



Macroeconomic Developments in the Republic of Macedonia in April 2003

On April 1, 2003, the implementation of the new value-added tax rates started in accordance with the amendments to the Law on the Value Added Tax (the general VAT rate was reduced from 19% to 18%, while its application was extended to a larger scope of products which, so far, have been taxed at preferred VAT rate of 5%). These amendments were an integral part of the arrangement with the IMF, as an alternative solution for the condition of in the budget after the abolishment of the financial transactions tax. The changes made in the tax policy resulted in an increase of the general level of prices in the economy, with a monthly inflation rate of 1.4.% being registered in April, according to the costs of living index. With regard to the character of the changes, it is a one-time effect on the inflation. Notwithstanding the monthly increase, the average inflation rate registered in the first four months of 2003 was minimal (0.1%). The price stability corresponds with the stable level of the Denar exchange rate, which in April remained at the level of Denar 61.2 per one Euro, after the successful elimination of the pressures on the foreign exchange market for Denar depreciation.

In April, the changes in the real and the external sector in the economy were negative due to the high comparison bases from the previous month. Nevertheless, on cumulative basis the positive indicators remained. Thus, in April, the industrial output registered a monthly fall of 9.7%, while the foreign trade dropped by 11.8%. However, in the first four months of 2003, compared to the same period of the previous year, the industrial output went up by 2.4%, and the foreign trade increased by 21.3% (given the increase in both the imports and the exports of 23.7% and 20%, respectively).

In April, in the monetary sector, the easing of the monetary policy continued further, in line with the overall developments in the economy. After the changes in the NBRM interest rate policy in February 2003, in April the interest rates were further reduced as follows: the discount rate was reduced from 8% to 6.5%, whereas the interest rate on Lombard loans reduced from 17.5% to 16%. Also, since April 11, 2002, the CB bills interest rate has been fixed at a level of 7%, in conformity with the changed type of auction (volume tender). These changes sent a signal to the banks for proportional reduction of their interest rates, and consequently, larger financial support to the economic activity in the country and inducing of the economic development.

The payment of the third installment and the interest on the government bonds for the old foreign exchange savings on April 1, 2003, was a major factor for the increased budget spending, which directly resulted in higher liquidity of the banks in April. Given the simultaneous increase in the demand for currency in circulation, due to the Easter and Labor's Day Holidays, in April, the reserve money registered significant increase of 10.6% on monthly basis.

In April, the decrement of the average weighted interest rate on the CB bills auctions and on the Money Market continued. The high liquidity in the period in which the interest rate tender auctions were still in place, as well as the later fixing of the interest rates on the CB bills at the level of 7%, led to decline in the average weighted interest rate on the CB bills of 2.6 percentage points in April, compared to the previous month, thus reducing it to 7%. Simultaneously, taking into account the higher supply relative to the demand for liquid funds on the Money Market, the average weighted interest rate registered a fall of 1.6 percentage points and equaled 10.6%. In April 2003, the Denar lending interest rates of the banks remained at the level of the previous month (17.3%), whereas the Denar deposit interest rates reduced by 0.3 percentage points and equaled 8.9%, annually.

In April, the monetary aggregates registered a monthly increase. Thus the money supply M1 went up by 3.2%, due to the rise in the currency in circulation and the households' demand deposits. The money supply M2 was by 6% higher, with the short-term Denar deposits increasing much faster than the short-term foreign exchange deposits. The broadest monetary aggregate M4 registered an increase of 5.3%, given the increase in the foreign exchange, and the decrease in the Denar non-monetary deposits. From the aspect of the total deposit structure, the share of both the short-term and the foreign exchange deposits still dominates.



The Republic of Macedonia concluded a Stand-by arrangement with the IMF

On April 30, 2003, the International Monetary Fund (IMF) Executive Board extended a Stand-by arrangement to the Republic of Macedonia in the amount of Special Drawing Rights (SDR) 20 million, or around US Dollar 27 million. The arrangement is a financial support to the macroeconomic policy for the period from April 30, 2003 to June 15, 2004. Additionally, this arrangement is a prerequisite for receiving the announced funds from the foreign donors and creditors. Thus the stress is laid on *ensuring sustainable fiscal and external position in a medium run and inducing the economic growth and the employment*. In order to achieve such goals, the following macroeconomic framework was established:

- **Monetary and exchange rate policy** – the strategy of *de facto exchange rate targeting of the Denar against the Euro* was considered a proper monetary strategy for this period. The IMF competitiveness indicators show neither overvaluation nor undervaluation of the exchange rate. *The monetary policy* will be conceived in function of successful maintenance of the stability of the exchange rate and further successful achievement of its ultimate objective, preserving the price stability. From the operational point of view, the CB bills auctions and their interest rates further remain major monetary policy instrument.
- **Fiscal policy** – the adjustments within the fiscal policy are aimed at *ensuring sustainable fiscal position*. Therefore suitable changes were made on the sides of both the expenditures and the revenues. Thus after the exceptionally high public spending in 2001 (for security reasons) and in 2002 (year of parliamentary elections), considerable reduction in the public spending is planned for 2003 (by eliminating the extraordinary expenses and taking other measures so as to reduce the budget spending). On the revenue side, after the abolishment of the temporary financial transactions tax, the revenues are planned to be supplemented through the changed structure in the value-added tax (a larger portion of the non-food products will no longer be taxed on the basis of preferred, but on the basis of the general tax rate). These measures are expected to lower the budget deficit and to reduce it to 2.0% of the GDP in 2003.
- **Structural reforms** – in this area, the reforms are focused on increasing the flexibility on the labor market, support of the small and medium enterprises (by promoting the entrepreneurship, facilitating the access to credits by establishing a Credit Guarantee Fund), solving the problem with the loss making enterprises, completing the privatization, as well as undertaking measures for reducing the corruption. Within these frameworks, the admission of the Republic of Macedonia to the World Trade Organization is considered positive.