

II. Objectives and Implementation of the Monetary Policy

2.1. Monetary Policy Objectives

In compliance with the applied strategy of foreign exchange rate targeting, the monetary policy in the first half of 2000 was oriented towards maintaining the price stability by maintaining a stable nominal foreign exchange rate of the Denar against the Deutsche mark. The prevention of uncontrolled inflation movements were especially important in conditions of expected growth in prices, caused by the introduction of value-added tax and preservation of higher tariff for calculation of electricity, as well as growth in the prices of crude oil at the world market in conditions of appreciation of the U.S. Dollar against the Deutsche mark and the Denar. Using the monetary supply as an instrument for maintaining stable exchange rate of the Denar as nominal anchor in the economy, i.e. keeping the fundamental factors in the economy on a sound basis, the monetary policy in the first half of 2000 was expected to be aimed at reduction of unfavorable influence of the non-monetary factors on the price level.

Regarding the projected values, in the first half of 2000, the net-purchase of foreign currency by the Central Bank from the foreign exchange markets was projected to be USD 17 million. In regard to the timeframes, in the first quarter of the year a net-purchase of USD 3 million was projected, whereas in the second quarter, larger supply of foreign currency at the foreign exchange market was expected and accordingly, a purchase of USD 14 million was projected. In addition to the usage of monetary policy instruments for withdrawal of base money, in the first and second quarter of 2000, Denar 400 million and Denar 300 million, respectively, were to be deposited from the budget with the National Bank of the Republic of Macedonia, in order to stabilize the monetary effects from the foreign exchange transactions of the Central Bank.

The developments in the monetary aggregate were projected in compliance with the initial presumptions of the macroeconomic policy and expected movements in the foreign exchange markets. Therefore, at the end of June 2000, the annual growth rate of the money supply M-1 was projected to be 22.3%, while the monetary aggregate M-2 – Denar component was projected to grow by 26.7%. At the end of June, according to the projections, the annual growth rate of the base money equaled 22.5%.

2.2. Monetary developments

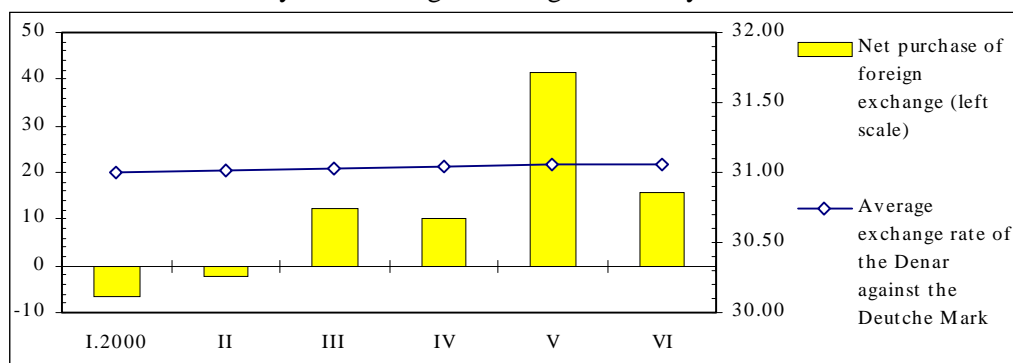
2.2.1. Money supply

In the first half of 2000, the stability of the foreign exchange rate of the Denar against the Deutsche mark was maintained, considered as intermediate target of the monetary policy. The excess of foreign currency on the foreign exchange market influenced the developments of the monetary aggregate, which under conditions of foreign exchange rate targeting has endogenous character.

In the first half of 2000, the money supply registered high annual growth rates, which were relatively higher in the first quarter compared to the second quarter of the year. The increase in the monetary aggregate was primarily due to the strengthened process of monetary multiplication, as a result of the increase banks' deposit potential.

Chart 10

Movement in the exchange rate of the Denar against Deutsche mark and net-purchase of foreign currency at the foreign exchange market by the NBRM



At the end of the first half of 2000, the money supply M1 equaled Denar 18,753 million, which resulted in increase of Denar 2,696 million or 16.8%, on annual basis (June 2000 / June 1999). At the end of June 2000, compared to the end of 1999, the money supply M1 was lower by Denar 941 million, or by 4.8%. Simultaneously, at the end of the first half of 2000, the money supply M1 was by Denar 878 million, or by 4.5% lower compared to the projections.

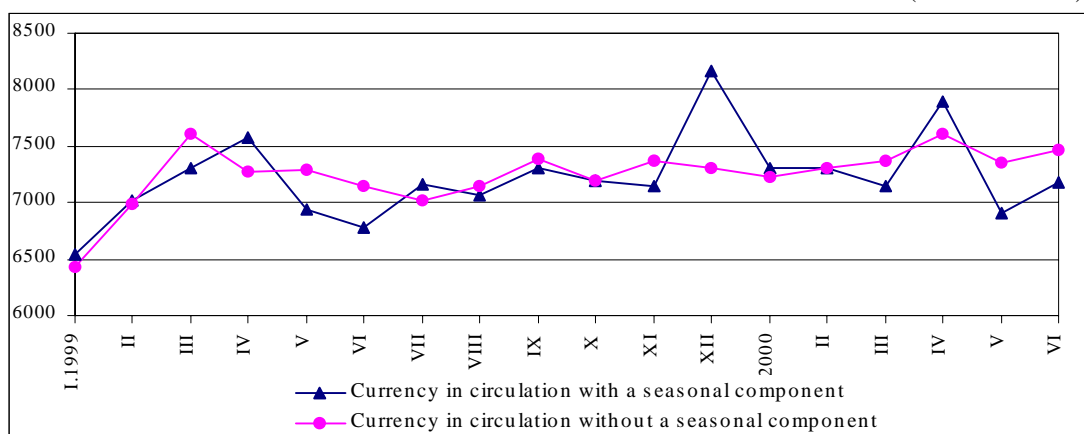
In regard to the timeframes, in the first quarter of 2000 the money supply M1 declined by Denar 359 million, or by 1.8%. The decline is common seasonal occurrence for this period of the year, determined by the movement of currency in circulation. In the second quarter of 2000, the money supply M1 decreased by Denar 582 million, or by 3.0%, due to the fall in the deposit money. This decline indicates move of the transaction deposits into savings deposits (particularly foreign currency savings deposits) with one-year maturity.

In the first half of 2000, the currency in circulation decreased by Denar 987 million, or by 12.1%, primarily due to the high comparison base in December. In January – June 2000 period, the currency in circulation declined by Denar 1,021 million, or by 12.5% reflecting the stabilization of their level following the increase influenced by the seasonal factor at the end of the year, immediately prior to the New Year holidays. In the second quarter of 2000, the currency in circulation registered a slower growth of Denar 34 million, or 0.5%. The introduction of value-added tax and the increased efficiency in tax collection resulted in lower tax evasion and “gray economy”, which resulted in reduced cash demand. On annual basis (June 2000 / June 1999), the currency in circulation was by Denar 402 million, or by 5.9% higher.

Chart 11

Currency in circulation with and without seasonal component

(in Denar million)



In the first half of 2000, the demand deposits increased by Denar 46 million, or by 0.4%. Analyzed by quarters, the demand deposits registered divergent movements. Thus, in the first quarter they increased by Denar 662 million, or by 5.7%, whereas in the second quarter they declined by Denar 616 million, or by 5.0%. However, the demand deposits registered marked annual growth in the amount of Denar 2,294 million, or by 24.7%.

Table 7

Money supply M1 creation and withdrawal¹

(in Denar million)

	Balance as of 31.12.1999	Changes by quarters			Balance as of 30.06.2000
		I	II	Vkupno	
Money Supply M1	19694	-359	-582	-941	18753
Net foreign assets ²	26120	811	8351	9162	35282
Net domestic assets	14361	274	-8462	-8188	6173
Domestic credits	40804	-570	-5264	-5834	34970
out of which:					
Social and private sector credit ³	30267	1125	2284	3409	33676
- in Denars	23834	865	3010	3875	27709
- in foreign currency ²	6433	260	-726	-466	5967
NBRM claims on Government, net	-2597	-1973	-6681	-8654	-11251
Other items, net	-26443	843	-3197	-2354	-28797
Quasi- and non-monetary deposits ⁴ (non-government sector)	18409	1596	431	2027	20436
Government deposits ⁴	2378	-152	40	-112	2266
- demand deposits	926	-266	20	-246	680
- quasi- and non-monetary deposits	1452	114	20	134	1586

1/ (+) creation of money supply (M1); (-) withdrawal of money supply (M1)

2/ Stocks are shown at constant exchange rate; flows are shown at current exchange rate

3/ The accounting balance of the banks' credits to the private and social sector is presented.

4/ Positive sign refers to money supply withdrawal, negative sign refers to money supply creation.

The sector-by-sector analysis of demand deposits indicates a fall in the demand deposits of enterprises and households in the first half of 2000. In this period, the demand deposits of enterprises decreased by Denar 309 million, or by 4.1%. Hence, their share in the total demand deposit declined by 2.9 percentage points and on June 30, 2000, it equaled 62.8%. In the first half of 2000, the demand deposits of households decreased by 247 million, or by 16.5%. Their share in total demand deposits was by 2.2 percentage points lower, thus reducing to 10.8%. At the same time, the structural share of the demand deposits of business entities with the National Bank of the Republic of Macedonia registered an increase of 4.1 percentage points in the first half of 2000, thus at the end of June reaching 13.4%.

The movements in the money supply M1 components in the first half of 2000 resulted in positive movements in the structure of this monetary aggregate. Thus, at the end of June 2000, the share of the currency in circulation in the money supply M1 reduced to 38.3%, which is by 3.2 percentage points lower compared to their share at the end of 1999. In January – June 2000 period, the average share of the currency in circulation in the money supply M1 equaled 38.1%, which is by 7.9 percentage points lower compared to the same period of the previous year.

Table 8

Monetary aggregates

(in Denar million)

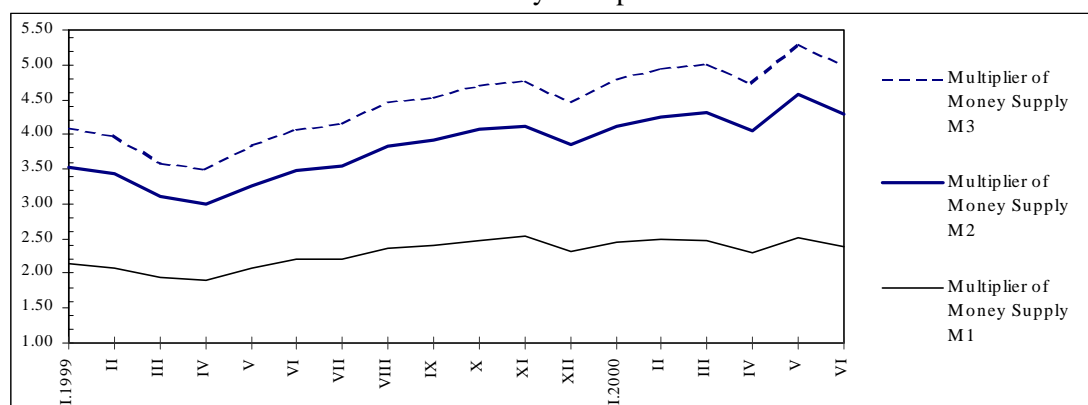
	Balance as of			Changes by quarters		
	31.12.1999	31.03.2000	30.06.2000	I	II	Total
Currency in circulation	8169	7148	7182	-1021	34	-987
Demand deposits	11525	12187	11571	662	-616	46
Money Supply M1	19694	19335	18753	-359	-582	-941
Quasi-Denar deposits	6815	7298	7075	483	-223	260
Quasi-foreign currency deposits*	6328	7087	7779	759	692	1451
Money Supply M2	32837	33720	33607	883	-113	770
Non-monetary Denar deposits	3816	3663	3791	-153	128	-25
Non-monetary foreign currency deposits*	1450	1957	1791	507	-166	341
Money Supply M3	38103	39339	39189	1236	-150	1086

* Stocks are shown at constant exchange rate; flows are shown at current exchange rate

Contrary to the money supply M1, the broader monetary aggregates registered an increase in the first half of the year. Thus, at the end of June 2000, the money supply M2 amounted to Denar 33,607 million and was by Denar 770 million, or by 2.3% lower compared to December 31, 1999. The money supply M2 increment was due to the increase of Denar 1,451 million, or 22.9% in its foreign exchange component. In the first half of 2000, the money supply M2 Denar component declined by Denar 681 million, or by 2.6%, thus being lower by Denar 498 million, or by 1.9% compared to the projections for this period of the year. However, on annual basis (June 2000 / June 1999), the money supply M2 – Denar component registered high growth rate of 24.4%. The broadest monetary aggregate M3 reached Denar 39,189 million at the end of June 2000 and compared to December it was by Denar 1,086 million, or by 2.8% higher. At the end of June 2000, the monetary aggregates M2 and M3 registered identical annual growth rate of 32.6%.

Chart 12

Monetary multipliers



Taking into account the registered decrease of reserve money in the first half of 2000 (by 8.0%), the increase in the money supply was due to the strengthened process of monetary multiplication. Under conditions of unchanged compulsory reserve rates and decreased cash demand, the increment in the monetary multipliers in the first half of 2000 was a result of the business entities preference to keep the available funds in the banking system. Thus, the average level of the monetary multiplier of the money supply M1 amounted to 2.43 in the first half of 2000, compared to 2.22 in 1999. The increased rate of monetary multiplication is even more visible in the broader monetary aggregates, where the effect from the decline in the currency in circulation is being reduced, compared to the increase in the deposits with the banks. In the first half of 2000, the average level of monetary multipliers of the money supply M2 and M3 reached 4.26 and 4.97, respectively, compared to 3.94 and 4.18 in 1999.

2.2.2. Total deposits

In the first half of 2000, the total deposits of the non-government sector (sight deposits, term deposits and restricted deposits, denominated in Denar and foreign currency) registered an increase. At the end of June 2000, compared to December 1999, their level was by Denar 2,027 million, or by 11.0% higher, thus reaching Denar 20,436 million. The annual comparison (June 2000 / June 1999) indicates fast growth in the total deposits in the amount of Denar 6,947 million, or by 51.5%. The increment in the deposits in the first half of 2000 was a basis for increased monetary multiplication, which resulted in adequate money supply growth. The business entities prefer to deposit funds in foreign currency and in short term.

Analyzed by quarters, the largest portion (78.7%) of the increase in the total deposits in the first half of 2000 was registered in the first quarter. In January – March 2000 period, the total deposits of the non-government sector increased by Denar 1596 million, or by 8.7%, while in April – June 2000, period they registered an increase of Denar 431 million, or by 2.1%.

Table 9

Total deposits

(in Denar million)

	Balance as of			Changes by quarters		
	31.12.1999	31.03.2000	30.06.2000	I	II	Total
Total deposits of the non-government sector	18409	20005	20436	1596	431	2027
- Denar	10631	10961	10866	330	-95	235
- foreign currency/1	7778	9044	9570	1266	526	1792
I. Short-term deposits/2	13143	14385	14854	1242	469	1711
- Denar	6815	7298	7075	483	-223	260
- foreign currency/1	6328	7087	7779	759	692	1451
II. Long-term deposits/3	5266	5620	5582	354	-38	316
- Denar	3816	3663	3791	-153	128	-25
- foreign currency/1	1450	1957	1791	507	-166	341

1/ Stocks are shown at constant exchange rate; flows are shown at current exchange rate.

2/ Short-term deposits include: sight deposits and time deposits with up to one-year maturity.

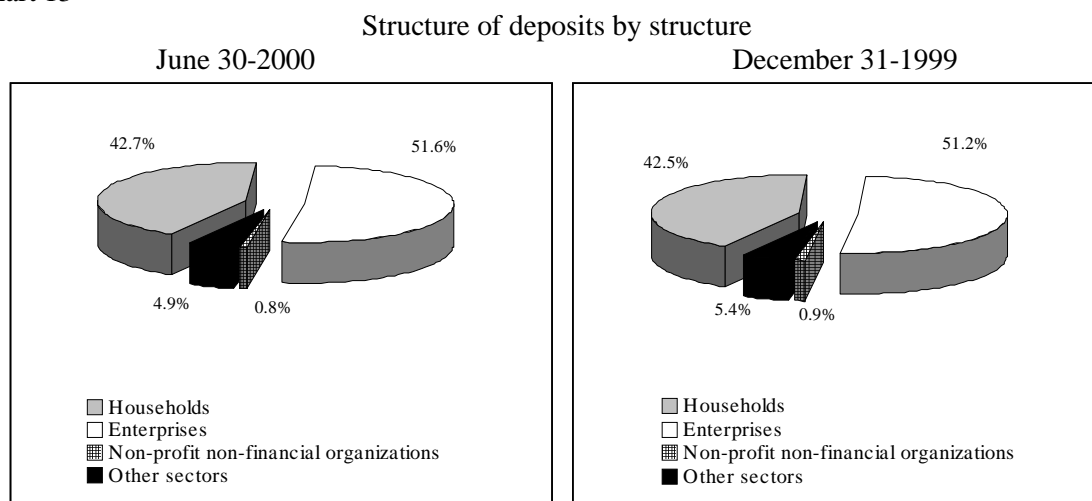
3/ Long-term deposits include: time deposits with more than one-year maturity and restricted deposits.

With respect to maturity, the growth in the total deposits in the first half of 2000 was due to the fast increase in the short-term deposits (Denar and foreign currency sight deposits and deposits with maturity of up to one year). In January – June 2000 period, the short-term deposits increased by Denar 1,711 million, or by 13.0%. In the same period, the long-term deposits (deposits with maturity of more than one year and restricted deposits) increased by Denar 316 million, or by 6.0%.

With respect to currency of denomination, the foreign currency deposits registered a faster growth compared to the Denar deposits. Thus, at the end of June 2000 compared to the end of 1999, the total foreign currency deposits were by Denar 1,792 million, or by 23.0%. The short-term foreign currency deposits registered an increase of Denar 1,451 million, or 22.9%, while the long-term foreign currency deposits increased by Denar 341 million, or by 23.5%.

In the first six months of 2000, the total Denar deposits increased by Denar 235 million, or by 0.2%. With respect to the maturity, the increase was a result of the growth in the short-term Denar deposits of Denar 260 million, or 3.8%, whereas the long-term deposits declined by Denar 25 million, or by 0.6%.

Chart 13



The deposit analysis by sectors indicated that at the end of June 2000, the deposits of the enterprises (51.6%) and the deposits of the households (42.7%) had the most significant share in the total deposit structure. Compared to December 1999, the share of the deposits of enterprises and households was higher by 0.4 percentage points and 0.2 percentage points, respectively. In January – June 2000 period, the enterprises' deposits increased by Denar 1,213 million, or by 12.1%, while the increment in the households' deposits amounted to Denar 982 million, of 11.8%.

2.2.3. Net foreign assets of the monetary system

In the first half of 2000, the net foreign exchange assets of the monetary system registered fast growth, thus representing significant flow of money supply creation. In January – June 2000 period, the net foreign exchange assets of the monetary system increased by Denar 9,162 million, or by 35.1%, thus reaching Denar 35, 282 million at the end of June. The increment in the net foreign assets of the monetary system in the first half of the year was due to the growth registered in the net foreign assets of NBRM and the deposit money banks.

Table 10

Net foreign exchange assets of the monetary system*

	Balance as of 31.12.1999	Changes by quarters			Balance as of 30.06.2000
		I	II	Total	
Net foreign assets of the monetary system	26120	811	8351	9162	35282
Net foreign assets of NBRM	18699	92	6953	7045	25744
Foreign assets	23618	-227	7520	7293	30911
Foreign liabilities	4919	-319	567	248	5167
Net foreign assets of the deposit money banks	7421	719	1398	2117	9538
Foreign assets	20648	77	523	600	21248
Foreign liabilities	13228	-642	-876	-1518	11710

* Stocks are shown at constant exchange rate; flows are shown at current exchange rate.

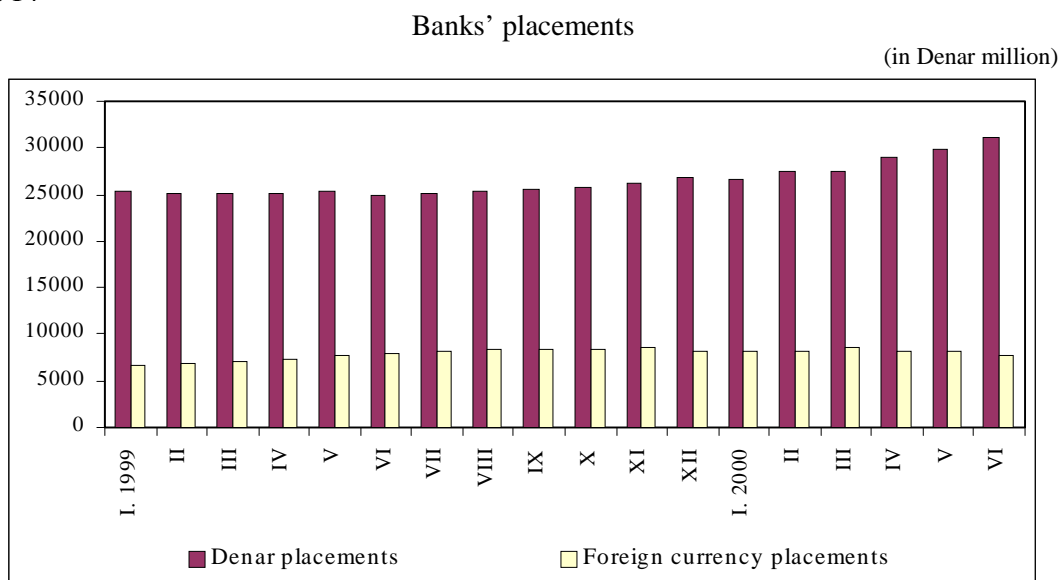
In January – June 2000 period, the net foreign exchange assets of the NBRM increased by Denar 7, 045 million, or by 37.7%, primarily due to the high amount of foreign currency purchased at the foreign exchange market (USD 70.3 million). The growth was entirely registered in the second quarter of the year, when the largest portion of foreign currency was purchased at the foreign exchange market (USD 67.1 million). Simultaneously, in the first half of the year, the inflow on the government external account with NBRM, as well as the net-inflow based on interest in the amount of USD 26.4 million, and USD 9.3 million, respectively, acted towards increase the net foreign assets of the NBRM.

In January – June 2000 period, the net foreign assets of the deposit money banks increased by Denar 2,117 million, or by 28.5%. In regard to the timeframes, in the first quarter of 2000, the net foreign assets of the banks increased by Denar 719 million, while in the second quarter they increased by Denar 1,398 million. Analyzed by components, the increment in the net foreign assets of the deposit money banks was due to the increase in the foreign assets and decrease in the foreign liabilities. The increase in the foreign assets in the amount of Denar 600 million was due to the increased amount of foreign currency funds on the accounts of the banks abroad, while the fall in the foreign exchange liabilities by Denar 1,518 million was primarily due to the decline in the foreign exchange deposits of non-residents.

2.2.4. Banks' placements⁹

Analyzing the credit activity of the banks in the first half of 2000, two sub-periods can be distinguished: January – March period, in which the credit limits over the Denar placements were still applied, and April – June period in which they were abandoned, as direct, non-market monetary regulation instrument. This resulted in more expansive credit activity of the banks in the second quarter of 2000.

Chart 14



The total Denar and foreign currency placements of the banks to the non-government sector reached Denar 38,835 million, and compared to the end of 1999, they were by Denar 3,728 million, or by 10.6% higher. On annual basis (June 2000 / June 1999), the total banks' placements were by Denar 6,008 million, or by 18.3% higher.

With respect to the currency of denomination, the growth in the total banks' placements was due to the increase in the Denar placements, whereas the foreign currency placements were

⁹Banks' placements are shown in accordance with their actual balance. The actual balance differs from the accounting balance because it includes the claim of one bank in 1997 in the amount of Denar 4,144 million, the claims of banks on the basis of principal and overdue interest in the June 1998 - June 2000 period in the amount of Denar 3,784 million, as well as the net effects based on swap transaction of a bank with the Government in amount of Denar 1.686 million in December 1999, while it excludes the increase in credits due to the consolidation of accounts in December 1998 in the amount of Denar 6,270 million. Foreign currency placements include the accounting re-recordings in December 1998 in the amount of Denar 774 million and the net-effects based on swap transaction with the Government and re-recordings with one bank in the amount of Denar 1.041 million.

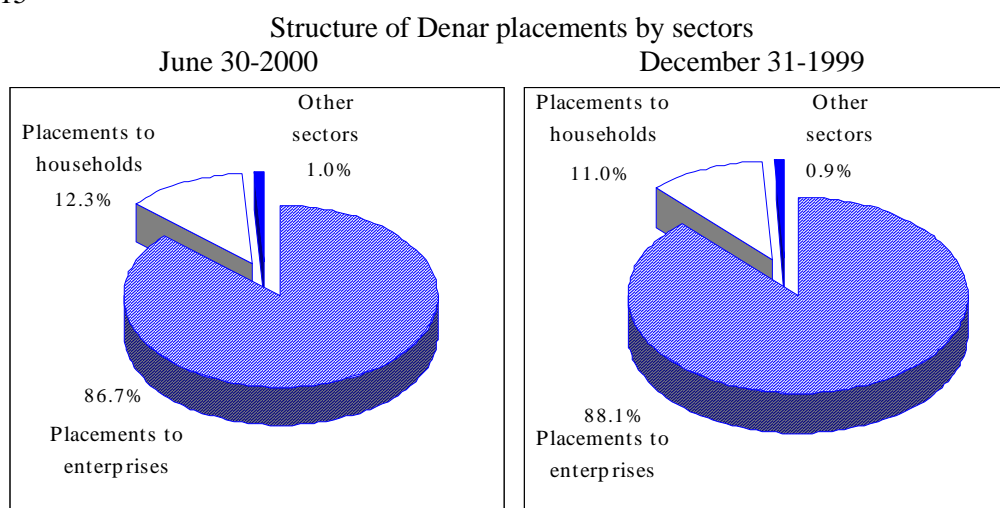
reduced. Thus, in the first half of 2000, the Denar banks' placements to the non-government sector increased by Denar 4,194 million, or by 15.6%, thus reaching Denar 31,053 million at the end of June 2000. In June 2000, compared to the same month of the previous year, the banks' Denar placements were by Denar 6,111 million, or by 24.5% higher. In the first six months of 2000, the average annual growth rate of the Denar placements equaled 13.8%. Simultaneously, the banks' Denar placements to the non-government sector exceeded the projections for the end of the first half of 2000 by Denar 2,183 million, or by 7.6%.

In regard to the timeframe, high growth rates in the banks' Denar placements to the non-government sector were primarily registered in the second quarter of 2000. In the first quarter, the Denar placements registered a growth of Denar 720 million, or 2.7%. The average annual growth rate registered in the first quarter of 2000 equaled 8.1%. The removal of the credit limits over the banks' Denar placements at the end of March 2000 resulted in accelerated credit activity of the banks. Thus, in the second quarter of 2000, the banks' Denar placements in favor of non-government sector registered an increase of Denar 3,474 million, or 12.6%. Simultaneously, the banks' Denar placements registered markedly higher average annual growth rate of 19.5%.

In January – June 2000 period, the overdue claims based on principal increased by Denar 1,566 million, or by 17.5%. Simultaneously, the overdue claims based on interest increased by Denar 1,306 million, or by 4.2%. This indicates the presence of the problem of claim collection in the first half of 2000. However, this problem primarily reflects the credit activity in the period of credit limits, considering the fact that the acceleration of the credit activity of the banks in the second quarter of 2000 was directed towards clients having high financial reliability.

The maturity structure of the banks' Denar placements to the non-government sector in the first half of 2000 remained unfavorable for the economic development, as a result of the dominant share of short-term placements. In the end of June 2000, the share of short-term placements in the total banks' Denar placements equaled 70.6%, which is by 2.7 percentage points more compared to the end of 1999. Analyzing by sectors, at the end of June 2000, the enterprises' placements were dominant with a share of 86.7% in the total Denar placements, while the share of the banks' placements to the households equaled 12.3%. Compared to the end of 1999, the share of the placements to the enterprises registered a decline of 1.4 percentage points, whereas the share of placements to the households registered an increase of 1.3 percentage points.

Chart 15



At the end of June 2000, the banks' foreign currency placements to the non-government sector amounted to Denar 7,782 million, which is by Denar 466 million or by 5.6% less compared to the end of 1999, and by Denar 103 million or by 1.3% less, on annual basis. Analyzing by quarters, the banks' foreign currency placements registered divergent movements. Thus, in the first

quarter of 2000 they increased by Denar 260 million, or by 3,1%, whereas in the second quarter of the year, they registered a decline of Denar 726 million, or by 8.5%. In condition of increased foreign currency deposit potential of the banking system, these movements are due to the increased prudence of the banks, regarding the withdrawal of funds from the foreign credit lines. At the end of the first half of 2000, the banks' foreign currency placements to the non-government sector were by Denar 1,889 million, or by 19.5% lower compared to the projections.

At the end of June 2000, the maturity structure of the banks' foreign currency placements was more favorable compared to the corresponding structure of the Denar placements, which is a result of the more favorable structure of the credit potential, on which these placements are based (foreign credit lines). The share of the short-term and long-term foreign currency placements equaled 56.3% and 43.7%, respectively. Such maturity structure of the foreign currency placements was almost identical relative to the end of 1999. Analyzing by sectors, the banks' foreign currency placements to the non-government sector are almost entirely extended to the enterprises (99.4%).

2.2.5. Reserve money

In the first half of 2000, the reserve money registered a fall, which corresponds to their usual movement in this period of the year. At the end of June 2000, compared to the end of 1999, the reserve money was by Denar 681 million, or by 8.0% lower, thus reducing to Denar 7,834 million. As a result, the level of reserve money was by Denar 1,068 million, or by 12.0% lower compared to the projections for the end of the first half of 2000. On annual basis (June 2000 / June 1999), the reserve money was by Denar 570 million, or by 7.8% higher. Structurally observed, the movement in the reserve money was primarily caused by the developments in the currency in circulation. In the first half of 2000, the currency in circulation significantly decreased due to the following: a. influence of seasonal factors; b. continuous decrease in cash demand as a result of the shift in the preferences of the economic agents, influencing the structure of their portfolio.

Table 11

Reserve money by the narrowest definition

	Balance as of 31.12.1999	Changes by quarters			Balance as of 30.06.2000
		I	II	Total	
Reserve money (narrowest definition)	8515	-689	8	-681	7834
- currency in circulation	8169	-1021	34	-987	7182
- giro-accounts and cash in vaults	346	332	-26	306	652

In the first half of 2000, the largest portion of the reserve money were created through the foreign currency transactions of the NBRM at the foreign exchange market, where net foreign currency in the amount of USD 70.3 million were purchased, resulting in issuance of reserve money in the amount of Denar 4,446.4 million. The purchase exceeded the projections for January – June 2000 period by USD 53.3 million. In order to maintain the monetary policy within the projected framework, there was a need of NBRM to sterilize the monetary effects of the foreign exchange transactions, i.e. the purchase of foreign currency at the foreign exchange market, above the projected level. In order to achieve this objective, the NBRM received assistance by the fiscal policy, with the government depositing funds with the NBRM in the amount of Denar 6,518 million. Having regard to the high reserve money issuance based on foreign exchange transactions, the NBRM ceased using the credit auction as a reserve money issuance instrument, and the short-term fluctuations were offset through interventions at the CB bills auctions.

Table 12

Reserve money creation and withdrawal*

(in Denar million)

	Balance as of 31.12.1999	Changes by quarters			Balance as of 30.06.2000
		I	II	Total	
Reserve money	8515	-689	8	-681	7834
Net foreign assets**	18699	92	6954	7046	25745
Net domestic assets	-10184	-781	-6946	-7727	-17911
- Credit to banks	984	-427	-63	-490	494
- Credit to Government	5205	93	-513	-420	4785
- Government deposits***	-9684	-2426	-4092	-6518	-16202
- External financing	1882	361	-2077	-1716	166
- Instruments	-3842	1265	525	1790	-2052
- Other items, net	-4729	354	-726	-372	-5101

* (+) Creation of reserve money; (-) withdrawal of reserve money.

** Stocks are valued at a constant rate; flows are valued at a current rate.

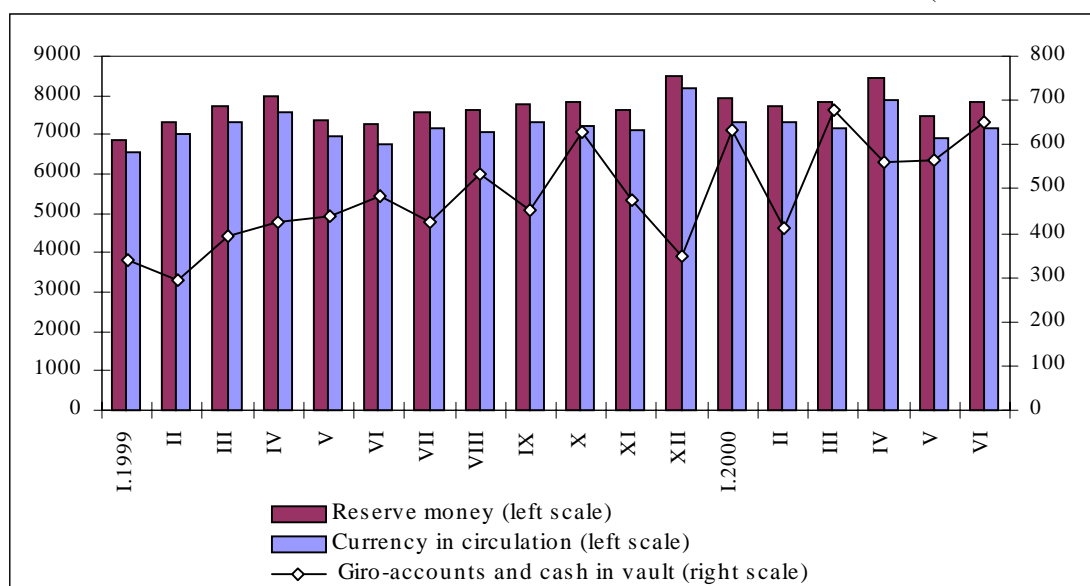
*** Since these are liabilities shown on the assets side, their balance as of December 31, 1999 and June 30, 2000 is shown with a negative sign. In the columns representing the changes by quarters, a negative sign reflects an increase in deposits, while positive sign reflects their decline.

With respect to the timeframe, in the first quarter of 2000, the reserve money was by Denar 689 million, or by 8.1% lower compared to the end of 1999. This was due to the decrease in the currency in circulation (by Denar 1,021 million, or by 12.5%), thus normalizing the demand for cash following the seasonal growth determined prior to the New Year holidays. The foreign exchange transactions of the National Bank of the Republic of Macedonia did not affect the movement in the reserve money in the first quarter of 2000. The net foreign currency purchased by the NBRM at the foreign exchange market in the amount of USD 3.2 million and the reserve money issuance in the amount of Denar 196.6 million did not compensate the fall in the currency in circulation caused by season factors in the first three months of 2000. Simultaneously, the effects of the foreign exchange transactions of the NBRM on the reserve money issuance were offset through the increase of Denar 2,426 million in the government deposits with the NBRM.

Chart 16

Reserve money and their components

(in Denar million)



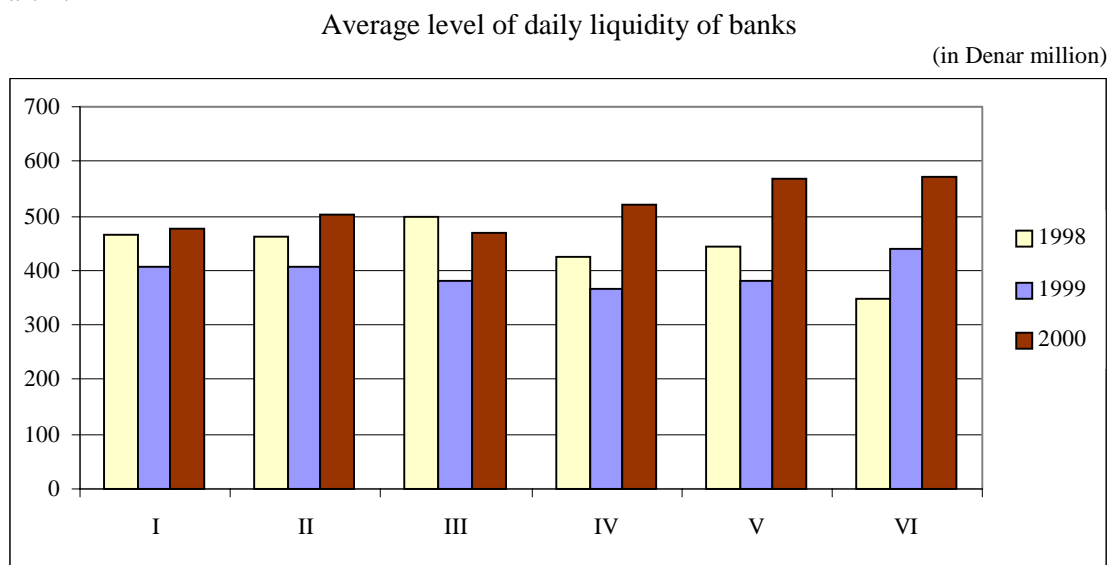
At the end of the second quarter of 2000 compared to the end of the first quarter, the reserve money remained almost unchanged, which corresponds to the minimum increase in the

currency in circulation of Denar 34 million, or 0.5%. In the second quarter of 2000, the Central Bank purchased net foreign currency in the amount of USD 67.1 million at the foreign exchange market, and therefore, issued reserve money in the amount of Denar 4,366.3 million. The increased foreign currency demand at the foreign exchange market was due to the inflow by the sale of the largest bank in the Republic of Macedonia to foreign investor (in April) and the financial aid received from USAID (in May). The effects from the foreign exchange transactions of the NBRM, aimed at increase in the reserve money, were sterilized through the increase in the government deposits with the NBRM of Denar 4,092 million.

2.2.6. Banks' liquidity

In the first half of 2000, the banks' liquidity, expressed through the funds on giro-account and the cash in vault, registered significant increase, due to the relatively low level of currency in circulation and the tendency of increase in the deposits with the banks. The average level of daily liquidity of the banks amounted to Denar 518 million, which compared to the average in the first half of 1999 was an increase of Denar 120.7 million, or by 30.4%. The annual increase in the average level of daily liquidity of the banking system in the first quarter was lower and equaled 20.7%, compared to 40.1% in the second quarter. In the first half of 2000, highest level of the average daily liquidity of the banks was registered in June (Denar 571.8 million), while the lowest level was registered in March (Denar 469.1 million).

Chart 17



As of June 30, 2000, the banks' liquidity amounted to Denar 652 million, which is by Denar 306 million or by 88.4% higher compared to December 1999. On annual basis (June 2000 / June 1999), the banks' liquidity was by Denar 168 million, or by 34.7% lower. Compared to the projections for the end of the first half of 2000, it was by Denar 59 million, or by 9.9% higher. In regard to the timeframes, each quarter registered divergent movements. Thus, in the first quarter of the year, the banks' liquidity registered fast increase of Denar 332 million, or by 95.9%, whereas in the second quarter it fell slightly (by Denar 26 million, or by 3.8%).

In the first half of 2000, as a result of the relatively high liquidity in the banking system the amount of compulsory reserves allocated by the banks, compared to the minimum requirement, was higher by 3% on average.

2.2.7. Net foreign exchange assets of the NBRM

In the first half of 2000, the net foreign assets of the NBRM, defined as difference between the foreign assets and the foreign liabilities of the Central Bank, represented a flow of reserve money creation. At the end of June 2000 compared to the end of 1999, the net foreign assets of the NBRM were by Denar 7,046 million, or by 37.7% higher, thus reaching Denar 25,745 million. Compared to the end of June 1999, it was by Denar 13,016 million, or by 102.2% higher. As of June 30, 2000, the net foreign exchange assets of the NBRM exceeded the projections by Denar 3,284 million, or by 14.6%.

Table 13

Net foreign exchange assets of the NBRM

(in million denars)

	Balance as of 31.12.1999	Changes by quarters			Balance as of 30.06.2000
		I	II	Total	
Net foreign assets*	18699	92	6954	7046	25745
- Assets	23618	-227	7520	7293	30911
- Liabilities	4919	-319	567	248	5167

* Stocks are valued at a constant rate; flows are valued at a current rate.

The growth in the net foreign assets of the NBRM in the first half of 2000 was primarily due to the following: a. net foreign currency purchased at the foreign exchange market in the amount of USD 70.3 million, USD 3.2 million of which in the first quarter and USD 67.1 million in the second quarter; b. net inflow to the external financing account of the government in the amount of USD 26.4 million and c. net inflow of foreign currency based on interest in the amount of USD 9.3 million.

In regard to the timeframes, in the first quarter of 2000, the net foreign assets of the NBRM increased by only Denar 92 million, or by 0.5%. However, in April – June 2000 period, the net foreign assets of the NBRM registered an increase of Denar 6,954 million, or 37.0%. The increase was due to the high net foreign currency purchased by the Central Bank in the amount of USD 67.1 million, primarily based on the international financial aid and high foreign currency supply by the banks at the foreign exchange market.

2.2.8. NBRM placements

In the first half of 2000, the domestic credits of NBRM declined by Denar 9,144. The need of sterilization of the effects of the foreign exchange transactions resulted in reserve money withdrawal. The fall in the domestic credits of the NBRM was due to both significantly decreased amount of credits extended to the banks and increase in the net liabilities of the NBRM to the government.

Table 14

NBRM placements

(in Denar million)

	Balance as of 31.12.1999	Changes by quarters			Balance as of 30.06.2000
		I	II	Total	
Domestic credits	-1613	-2400	-6744	-9144	-10757
I. Credits to banks	984	-427	-63	-490	494
- deposits sold at auction *	534	-434	-100	-534	0
- liquidity credits	0	15	-15	0	0
- other credits	450	-8	52	44	494
II. Government, net	-2597	-1973	-6681	-8654	-11251
- Credit to Government	5205	93	-513	-420	4785
- Government deposits **	-9684	-2426	-4092	-6518	-16202
a) for monetary policy support	-5413	-400	-300	-700	-6113
b) giro-account	-2805	-1726	-3559	-5285	-8090
v) other restricted deposits	-1466	-300	-233	-533	-1999
- External financing	1882	361	-2077	-1716	166

* On April 15, 2000 the Decision on conducting auctions of denar deposits ceased to be effective, and was replaced by the Decision on conducting auctions of NBRM credits ("Official Gazette of the Republic of Macedonia" No. 24 dated March 29, 2000)

** Since liabilities are shown on the assets side, the balance as of December 31, 1999 and June 30, 2000 are shown with a minus sign. In the change by quarters, the changes with minus sign represent an increase in deposits and vice versa.

In the first half of 2000, the credits extended to banks by the Central Bank decreased by Denar 490 million, or by 49.8%. Such a decrease was primarily due to the reduced amount of credits extended to the Central Bank auctions. In the first half of 2000, similar to the second half of 1999, the National Bank of the Republic of Macedonia continued to gradually reduce the amount of credits extended at the auctions, as a result of the satisfactory level of liquidity in the banking system. In this period, their level decreased by Denar 534 million, thus reducing to zero, in June 2000.

In regard to the timeframes, in the first quarter of 2000, Denar 434 million was withdrawn by the credit auctions. It indicated their stabilization, following the fast growth at the end of 1999, when due to the seasonal increase of currency in circulation, the banks are facing outflow of liquid funds, and are forced to borrow liquid funds at the credit auctions. In the second quarter, the amount of credits extended at auction, additionally decreased by Denar 100 million.

The item "NBRM net claims on the government" includes: credits extended to the Government, Government deposits with the NBRM, and the balance of the Government external account with the National Bank of the Republic of Macedonia. According to this definition, at the end of June 2000, the NBRM net claims on the government amounted to Denar 11, 251 million, and had a negative sign, due to the higher NBRM liabilities to the government, relative to the claims on the government. In the first half of 2000, the NBRM net claims on the government were aimed at reserve money withdrawal in the amount of Denar 8,654 million. In regard to the timeframes, the NBRM claims on the government registered significant faster fall in the second quarter of 2000. In the first and second quarter of the year they reduced by Denar 1,973 million and by Denar 6,681 million, respectively.

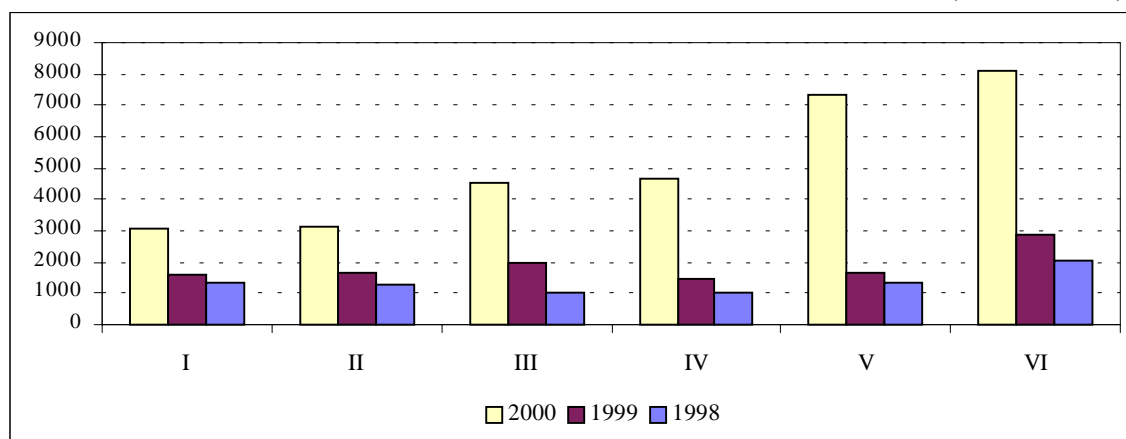
Structurally observed, the increase in the Central Bank net claims on the government was caused by all three components of this category. The Government deposit with the Central Bank for monetary policy support increased by Denar 700 million, which entirely corresponds with the projected growth. When the Central Bank purchased significantly higher amount of net foreign currency at the foreign exchange market, the amount of deposited funds of the Government with the Central Bank was not sufficient to sterilize the monetary effects of the NBRM foreign exchange transactions. However, it was compensated with the growth of the other government deposits with

the NBRM. In January – June 2000 period, the funds on the government giro-account with the NBRM increased by Denar 5,285 million, with Denar 3,559 million increase in the second quarter of 2000. Simultaneously, the remaining restricted deposits registered an increase of Denar 533 million. Thus, the total government deposits with the NBRM in the first half of 2000 increased by Denar 6,518 million, or by 67.3%.

Chart 18

Funds on the government giro-account with the NBRM

(in Denar million)



The credits extended to the government in the first half of 2000 declined by Denar 420 million, or by 8.1%. In the first half of 2000, the NBRM claims on the government resulting from the external account, decreased by Denar 1,716 million, or by 91.2%. In the first quarter, the NBRM payments for the account of the government exceeded the inflows on the external account by Denar 361 million, whereas in the second quarter, the inflows compared to the payments were markedly higher (by Denar 2,077 million).

2.2.9. Reserve money withdrawal instruments

In the first half of 2000, the compulsory reserve and the CB bills auctions, considered as traditional reserve money withdrawal instruments, were used for reserve money creation. In January – June 2000 period, the total amount of withdrawn money declined by Denar 1,790 million, which is equal to the reserve money issued on this basis. Thus, at the end of June 2000, the total amount of withdrawn reserve money was reduced to Denar 2,052 million, and compared to the projections, it was by Denar 603 million, or by 22.7% lower.

Table 15

Reserve money withdrawal instrument *

(in Denar million)

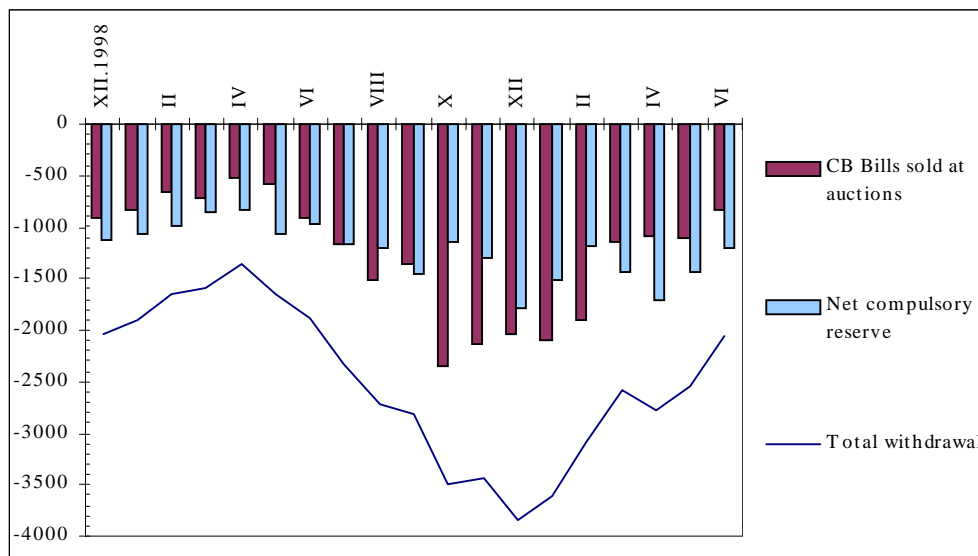
	Balance as of 31.12.1999	Changes by quarters			Balance as of 30.06.2000
		I	II	Total	
Compulsory reserve	-1795	360	227	587	-1208
Central Bank bills sold at auction	-2047	905	298	1203	-844
Total amount withdrawn	-3842	1265	525	1790	-2052

* (-) Reserve money withdrawal; (+) Reserve money creation.

At the end of June 2000 compared to the end of 1999, the net compulsory reserve was by Denar 587 million, or by 32.7% lower, thus amounting to Denar 1,208 million. At the end of June 2000 compared to the projections, the compulsory reserve was by Denar 97 million, or by 7.4% lower.

Chart 19

Effects of the use of reserve money withdrawal instruments
(in Denar million)



At the end of June 2000, the total amount of CB bills sold by auctions amounted to Denar 844 million, which is by Denar 1,203 million, or by 58.8% more compared to December 31, 1999. At the end of the first half of 2000 compared to the projections, the amount of CB bills sold by auctions was by Denar 506 million, or by 37.5% lower. In regard to the timeframes, in the first quarter of the year, Denar 905 million of reserve money was created through this instrument, as a result of the increase in the amount of CB bills sold. Taking into account the withdrawal of reserve money by the credit auctions, the collection of due CB bills was a major source of banks' liquidity. In the second quarter of the year, the amount of CB bills was reduced, and additional reserve money was issued in the amount of Denar 298 million. The introduction of collateralized credit auctions in April 2000 (with the CB bills as collateral) diminished the use of CB bills for reserve money withdrawal. The restrictions in the requirements for extending funds at the credit auctions, forced the banks to decrease the amount of CB bills, in order to meet the need of liquid funds. At the same time, the fall in CB bills reflected the shift in the banks' preference for the placement of the available liquid funds. Taking into consideration the removal of credit limits (April 2000) the banks reoriented themselves from placement in CB bills towards increased credit activity.

2.2.10. Interest policy

The relatively high banking system liquidity in the second half of 1999 continued in the first half of 2000. As a result, the demand for liquid funds continued to decrease, causing further reduction in the interest rate at the credit auctions (deposits)¹⁰ and the Money market.

In regard to the timeframes, in January – March 2000 period, the NBRM did not hold Denar deposit auctions with seven-day maturity. In the last 10 days of March 2000, an auction for sale of deposits with one-day to three-day maturity was held with the average weighted interest rate registered at the auction of these deposits equaling 11.4%, p.a. In April 2000, the NBRM held two credit auctions¹¹ with maturity of 1 and 7 days. The monthly weighted interest rate at the auctions

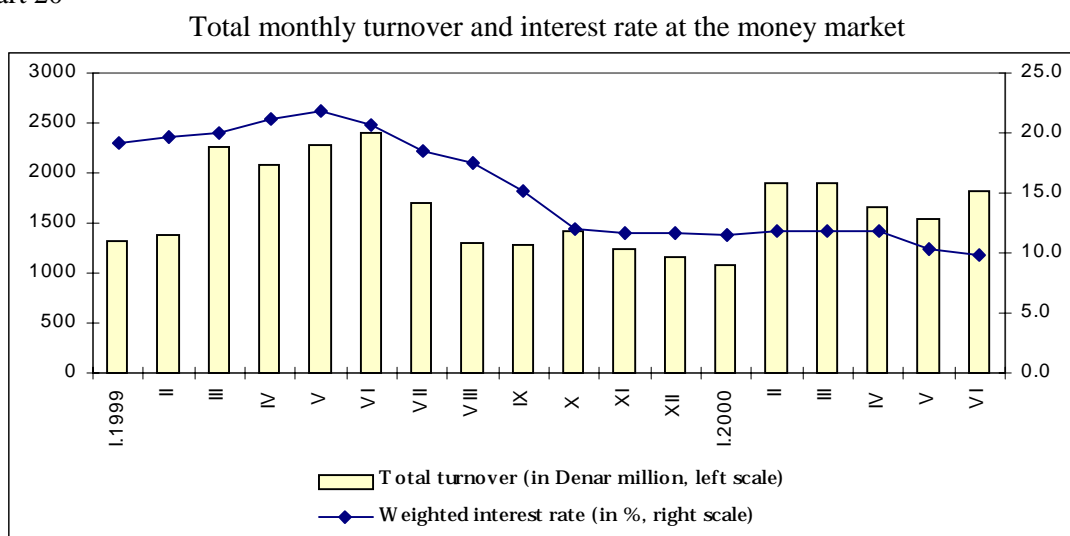
¹⁰ The Decision on auction sale of Denar deposits was abolished on April 15, 2000. The Decision on NBRM credit auction became effective. (Official Gazette of the Republic of Macedonia, no. 24, dated March 29, 2000).

¹¹ Idem

of credits with 7-day maturity reached 13.0%, p.a. Since there was no need of using this monetary policy instrument, in May and June 2000, there were no Central Bank credit auction.

In April 2000, the NBRM reduced the discount interest rate from 8.9% to 7.9%, p.a. Although the NBRM does not apply this interest rate in any form of credit activity, it was reduced in order to produce the so-called signaling effect. Simultaneously, in May 2000, the interest rate of the Lombard credit was reduced from 18.5% to 17.5%, p.a. The decrease in the interest rate of the Lombard credits was supported to bring it in line the movements of the interest rates at the money market, which have been registering a decline for a longer period of time. Additionally, since April 2000, the interest rates of the CB bills are being formed on the market. The interest rates are modified depending on the type of tender (interest rate tender or volume tender). In the first half of 2000, the CB bills with 28-day maturity were most frequently traded at the CB bill auctions, with the average weighted interest rate equaling 9.5%, p.a.

Chart 20



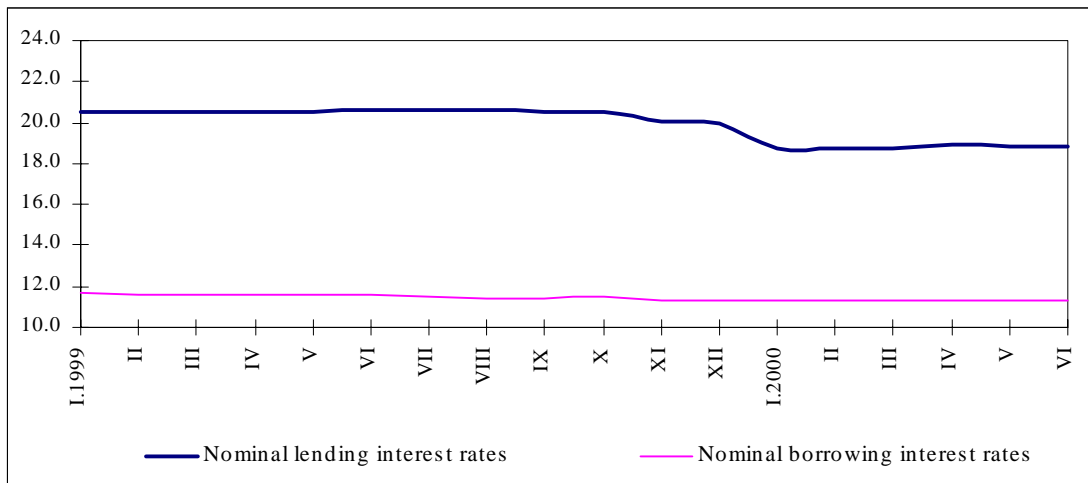
The high banks' liquidity also influenced the interest rates at the money and short-term securities market. In January – June 2000 period the weighted interest rate registered at this market equaled 11.2%, on average, which is by 9.2 percentage points lower, compared to the same period of 1999. In regard to the timeframes, the downward trend in the average weighted interest rate at the money market in the second half of 1999, turned positive in February 2000, thus reaching 11.9% in March, which was its highest level since the beginning of 2000. In June 2000, it began decreasing again, and was reduced to 9.8%, which has been its lowest level, so far. Consequently, the activity at the money market declined. Thus, in the first half of 2000, compared to the same period of 1999, it was by 15.1% lower, due to the faster fall in demand for liquid funds (by 17.6%), compared to the fall in the supply (of 6.6%).

The satisfactory level of liquidity in the banking system resulted in a reduction in the nominal weighted lending interest rates of the deposit money banks, and consequently, in the interest rate margins. In the first half of 2000, the nominal weighted lending interest rates of the banks equaled 18.8%, on average. Compared to the end of 1999, they were by 1.2 percentage points lower. In January – June 2000 period compared to the end of 1999, the nominal weighted deposit interest rates of the banks remained unchanged, equaling 11.3%. Compared to the first half of 1999, the nominal weighted lending and deposit interest rates were lower by 1.7 percentage points and by 0.3 percentage points, respectively.

Chart 21

Weighted interest rates of banks

(in %, on annual basis)



In conditions of unchanged nominal weighted deposit interest rates, the fall in the nominal weighted lending interest rates resulted in lower the interest rate margins of the deposit money banks. Thus, in the first half of 2000 they equaled 7.5 percentage points, on average, which is an indicator for the lack of efficiency in the banking system. Compared to the end of 1999, the interest rate margins were by 1.2 percentage points lower, while compared to the first half of 1999, they were by 1.4 percentage points lower.

In January – June 2000 period, taking into account the positive monthly inflation rates, the real lending and deposit interest rates of the banks amounted to 1.2% and –6.3%, respectively (compared to 26.5% and 17.3%, respectively, in the same period of 1999).