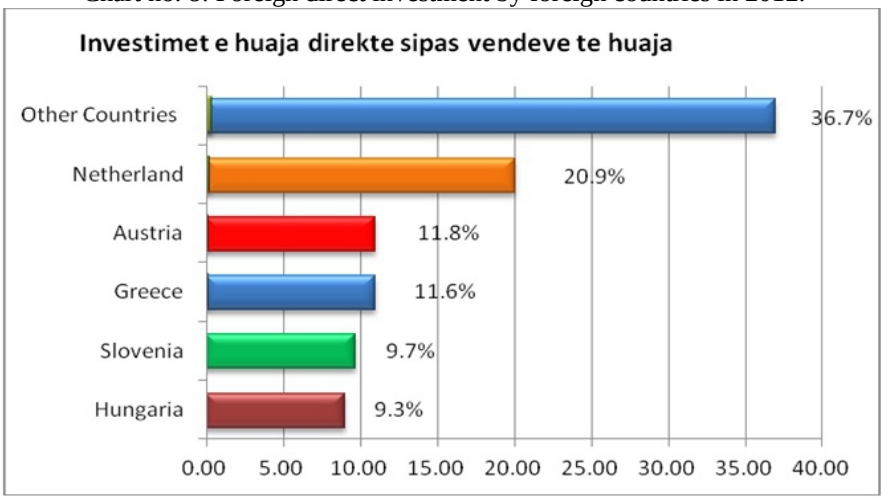


Source: Financial report of the statistics of the Central Bank of Macedonia, 2012

FDI have been present in transition countries since the eighties. In Macedonia, they started to appear much later because of the instability in the region and high political risks. After the situation in the country calmed down, the conditions were right for investment in Macedonia, which is still working on increasing investment and having a favorable macroeconomic stability. Bearing in mind the problems that Macedonia has with its neighboring countries concerning the EU membership, the perspective of FDI is not as favorable, and the country becomes even less attractive to foreign investors.

According to the chart shown below, we can conclude that the largest investor in Macedonia during
2012 was the Netherlands with 20.9% of the investment, followed by Austria with 11.79%, and
Greece with 11.64%.

Chart no. 8: Foreign direct investment by foreign countries in 2012.

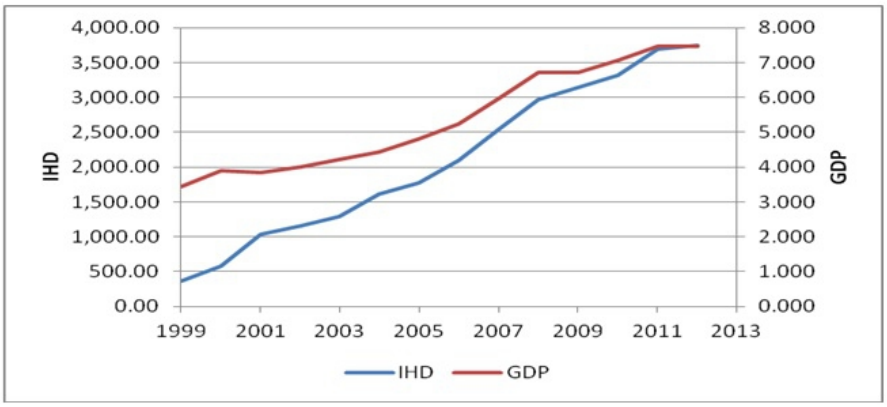


Source: Financial report of the statistics of the Central Bank of Macedonia, 2012

Nowadays, investments in the “Greenfield” manufacturing sector are much less pronounced in Macedonia, for example, exports to other countries in transition, which could lead to a sharp increase in foreign trade surplus. Therefore, the structure of foreign direct investment has to change, which will have a significant impact on economic restructuring. The American company, Johnson Controls has opened a factory for the production of car seat fabrics in Eastern Macedonia. The company has invested about 20 million euros and has created 1400 jobs. However, the products will be exported to the European and Russian market. This type of investment has reduced unemployment in this region and the Macedonian state will undoubtedly be satisfied due to export growth results which should be available by the end of 2014.

Furthermore, we can also see from the graphic that foreign direct investments and GDP have a growing trend over the last 8 years. We analyze in the next section of the paper this issue with the empirical analysis.

Chart No. 9: Flow of FDI and GDP in Macedonia (in millions of €)



Source: Data from the Central Bank of Macedonia (2013), graphical representation

Empirical Analysis and Results

Foreign direct investments are known to have effects on economic growth and vice versa. So, the higher the foreign direct investment, the higher the economic growth of a country, and the higher the economic growth of a country, the higher the foreign direct investment as well. The methodology used in this case is that of a multiple regression. Economic growth, as measured by the growth percentage of the GDP is a dependent variable, while the Foreign Direct Investment inflows are the most important independent variable. However, we will begin discussing the problem from the econometric models.

This paper proposes the following hypothesis:

H1: FDI is not important for GDP.

H2: GDP is not important for FDI.

In addition, we applied statistical analysis methods using Eviews 7. The results are as expected from theory, particularly the link between FDI and economic growth.

According to this model, the coefficient of determination is 0.97927, and it is closer to 1 than 0. Thus, as a result, the model we have estimated in this study is important.

The limited model would be: GDP = 0.001269 IHD + 2.716977

According to the results from table 1(Appendix), we conclude that for every increase by one unit of foreign direct investment, GDP increases by 0.0012 units.

We brought up the hypotheses to evaluate the significance of the model.

H0: a1 = 0; the FDI variable is not important or is not explanatory to the variable of economic growth. H1: a1 ≠ 0; the FDI variable is important or is explanatory to the variable of economic growth.

F actual > F critical

In this case, the H0 does not stand and the alternative hypothesis H1 does. So the model is important, as there is at least one coefficient in our equation that gives importance to the model. However, another way is to compare the probability of coefficients α = 5%. For the coefficient near to X, it is statistically important by 95% confidence level.

The Durbin-Watson test is 1.11, and so, there is no autocorrelation. Thus, this test is used to detect the serial correlation of the first order.

From the equation, we can explain that If FDI is zero at a certain point in time, then we see that economic growth is 2.716977. So there is an increase in economic growth by 2.716977 units.

If FDI is increased by 1 unit, we will have: ∂ Economic Growth = FDI 0.001269 (because it becomes the delta of all, and those that do not differ are eliminated) As a result, the economic growth will increase by 0.001269 units or 0.1269%.

The analysis of the covariation shows that the GDP values are uncorrelated; therefore, their covariation is zero or there is no linear connection between them Cov (Yi, YJ) = 0

The study of stationarity

Ho: Y is stationary

H1: Y is not stationary

The probability of less than 0.05, means that the basic hypothesis is rejected. Hence, the Y series is not stationary. The partial correlation shows that there is no autocorrelation to any degree and that the correlation has a trend.

Case 1

The evaluation of the link between economic growth and FDI and other indicators with 1time delay (1 lag). To show their real effect, at this point, we present the connection with 1 time lag for foreign direct investment. The results show that all variables resulted with the predicted outcome to be positive. However, their effects are all positive and are all seen to be contributing to economic growth.

The econometric model is:

Y = 0.001280 (-1) + 3.004532

This means that it is a model built in a way that it shows the impact of FDI on the value of GDP from the year before. This model accepts the zero hypotheses for a probability of 0.00. This means that for p = 0.05, we

accept the zero hypothesis and it results in x (-1) being statistically important by 95% confidence levels.

Nevertheless, we can see that this model is suitable.

Specifically, the Foreign Direct Investments positively affect the economic growth in Macedonia. If foreign direct investment increased by 1 unit, then the FDI increases by 0.001280 units for lag = 1. Therefore, we can see that the coefficient of determination is 0.96. It is closer to 1 than 0, and as a result, the model should be relatively important.

H0: The model is not important

H1: The model is important.

From table 3, we see the importance or unimportance of the model according to the Fisher criterion. The observed F in this case is compared with the F critical with 2 or 13 degrees of freedom and alpha to be 0.05. In this case, we conclude from the table that the probability is 0.000. Also, with a 95% confidence levels, our model is important.

Case 2

We will try to take foreign direct investment (FDI) as a dependent variable, while the real economic growth (GDP) variable as an independent one.

FDI=-2053.162 + 771.662 GDP

The table shows that the coefficient of determination is 97.9%, and is closer to 1 than 0. Thus, as a result, the model should come out relatively important.

H0: The model is not important

H1: The model is important

From the table, we see the importance or unimportance of the model according to the Fisher criterion. We also have probability which is 0.000 <0.05, our model is important because the alternative hypothesis H1 stands.

Regarding the importance of the GDP, we bring up the hypotheses:

H0: a1 = 0; the real GDP variable is not important or is not explanatory to the variable of foreign direct investment (FDI). H1: a1 ≠ 0; the real GDP variable is important or is explanatory to the variable of FDI. If 0.000 <0.05, the alternative hypothesis stands. Therefore, the GDP variable is important or is explanatory to the variable of the economic growth.

Conclusion

In the last ten years in Macedonia, an unavoidable topic of many debates at all levels of society is the subject of foreign investment. The time we live in today shows that without foreign investment or connections to the rest of the world, there would be no continuous development and progress in

the country. However, the closing of borders does not lead to future growth, but ruins the economic system of a country.

The results of the regression analysis reveal strong support of the proposed hypotheses. Therefore, the regression coefficients related to H1 and H2 are all statistically significant, and the directions are also in line with theoretical expectation.

Financial globalization and its processes have led to the emergence of foreign direct investment. This have been the most important source of international financing. Such form of international capital is particularly important for developing countries, and because of the incentives and developmental characteristics.

Foreign Direct Investments have advantages such as international forms of financing which are long term by character from many credits, and are not included in the country's external debt. More importantly, they can directly and fully influence the economic development of the country, the transfer of new techniques and modern technology, know-how, organizational skills and marketing, establishing links with local business, and a number of other ways and measures.

The fall of production and the rising unemployment that has emerged in recent years in Macedonia, has brought the need for an injection of foreign capital as a recovery from the very little capital. Therefore, foreign direct investment as well as many other economic factors, may affect the economy of a country either positively or negatively.

The empirical analysis can be divided into two important parts: graphical and econometric analysis.

According to the graphical analysis, we can see that there is a positive link between FDI and gross domestic product. The higher the level of GDP, the higher the level of FDI as it results from the analysis. This founding shows that the more sustainable the economy of a country is, the larger and the more investments will be in that country.

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Appendix
Regression Results

Table 1

Dependent Variable: Y
Method: Least Squares

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	2.716977	0.126274	21.51652	0.0000
IHD	0.001269	5.33E-05	23.80888	0.0000

R-squared	0.979270	Mean dependent var	5.375500
Adjusted R-squared	0.977542	S.D. dependent var	1.472241
S.E. of regression	0.220629	Akaike info criterion	-0.053104
Sum squared resid	0.584126	Schwarz criterion	0.038190
Log likelihood	2.371729	F-statistic	566.8627
Durbin-Watson stat	1.117905	Prob(F-statistic)	0.000000

Table 2

Sample: 1999 2012
Included observations: 14

Autocorrelation	Partial Correlation		AC	PAC	Q-Stat	Prob
. |****** |	. |****** |	1	0.821	0.821	11.618	0.001
. |***** |	. *| . |	2	0.626	-0.147	18.938	0.000
. |***. |	. *| . |	3	0.419	-0.156	22.518	0.000
. |** . |	. *| . |	4	0.205	-0.167	23.461	0.000
. | . |	. **| . |	5	-0.028	-0.238	23.480	0.000
. **| . |	. *| . |	6	-0.214	-0.080	24.768	0.000
.***| . |	. | . |	7	-0.339	-0.024	28.451	0.000
.***| . |	. *| . |	8	-0.421	-0.069	35.054	0.000
.***| . |	. | . |	9	-0.441	0.001	43.778	0.000
.***| . |	. | . |	10	-0.395	0.041	52.517	0.000
.***| . |	. *| . |	11	-0.339	-0.100	61.084	0.000
. **| . |	. | . |	12	-0.253	0.003	68.244	0.000

Table 3

Dependent Variable: Y
Method: Least Squares

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	3.004532	0.170100	17.66333	0.0000
X(-1)	0.001280	7.63E-05	16.76904	0.0000
R-squared	0.962355	Mean dependent var		5.523769
Adjusted R-squared	0.958932	S.D. dependent var		1.419400
S.E. of regression	0.287644	Akaike info criterion		0.486450
Sum squared resid	0.910128	Schwarz criterion		0.573365
Log likelihood	-1.161922	F-statistic		281.2008
Durbin-Watson stat	1.196949	Prob(F-statistic)		0.000000

Table 4

Dependent Variable: Y
Method: Least Squares

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-2053.162	180.1892	-11.39448	0.0000
X	771.6627	32.41071	23.80888	0.0000
R-squared	0.979270	Mean dependent var		2094.911
Adjusted R-squared	0.977542	S.D. dependent var		1148.035
S.E. of regression	172.0438	Akaike info criterion		13.26494
Sum squared resid	355189.0	Schwarz criterion		13.35623
Log likelihood	-90.85457	F-statistic		566.8627
Durbin-Watson stat	1.110086	Prob(F-statistic)		0.000000