

NATIONAL BANK  
OF THE REPUBLIC  
OF MACEDONIA

**ANNUAL REPORT 1993**

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## **I. GOALS AND OBJECTIVES OF MONETARY AND FOREIGN EXCHANGE POLICY**

### 1. Goals and objectives of monetary policy

The National Bank of the Republic of Macedonia (hereinafter: National Bank) is a central bank with a basic goal - insurance of the national currency stability - set by law. According to that, the National Bank can not choose the goal it will pursue. Depending on macroeconomic policy goals and current instability, the National Bank can choose only the level and the dynamics of realization of national currency stability. Thus, there is a coordination and harmonization of monetary policy with other instruments of economic policy.

The 1993 macroeconomic policy should have been oriented towards the realization of two goals, as follows: gradual lowering of inflation and reducing the pace of decline of economic activity. Although, this two goals are basically in conflict and the economic policy can hardly deal with them in the same time, it was considered that their conflict would be avoided by appropriate combination between the instruments of economic policy.

Monetary policy accepted the maintenance of the economic stability level determined by global economic policy as the basic goal of 1993 monetary policy measures. In accordance with this, 1993 monetary policy measures were bound to achieve annual inflation rate of 434.2%, i.e., average monthly inflation rate of 15%.

The stabilization impact of monetary policy was projected to be realized primarily through money supply regulation, having the growth of money supply (M1) determined as a basic intermediate goal of monetary policy. Having in mind the final goal of the monetary policy (the annual inflation rate of 434.2%), and the factors which determined the real money demand and the projected economic and financial transactions abroad, the money supply (M1) for 1993 was set to be increased not more than 268.3%.

Besides that, in 1993 it was projected to start the realization of the monetary reform leading to an increase of the effectiveness of monetary policy, thus creating conditions for using interest rates and exchange rate as additional intermediate goals of monetary policy. Monetary reform was planned to consist of a number of components such as introduction of definite paper money, denomination of denar value, change of issuing mechanism and initiating market-based interest rates of the National Bank.

## 2. Goals and objectives of foreign exchange policy

Goals and objectives of foreign exchange policy for 1993, were established by the Decision on Foreign Exchange Policy and Balance of Payments Projection of the Republic of Macedonia for 1993. Because of delay in passing the system-based laws from the area of foreign exchange and foreign trade system, this Decision was passed by the Council of the Republic of Macedonia on May 18, 1993.

Apart from this Decision, institutional prerequisites for realization of the basic goals and objectives of foreign exchange policy were fulfilled by adopting regulations that established the following: 1) organized foreign exchange market within the banks authorized for foreign transactions; and 2) currency exchange market, i.e., buying and selling foreign currency in exchange offices which could be founded by banks, and legal and natural persons as well.

To realize projected balance of payments proportions, determined by the Balance of Payments Projection for 1993, of crucial importance was the determination of denar exchange rate policy, i.e., adoption of the system of freely fluctuating exchange rate depending on foreign exchange supply and demand on the foreign exchange market, abolishing the existing fixed denar exchange rate regime towards a basket of convertible currencies. In the same time, besides the monetary policy measures, the interventions on foreign exchange market with foreign exchange reserves handled by the National Bank (depending on the achieved level of foreign exchange reserves) were projected to influence the exchange rate stability, with an objective to remove the adverse effects of possible volatile exchange rate fluctuations.

As a result of the projected current transactions deficit and foreign capital inflow, the foreign exchange reserves were expected to increase. Permanent foreign exchange reserves handled by the National Bank, were set on the level of at least one month current foreign payments (approximately USD 80 million), whereas the total foreign exchange reserves of the Republic of Macedonia were planned to achieve the level of three months current foreign payments (USD 240 million).

Within the frameworks of foreign credit and financial relations policy, only the obligations towards the IMF and the World Bank were projected to be met, as the necessary condition to enter this financial institutions and to use new credits from them. Considering the high amount of outstanding debt to the World Bank, settlement solutions were defined in cooperation with the countries of the constituency to which the Republic of Macedonia belongs. In the same time, activities for rescheduling the obligations towards other creditors (Paris Club, Zurich Agreement and other institutions) were planned.

## II. REALIZED REAL MOVEMENTS

### 1. Domestic production and aggregate supply

Gross national product of the Republic of Macedonia for 1993 amounted to Denars 360 millions expressed in constant prices (1990 prices). Compared to the previous year, it was decreased by 15.5%. The decrease of the real gross national product had been recorded four years in a row. Compared to 1989, the 1993 real GNP decreased by 40.0%. Thereby, there was an accelerating pace of the real GNP decline. Thus, in 1990, the real national product declined by 9.5%, in 1991 by 10.7%, in 1992 by 13.4%, and in 1993 the real GNP declined by 15.5%. The acceleration of the real GNP decline in 1993 was a reflection of deep economic depression, dissolution of former Yugoslav market, economic blockades applied by some neighboring countries against the Republic of Macedonia, transition from self-management system towards market-oriented economy, and slow restructuring on micro and macro level.

#### National Product

(in million denars)

	1989	1990	1991	1992	1993*
Current prices	126	551	1,136	16,015	71,526
Constant prices (1990)	608	551	492	426	360
Indices against previous year					
Current prices	1,576.0	436.2	206.4	1,409.7	446.6
Constant prices (1990)	101.9	90.5	89.3	86.6	84.5

Source: Republican Statistical Office

\*) Provisional data

The increase in unemployment was an inevitable consequence from the economic activity decline. At the end of 1993, the total number of employed persons was 408,648 . That was by 6.6% lower than the number of employed persons at the end of 1992. Compared to the end of 1989, the number of employed persons decreased by 20.3%, i.e., half of the real national product decline. Accordingly, an exceptionally large decline in labor productivity took place in this period.

Thereby, in the years of 1990-1993, there was a stronger decline in the number of employed persons in economic sector enterprises, in relation to the decline in the number of employed persons in non-economic sector enterprises. In 1993, the number of employed persons in economic sector enterprises declined by 8.0%, and in the non-economic sector enterprises, it declined by 0.7%.

Total number of employed persons  
-indices against each previous year-

	XII. 1993 Employed persons	1989	1990	1991	1992	1993
Total	408,468	100.8	96.0	94.2	94.3	93.4
-Economic sector	323,936	100.7	95.4	93.4	93.5	92.0
-Non-economic sector	84,532	101.1	99.1	97.8	97.8	99.3
Number of persons seeking employment	177,156	101.2	103.8	104.7	103.9	102.2

Source: Republican Statistical Office

In the same time, the number of persons seeking employment in 1993 increased by 2.2% and at the end of 1993 reached the number of 177,156 persons. Compared to the position on December 31, 1989, number of persons seeking employment increased by 15.4%.

Economic activity decline in 1993 was a result of the decline in the industrial and agricultural production. The volume of 1993 industrial production decreased by 11.9% compared to the level of 1992. The decline in industrial production volume by particular goods was as follows: equipment- 23.8%; raw materials - 10.4%; and personal consumption goods - 15.8%. Compared to 1989, cumulative decline in the industrial production volume (46.3%) by particular goods was as follows: equipment- 76.1%; raw materials - 40.2%; and personal consumption goods - 44.9%.

Industrial production:  
-indices against each previous year-

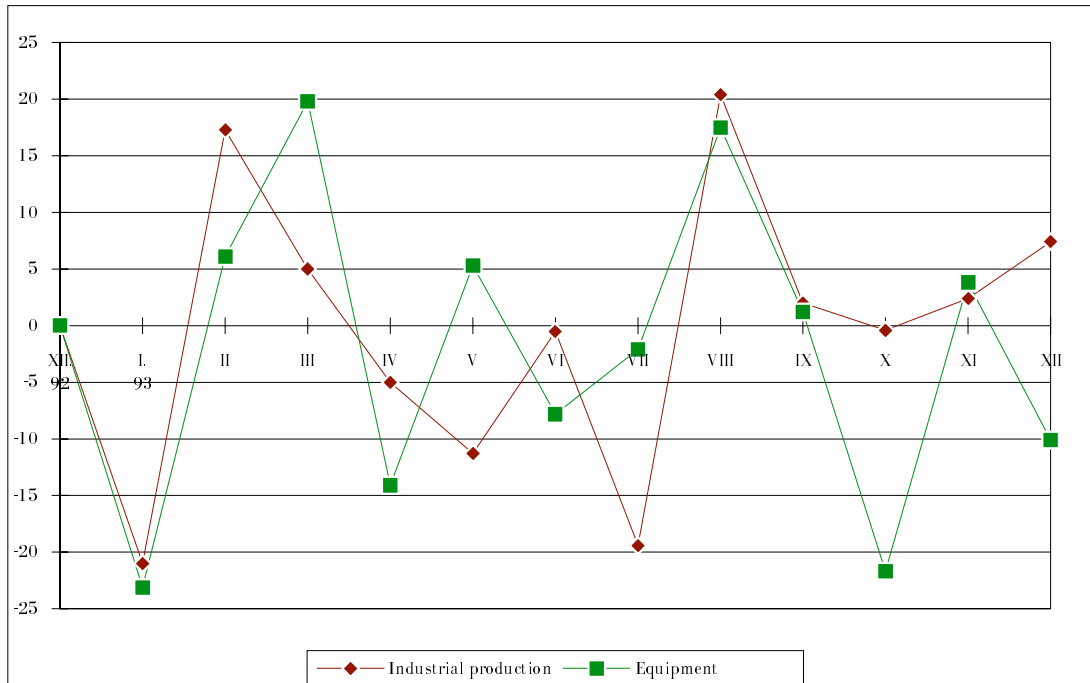
	1989	1990	1991	1992	1993
Equipment	114.1	67.7	67.4	68.6	76.2
Raw materials	103.4	91.2	85.2	85.9	89.6
Personal consumption goods	103.5	90.2	84.4	85.9	84.2
Total:	104.3	89.4	82.8	84.2	86.1

Source: Republican Statistical Office

The decline in industrial production volume was especially emphasized in the first seven months of 1993. In this period the industrial production volume declined with an average monthly rate of 5.8%. From August to December 1993, the industrial production started recovering and the industrial production volume was increasing in this period by an average monthly rate of 6.1%. But, for 1993 as a whole, the industrial production declined by an average monthly rate of 0.9%.

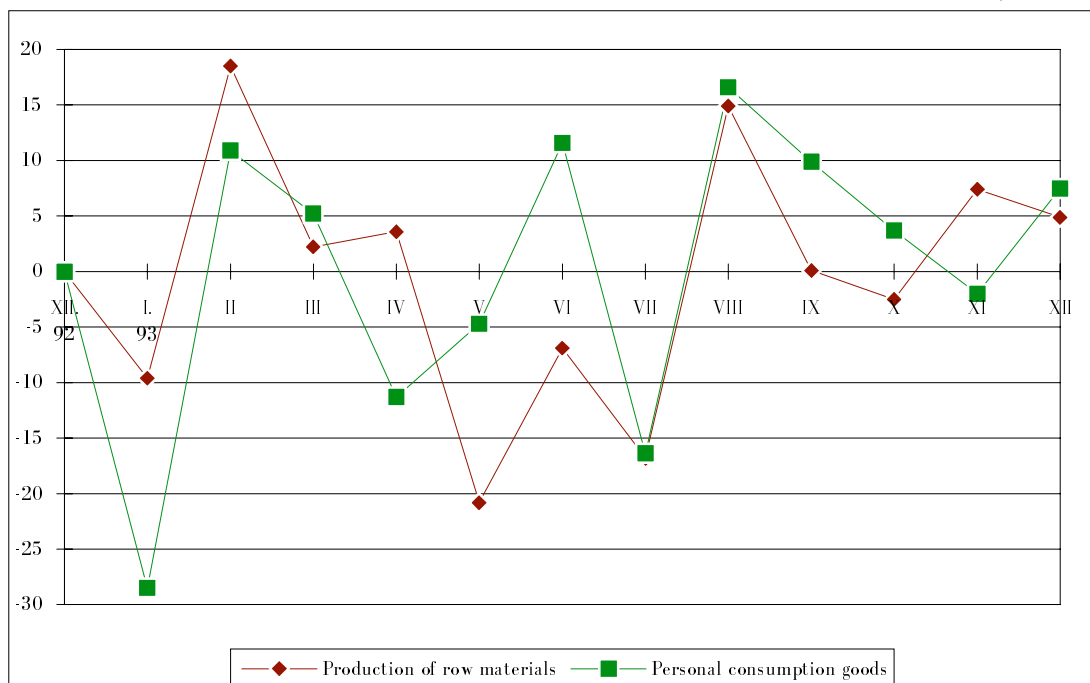
### Dynamics of the volume of total industrial production and production of equipment

(%, monthly)



### Dynamics of the volume of production of raw materials and personal consumption goods

(%, monthly)



As a consequence of the drought, a decline in agricultural production took place in 1993. The primary agricultural production in 1993 decreased by 22.5%, compared to 1992. Thereby, the production decline of the economic subjects in social ownership was

2.3 percentage points bigger than production decline of the economic subjects in private ownership.

**Agricultural production**  
-indices against each previous year-

	1989	1990	1991	1992	1993*
Agriculture - Total	104.4	89.8	117.6	100.4	77.5
Social sector	100.0	90.2	100.3	96.1	75.8
Private sector	106.6	89.6	124.9	101.9	78.1

Source: Republican Statistical Office

\*)Provisional data

## 2. Domestic consumption

Under conditions of significant real decline in national product (-15.5%), real domestic consumption in 1993 showed insignificant decline (-0.7%), while only the investments in fixed assets showed a real decline by 15.0%. This was the third consecutive year of decline in fixed assets investment. Compared to 1990, they declined by 42.8% in real terms. Their participation in the national product was reduced to only 15.5%, in 1993.

**Domestic consumption**  
-indices against each previous year-

	1989	1990	1991 1)	1992 1)	1993 2)
<b>Current prices</b>					
a) investments in fixed assets	1,132.6	581.5	212.8	1,274.3	386.7
b) personal consumption	1,549.4	453.4	204.0	1,383.4	456.4
c) public consumption	1,107.5	548.4	232.4	1,247.7	385.9
<b>Total:</b>	<b>1,407.9</b>	<b>485.2</b>	<b>208.4</b>	<b>1,344.9</b>	<b>434.6</b>
<b>Constant prices</b>					
a) investments in fixed assets	72.4	120.4	88.6	76.0	85.0
b) personal consumption	102.3	88.8	87.2	84.6	103.0
c) public consumption	93.7	84.2	100.6	83.9	104.0
<b>Total:</b>	<b>93.7</b>	<b>94.3</b>	<b>88.6</b>	<b>82.6</b>	<b>99.3</b>

Source: Republican Statistical Office

1)Previous data

2)Provisional data

Personal and public consumption in 1993 showed a real increase of 3%, and 4% respectively. Compared to 1989, personal consumption showed a real decline of 32.5%, while public consumption decreased by 26.1%.



### 3. Price movements

In 1993, 84% of the prices were formed freely. The price of energy, products of importance for the living standard of population, prices of transportation and telecommunication services, and prices of public utility services were under direct control. Price developments in 1993 were influenced indirectly through the economic policy measures.

Current increase in the general level of the prices, measured through the increase of retail prices in 1993, was 229.6%. It was 8.4 times less than the price increase in 1992. Current increase in the costs of living was 248.2% being 7.2 times lower than in 1992. Current increase in the wholesale prices of industrial goods was 176.1%. It was 12.2 times lower than the increase of these prices in 1992.

Current price increase  
-indices against each previous year-

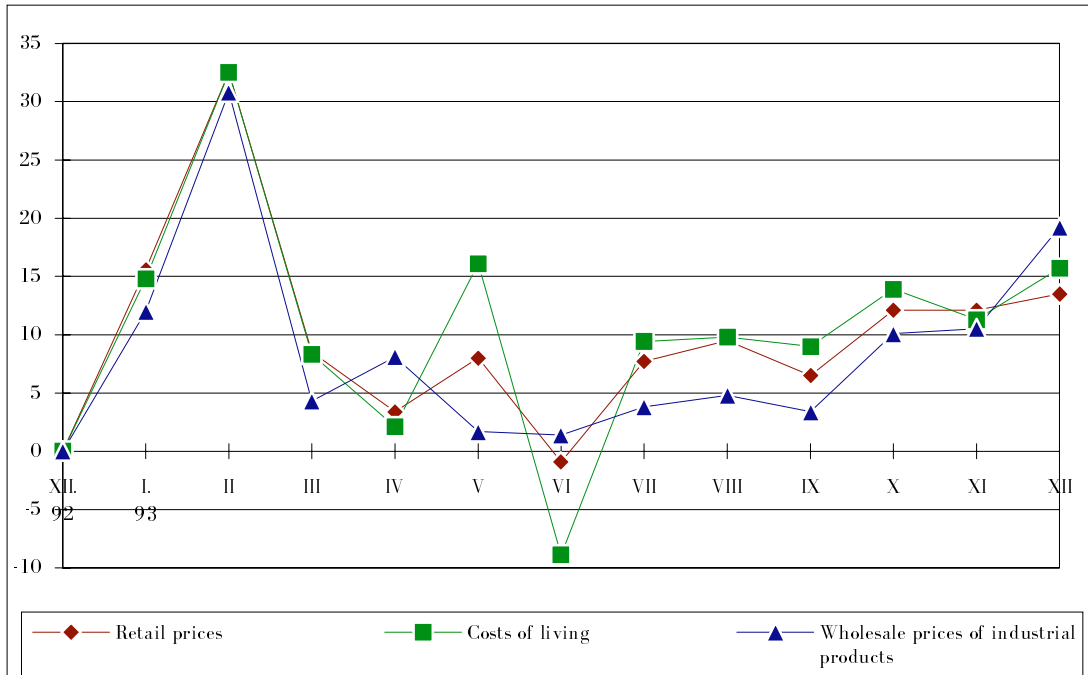
	1989	1990	1991	1992	1993
Industrial products					
Retail prices	2,832.5	202.4	357.9	2,055.7	310.7
Wholesale prices	2,957.8	141.8	381.5	2,248.6	276.1
Retail prices (total)	2,863.4	220.5	329.7	2,025.2	329.6
Retail prices of agricultural products	2,379.1	260.4	261.9	2,546.4	263.0
Prices of services	3,225.5	306.8	244.6	1,746.1	434.6
Costs of living	2,945.1	215.6	313.4	1,880.3	348.2

Source: Republican Statistical Office

Price movements in 1993 by particular months, were volatile. Hence, the average monthly rate of the retail prices was 10.4%, in February 1993 increasing by 32.5%, whereas in June 1993 the retail prices declined by 0.9%.

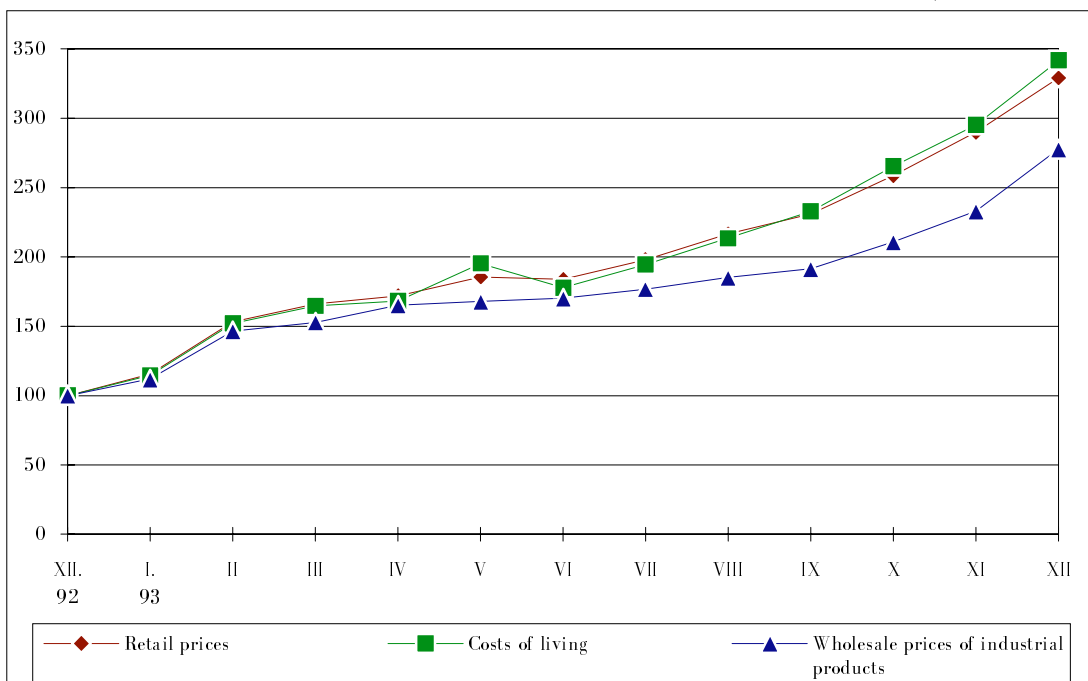
### Monthly dynamics of retail prices, costs of living and wholesale prices of industrial products

(in %)



### Level of retail prices, costs of living and wholesale prices of industrial products

(31.XII.1992=100)



### III. REALIZED GOALS AND OBJECTIVES OF THE MONETARY POLICY

The monetary policy in 1993 was realized under extremely difficult conditions. The anti-inflation policy was realized mainly through the instruments of the monetary policy and the exchange rate policy. In addition, there was no optimal coordination between the influence of the monetary policy and the exchange rate policy, on one side, and the influence of the fiscal policy and the wage policy, on the other side. Formally, the budget was in equilibrium. However, there was *de facto* a big budget deficit (10.1% of the gross social product) financed through arrears in the budget towards the final users. Thus, the budget deficit was indirectly monetized through the indebtedness of the final users with the commercial banks. In addition, in 1993, the business enterprises reported uncovered losses of 15.6% of the social product.

The wages increase in 1993 was realized without any limitations. In addition, in terms of wider lack of financial discipline and "soft budget constraints", the level of the liquidity was not a constraining factor to the increase of the wages. On the contrary, there was an adverse tendency, to exhaust the liquidity of the economic sector through uncontrolled increase of the wages, and to force relaxation of the monetary policy through acceleration of the growth of money supply.

However, though under such conditions in 1993, the monetary policy completely realized the projected targets. The basic intermediate target of the monetary policy - the money supply (M1) - in 1993 increased by 239.7% which was 28.6 percentage points less than the planned increase. The realized increase in the money supply in 1993 would have been lower for 25.2 percentage points if there was no extreme increase in the currency in circulation (by 28.9%) in the last ten days of December, 1993 as a result of the influence of the seasonal factors (the forthcoming New Year and Christmas holidays), which determined high increase in the demand for currency in circulation by the households.

The money supply (M1) in 1993 served as an immediate target of the monetary policy through which the ultimate target of the macroeconomic policy was realized, i.e., a significant deceleration of the inflation. With the money supply policy and with the other instruments of the economic policy, in 1993, the inflation rate was realized by 229.5%, measured through the retail prices increase in December 1993 related to December 1992.

On average, there was a high correlation of 1:1.04 between the money supply (M1) and the inflation rate in 1993, meaning that an increase by one percent in the money supply (M1) provoked an increase in retail prices by 1.04 percentage points. Accordingly, the monetary policy instruments may be used for conducting anti-inflation policy, only if they lead to decrease in the growth of the money supply.

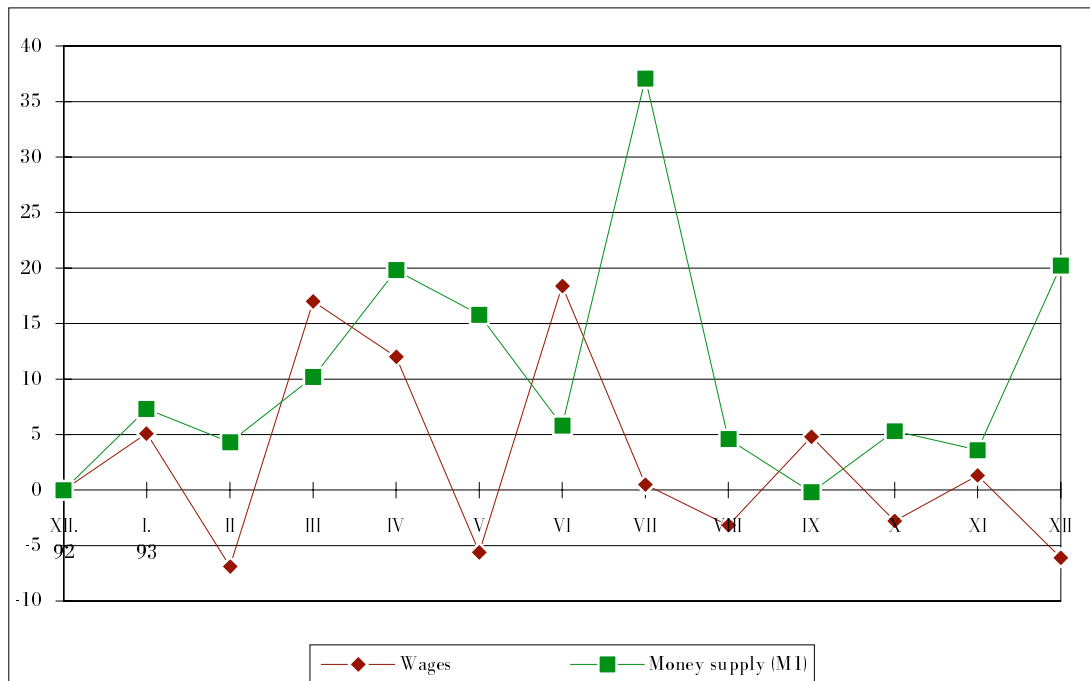
In order to implement efficient stabilization policy by the Central Bank, certain preconditions have to be fulfilled: a) the Central Bank to be able to control the money supply movement, and b) the demand for money to be relatively stable. In 1993, these preconditions were partially fulfilled.

It is difficult to control the growth in the money supply with the monetary policy instruments, if there is no coordination between the wage and fiscal policy with the monetary policy. The Central Bank is not able to establish control over the money supply, if there is no control in the field of wages. The real growth of the wages increases the real money demand of the households, resulting in huge liquid assets outflow from the enterprises to the households. In order to compensate the lost liquidity, the enterprises are getting into debts with the banks, and as a result of that there is an increase in the indebtedness of the enterprises and an increase in the money supply. Hence, the growth of the money supply becomes autonomous and the growth of the monetary variables is adjusted to the growth of the wages.

In 1993 there was almost no implementation of particular policy in the field of wages. The wages were freely determined, under conditions of still predominant social ownership of the enterprises. Under such conditions, the tendency of their constant growth appeared, and that hindered extremely the control of the money supply. Thus, depending on the growth of nominal and real wages, in 1993, three different rates of growth in the money supply (M1) were realized.

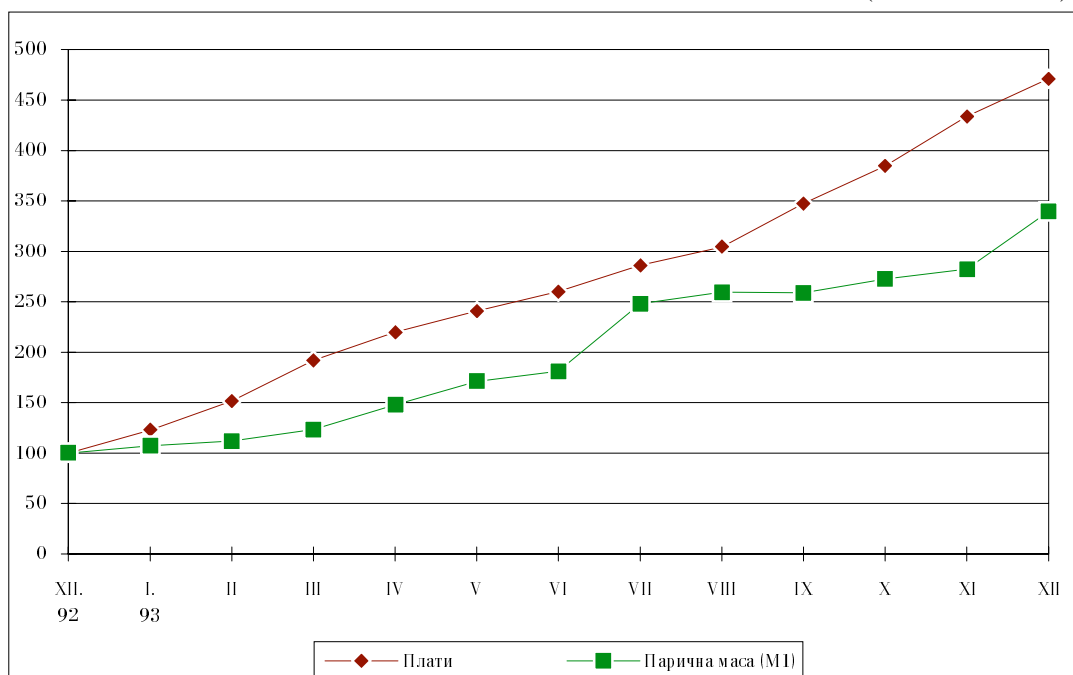
Monthly rates of growth of real wages and of money supply (M1)

(in %)



## Nominal wages and money supply (M1)

(31.XII.1992=100)



The first, accelerating rate of growth in the money supply (M1), was realized in the period January-July, 1993, under conditions of high rates of growth in the nominal and real wages. In this period, the nominal wages were increasing with an average by 16.2% per month, while the real wages were increasing by an average rate of 5.3% per month. This led to large exhaustion of the liquidity in the economic sector enterprises and to constant lack of liquid assets. In accordance with that, in this period, despite the high nominal and real interest rates, there was a high demand for credits by the enterprises. Thus, the money and credit demand did not react at all on the changes in the interest rates, but, it was determined by the amount of liquid assets outflow from the enterprises for wage payments. Hence, in this period, the money supply (M1) increased by 148.2% cumulatively, or it was increasing by average monthly growth rate of 13.9%.

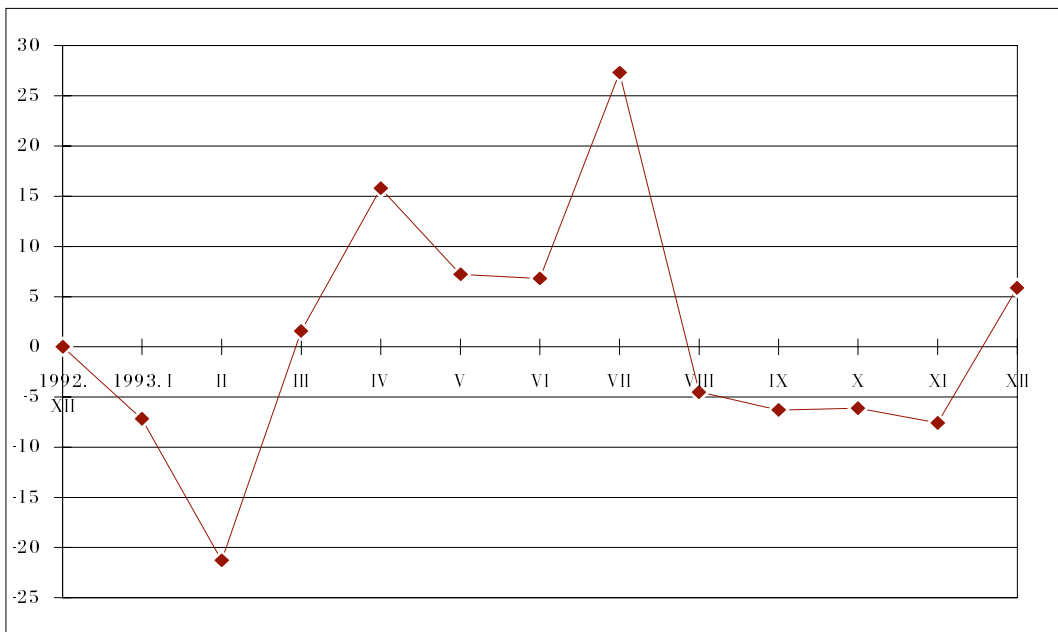
In the period of August-September 1993, the growth of the wages slowed down. They were increasing by monthly average growth rate of 10.3%. Thus, the outflow of liquid assets from the enterprises decreased creating preconditions for conducting more restrictive monetary policy which was not followed by strong recession effects. In this period, the average monthly rate of growth in the money supply (M1) was 3.2%, but in September 1993, in relation to the level in the previous month, the decrease in money supply (M1), was realized by 0.2%.

In November, 1993, there was again an acceleration of the growth in the nominal wages (12.7%). Despite that, as a result of the introduction of credit ceiling as an instrument of monetary policy for limiting the growth in the denar investments of a bank which would be applied in 1994, in December 1993, a high credit activity was realized by the banks. In that month only, in relation to the situation from the previous month, the bank denar investments increased by 40.6%. Together with the acceleration of the growth of the wages, it resulted in money supply increase in December, 1993, by 20.2% after the moderate increase in the money supply in November (3.6%).

The unstable money demand by months, also hindered the control of the money supply. The decreased money demand, having other conditions unchanged, had the same effects as if there had been an increase in the money supply. On the other side, the increased demand for money, having other conditions unchanged, had the same effects as if there was a decrease in supply of money. In 1993, as a result of high variations in the inflation rate and in the denar exchange rate, the demand for money by months was very unstable. This especially concerned the demand for money in the first half of 1993. In the second half of 1993, as a result of the inflation rate and the denar exchange rate stabilization, there was a relative stabilization of the money demand. This created preconditions for implementing more effective monetary policy in the second half of the year.

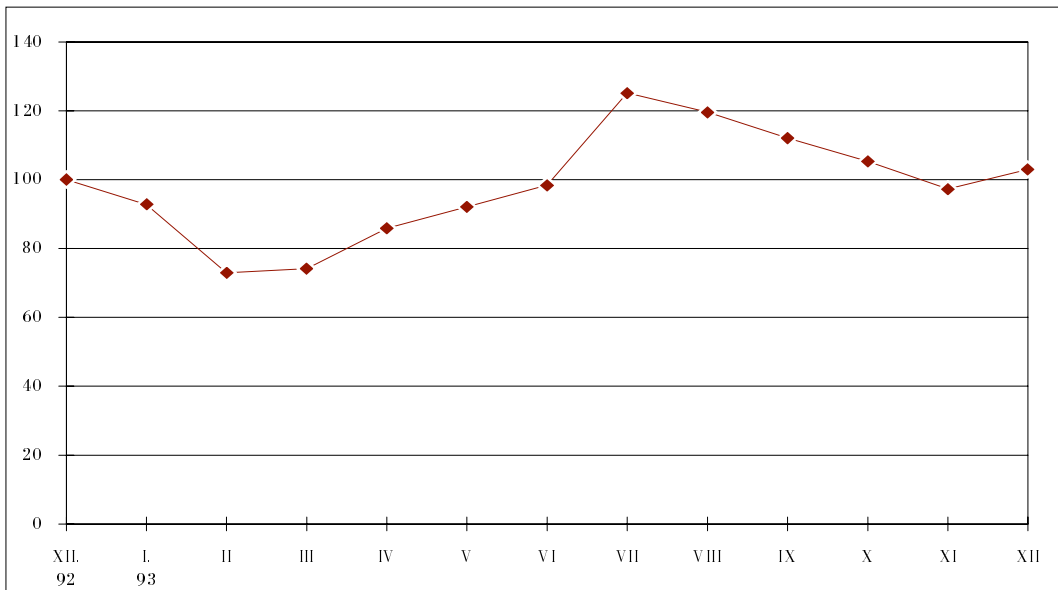
Monthly rate of growth of demand for money

(in %)



Real demand for money by months

(31.XII.1992=100)



The monetary reforms were realized through 1993. The main aim was to increase the monetary policy efficiency, and especially to increase the efficiency of the money supply control policy.

On the monetary independence anniversary (April 27, 1993), the Yugoslav coins in denominations of 1, 2 and 5 dinars ceased to be a legal tender in the Republic of Macedonia. Their withdrawal from the circulation was realized in the period from April 27 to May 8, 1993.

Definite banknotes and coins were put in circulation on May 10, 1993 in the following denomination structure: coins of 50 deni (1 denar equals 100 deni), 1, 2 and 5 denars; and banknotes in denomination of 10, 20, 50, 100 and 500 denars.

At the same time, the value coupons of 10 and 25 denars ceased to be a legal tender. The other value coupons remained to be a legal tender together with the definite banknotes and coins. Their withdrawal from circulation was realized gradually throughout the year in the following way: the value coupons in denominations of 50, 100 and 500 denars ceased to be a legal tender on August 31, 1993 and the value coupons in denominations of 1,000, 5,000 and 10,000 denars ceased to be a legal tender on November 30, 1993.

When definite banknotes and coins were put in circulation on May 10, 1993, the reduction of denar value in ratio 100:1 was realized. The nominal value of the coupons that remained in circulation since May 10, 1993 was reduced 100 times. Also, the value of all claims and liabilities expressed in denars since May 10, 1993 was reduced 100 times.

Since the beginning of May 1993, in order to obtain more effective control on the money supply, the selective credits as an instrument of the monetary policy were gradually abolished. Their definite abolishment was planned to be realized until the end of March, 1994. In order to realize rather harmless abolishment of the selective credits and to introduce new more effective and more flexible issuing mechanism, in May 1993, the National Bank made a conversion of the short-term into long-term credits from the primary issue for the purposes in the area of agriculture with on March 31, 1993 in total amount of Denar 455 million. It should have contributed to a decrease in the credit demand by these enterprises. On the granted long-term credit, the final users have to pay only annual commission of 2.5%. The period of repayment of the loan is 15 years with grace period of 10 years.

#### **IV. REALIZED MONETARY AND CREDIT MOVEMENTS**

In 1993, as in 1992 after the monetary independence of the Republic of Macedonia, the concept of monetary targeting was applied as a mechanism for realization of the ultimate goals of the monetary policy (to bring down the inflation). This concept of monetary policy was considered as the most appropriate for three reasons: 1) nonexistence of developed structure of financial institutions and instruments; 2) impossibility for the interest rate to be used as intermediate target of the monetary policy; and, 3) high empirical correlation between the growth rate of money supply and the inflation rate. Thus, since the end of May 1993, after establishing the foreign exchange market and market determination of the denar exchange rate, the concept of monetary targeting was realized so that the denar exchange rate was used as a basic indicator for the monetary policy. Stable exchange rate was a sign that the money supply increases according to the money demand. Rapid denar exchange rate depreciation was an indicator that the money supply increases faster than the money demand. Thus, the exchange rate was used as a signal of the equilibrium between money supply and money demand.

The mechanism of monetary targeting by using the exchange rate as an indicator of the monetary policy was quite effective procedure for money supply control. The results would have been far more significant if the monetary policy was supported with appropriate wage policy and if there was more effective and more flexible mechanism for reserve money issue.

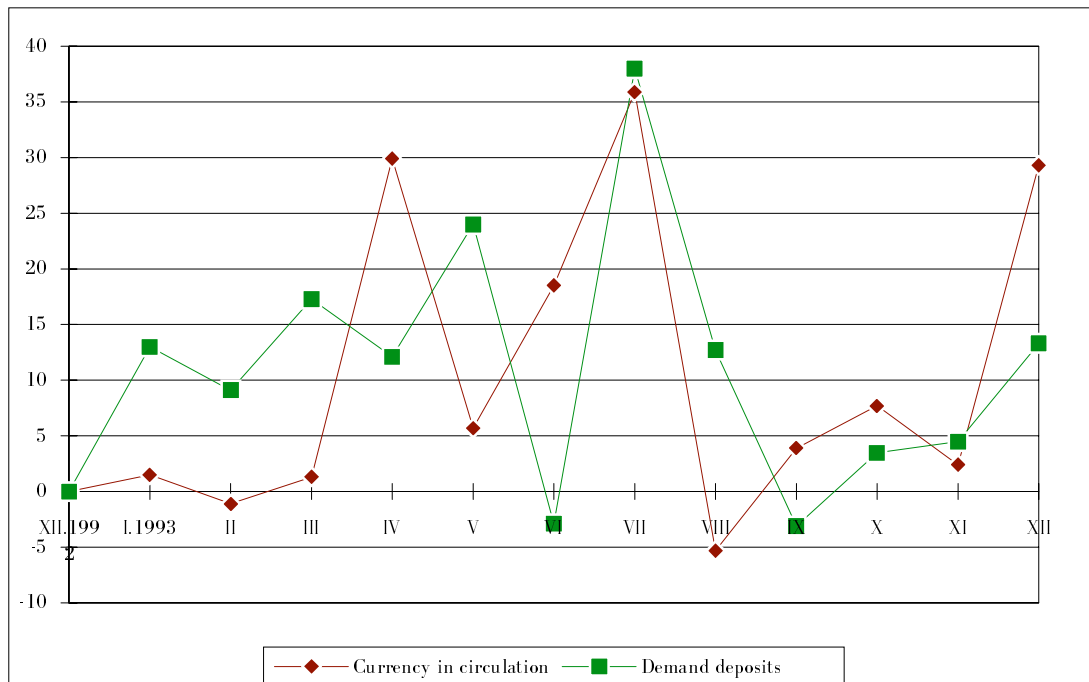
The money supply (M1) was the basic target in 1993. At the end of December, 1993 in relation with the position on December 31, 1992, it was higher by Denar 4,331 million, or by 239.7%. It was about 28.6 percentage points less in relation with the set monetary target for 1993. In relation with the realized growth in 1992 (704.5%), the growth in the money supply (M1) in 1993 was lower by 464.8 percentage points.

From structural point of view of the money supply in 1993, the demand deposits (transaction deposits) realized by 46.2 percentage points higher growth in relation to the currency in circulation. As a result of that, the participation of the currency in circulation in the money supply decreased from 49.4%, as it was at the end of 1992, to 42.8% on December 31, 1993. The rate of growth of currency in circulation would have lagged even more behind the rate of growth of the demand deposits if there was no high seasonal increase in the currency in circulation in December, 1993 (repurchasing of the tobacco from the individual farmers and the increased demand for currency in circulation as a result of the forthcoming New Year and Christmas holidays).



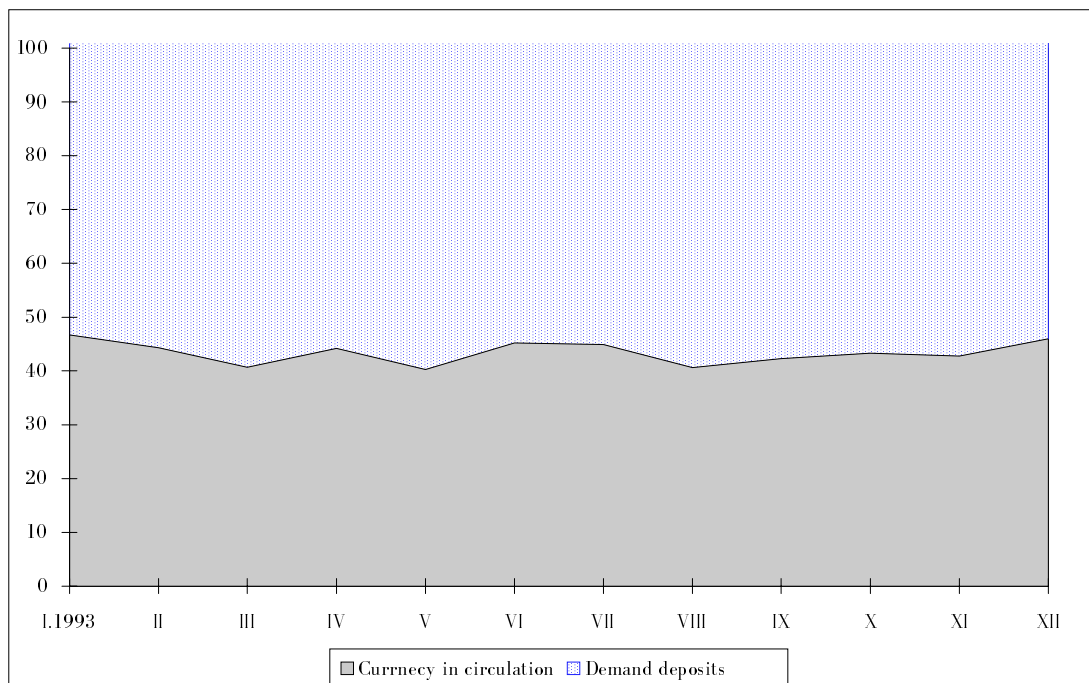
### Monthly rate of growth of the currency in circulation and demand deposits

(in %)



### Participation of the currency in circulation and the demand deposits in the money supply

(in %)



The main factor that influenced the decrease of the ratio of currency in circulation in money supply was the institutional set up of foreign exchange market, on which all foreign exchange transactions were realized with deposit money. Thus, at the end of May, 1993 (i.e., after the institutional set up of the foreign exchange market), the

ratio of currency in circulation in money supply (M1) was brought down to 40.3%. Despite this decrease, the ratio of currency in circulation in money supply in 1993 still remained high. This situation was a result of the following factors: the lack of confidence in the banking system, high degree of US. dollar and German Mark background of the economy, speculative transactions with the currency in circulation, the tax evasion and high commissions charged by the banks for transferring the assets.

The increase of all other monetary aggregates in 1993 functionally depended on the realized increase in money supply. In addition, the movements of monetary variables that include foreign currency as a component were mainly determined by the changes of denar exchange rate.

#### Net domestic assets of the banking system

(in million denars)

	31.12.1992	31.12.1993	Changes I-XII.1993	Indices <u>31.12.1993</u> 31.12.1992
Banking investments	9.453	43.881	34.428	464,2
-denar investments	3.140	18.179	15.039	578,9
-f/ex investments	6.313	25.702	19.389	407,1
Other net assets	9.914	26.343	16.429	265,7
Net domestic assets	19.367	70.224	50.857	362,6
Net f/ex liabilities	5.674	19.706	14.032	347,3
Total deposits (D-4)	13.693	50.518	36.825	368,9
Money Supply (M <sub>1</sub> )	1,807	6,138	4,331	339,7
-currency in circulation	893	2,825	1,932	316,3
-demand deposits	914	3,313	2,399	362,5
Liquid assets (M <sub>2</sub> )	7,395	28,053	20,657	379,3
-quasi deposits	5,588	21,915	16,326	392,1
a) denars	326	3,122	2,796	957,7
b) in f/ex	5,263	18,793	13,530	357,1
Other limited and time deposits over one year	7,190	25,290	18,100	351,7
a) denars	155	1,508	1,353	972,9
b) in f/ex	7,035	23,782	16,747	338,0

Total non-monetary deposits increased in 1993 by Denar 34.426 million, i.e., by 269.4%. The main part of this increase (Denar 30,277 million, i.e., 87.9%) was a result of the increase of non-monetary deposits in foreign currency. Despite the high nominal increase of the non-monetary deposits in foreign currency (246.2%), they decreased in real terms.

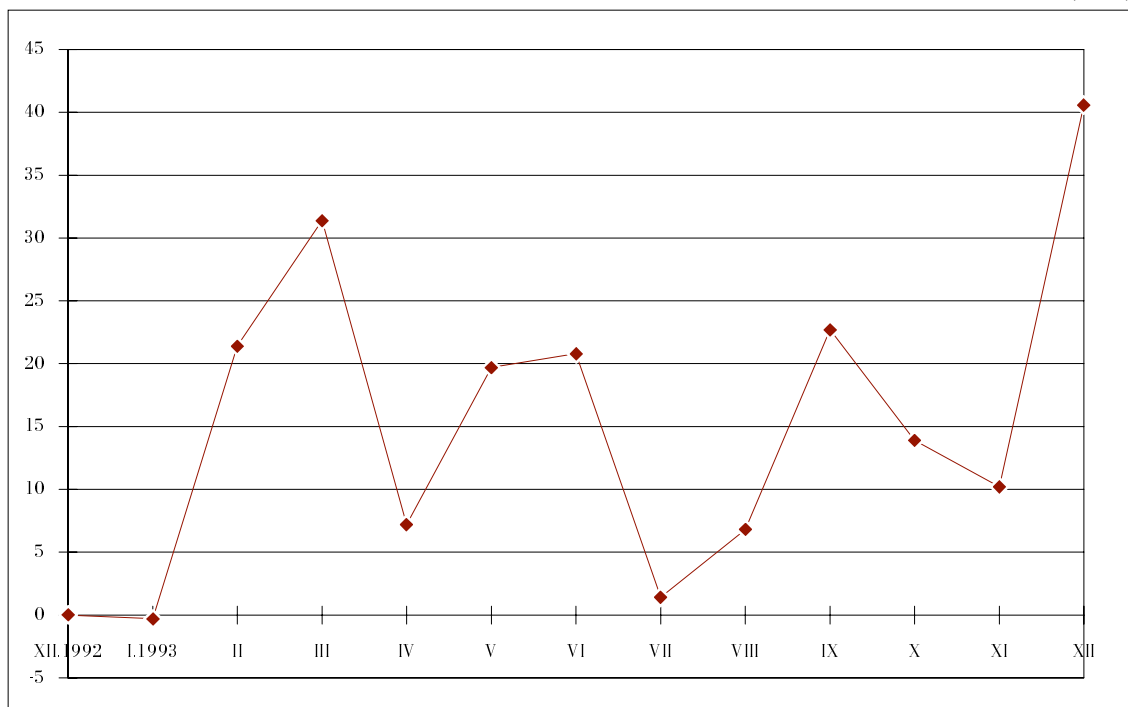
Denar non-monetary deposits, although having low nominal growth in 1993 (Denar 4,630 million), in relative terms increased by 616.4 percentage points more than the non-monetary deposits in foreign currency. As a consequence, the ratio of denar non-monetary deposits in total non-monetary deposits increased from 3.8% ( in December, 1992) to 9.8% (in December, 1993). General factors that determined the shift of the structure of non-monetary deposits were the following: high nominal and real interest rates on denar time deposits, and the relatively high stability of the denar exchange rate in the period June-December 1993.

Total banks investments in 1993 increased by Denar 34,428 million, i.e., by 364.2%. Investments in domestic currency increased by Denar 15,039 million, i.e., by 478.9%. The increase of this aggregate had significant oscillations from month to month. Namely, the bank denar investments were residual variable that supported the realization of the projected money supply growth. In accordance with this, when there was an inflow of liquid assets from the foreign exchange transactions, the increase of denar investments was decelerated, and vice versa.

The only exception was in December 1993, when denar investments increased by 40.6%. In order to reach better initiating position in December 1993, the banks artificially increased their denar investments, as a result of the announcement of the implementation of credit ceilings in 1994.

Monthly dynamics of growth rate in denar investments

(in %)



Banks investments in foreign currency increased in 1993 by Denar 19.389 million i.e., by 307.1%. Monthly rate of growth of these investments was in accordance with the denar exchange rate depreciation and the reinvestment and repayment of one part of the credit granted by Mr. Soros to the Republic of Macedonia.

According to the accepted conception for monetary targeting, the intermediate objective determined by the monetary policy should be realized through direct regulation of the growth of the monetary base. The broadest definition of the monetary base (including currency in circulation, float, banks giro-accounts, giro-account of the National Bank and banks deposits with the National Bank) increased in 1993 by Denar 2,556 million, i.e., by 221.1%. In the same period, the narrowest definition of the monetary base( including currency in circulation, float, and banks giro-accounts), which will be the main intermediary target of the monetary policy in 1994 in accordance with the STF arrangement with the IMF, increased by Denar 2,438 million in 1993, i.e. by 262.4%.

On the liabilities side of the Balance sheet of the National Bank, regarding the forms in which it is held, the monetary base in its broad definition is a very heterogeneous category depending on three groups of subjects: the central bank, banks and non-banking sector. The Central Bank determines the movements of compulsory reserve, compulsory central bank bills, assets on its giro-account, and through the monetary instruments it regulates the global level of liquidity in the banking system. In their operations, the commercial banks determine the flows on their giro-accounts and cash in vaults, as well as the amount of voluntary CB bills, while the flows of currency in circulation are determined by the non-banking sector.

#### Monetary base of the National Bank of the Republic of Macedonia

(in million denars)

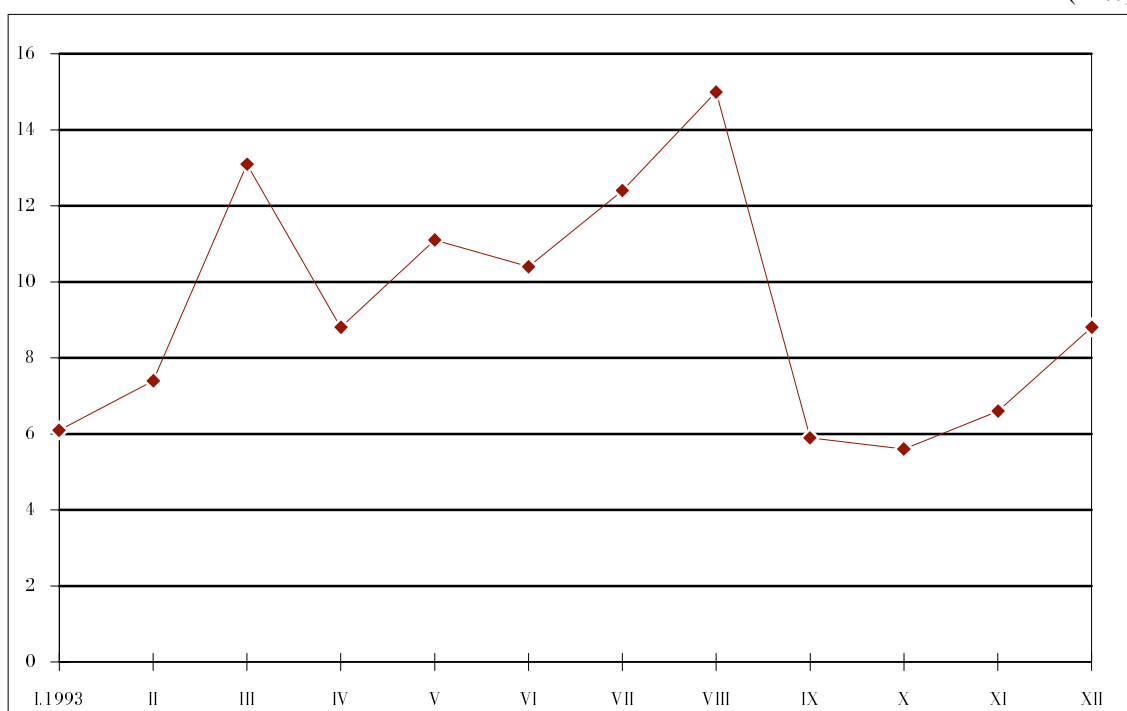
	Position on:		Changes	Indices
	31.XII.1992	31.XII.1993	I-XII.1993	<u>XII.1993</u> XII.1992
1. Currency in circulation	893	2,825	1,932	316.3
2. Assets in payments operations	-	4	4	-
3. Assets on banks giro-accounts	36	538	502	1.494.4
-giro-accounts	18	411	393	2.283.3
-cash in vault	18	127	109	705.6
Narrowest definition of the monetary base	929	3,367	2,438	362.4
4. Giro-account of the NBRM	29	216	187	744.8
5. Bank deposits with the NBRM	198	129	-69	65.2
a) Compulsory reserve	127	126	-1	99.2
b) CB bills	71	3	-68	4.2
-voluntary	-	-	-	-
-compulsory	71	3	-68	4.2
Total monetary base	1156	3,712	2,556	321.1
6. F-ex transactions	399	2,226	1,827	557.9
7. Investments directly in behalf of the banks	441	1,020	579	231.3
8. Deposits sold at auctions	-	156	156	-
9. Claims on the Republican Budget	-	64	64	-
10. Overdue claims and interest	18	3	-15	16.7
11. Claims on NBYugoslavia	136	136	-	100.0
12. Other claims	162	107	-55	66.0

At the end of 1993, currency in circulation participated with 76.1% in the monetary base. It was increased in 1993 by Denar 1,932 million, i.e., by 216.3%. The movements of this monetary aggregate depended explicitly on the households and enterprises demand for currency. The global demand for currency was mainly determined by: the institutional frames that settle the payment system and the control of financial flows; the institutionalization of the foreign exchange market; the level of economic activity; the system of wages and pensions payments; the scope of speculative transactions performed with banknotes in circulation and the tax evasion.

At the end of December 1993, banks giro accounts amounted to Denar 538 million, being a coefficient of 0.088 in relation to the money supply. Related to the position from the end of 1992, they were higher by Denar 502 million, i.e., around 15 times more. The level of banks giro-accounts was not stable within months, whereas the coefficient of giro-accounts in relation to the money supply moved from 0.056 (in October, 1993) to 0.150 (in August, 1993). Those fluctuations made the money multiplier unstable, which in turn aggravated the money supply regulation. The main factors determining the movements of banks giro-account were the following: seasonal primary issue on the basis of selective credits; unbalanced credit expansion in different months; and, the dynamic reduction of the compulsory reserve in 1993.

Coefficient of the ratio between assets  
on giro-accounts of the banks and money supply (M1)

(in %)



Assets on giro-account of the National Bank in 1993 increased by Denar 187 million, i.e., by 644.8%. The movements in the giro-account of the National Bank depended on the coordination between the interest payments to and repayments by the National Bank, as well as on the dynamics of the operational expenses of the Bank.

Bank assets absorbed with the National Bank on the basis of compulsory reserve and central bank bills, despite the increase of the deposits on which they were calculated and charged, in 1993, decreased by Denar 69 million, i.e. by 34.8%. The decrease of the liabilities, with an effect on additional primary issue, resulted from the dynamic reduction of the compulsory reserve rate and the central bank bills rate in 1993, by lowering the rates used for the calculation.

On the assets side of the Balance sheet of the National Bank, reserve money creation was realized through the following flows: foreign exchange transactions; primary issue investments in favor of banks; sale of deposits to the banks on auctions and investments in favor of the Budget of the Republic.

The creation of reserve money through transactions of the National Bank on the foreign exchange market was of autonomous character. This transactions primarily served for realization of the policy of foreign reserves and the exchange rate policy. Monetary policy realization was here of secondary importance. Objectives of the monetary policy were realized through monetary policy instruments, first of all through primary issue investments directly in favor of banks and through buying and selling deposits at auctions. Foreign exchange transactions of the Central Bank in 1993, influenced reserve money creation. Thus, in the period January-December 1993, they increased by Denar 1,827 million, i.e., by 457.9%, representing 71.5% of the total increase of the monetary base.

In 1993, there was an increase in the reserve money by Denar 579 million, or by 131.3% through primary issue transactions directly in favor of the banks based on rediscount (selective) credits by Denar 189 million, i.e., by 50.7%, and long-term credits for working assets by Denar 455 million, i.e., 11.4 times more. Simultaneously, loans to household on the basis of definitive sale of "frozen" foreign currency deposits decreased by Denar 40 million (position on December 31,1993, related to the position on December 31,1992) while loans for daily liquidity maintenance of the banks decreased by Denar 25 million.

In order to improve the flexibility of the monetary policy instruments, in the beginning of November 1993, auctions on buying and selling deposits as a flow for primary money issue and withdrawal, were introduced as an instrument of the monetary policy. Through this instrument, an amount of Denar 156 million reserve money was issued till the end of 1993.

Primary issue investments directly on behalf of the banks

(in million denars)

	Position on:		Change	Indices
	31.XII.1992	31.XIII.1993	I-XII.1993	<u>XII.1993</u> XII.1992
Total investments directly on the behalf of the banks	441	1,020	579	231.3
I. Rediscount loans	373	562	189	150.7
1. Imports	37	22	-15	59.5
2. Agriculture	336	540	204	160.7
-production	56	145	89	258.9
-livestock	24	35	11	145.8
-inventories	256	360	104	140.6
3. Market commodity reserves	-	-	-	-
4. Artificial fertilizers	-	-	-	-
5. Coal reserves	-	-	-	-
II. Loans for covering adverse movements in f/ex savings accounts	40	-	-	-
1. Special purpose liquidity loans	-	-	-	-
2. Loans to households based on absolute sale of f/ex savings deposits	40	-	-40	-
III. Regular loans for currents liquidity	25	-	-25	-
IV. Long-term loans for working capital	4	459	455	11,450.0

In order to regulate the obligations towards banks on the basis of repayments from foreign currency savings deposits in 1992, in the beginning of April 1993, the Republic of Macedonia was indebted in amount of Denar 64 million with the National Bank. In this amount, an amount of Denar 40 million was realized as a transfer of the National Bank claims from the commercial banking on the Republican Budget, whereas the amount of Denar 24 million was realized through direct indebtedness of the Budget with the National Bank. Consequently, monetary effects arising from this obligation of the Republic of Macedonia in 1993, were Denar 24 million, being the additional direct debt of the Budget.

## **V. MONETARY POLICY INSTRUMENTS**

### **1. Bank refinancing**

Apart from the fact that in 1993 there was a beginning in reforming the mechanism of instruments of the monetary policy for to implement and develop flexible market-oriented instruments, in 1993 bank refinancing operations remained a basic instrument of monetary regulation. Through this instrument, the National Bank regulates directly the monetary base, and through the base it indirectly regulates the money supply (M1) movements. This is the basic instrument through which, monetary effects from foreign exchange transactions should be neutralized, where primarily, the foreign exchange policy and foreign exchange rate policy are realized. In addition, through the bank refinancing operations in 1993, there was a realization of selective function of the monetary policy, i.e., directing the bank loans to finance particular purposes.

Refinancing operations were made in a form of rediscounting the loans granted by banks to final users for purposes defined in the Decision of the Parliament of the Republic of Macedonia for aims and objectives of the monetary and credit policy in 1993. Thus, besides the quantitative function, the National Bank performed the selective function as well, to direct the funds from the primary issue to determined economic activities of priority. Due to high seasonal volatility in reserve money demand in activities of priority, there was a frequent conflict in 1993 between quantitative and selective functions of the monetary policy. It was settled by limiting the assets to rediscount credits to banks for particular purposes. This was realized by quotas determination as maximum possible frameworks for bank loan refinancing granted to final users. The level of the quotas was determined for each quarter respectively in accordance with the monetary policy projection. In order not to have sudden liquidity increase, use of the funds, determined by quotas was broken by months dynamically within the frameworks of the particular quarter, in order to coordinate quantitative and selective functions of the monetary policy. Anyway, under such conditions, the initiative for reserve money creation came from enterprises with the economic activity financed from the funds of the primary issue. Rigidity of rediscount credits as an instrument of the monetary policy was especially noticeable in cases with a creation of significant amounts of reserve money through the foreign exchange operations of the National Bank, whereas the rediscount credits were not available to be used as an instrument to neutralize these effects. Namely, once the rediscount quotas are determined, they are treated as a right that can not be deprived no matter how high the liquidity level in banking sector is. Under such conditions, rediscount loans were losing their residual character and they turned into an inefficient instrument for realizing the quantitative function of the monetary policy, which was a reason to begin their abolishment gradually through monetary policy reforms, starting from May 1993.

In this sense, in the last ten days of May 1993, there was a transformation of short-term rediscount loans into long-term loans for permanent working capital. Transformation of short-term into long-term loans was made in full regarding the position of rediscount loans for agricultural area, on March 31, 1993. Thus in the third



ten day period of May, 1993, Denar 455 million were transferred into long-term loans for working assets, based on: rediscount loans for wheat production Denar 108 million; livestock - Denar 24 million; wheat stock - Denar 20 million; sunflower stocks - Denar 18 million; sugar beet stocks - Denar 7 million; vine stock - Denar 39 million; corn stocks - Denar 6 million; rice stocks - Denar 18 million; tobacco stocks - Denar 212 million, and milk production - Denar 1 million.

In addition, in the period of May-December, 1993, based on rediscount loans, within the frameworks of determined quotas, there was an additional issue of Denar 378 million based on rediscount loans for: wheat production - Denar 83 million; tobacco production - Denar 14 million; livestock - Denar 31 million; wheat stocks - Denar 92 million; sunflower and oil stocks - Denar 27 million; tobacco stocks - Denar 227 million, and sugar beet and sugar stocks, as well as corn stocks - Denar 11 million. At the same time, there was a decrease in rediscount loans for: export - Denar 38 million; oil-plants production - Denar 40 million, and sugar beet and corn production - Denar 15 million.

For the first quarter of 1994, on the basis of refinancing the commercial banks loans to agriculture, new net quota in amount of Denar 140 million was approved to be issued, in which: Denar 50 million for wheat sowing financing, and Denar 90 million for tobacco repurchase financing. In the period January 1 - March 15, 1994, reserve money amounted Denar 134.6 million, out of which Denar 46 million for wheat sowing refinancing, and Denar 88.6 million for tobacco repurchase refinancing.

The selective loans as an instrument of the monetary policy (in form of refinancing commercial banks loans to specific activities of priority) will be abolished since April 1, 1994.

## 2. Buying and selling deposits at auctions

Buying and selling deposits at auctions was introduced as a monetary policy instrument, on November 10, 1993, with the unique quantitative function to regulate the liquid, issuing potential of commercial banks. This is particularly flexible market oriented instrument of monetary policy. As such, it is suitable for neutralizing the effects resulting from central bank operations on the foreign exchange market. Besides, market determination of interest rates is realized through auctions of deposits.

Under conditions of non-existence of inter-bank money market and lack of any securities of good quality, auctions of deposits are a transitional solution and they are the first step on the open market operations implementation, as the basic instrument of monetary regulations. Auctions of deposits are carried out every fourteen days. By selling deposits, the National Bank issues reserve money. By buying deposits, the National Bank withdraws reserve money. The period for buying and selling deposits is standard and it is of fourteen days.

Deposits are bought and sold at interest rates determined at the auction. They are sold at unique interest rate equal to interest rate reached when selling the last (marginal) deposits being sold at the auction. Deposits are bought at unique interest rate achieved

on the auction, not higher than the maximum interest rate determined for each auction by the National Bank.

In the period November 10-December 31, 1993, the National Bank carried out four auctions on selling deposits. At these auctions, the National Bank sold deposits in total amount of Denar 377,1 million, or on average Denar 94.3 million per auction. Average interest rate obtained at the auctions was 12.03% on a monthly level, i.e., from 10.39% per month (at the first auction) to 13.10% (at the last auction in 1993).

#### Auction of deposits

(in millions denars)

No.	Date	Deposits sold	Deposits purchased	Balance	Interest rate (in %)		
					Min.	Max.	Achieved
1.	10/11/93	120.00		120.00	9.50	14.00	10.39
2.	24/11/93	40.00		40.00	11.00	15.00	12.50
3.	08/12/93	61.20		61.20	11.00	15.00	12.20
4.	22/12/93	155.90		155.90	12.00	20.00	13.10

### 3. Compulsory reserve

In the monetary system of former Yugoslavia, the compulsory reserve instrument was mainly used for drawing all bank liquidity and creating artificial monetary frameworks for additional primary issue. For these reasons, compulsory reserve rate was maintained on quite a high level. At the moment of establishing the monetary independence of the Republic of Macedonia, it was 27.2%.

The compulsory reserve rate was first reduced in June, 1992. By the end of 1992, the rate was reduced twice. Despite this, the compulsory reserve rate at the beginning of 1993 was still high. Thus, the compulsory reserve rate on sight deposits and time deposits up to three months was 15.0%, on deposits over three months 5.5%, and 5% on Government deposits. In accordance with this, during 1993 the policy of compulsory reserve rate reduction continued.

First reduction was realized in June, 1993. The compulsory reserve rate on sight and time deposits up to three months was reduced from 15.0% to 12.0%. The compulsory reserve rates on other deposits remained the same. This reduction resulted in prompt liquidity increase in the banking system of Denar 80 million.

Second reduction of the compulsory reserve rate was realized in September. For sight deposits and time deposits up to three months the rate was reduced from 12.0% to 10.0%, on time deposits over three months the rate was reduced from 5.5% to 4.5%, and on Government deposits from 5% to 4%. This reduction resulted in prompt increase of the liquidity of the banking system by Denar 97 million.

Third, and last reduction of the compulsory reserve rate was realized in November 1993. The rate on sight deposits and time deposits up to three months was reduced from 10.0% to 8.0%, on time deposits over three months the rate was reduced

from 4,5% to 3,5%, and on Government deposits from 4% to 3%. This reduction resulted in prompt increase of the liquidity of the banking system for Denar 105 million.

#### 4. Minimum liquidity and compulsory central bank bills

In accordance with its legal authorization, the National Bank determines the level, terms and the manner for banks and other financial institutions minimum liquidity maintenance. In January 1993, banks were obliged to hold primary liquidity on their giro-accounts on average 7% per month from their short-term resources position at the end of the previous month. The primary liquidity reserve should serve the purpose to neutralize the denar transactions oscillations in the commercial banks. Namely, the primary liquidity level should be equal to the projected level of oscillations of denar inflows and outflows on the banks' giro-accounts in particular periods.

The minimum liquidity rate of 7.0% was determined immediately after the monetary independence of the Republic of Macedonia (April 30, 1992), as a consequence of high oscillations in the inflows and outflows on the commercial banks giro-accounts. After stabilizing the oscillations, the rate of 7.0% was reduced to 4.0% (since the beginning of February, 1993). In March 1994, the minimum liquidity rate was reduced from 4.0% to 3.2%. In order to stimulate the development of market oriented instruments, each bank was allowed to use 70.0% of the minimum liquidity amount for subscription of central bank bills at the auction.

In 1993, in addition to the primary liquidity reserve, the banks were also obliged to hold secondary liquidity reserve in securities, i.e. compulsory central bank bills in a specified portion of the amount of banks minimum liquidity determination. But, the subscription of compulsory central banks bills, in fact, had the same function as the compulsory reserve. Therefore, with the reforms in the monetary sphere it was planned to abolish compulsory central bank bills simultaneously with the introduction of market oriented instruments of the monetary policy. In accordance with this, in 1993, there was a dynamic reduction of the role of compulsory central bank bills. Thus, in the beginning of February 1993, the compulsory central bank bills rate was reduced from 5.5% to 3.0%. Since mid-October 1993, the rate has been decreased to 2.0%. After implementing the instrument of buying and selling of deposits at auctions, in mid-December 1993, compulsory central bank bills were abolished completely as an instrument of the monetary policy.

#### 5. Interest rate policy

The price of reserve money is the discount rate as a factor with a significant influence on the reserve money supply and demand in the economy. In the economies with developed financial market, the changes of the discount rate of the central bank have direct impact on the movements of the interest rates on the money market, by increasing or decreasing the money supply and demand.

The present mechanism of reserve money issue in the Republic of Macedonia, however, does not create preconditions for market determination of the discount rate.

Moreover, a developed financial structure does not exist, and within its frames a lack of money market through which the appropriate influence of the discount rate on the commercial banks interest rates would be realized. At the same time, the lack of financial discipline makes the economic subjects indifferent regarding the interest rate changes, which additionally makes leading efficient interest rate policy impossible. Under such conditions, there is a need for using the appropriate model for discount rate determination.

Through eleven months of 1993, the discount rate of the National Bank was determined by using the methodology adopted in December 1992, according to which the discount rate was calculated based on the average inflation rate in the previous three months and the projected rate of inflation for the following three months, increased by one percentage point (0.5 percentage points from September 1993) as a real rate. Since the beginning of December 1993, in accordance with the IMF, the discount rate has been determined according to new methodology based on the average annual rate of inflation in the last two months adjusted to the effect of seasonal increase in prices, plus 5.0% on annual level as a real part.

In accordance with this, during 1993 the discount rate was being changed every month. The National Bank intended to link the discount rate calculation with the trend rate of the inflation, with a certain part as a real interest rate. The discount rate of the National Bank in 1993 completely fulfilled the expectations. The average nominal discount rate on annual level was 261.4% including real positive interest rate of 9.7% on annual level, as well.

#### Discount rate

	Discount rate		(in %)
	On annual level	On monthly level	Inflation rate On monthly level
XII. 1992	250.0	11.0	17.5
I.1993	385.0	14.1	15.6
II	333.0	13.0	32.5
III	392.0	14.2	8.5
IV	520.0	16.4	3.4
V	382.0	14.0	8.0
VI	151.8	8.0	-0.9
VII	105.8	6.2	7.7
VIII	140.8	7.6	9.5
IX	170.0	8.6	6.5
X	233.0	10.5	12.1
XI	224.3	10.3	12.1
XII	295.0	12.1	13.5
I-XII.1993	261.4	11.3	10.4

According to the institutional setting of the financial system, the commercial banks are independent in formulating and implementing their business policy, including the interest rate policy. Under circumstances when the discount rate is not determined in a market way (i.e., by using the methodology) and with a high level of rigidity of the issuing mechanism, the credibility of the central banking institution remains the only potential motive for the commercial banks to connect their interest rate policy to the discount rate policy of the National Bank.

Two periods can be distinguished in the commercial banks interest rate policy implementation in 1993. In the first period (January-June, 1993) the commercial banks were implementing independent interest rate policy, which was not coordinated by the discount rate policy of the National Bank. The basic features of this policy were the following: 1) interest rates were not market determined; 2) the level of interest rates was not determined by the influence of the fundamental factors: rate of inflation, level of economic activity, the productivity, the exchange rate, the level of liquidity etc.; 3) interest rates were very rigid in their downward movements, and very flexible in their upward movements; 4) there were big deviations among the interest rates for the same type of deposits or loans by banks; 5) extremely high margins between active and passive interest rates.

The regime of commercial banks interest rate policy reached its extremes in June 1993, when in terms of deflation of -0.9%, monthly nominal interest rates on time deposits over three months were between 9.0% and 16.0%, while the nominal interest rates on short-term loans for agriculture were between 18.0% and 25.0% per month.

#### Commercial banks interest rates

in %					
1993	rate of inflation on a monthly level	nominal interest rates on time deposits over 3 months	real interest rates on time deposits over 3 months	nominal interest rates on short-term loans to agriculture	real interest rates on short-term loans to agriculture
January	15.6	16.2 - 24.1	0.8 - 7.4	24.3 - 26.9	7.5 - 9.8
February	32.5	20.0 - 24.7	(-9.5) - (-9.5)	25.3 - 29.9	(-5.4) - (-1.7)
March	8.5	20.0 - 24.7	10.6 - 12.4	25.3 - 32.2	15.5 - 21.8
April	3.4	20.0 - 24.7	16.1 - 18.3	26.0 - 33.0	21.9 - 28.6
May	8.0	17.0 - 22.0	8.3 - 13.0	20.0 - 25.6	11.1 - 16.3
June	-0.9	14.0 - 21.0	15.0 - 22.0	18.0 - 25.0	19.1 - 26.1
July	7.7	9.0 - 16.0	1.2 - 7.7	11.0 - 15.0	3.1 - 6.8
August	9.5	9.0 - 11.0	(-0.5) - 1.4	10.5 - 15.0	0.9 - 5.0
September	6.5	9.0 - 11.0	2.3 - 4.2	9.5 - 16.0	2.8 - 8.9
October	12.1	11.0 - 13.0	(-1) - 0.8	10.7 - 17.0	(-1.2) - 4.4
November	12.1	10.0 - 13.5	(-1.8) - 1.2	11.5 - 18.0	(-0.5) - 5.2
December	13.5	11.0 - 16.0	(-2.2) - 2.2	11.0 - 18.0	(-2.2) - 4.0

In the second period (July-December 1993) as a result of measures taken by the economic policy makers, there was a relatively better coordination between the discount rate policy of the National Bank and the commercial banks interest rate policy. The flexibility of commercial banks interest rates in their upward, as well as in their downward movements was high. Thus, in December 1993, the discount rate was determined on 12.1% on a monthly level, the interest rate on time deposits over three months was between 12.0% and 16.0% per month, while the interest rate on short-term loans for agriculture was between 11.0% and 18.0% per month.

## **VI. REALIZATION OF 1993 FOREIGN EXCHANGE POLICY**

In the beginning of 1993, the internal and external political and economic situation in the Republic of Macedonia was characterized by further existence of negative trends also present in 1992. Under such conditions, the 1992 foreign exchange system still existed having the following basic characteristics: policy of fixed official exchange rate against the basket of seven convertible currencies; nonexistence of organized exchange market; exporters' surrender requirement of 30% of the realized foreign exchange inflow under the official unreal exchange rate as well as system of exchange offices of the commercial banks repurchasing the effective foreign currency in the behalf of the National Bank, i.e., for building up the foreign exchange reserves of the Republic.

Main weaknesses of this system reflected in the existence of parallel exchange rate, significantly higher than the official, and, in the existence of parallel exchange market of rights of the exporters within the authorized banks for transactions abroad where foreign exchange buying and selling were carried out under this remarkably higher exchange rate. As a result of the unreal official rate and surrender requirement of 30% of foreign exchange inflow under that rate, the exporters were extremely discouraged from declaring the foreign exchange inflow from goods and services, and, simultaneously, there was a considerable decrease in the repurchase of foreign currency in the exchange offices. There was a larger use of cash payments and export/import payments besides the regular banking foreign payments system, where the shortage of the foreign exchange was compensated by purchasing it at the black market.

In order to overcome the negative situations and trends that appeared in the functioning of the foreign exchange system, during January 1993, the National Bank prepared and proposed a concept of new foreign exchange system with necessary measures for its implementation. The system was in general terms approved by the Government of the Republic of Macedonia and its realization started in mid-May 1993 by passing the basic laws on foreign exchange and external trade operations and the Decision on Foreign Exchange Policy and Projection of Balance of Payments of the Republic of Macedonia for 1993, as well as other appropriate regulations.

Furthermore, the realization of general determination of the concept on new foreign exchange system began, first of all, by implementing floating exchange rate freely determined according to the foreign exchange supply and demand at the organized foreign exchange market within the authorized banks for transactions abroad. The floating exchange rate policy strongly influenced the realization of positive results in the balance of payments, increase of the national foreign exchange reserves, and creation of real basis and preconditions for liquidity in payments abroad and external debt servicing primarily towards international financial institutions. The role of the National Bank when intervening at the exchange market within the limits of the foreign exchange reserves, was also realization of a real stable exchange rate without significant volatile fluctuations bringing possible inflationary pressures. Such role of the National Bank determines the denar rate as freely fluctuating exchange rate.

Implementation of new foreign exchange system was enabled after passing the Decision on the Terms and Conditions for Buying and Selling Foreign Exchange among Legal Persons in the Republic of Macedonia by the Council of the National Bank on May 13, 1993. This Decision marked an introduction of a free foreign exchange buying and selling among the legal persons on the foreign exchange market under freely determined exchange rate, where one of the subjects was the National Bank. The exporters' surrender requirement of 30% of the realized foreign exchange inflow ceased, and, at the same time, the exporters were allowed to use freely their exchange inflow within the range of few possible choices, as follows: to use the inflow for paying their obligations abroad; to sell it to another enterprise or to a bank; or, to keep it as a deposit on a foreign exchange account not more than 90 days.

Simultaneously, there was a Decision on Terms and Conditions for Exchange Operations which enabled buying and selling of effective foreign currency among domestic natural persons and through authorized exchange offices that can be established by banks and by other legal and natural persons, as well. The limit for selling foreign exchange to domestic natural persons in amount up to 50% of the foreign currency purchased during the day, was determined with a separate Decision by the Government of the Republic of Macedonia. In September 1993, an amendment of this Decision allowed an increase in the amount of foreign exchange sale to 60% of the realized purchase.

This Decision was a realization of the objective set out in the Decision on Foreign Exchange Policy and Balance of Payments Projection of the Republic of Macedonia for 1993 for creating institutional and other conditions for functioning and operation of the foreign exchange market, as well as buying and selling effective foreign currency through exchange offices. The adoption of the measures of the new foreign exchange system was a creation of real basis for eliminating the illegal foreign exchange market among the enterprises and among the households.

In a relatively short period of time from the implementation of the new foreign exchange system, significant results have been reached, evident mostly in considerably increased volume of payments transactions abroad through the banking system and in the functioning of foreign exchange market within the present banks authorized for transactions abroad and in most of the newly-founded banks authorized for payments operations abroad. The realized foreign exchange inflow from export of goods and the payments for import of goods were almost twice the ones registered in 1992. In the second half of the year, there was a tendency of growth in the surplus in current transactions abroad. Thus, of significant importance was the increase in purchased foreign means of payment from the exchange transactions that in the period of January-May 1993 amounted to only USD 1.9 million, whereas until the end of the year the amount was USD 70.1 million. These movements contributed to the increase of total foreign exchange potential of the country, noting an increase of the foreign exchange reserves handled by the National Bank, and of foreign exchange reserves with the commercial banks, whereas there were USD 49.3 million on the foreign exchange deposits of the exporters at the end of 1993.

## 1. Denar exchange rate movements

From the beginning of the year until May 14, 1993, there was an implementation of fixed denar exchange rate according to the basket of seven convertible currencies with an allowed deviation of the rate within the determined margin of +/- 10% for taking into account the realized changes in the cross-rates of basket currencies, as well as for the determination not to allow a decrease in exchange rate against a particular currency. There was a minimum increase in the denar exchange rate against particular currencies in this period. So, against the German Mark there was an increase from Denar 7.6556, at the beginning of the year, - to Denar 8.0284 on May 13, 1993, i.e., an increase by 4.9% only. Against the US Dollar, there was an increase from Denar 12.3565 to Denar 12.9378, or by 4.7%.

When implementing the system of free determination of denar exchange rate on the foreign exchange market, the denar rate was determined on Denar 12.94 for DEM 1 which was an increase of 61.31%, i.e. Denar 20.88 for USD 1 with an increase of 61.36%. With such an increase, the spread between the official and unofficial exchange rate of the German Mark was decreased from 66.91% to 8.18%, and from 61.54% to 6.81% for the Dollar. With small deviations, the exchange rate was relatively stable until the beginning of September 1993, with gradual lowering of the spread between the official and unofficial denar exchange rate. In this period, deviations of the official rate against the unofficial one were between 0.75% to 2.00% of the German Mark, whereas the official dollar exchange rate happened to be even higher. Such a relative stability of the denar exchange rate is a result of a number of factors. First of all, there was an implementation of new foreign exchange system (abolishment of surrender requirement of 30% of the realized foreign exchange inflow; implementation of real denar exchange rate; foreign exchange market functioning, etc.) that enabled relatively high foreign exchange supply at the very beginning of foreign exchange market functioning. The resources used from the credit from the Soros Foundation, directly invested in the economy, - contributed to a decrease in demand of foreign exchange, and at the same time the obligations on drawn foreign medium- and long-term credits, were not met.

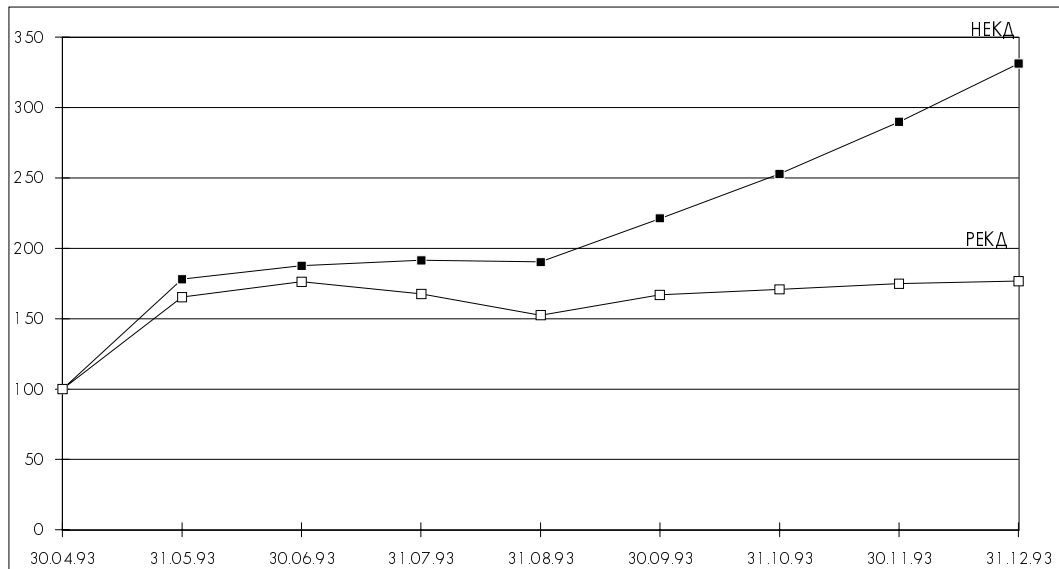
In the beginning of September, the increased demand for foreign exchange on the foreign exchange and currency exchange market renewed the instability of denar exchange rate and brought a new increase in the spread between the official and unofficial denar exchange rate. By implementing tight credit and monetary policy and with the interventions of the National Bank by selling foreign exchange from foreign exchange reserves on the foreign exchange market (in October, the National Bank sold USD 14.4 million), there was again a stabilized exchange rate and diminishing spread against the unofficial exchange rate, in the end of October. The exchange rate, however, was successfully maintained stable in a relatively short period of time until mid-October. Foreign exchange outflow because of the payments of the traditionally high imports in the fourth quarter of the year, resulted in every day increase in foreign exchange demand on the foreign exchange and currency exchange market. The largest repayment of credit obligations to Mr. George Soros (USD 20 million repaid in the fourth quarter, i.e. 80% of the principal of the credit) influenced the increase of foreign exchange demand in this time period.



The stability of the denar exchange rate was regained in the last days of the year. Changes in denar exchange rate during 1993, can be seen through the movement of the nominal and real effective denar exchange rate.

#### Movement of nominal and real effective denar exchange rate

(30.04.1993 = 100)



The effects of the denar exchange rate policy on the price competitiveness of the imports can be most easily monitored through the movements of the index of the real effective exchange rate. Annual indices of the real effective exchange rate, as well as the index calculated on the basis of the price competitiveness since the end of 1989, are presented in the following table:

#### Movements of price competitiveness of imports monitored through the movement of the real effective denar exchange rate index

Index	<u>31.12.1990</u>	<u>31.12.1991</u>	<u>31.12.1992</u>	<u>30.04.1993</u>	<u>31.12.1993</u>	<u>31.12.1993</u>
	31.12.1989	31.12.1990	31.12.1991	31.12.1992	30.04.1993	31.12.1992
1. Nominal effective denar exchange rate	96.4	184.8	5,984.9	104.9	331.2	347.5
2. Index of domestic retail prices	221.7	335.2	2,025.2	171.8	191.8	329.5
3. Index of foreign retail prices	105.4	103.7	103.5	101.2	102.4	103.6
4. Relative prices (2/3*100)	210.1	323.2	1,956.7	169.8	187.3	318.1
5. Real effective denar exchange rate	45.8	57.2	305.9	61.8	176.8	109.3
Real effective denar exchange rate: 31.12.1989 = 100	45.8	26.2	80.1	49.6	87.6	87.6

\*The real effective exchange rate index, being the averaged index of domestic currency movement against the basket of currencies of countries where the biggest part of the imports is made, adjusted for price movements in certain countries and on the domestic market, - is internationally accepted and generally applied indicator for to evaluate the reality of the exchange rate of the currency of a country. During the calculation of the real effective denar exchange rate, the position at the end of 1989 was taken as the basis, as the period when the implementation of fixed exchange rate policy began and as evaluated real level of the exchange rate. Weights for calculating the average exchange rate against the basket of currencies are the participation of the currencies in the foreign exchange inflow from the import of goods and services in the Republic. The real effective exchange rate over 100 is an increase in price competitiveness, and the index under 100 is a decrease in price competitiveness.

Taking into account that there was a policy of regular monthly adjustment between the exchange rate and the price movements on domestic and foreign markets till the end of 1989 in order to maintain the price competitiveness of imports, only the position at the end of this year can be taken as the basis for obtaining the real denar exchange rate and the effects of the exchange rate policy implementation in the last period of time.

The fixed dinar exchange rate policy in the period from 1990 until the monetary independence, resulted in significant decrease in price competitiveness of imports (by 54.2% in 1990, and by 42.8% in 1991). With the monetary independence and with the determination of the denar exchange rate on 360 denars for one German Mark, the price competitiveness of imports not only reached the level from the end of 1989, but it also additionally increased by 60%. However, the problems of inconsistent implementation of the first anti-inflation program of the Government of the Republic of Macedonia after the monetary independence of the Republic in 1992, as well as the delayed and inappropriate correction of denar exchange rate, did not maintain the price competitiveness of the Macedonian export. Besides the fact that the price competitiveness was by 9.3% higher at the end of 1992 compared to end-1991,- it was by 12.4% lower compared to end-1989.

The fixed exchange rate policy in the beginning of 1993, i.e., until implementing floating denar exchange rate, did not follow the price movements on domestic and foreign markets. This created continued reduction of price competitiveness in this period, so that it was lower by 50.4% in end-April compared to end-1989.

With the implementation of floating denar exchange rate, the price competitiveness of imports was immediately brought to a level from the end-1992, though still lower by 18% compared to the level from end-1989. Despite the permanent devaluation of denar exchange rate since the implementation of floating exchange rate till the end of the year (nominal effective denar exchange rate at the end of 1993 being by 231.2% higher than the one at the end of April 1993), and, the level of 76.81% higher competitiveness at the end of the year compared to end-April 1993, - at the end of the year, the price competitiveness of Macedonian export was by 12.4% lower than the level at the end of 1989.

Floating exchange rate policy together with the other measures of the new foreign exchange system (the introduction of the foreign exchange market) resulted in creating better conditions also in the area of economic relations abroad, compared to the first months of the year.

Thus, in June, the foreign exchange inflow of imported goods and services (USD 67.5 million) was twice the foreign exchange inflow on this basis in May (USD 32.6 million), whereas the average monthly foreign exchange inflow in the period until the new foreign exchange system was USD 28.9 million, and in the period from June till the end of the year it was USD 60.5 million.

On the other side, however, normal functioning of the foreign exchange market and the possibility to buy foreign exchange on the foreign exchange market under a real

exchange rate, resulted in larger part of payments abroad carried out within the banking system of the Republic. Foreign exchange outflow for export of goods and services made through the banking system in the first months of the year was USD 38.8 million on an average monthly level, whereas it was USD 69.9 million in the last seven months of the year.

The positive influence of such denar exchange rate policy on foreign exchange reserves of the Republic of Macedonia is obvious in the fact that in the period after the implementation of floating denar exchange rate and free functioning of the exchange market, apart from the repurchase of foreign exchange on the foreign exchange market, - the main resource for building up the foreign exchange reserves were the exchange operations. Thus, until the end of May, with the exchange operations there was an inflow in foreign exchange reserves handled by the National Bank of only USD 1.9 million, while from June to end of year, this inflow amounted to USD 34.1 million.

## 2. Functioning of foreign exchange and currency exchange market

### 2.1. Foreign exchange market

The first foreign exchange market in the Republic of Macedonia started to operate in mid-May, 1993, based on qualitatively completely different principles than the ones implemented in former Yugoslavia. Of great importance was the transition to free denar exchange determination, based on foreign exchange supply and demand, meaning in practice an acceptance of foreign exchange market operation principles of developed market economies. However, having no bank association, the first foreign exchange market was institutionally established as a market within each bank authorized for payments operations abroad. In addition, buying and selling foreign exchange on such organized foreign exchange market was possible among enterprises, among the enterprises and banks, and, among banks.

At the beginning of the operations, there was relatively modest turnover on the foreign exchange market of about USD 0.4 million on an average daily level in the first week, reaching USD 2.4 million on an average daily level in the following period until June 30, 1993. Since the beginning of the foreign exchange market operation until the end of June, 1993, the total turnover was USD 65.8 million.

The functioning of foreign exchange market continued in the third quarter of the year with an unreduced speed. Hence, the average daily level was the amount of USD 2.4 million as it was in June, and the total turnover in this period was USD 138.5 million.

The turnover in the fourth quarter of the year was higher than in the previous month and it amounted USD 141.7 million with an average daily level of USD 2.6 million. Higher turnover in this quarter was mainly due to rather high turnover in December in amount of USD 60.6 million (the average monthly turnover being USD 49.4 million), whereas the daily level was USD 2.9 million. Such high turnover in this month was mainly a consequence of a large number of obligations that matured before

the end of the year, where also the highest turnover among the enterprises as entities on the foreign exchange market was reached in this month (USD 23.5 million).

The highest daily turnover was USD 6.8 million and it was realized in the beginning of the foreign exchange market operations on June 18, 1993 and USD 5.8 million in the end of the year on December 30, 1993.

In the first year of its existence, the total foreign exchange market turnover was USD 345.9 million, where 63.4% of the turnover was among enterprises and authorized banks, 34.5% in direct buying and selling among enterprises, and only 2.1% among banks.

In this period of foreign exchange market functioning, the National Bank repurchased a surplus in foreign exchange on the foreign exchange market in amount of USD 20.8 million, and it intervened by selling USD 46.9 million. In the first two months after the introduction of the foreign exchange market, the National Bank repurchased foreign exchange mainly determined as a surplus on the foreign exchange market (USD 16 million), and intervened by selling USD 7.9 million for crude oil purchases. Such high foreign exchange supply on the foreign exchange market in the first months of its existence, was mainly because of the termination of the surrender requirement of 30% of the foreign exchange inflow of the exporters for building up the foreign exchange reserves and the real level of denar exchange rate, which was an incentive for the exporters to bring the foreign exchange inflow in the country, maintained until then on their accounts abroad. In the period from August until the end of the year, the National Bank repurchased USD 4.8 million being a surplus on the foreign exchange market and in the same time it intervened by selling USD 39.0 million. Such interventions of the National Bank from the foreign exchange reserves were strictly with a purpose for import payments of crude oil, raw materials and semi-manufactures (wheat mainly), and, they furthermore influenced the relative stability of denar exchange rate as a result of balanced foreign exchange supply and demand in this time period.

In this period of time, out of 17 banks authorized for payments operations abroad, only 11 banks realized a foreign exchange market turnover. The biggest part of the turnover, i.e., 55.5% was through Stopanska Banka a.d., Skopje, 22.6% through Komercijalna Banka a.d., Skopje, 10% through Ljubljanska Banka-Makedonska Banka a.d., Skopje, and, 4.4% through Kreditna Banka a.d., Skopje, - having a tendency to increase and to gain regular payments operations with other banks, particularly since the end of June.

Having such organized foreign exchange market, payments operations abroad were brought within the limits of the banking system of the Republic. The average monthly sale on the foreign exchange market was about 35.5% of average monthly payments for import of goods and services in the period from the beginning of June until the end of December 1993, whereas the other payments were made from the foreign exchange inflows of the importers.

In respect to relatively short period of time since the beginning of the foreign exchange market functioning, the results can be defined as satisfactory, and from the

previous experience from the foreign exchange market operation, as well as in further considerations and solutions to particular problems and defaults in its functioning, - foreign exchange market improvement can be expected in the future.

## 2.2. Currency exchange market

Parallel to the beginning of foreign exchange market operations, the currency exchange market operations have also started. Basically, there is a liberalization in the exchange market operations, thus expanding the group of entities that can equally act, apart from the commercial banks and other legal and natural persons. In addition, besides the exchange operations, the authorized exchange operators are allowed to perform in their name and on their account, or, on account of the authorized bank or the National Bank after receiving the license by the Governor of the National Bank. The exchange offices that operate in their name and on their account determine the exchange rate freely, related to the supply and demand, announcing daily their own exchange list. However, the limiting factor freely determining the exchange rate is an obligation to sell a portion of the purchased foreign exchange to a commercial bank, or to the National Bank (50%, i.e., 40% since September, 1993), under the exchange rate of the bank-buyer.

After passing the Decision until the end of 1993, 370 licenses were issued to exchange offices with a total number of 448 exchange windows. Thus, there were 140 exchange offices determined to operate in their own name and on the account of the National Bank, 19 exchange offices on the account of the authorized banks, and 197 exchange offices operating in their own name and on their own account.

In the period from the beginning of liberalization of the exchange offices until the end of the year, the exchange offices operating on the account of the National Bank purchased an amount of USD 12.8 million, while selling USD 1.5 million. At the same time, exchange offices operating in their name and on their account, repurchased USD 40.3 million and sold USD 8.6 million. For building-up the foreign exchange reserves handled by the National Bank, out of the realized net foreign exchange inflow from the exchange operations, USD 34.1 million were used, whereas the rest of USD 8.9 million was for an increase in the foreign exchange potential of the banks.

The impact of the spread of the official exchange rate and the unofficial denar exchange rate on the foreign exchange inflow in building-up the foreign exchange reserves, should be pointed out. This means, that in the period of bigger deviation of the official exchange rate than the unofficial one, the foreign exchange inflow from the exchange operations was decreased. This was particularly the case in October, when after the period of three months of relatively low deviation of the official exchange rate, there was renewed increase of this deviation. So, after relatively high inflow through September (USD 6.5 million); in October, there was a realized inflow of only USD 0.8 million. Already in November, when the deviation between the official exchange rate and the unofficial exchange rate was lowered, the foreign exchange inflow from exchange operations reached an amount of USD 6.3 million.

### 3. Foreign exchange reserves formation

In the first months of 1993, building up the foreign exchange reserves in the Republic of Macedonia was according to the Decision on Foreign Exchange Policy and Projection of Balance of Payments of the Republic of Macedonia for 1992, made by the Parliament of the Republic of Macedonia on the day of the monetary independence. Until May 18, 1993, the surrender requirement of 30% of the realized foreign exchange inflow of the enterprises from the import of goods and services, as well as the exchange operations performing completely for building the foreign exchange reserves, - were the basic resources for building the foreign exchange reserves.

After passing the new Law on Foreign Exchange Operations, on May 18, 1993, as well as the regulations for institutionalizing the foreign exchange market, free exchange operations, and after the implementation of floating denar exchange rate, - there were conditions suitable to leave the compulsory surrender of foreign exchange inflow not being incentive or popular way to build-up the foreign exchange reserves.

In 1993, the building-up of foreign exchange reserves, handled by the National Bank, was projected to be from the following sources:

- compulsory purchase of 30% of total foreign exchange inflow of the enterprises (until May 18, 1993);
- buying foreign exchange on the foreign exchange market (after its establishment in the second half of May, 1993);
- repurchase of foreign means of payment through exchange operations;
- toll paid by foreign vehicles when using the roads in the Republic of Macedonia;
- foreign exchange inflow from the petrol coupons;
- foreign currency provided by selling the social capital (social apartments and business premises);
- bond issue in foreign exchange;
- buying gold according to the Decision made by the Council of the National Bank.

With the Decision on Foreign Exchange Policy and Projection of the Balance of Payments of the Republic of Macedonia for 1993, total foreign exchange reserves were determined on the level of three months payment obligations abroad, i.e., USD 240 million, whereas the existing reserves were determined on the level of one month current payment obligations abroad (USD 80 million), and current foreign exchange reserves were of USD 160 million.

In the end of 1993, total foreign exchange reserves reached the amount of USD 156.17 million which, compared to the amount at the end of 1992, was an increase of USD 67.37 million, or 75.86%. In the same time, foreign exchange reserves handled by the National Bank were USD 119.22 million, where USD 80 million were the core reserves, while USD 39.45 million were current foreign exchange reserves, which compared to 1992 was an increase of USD 59.45 million, or 99.46%. Current foreign

exchange reserves with the banks authorized for operations abroad were USD 36.95 million, which is an increase of 8.95 million, or 31.96% compared to the end of 1992. Having in mind that, in the end of 1993, the exporters held USD 49.3 million on their foreign exchange deposit accounts with commercial banks, the total foreign exchange amount in the Republic of Macedonia was USD 205.5 million being by 14.4% lower than the projected one.

Through 1993, there was a realized inflow in the foreign exchange reserves handled by the National Bank in total amount of USD 152.56 million, and in the same time there was an outflow of USD 93.11 million.

The biggest participation in the total realized inflow was of the inflow based on repurchased foreign exchange from the banks and enterprises (35.31%); followed by the inflows provided from the exchange operations (23.55%), surrender of a portion of the foreign exchange inflow of the enterprises (21.28%), foreign exchange repurchase from selling the social apartments (5.83%), gold repurchase (4.97%), and other kinds of inflows as well.

In the reporting period, the crude oil import payments participated in great extent in the outflow (52.96%), followed by the outflows based on the repayments of the credit of Soros Foundation (11.20%), foreign exchange selling for payments of imported raw materials and semi-manufactures -mostly grain - (8.84%), debt payment towards the IMF (8.38%), debt payment towards the IBRD (8.16%), payments according to various decisions made by the Government of the Republic of Macedonia (5.45%), and other outflows (5.01%).

From the participation of particular components in the inflow and outflow structure, it can be noticed that the biggest part of the realized inflow coming in a way from the export operations, was again brought in the channels of the economy after the intervention of the National Bank by selling foreign exchange on foreign exchange market, first of all, for paying the import of crude oil, raw materials and semi-manufactures.

Monthly dynamics of the changes of foreign exchange reserves shows the following tendency:

- higher part of the foreign exchange reserves increase was realized until the end of May, when under smaller foreign exchange inflows - first of all because of arrears from foreign credits- the foreign exchange reserves were increased by USD 44.34 million, or 74.5% of the total increase (USD 59.45 million) in 1993;

- after establishing the foreign exchange market, the inflow in the foreign exchange reserves started with stronger pace, first of all based on exchange operations. This resulted in continuous increase of foreign exchange reserves until the end of August, 1993. However, payments based on debt servicing of the Republic of Macedonia towards the Soros Foundation, the International Monetary Fund and towards the International Bank for Reconstruction and Development, as well as selling a part of the foreign exchange reserves for paying the import of crude oil, raw materials and semi-manufactures with higher intensity in the last four months of 1993, - caused the higher level of total outflow in foreign exchange reserves than the total inflow in this

period, having a direct impact on the decrease of foreign exchange reserves until the end of 1993;

The amount of foreign exchange realized in the enterprises by export operations should be taken into account, not being sold on the foreign exchange market, but instead kept as a deposit up to ninety days with the banks, which was enabled by the Law on Foreign Exchange Operations, and the amount was USD 49.34 million on December 31, 1993. If those foreign exchange had been offered for sale on the foreign exchange market following the dynamics of their maturity, they would have contributed in a certain amount to the foreign exchange reserves of the Republic of Macedonia for the already mentioned payments, meaning that the amount of the foreign exchange reserves would have been larger in the end of the year.

#### 4. Execution of balance of foreign transactions through 1993

Having no evidence on the trade transactions of the Republic of Macedonia with other countries as a result of dissolution of the information system of former Yugoslavia, as well as the impossibility to record the exchange of goods of former Yugoslav republics, or with some neighboring countries being performed out of the banking system, - the analysis of the foreign economic relations of the Republic of Macedonia was made only on the basis of cash foreign exchange transactions within the banking system of the Republic.

##### 4.1. Current transactions

In the comparative analysis of the balance of foreign transactions through 1993 compared to 1992, various economic and political conditions and possibilities for the realization of foreign economic relations should be taken into account.

In 1992, until the monetary independence on April 26, the foreign economic relations of the Republic were through a complete system of legal regulations on foreign exchange operations in SFRY, which continued to be implemented even after the independence. On the other side, by passing the new Law on Foreign Exchange Operations in 1993 and with the free foreign exchange operations under market determined foreign exchange rate, based on foreign exchange demand and supply on May 18, - completely different system of legal regulations for economic relations was defined.

From the beginning of 1992 until the monetary independence on April 26, the exchange of goods and services among former Yugoslav republics (except for Slovenia and Croatia) operated also as trade within one country, i.e., in dinars, whereas in the current year the complete exchange was as foreign exchange transactions of the Republic in convertible currencies.

After closing the traditional Yugoslav markets (a result of the war on former Yugoslav territory and of the sanctions against SRY by the United Nations), where the Macedonian economy used to place a big portion of the products, - there was a need of



finding other foreign markets. This was an increase in foreign exchange transactions of the Republic with bigger foreign exchange effects on the Balance of foreign transactions of the Republic.

Under the influence of the already mentioned circumstances, within the foreign exchange cash transactions on the 1993 current account of the Republic, there was a surplus of USD 51 million, whereas in 1992, it amounted USD 7 million. The presented positive results were first of all due to the faster dynamics of the inflow increase in relation to the outflow. Total inflow in amount of USD 872 million was increased by 111.3%, and the total outflow in amount of USD 819 million was increased by 102.3%. It should be pointed out, however, that in the first half of the year, the largest part of the payments on imported goods and services was outside the banking system of the Republic of Macedonia, i.e., in foreign currency, giving the impossibility to be included, or to have any impact on the above data.

### Balance of foreign payments

(in million denars)

Table No. 1	from January 1 to June 30				
	1992	1993	01-06/93	06-12/93	indices
	1	2	3	4	5=2/1*100
<b>A. Current transactions - balance</b>	<b>7</b>	<b>51</b>	<b>-24</b>	<b>75</b>	<b>728.57</b>
1. Trade balance	-68	-152	-53	-99	223.53
1.1. Inflow from exports of goods	256	461	121	340	180.08
1.2. Outflow from imports of goods	324	613	174	439	189.20
2. Balance of services	24	48	3	45	200.00
2.1. Inflow	54	121	23	98	224.07
2.2. Outflow	30	73	20	53	243.33
3. Balance of goods and services	-44	-104	-50		236.36
3.1. Inflow from exports of goods and services	310	582	144	438	187.74
3.2. Outflow from imports of goods and services	354	686	194	492	193.79
4. Private transfers - balance	30	119	15	104	396.67
4.1. Inflow	77	226	49	177	293.51
4.2. Outflow	47	107	34	73	227.66
5. Interest - balance	-2	0	-1	1	-
5.1. Interest due to be received	-	5	1	4	-
5.2. Interest due to be paid	2	5	2	3	250.00
6. Other	23	36	12	24	156.52
6.1 Inflow	25	59	14	45	236.00
6.2 Outflow	2	23	2	21	1150.00
<b>B. Credit and financial transactions</b>	<b>-8</b>	<b>6</b>	<b>7</b>	<b>-1</b>	<b>-</b>
1. Mid- and long-term capital - balance	-7	-18	-4	-14	257.14
1.1 Inflow	3	-	-	-	-
1.2 Outflow	10	18	4	14	180.00
2. Short-term capital - balance	-16	-15	10	-25	93.75
2.1 Inflow	3	23	15	8	766.67
2.2 Outflow	19	38	5	33	200.00
3. Advances for exports of goods and services	16	60	13	47	375.00
4. Advances for imports of goods and services	-1	-21	-12	-9	2100.00
<b>C. Errors and omissions</b>	<b>61</b>	<b>2</b>	<b>61</b>	<b>-59</b>	<b>3.28</b>
<b>D. Change in foreign exchange reserves</b>	<b>-60</b>	<b>-59</b>	<b>-44</b>	<b>-15</b>	<b>98.33</b>

The exchange of commodities resulted in a net foreign exchange outflow of USD 152 million, which is 123.5% higher than in 1992. The increase in the trade balance deficit was a result of the faster dynamics on the outflow side (89.2%), compared to the increase on the inflow side (80.1%). This points out the fact that after the establishment of the foreign exchange market on May 18, 1993, and after the introduction of required certificates for secured funds for import payments, the foreign payments operations have been executed mainly within the financial system of the country.

The total turnover from the realized foreign trade of the Republic in 1993 was USD 1,074 million and was 85.1% higher than the turnover realized in the previous year. The biggest part of the turnover (72.5%) was realized after the introduction of the new foreign exchange system.

The section of services brought an increase in the surplus for 100%, so that the surplus amounted to USD 48 million. The total exchange of services of Macedonia with other countries showed an increase by 124.1% on the inflow side and by 143.3% on the outflow side. The largest increase in inflows (300%) was noted for the transportation services, due to the increased use of the services from the domestic transportation companies as a result of the break-down of former Yugoslavia. Due to the increased consignment operations with foreign goods and goods from former Yugoslav republics which were traditionally placed in the domestic market, an increase of 300% was recorded for the inflow of commission fee. An increase was recorded also in the area of tourism services - 23.2% and in the goods refinement services. The largest outflow was realized for transportation services recording the largest increase (129.5%) compared to the previous year.

In the area of private transfers including the foreign exchange remittances and foreign currency from operations with domestic persons, the period under survey showed a surplus of USD 119 million, which was 296.7% higher than the surplus realized from the transactions in the previous year. An increase was noted both on the outflow and inflow side. A net outflow of USD 8 million was realized on basis of foreign exchange remittances, while a net inflow of USD 62 million was realized on basis of depositing foreign currency on foreign exchange accounts of individuals. In the same period, USD 70 million of foreign currency are bought from the individuals, due to the liberalization of the exchange market. At the same time, USD 5 million of foreign currency were sold.

In the reporting period there was an inflow of USD 5 million on basis of interest, which was in whole attributed to the interest paid for deposited foreign exchange reserves with foreign banks. Concerning the payment of interest for drawn mid- and long-term foreign credits, the delay in payments without official announcement and approval of foreign creditors was continued during 1993, too. Only the interest on credits from the IMF in the amount of USD 1.4 million, the interest on credits from the World Bank maturing in the fourth quarter of the year in the amount of USD 2.7 million, and the interest on credits from the short-term credits for debt buy-back and the credit from the Soros Foundation were regularly repaid. The remainder represented interest paid by the banks on short-term commercial credits.

The increased inflow in the item 'Other', was due mainly to sale of foreign goods on consignment.

#### 4.2. Credit and financial transactions

An outflow of USD 18 million from the foreign exchange reserves of Macedonia was recorded during 1993 on basis of drawn medium- and long-term foreign credits, out of which USD 7.8 million were repaid principal towards the IMF and USD 4.8 million repaid principal towards the World Bank maturing in the fourth quarter of the year, while the remainder was the repaid principal by the banks on drawn foreign credits.

In the beginning of 1993, short-term credits in the total amount of USD 33 million were drawn, of which USD 25 million were from the Soros Foundation. However, a part of this credit (about USD 10 million) was used for crude oil purchases and was included in the record of foreign payments as an outflow on import of commodities, while the rest was placed with the active exporters in the Republic as a short-term financial credit. At the same time, repayments on drawn short-term credits were executed in the amount of USD 38 million, where the obligations on the Soros Foundation credit were paid in full, USD 2 million were committed own funds and repayments on drawn short-term credits for debt buyback, while the remainder were repayments on commercial credits drawn by the commercial banks.

As a result of the execution of payments operations within the national financial system after the introduction of the new foreign exchange system, the errors and omissions in the record of foreign payments were reduced from USD 62 million in 1992 to USD 2 million in 1993.

The foreign exchange reserves in the reporting period showed an increase of USD 59 million, out of which USD 44 million were an increase realized in the period until June 1993, when the surrender requirement of 30% on the foreign exchange inflow of exporters was still effective, and USD 15 million in the period from beginning of June until the end of 1993. It should be noted, however, that the largest outflow of foreign exchange reserves was made in the last quarter of the year, and also the largest interventions on the foreign exchange market from the foreign exchange reserves were carried out in this period.

#### 5. The position of external debt of the Republic of Macedonia on December 31, 1993

The position of external debt on drawn medium- and long-term foreign credits of the Republic of Macedonia on December 31, 1993 amounted to USD 702.9 million. The interest obligations on drawn medium- and long-term credits amounted to USD 388.2 million.

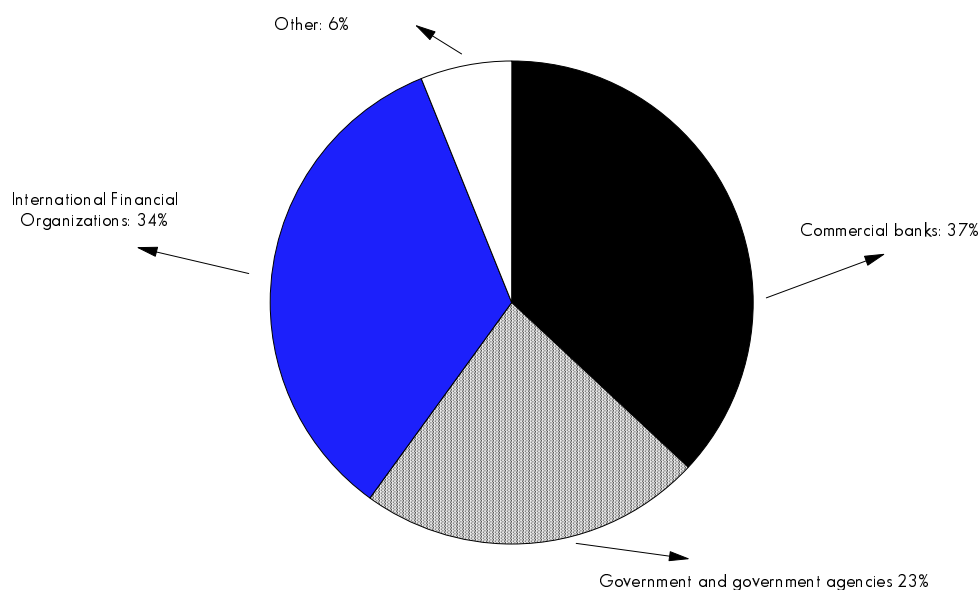
This position of debt of the Republic of Macedonia, as well as the obligations on matured interest did not include the obligations taken over by the Federation according to the "Official Gazette of SFRY", No. 83/89, with the exception of the obligations

towards the World Bank in the amount of USD 15.1 million principal and USD 3.9 million interest. Such presentation of the obligations on the external debt of the Republic of Macedonia was made because of the problem with the succession of assets and liabilities of former Yugoslavia. Namely, the obligations taken over by the Federation which on December 31, 1992 amounted to USD 140.2 million principal and USD 54.5 million interest are subject to the succession of assets and liabilities, part of it being obligations toward the World Bank (USD 15.1 million principal and USD 3.9 million interest). However, the basic precondition for drawing new credits from the World Bank is the regular settlement of obligations toward this international financial institution. As for the fact that in this period, the Republic of Macedonia negotiated for the new instrument of the World Bank for crediting the countries in transition - the ERL, the obligations taken over by the Federation related to the World Bank were accepted as an obligation by the Republic of Macedonia, and, the settlement of the matured obligations towards this international financial institution commenced in the fourth quarter of the year.

The payment arrears from the debt of the Republic of Macedonia presented in this way amounted to USD 330.4 million (USD 210.4 million of principal and USD 120.0 million of interest). The obligations unpaid until 1991 amounted to USD 55.9 million, in 1992 - USD 142.8 million, and in 1993 - USD 131.7 million.

It should be noted that the position of the presented payment arrears on interest did not include the amount of regular interest on the total matured obligations which continued to be accrued, as these obligations have not been settled yet (except for the obligations towards the World Bank).

The composition of the medium- and long-term debt of Macedonia on December 31, 1993

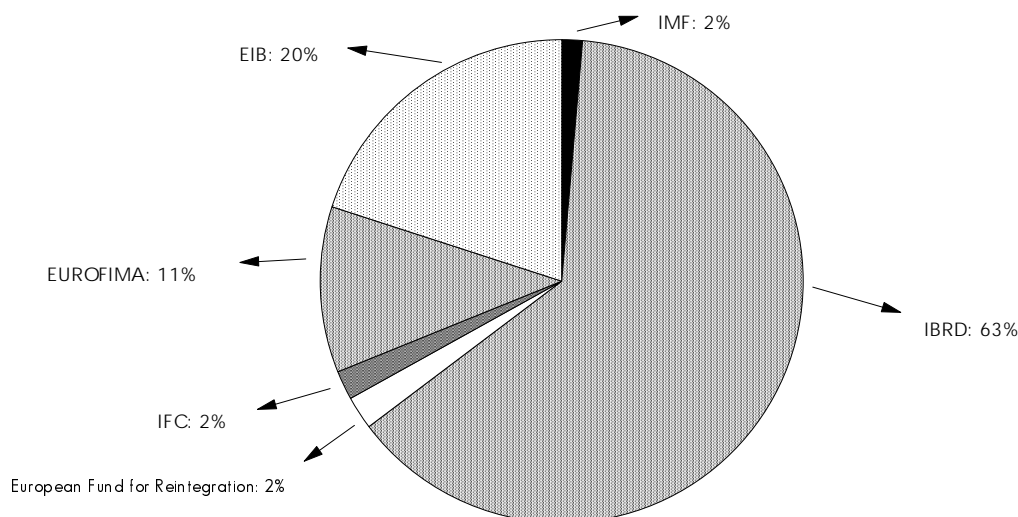


The largest portion of the total debt of the Republic is the debt towards the foreign commercial banks in the amount of USD 263.8 million. During the reporting period, the obligations towards these creditors were not settled at all, instead, in accordance with the Decision on the Foreign Exchange Policy and the Balance of Payments Projection of the Republic of Macedonia for 1993, contacts for beginning the settlement negotiations were established. Payment arrears towards these creditors are only interest payments, amounting to USD 56.5 million. The unpaid interest of USD 27.3 million relates to 1992 and USD 29.2 million to 1993.

The debt towards the Paris Club amounts to USD 158.5 million, half of it being USD 86.4 million of payment arrears. Contacts for settling the obligations have already been established with these creditors as well, so that during 1993 the obligations were not cleared both for the matured principal and for the interest. The payment arrears towards these creditors until the end of 1993 amounted to USD 86.4 million principal and USD 20.5 million interest.

In respect to the drawn medium- and long-term credits from the international financial institutions, the Republic of Macedonia is indebted in amount of USD 240.6 million, which represents 34.2% of the total debt. More than half of the debt towards these institutions (USD 151.9 million) is related to the World Bank, USD 47.5 million to EIB, USD 27.1 million to EUROFIMA, USD 5.9 million to the European Fund for Re-integration, USD 4.3 million to the IFC and USD 3.9 million to the IMF.

The composition of the medium- and long-term debt towards the international financial institutions



The payment arrears towards these creditors amount to USD 90.1 million principal and USD 35.8 million interest. During 1993, only the obligations towards the IMF were regularly settled so that USD 7.8 million principal and USD 1.4 million interest were repaid. In order to create the preconditions for using new financial

resources in form of credits and loans from the World Bank, the maturing obligations towards this international financial institution in the amount of USD 4.9 million principal and USD 2.7 million interest were repaid in the fourth quarter of the year. An amount of USD 1.9 million principal and USD 0.9 million interest of the repaid obligations towards the World Bank were obligations on the debt taken over by the Federation (Official Gazette of SFRY, No. 83/89).

Payment arrears towards the IBRD amount to USD 82 million principal and USD 23.1 million interest, and are related to 1992 and 1993, although the settlement of obligations towards this financial institution in 1993 was established by the Decision on the Foreign Exchange Policy and the Balance of Payments Projection of the Republic of Macedonia for 1993. However, as it was mentioned earlier, due to the negotiations started with the World Bank on using new financial facilities and participation of the Republic of Macedonia in the international financial flows, all payment arrears towards this international financial institution were cleared in the beginning of 1994.

Based on the activities undertaken since 1992 on the buyback of the Macedonian debt towards the foreign commercial banks due to its low price on the secondary financial markets, USD 17.5 million of nominal debt was purchased during 1993, out of which USD 13.3 million were purchased by the National Bank with the engaged foreign agencies as intermediaries, and USD 4.2 million were purchased by Stopanska Banka AD Skopje. For the debt buyback carried out by the National Bank with the mediation of the engaged foreign agencies (USD 13.3 million), own foreign exchange funds of USD 1.2 million and short-term financial credits of USD 1.1 million were engaged. The average realized price for this buyback was USD 0.1777 for USD 1.