

**NATIONAL BANK OF THE REPUBLIC OF MACEDONIA**



**Macroeconomic Consolidation of Macedonia  
after the Ohrid Framework Agreement:  
A Contribution for Successful Euro -Integration**

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**February 27, 2004  
London**

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The gradual revitalization of the Macedonian economy in the post-transitional period resulted in its entry in the area of positive economic growth rates (since 1996) and simultaneous maintenance of low and stable rates of inflation. The positive macroeconomic performances represent a combined effect of the undertaken structural reforms and the consistent macroeconomic policy. The capacity of the Macedonian economy for generating successful performances was proved in 1999. Namely, despite the negative effects caused by the instability in the region (the Kosovo crisis) the positive growth rates, the low inflation, the stability in the banking system and the implementation of prudent fiscal policy were retained. Such economic results should give an adequate contribution for gradual approach of Macedonia to the European Union. Namely, the membership in the European Union (and furthermore, the complete monetary integration which are the strategic objectives of the Republic of Macedonia) also mean an adequate level of macroeconomic convergence.

The trend of positive economic results was ceased in 2001, in presence of security crisis and significant country risk. Thus the undermined confidence of the domestic entities, as well as of the foreign investors and trading partners resulted in a decrease in the GDP of 4.5% in real terms (after a five-year continuous upward trend). The negative effects of the crisis especially dominated in the external sector, having in mind the hindered supply of raw materials and cancellation of the contracts with foreign partners, which resulted in significant deepening of the deficit in the current account of the balance of payments (in 2001 it equaled 6.5% of the GDP, compared to 1.9% in the previous year).

On the other hand, despite the external shock, the price stability was successfully maintained. The implementation of adequate monetary policy significantly contributed for maintaining low and stable inflation rate. Hence, the NBRM was successfully conducting the exchange rate targeting (Denar - Euro), preserving the stability of the nominal exchange rate through appropriate adjustment of the interest rate policy and simultaneous active interventions on the foreign exchange market. However, the foreign exchange reserves retained at the level of a 5.5-month coverage of the import.

In 2002, efforts for revitalization of the economic capacity of the country were made. The challenges, to a large extent, referred to an improvement of the macroeconomic performances, through applying a sustainable macroeconomic policy and continuing the initiated structural reforms. However, the macroeconomic indicators in 2002 proved that overcoming the consequences from the crisis needs time. Thus, in 2002, a moderate increase in the GDP of 0.9% and a deficit in the current account of the balance of payments of 9,6% was registered. On the other hand, the inflation performances were extremely favorable (the average rate of inflation in 2002 equaled 1.8%).

The potential for a successful returning of the economy to the positions it was registering before the crisis, was verified also through the relations with the international financial institutions. Namely, in 2001 the impossibility for an adequate implementation of the agreed policies due to the security crisis, imposed a cessation of the arrangement with the International Monetary Fund (IMF). However, the cooperation with the IMF continued in 2002 within the so-called Staff Monitored Program. It signaled that the crisis was temporary and that the Macedonian economy has a capacity for successful revitalization. Also, a Donor Conference for the Republic of Macedonia was held in 2002, at which a financial assistance in the amount of Euro 307 million was announced, aimed at supporting the balance of payments, the reconstruction of the war-stricken areas and for the implementation of the Ohrid Framework Agreement. Having regard the fact that the largest part of the financial support of the donators was conditioned by the conclusion of an arrangement with the IMF, a Stand-by arrangement with the Fund was concluded in April 2003, confirming the prudent macroeconomic policy.

The integration of the Macedonian economy in the global economic framework continued in 2002 with the official membership in the World Trade Organization (after the verification of the Membership Agreement by the WTO General Council). Thus the Republic of Macedonia took upon itself the obligation for improving the competitiveness and integrating in the world markets, as an important precondition for having a quality economic development. The analysis of the most important trading partners of the Republic of Macedonia shows that two out of three the most important trading partners are member-states of the EU (which indicates high orientation towards the European Union). Thus in 2003, the share of the foreign trade with Germany and Greece in the total trade equaled 15.9% and 13.1%, respectively. Simultaneously, new Law on Foreign Exchange Operations was adopted in 2002, which represents further liberalization of the foreign exchange regime and gradual convergence towards modern market economies. Namely, the new Law represents a step forward towards the harmonization of the Macedonian regulations with the EU directives and standards, which

is in compliance with the already initiated Stabilization and Association Agreement between the Republic of Macedonia and the European Union. The liberalization of the capital transactions shall be gradual, i.e. they shall be completely released after the expiration of the first phase of the implementation of the Pact.

In 2002, the monetary policy was implemented in the environment of more stable economic environment and acted in coordination with the fiscal policy. Namely, having in mind the public consumption for security needs which was still high (as well as the outflow of budget funds during the general elections), the NBRM was gradually adjusting the interest rate policy. Thus the monetary policy contributed in creating the environment of more intensive economic growth, with simultaneous maintenance of low and stable rates of inflation.

Taking into the consideration the significance of having efficient and stable banking system in order to implement the macroeconomic policy successfully, in 2002 the new payment system (RTGS) was initiated, which meant establishing of modern and efficient payment system. Also, the payment operations were transferred to the banks thus enabling more efficient management with their liquidity.

The favorable situation of the banking system was proved also during the conversion in Euro currency, when a significant amount of foreign exchange savings from “under the mattresses” was directed towards the banking system. After the moderate withdrawal of the deposited foreign exchange funds at the beginning of the year, further enlargement of the banks' deposit base was registered in the following period. This reflects the higher credibility of the banking system, the perceptions for lower country risk, as well as higher importance of the profit originating from interest, as an additional source of revenues.

In 2003, the significantly stabilized economic flows, the lower country risk, as well as the prudent fiscal policy created a room for gradual relaxation of the monetary policy. The changes in the monetary setting reflected through decrease in the interest rates. Thus in 2003, the discount rate and the Lombard credits rate declined (the discount rate of the National Bank decreased from 8.00% to 6.5%, while the interest rate of the Lombard credits declined from 23.00% to 14.00%). The downward trend was also registered in the interest rates of the central bank's bills, which are the main instrument for monetary regulation. During the year, they were flexibly adjusted to the needs for managing the liquidity, the movements on the foreign exchange market, as well as to the changes in the entire economic environment.

The changes in the monetary policy stance reflected appropriately also on the banks' interest policy. The responsiveness of interest rates policy of the banks to the monetary signals was a signal for reducing the rigidity of the banks' interest policy. Having in mind the so-far inflexibility of the interest rate policy of the banks (given the high level of "bad loans", inefficient realization of mortgages, low level of saving), such changes signalize gradual improvement in the efficiency in the banks' operations, as well as increased competitiveness.

The lower price of the credits, in combination with the significant increase in the banks' potential, the diversified supply of credits, the possibility for crediting in foreign exchange given to all interested entities (contrary to the so-far limitations, from the aspect of the purposes), as well as the higher level of competitiveness, resulted in intensive credit activity of the banks (annual increase in the total credits extended to the private sector of 19.1%). The banks directly financially supported enterprises and created additional financial potential for households (which should generate direct and indirect multiple developmental effects).

Having in mind more intensive financial support of the economy enabled through bank crediting, revitalization of the production of steel and intensified construction activity in 2003, an increase of 3.1% of the GDP is expected, given the registered average increase in the industrial output of 4.7%. Thus, the Macedonian economy restarts to generate higher positive rates of economic growth. In addition, the average rate of inflation in 2003 equaled 1.2%, which is within the objective of the European Central Bank for medium-term inflation.

In 2003, the further unfavorable dynamics of the foreign trade caused the deficit in the current account of the balance of payments to maintain on high level. Such movements were reflected on the foreign exchange market, where in certain occasions the NBRM intervened in order to close the gap between the supply of and the demand for foreign exchange and to preserve the stability of the exchange rate. In 2003, the foreign exchange reserves retained the level of the 4.7-month coverage of the import.

Although the structural adjustments in the real sector are underway, the Macedonian economy is still facing with the problem of high unemployment. However, observed on a long-term basis, these structural reforms in the sector of enterprises (within FESAL II Arrangement with the World Bank and within the Structural Adjustment Project financed by the EU) are expected to create preconditions for quality and sustainable economic development.

The need for larger inflows on the basis of foreign direct investments is an important precondition for having more intensive economic activity. Besides the positive effect on the

quality and the dynamics of the economic growth, the higher level of foreign direct investments would also mean more quality financing of the deficit in the current account (most of the financing of the deficit is made through foreign indebtedness). From the aspect of the realized movements, the unfavorable economic environment had negative reflection on the interest for foreign direct investments. Thus in the 1994 - 2002 period, foreign investments in the total amount of US Dollars 928 million were registered in the Republic of Macedonia, which is far behind the level of the advanced transitional economies.

In 2004, the monetary policy shall be oriented towards the maintenance of the price stability, through exchange rate targeting, adequate implementation of the monetary policy instruments and coordination with other macroeconomic policies, especially with the fiscal policy. The projected average rate of inflation for 2004 equals 2.8%. In 2004, further intensification of the economic activity is expected. Thus increase in the GDP of 4.0% in real terms is predicted as a result of the expected increase in the industrial output, investment activity and foreign direct investments; the deficit of the central Budget is projected on 0.9% of the GDP, while the deficit of the general Budget is expected not to exceed 1.5% of the GDP. Having in mind higher level of liberalization of the capital and financial transactions, as well as in compliance with the membership in the WTO, an increase in the exports and the imports of 9% and 4%, respectively, is expected.

The implementation of consistent macroeconomic policy, the successful inflation performances, the gradual revitalization of the economic activity, the cooperation with the international financial institutions, the stable banking system, as well as the integration of the Macedonian economy in the international trading and financial flows, create preconditions for gradual convergence towards the EU. The efforts for harmonization of the regulations, the reform in the pension system, the modernization and the development of the insurance sector, as well as the efforts put in developing and extending the capital market (at the beginning of 2004, the first short-term government bills were issued, which should be an impulse for gradual development of the financial market), also act in the direction of convergence towards the EU.

## Tables and Charts\*

**Table 1**  
**Basic macroeconomic indicators for Republic of Macedonia**

		1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Change in real GDP	%	-7.5	-1.8	-1.1	1.2	1.4	3.4	4.3	4.5	-4.5	0.9*	3.1 <sup>1</sup>
Change in real GDP per capita	%	-7.8	-2.4	-2.1	0.3	1.3	2.8	3.8	4.1	-4.9	0.5*	-
Inflation (avg.)	%	349.8	121.8	15.9	3.0	4.4	0.8	-1.1	5.8	5.5	1.8	1.7
Inflation (end-year)	%	229.6	55.4	9.2	0.2	4.5	-1.0	2.3	6.1	3.7	1.1	2.6
General Government balance	% GDP	-13.4	-2.9	-1.2	-0.5	-0.4	-1.7	0.0	2.5	-6.1	-3.1*	-
Exchange rate, end of year	DEN/EUR	n.a.	n.a.	n.a.	n.a.	n.a.	n.p.	60.6	60.8	61.0	61.1	61.3
Exchange rate, end of year	DEN/US\$	44.6	40.6	38.0	41.4	55.4	51.8	60.3	65.3	69.2	58.6	49.0
Exports (FOB)	US\$bn.	1.05	1.09	1.20	1.15	1.24	1.29	1.19	1.32	1.15	1.11*	1.23 <sup>2</sup>
Imports (FOB)	US\$bn.	1.01	1.27	1.43	1.46	1.62	1.81	1.69	2.01	1.68	1.92*	1.99 <sup>2</sup>
Trade balance	US\$bn.	0.04	-0.18	-0.22	-0.31	-0.39	-0.52	-0.49	-0.69	-0.53	-0.80*	-0.76 <sup>2</sup>
Current account balance	US\$bn.	-0.08	-0.26	-0.30	-0.34	-0.29	-0.27	-0.03	-0.07	-0.24	-0.36*	-0.26 <sup>2</sup>
as % of GDP	%	-2.4	-7.8	-8.9	-10.0	-8.3	-7.5	-0.9	-1.9	-6.5	-9.6*	-
Foreign exchange reserves	US\$bn.	0.12	0.16	0.27	0.27	0.28	0.33	0.48	0.71	0.77	0.73	0.90
Import cover (Reserves/imp.)	months	n.a.	1.3	1.9	2.0	1.9	2.1	3.2	4.1	5.5	4.4*	4.7*
Total foreign debt/	US\$bn.	1.14	1.26	1.44	1.17	1.13	1.47	1.49	1.49	1.51	1.61	1.87*
as % of GDP	%	45.5	37.2	32.3	26.5	30.3	41.0	40.0	38.2	40.5	42.9*	-
Total debt service	US\$bn.	0.02	0.14	0.05	0.14	0.12	0.14	0.15	0.16	0.20	0.23	0.23*

\* Preliminary data.

1/ Estimated data.

2/ January-November 2003.

**Table 2**  
**Openness and size of the Macedonian economy**

Year	1995	1996	1997	1998	1999	2000	2001	2002
<b>Foreign trade share in GDP</b>								
(in %)	87.2	81.8	87.2	90.2	79.5	87.6	76.4	81.9
<b>Foreign trade share in the world trade (in %)</b>	0.028	0.026	0.027	0.029	0.026	0.027	0.023	0.024

**Table 3**  
**Banks' ownership structure**

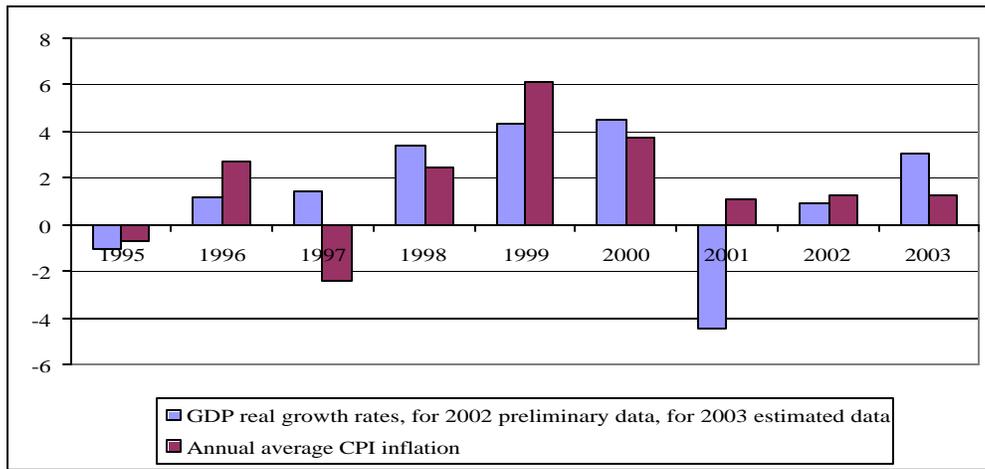
Ownership structure	Number of banks		Capital (%)		Assets (%)	
	31.12.2002	30.06.2003	31.12.2002	30.06.2003	31.12.2002	30.06.2003
<b>Banks owned by domestic private shareholders</b>	12	12	50.5	50.2	54	52.7
<b>State-owned banks</b>	1	1	4.9	4.9	2	1.9
<b>Banks owned by foreign shareholders</b>	7	7	44.6	44.9	44	45.4
<b>Total</b>	20	20	100	100	100	100

**Table 4**  
**Share of non-performing loans in total credit exposure of the banks**

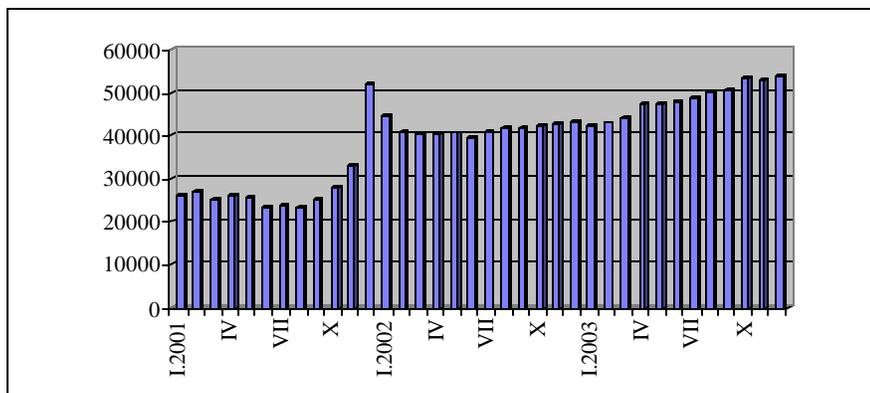
	XII.98	XII.99	XII.00	XII.01	XII.02	VI.03
<b>Non-performing loans</b>	32,9	41,3	34,8	33,7	15,9	16,4

\*Source: National bank of the Republic of Macedonia, State Statistical Office and Ministry of Finance

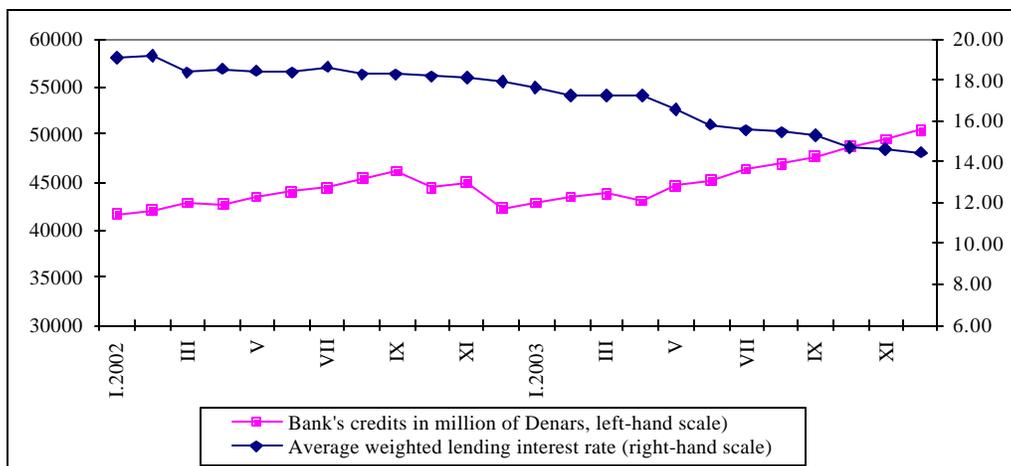
**Chart 1**  
**GDP real growth rate and average CPI inflation in Republic of Macedonia**



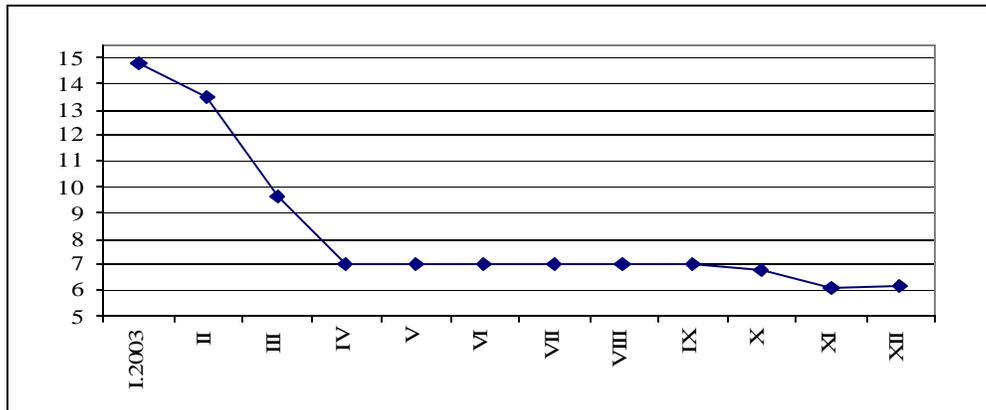
**Chart 2**  
**Non-government sector deposits in the banking system**  
**(in Denar million)**



**Chart 3**  
**Banks' credits to the private sector and average weighted lending interest rate**



**Chart 4**  
Average weighted interest rate on CB's bills auctions



**Chart 5: Foreign trade of the Republic of Macedonia by economic groups of the countries in 2003 (export and import)**

