

Honorable,

It gives me great honor and privilege to submit to your appraisal the 2000 Annual Report of the National Bank of the Republic of Macedonia (hereinafter NBRM). This act is a fulfillment of the legal obligation, stipulated in Article 8 of the National Bank of the Republic of Macedonia Act, for submission of the Report on the implementation of the monetary policy to the Parliament of the Republic of Macedonia.

Generally speaking, significant macroeconomic developments were registered in 2000, enlisting it as one of the most successful years for the Macedonian economy. The most significant macroeconomic achievement in 2000 was the preservation of the price stability, taking into account the circumstances that acted towards spiraling of the inflation. At the same time, the process of structural reforms was intensified in almost all sectors of the economy in 2000. The above mentioned conclusion is not only ours, but as well as of some other relevant international financial organizations. Hence, according to the "Transition Report" of the European Bank for Reconstruction and Development, in 2000 the Republic of Macedonia made significant progress in the implementation of the reforms in the banking sector, privatization of the state-owned capital, price liberalization, and the liberalization of the foreign-trade and foreign exchange flows. Together with the pronounced reform course of the fiscal policy, these developments resulted in an adequate growth rate of GDP, as well as the creation of a realistic basis for intensified economic growth on the long run. With respect to the responsibilities of the Central Bank, the major events of this year were the preservation of the price stability, the reforms in the set of monetary instruments, as well as the undertaken measures aimed at improving the performances of the banking sector.

In 2000, set of unfavorable circumstance acted towards acceleration in the inflation in the Republic of Macedonia, which was preserved at a stable and predictable single-digit level in the previous years. The economic theory and the practical world experiences show that the developments on the world markets are usually quickly transferred to the economic developments in small and open economies. Thus, the surge in the crude oil prices in 2000, together with the appreciation of the US Dollar, had an adequate reflection on the general level of prices in the Republic of Macedonia, taking into account the importance of this input in the Macedonian economy. At the same time, the preservation of the higher tariff in the calculation of the price of electricity, as well as the increase in the prices of certain commodities under direct control in the last quarter of 2000 acted towards an increase in the price level.

The influence of these factors of non-monetary nature resulted in a certain uphold in the price level and on December basis, the inflation rate, measured through the increase in the costs of living, equaled 6.1%. It is important to note that the non-monetary factors which resulted in a higher inflation rate in 2000 are of temporary nature, and the Denar exchange rate, the monetary, fiscal and wage policy, being the potential fundamental generators of inflation, remained under control and coordinated. This represents a necessary precondition for the preservation of the price stability on permanent basis.

In 2000, the GDP of the Republic of Macedonia registered a real growth rate of 5.1%, which represents a continuation of the positive developments in the previous five years and simultaneously represents an indicator of the intensified economic activity. The basic generators of the GDP growth are the increased consumption and investments. Namely, despite the increase in export demand, the domestic demand increased in 2000 as well, especially in the period prior to the introduction of the Value Added Tax. The Macedonian producers reacted on the increased demand through more efficient utilization of the existing capacities, increase in labor productivity in industry and reduced real unit labor costs. The efforts for the creation of a favorable investment climate, through the creation and

preservation of the macroeconomic stability, as well as through the intensified reforms in the real, fiscal and financial sectors, had a full impact in 2000. Namely, the investments in fixed assets in the Republic of Macedonia in 2000 compared to the previous year, increased by 52.0% in real terms, while simultaneously significant inflow of foreign capital was registered.

In line with the predetermined goals and objectives, the monetary policy in 2000 was directed towards the maintenance of the price stability through the preservation of a stable exchange rate of the Denar against the Deutsche mark, as a nominal anchor in the economy. By preserving a stable exchange rate of the national currency, the Central Bank acted towards stabilization of the inflationary expectations regarding the movement of prices. In addition, the empirically proven fact that a stable exchange rate of the national currency is of exceptional importance for the price stability in a small and open economy was once again affirmed.

The intensified export activity, together with the inflow of foreign exchange on the basis of foreign investments and donations, resulted in continuation of the trend of favorable developments on the foreign exchange market. Namely, in 2000, the supply of foreign exchange on the foreign exchange market significantly exceeded the demand for foreign exchange, which enabled a net-purchase of foreign exchange by the Central Bank in the amount of US Dollar 190 million. Therefore, the foreign exchange transactions of NBRM were the main flow of reserve money creation in the course of 2000. At the same time, the above-than-planned net-purchase of foreign currency from the foreign exchange market resulted in an increase in the gross foreign exchange reserves of NBRM by US Dollar 235 million. Consequently, their level as of December 31, 2000 reached US Dollar 714 million, which represents an equivalent of 4.1 months of imports.

The good coordination of the monetary and fiscal policy was reaffirmed in 2000. Namely, the monetary effects of the foreign exchange transactions of the Central Bank were neutralized through the increase in the Government deposits with the NBRM, which was the main flow of reserve money withdrawal during 2000. As a result of the increased inflow of funds in the budget on the basis of the introduction of the Value Added Tax and the more efficient collections of taxes in 2000, the Government deposits were continuously increasing. Such developments in the fiscal sector resulted in a budget supplement and the adoption of a program for the spending of the budget surplus at the end of the year. Among other things, at the end of December 2000, there was an early payment of the Government bonds for the old foreign exchange savings. Even though a substantial amount of these funds were sterilized through the increase in the CB bills, part of these funds remained at the giro-accounts of banks or were transferred into circulation, which reflected on the level of reserve money. Hence, as of December 31, 2000, the reserve money reached Denar 12,089 million and compared to their level at the end of the previous year, they were higher by significant Denar 3,574 million, or by 42.0%.

The money supply in 2000 was designed according to the needs for unhampered execution of the economic transactions. In addition, in the first half of 2000, the money supply registered high growth rates, whereas in the second half there was a slowdown in the annual growth rates due to the high comparison base from the previous year. Hence, as of June 30, 2000, the money supply M2 - Denar component was higher by 24.4% on annual basis, whereas at the end of December 2000 it was higher by 17.5% on annual basis.

The upward trend registered in the banks' deposit potential is of an exceptional importance for the operations of the banks in the Republic of Macedonia and the further acceleration of the economic growth on the long-run. Namely, the resolving of the problem of foreign exchange savings by issuing Government bonds in September 2000, the improvements in the legal framework considering the coverage of deposits by the Deposit Insurance Fund, as well as the strengthened supervisory control of banks' activities by the NBRM, resulted in a

gradual strengthening of the confidence in the banking sector. This can be seen from the growth rate of 23.1% of the non-Government deposits registered in 2000, while the households' deposits increased by 40.4%.

The liquidity of the banking sector was continuously preserved at a high level during 2000. The CB bills auctions served as the basic instrument for the regulation of the global level of liquidity. Since April 2000, the "interest rate tender" auctions became the dominant form of trading at the auctions, thus allowing free formation of the interest rates by the participating banks. Generally speaking, these interest rates had a declining trend in 2000 and in December 2000 they equaled 6,8%. Taking into account the reduced demand for liquidity, the interest rate at the money market registered a decline, as well. Namely, in December, this interest rate was brought down to 7.1%, which is by 4.5 percentage points below its level at the end of 1999.

In order to influence a reduction in the banks' interest rates, in April 2000, the NBRM reduced the interest rate on Lombard credits and the discount rate by one percentage point, thus reducing them to 17.5% and 7.9%, respectively. However, these changes, as well as the developments in the interest rates at the CB bills auctions and the money market, did not have an adequate reflection on the level of banks' lending and deposit interest rates which equaled 18.9% p.a. and 11.2% p.a., respectively. Compared to 1999, the banks' interest rates are lower by 1.6 percentage points and 0.3 percentage points, respectively, thus reflecting the existence of factors of systemic nature which induce their rigidity.

With the abolition of the credit ceilings on banks' Denar placements in April 2000, the NBRM made full transfer towards the use of indirect instruments of monetary regulation. The discarding of credit ceiling resulted in a corresponding credit expansion, which according to the reports of the supervision examination is directed towards credit-worthy clients. Taking into account the more attractive interest rate on the banks' Denar placements, the banks reduced their supply of foreign currency placements and oriented themselves towards Denar placements. Hence, as of December 31, 2000, banks' Denar placements were higher by 27,8%, whereas their foreign currency placements fell by 17.2%.

The increase in imports in the first quarter of 2000, prior to the introduction of the Value Added Tax, had a permanent effect on the balance of the foreign trade of Republic of Macedonia. Namely, the more intensive increase in imports relative to exports in 2000, resulted in a foreign trade deficit in the amount of US Dollar 766 million. Such developments in the foreign trade of Republic of Macedonia resulted in a balance of payments deficit of 3.0% of GDP, close to its level in the previous year. On the capital account of the balance of payments, it is important to note the inflow of foreign direct investments in the amount of US Dollar 170 million, which is the highest level registered so far and is a primarily due to the sale of few economic enterprises to strategic foreign investors.

The signing of arrangements with the international financial organizations is of exceptional importance for covering the financial gap in the balance of payments, as well as for the credibility of the country in the world. Hence, after a short time period, in the last months of 2000, the Republic of Macedonia concluded arrangements with the International Monetary Fund (IMF) and with the International Bank for Reconstruction and Development (IBRD). The signing of the arrangements with the international financial organizations represents a significant confirmation of the macroeconomic policy in Republic of Macedonia in the last few years. Besides the financial effect, the importance of the concluded arrangement is contained in the formulation of consistent medium-term macroeconomic policy, aimed at implementing the structural reforms in the economy. Their implementation and acceleration is of outmost importance for the dynamics of the economic growth in the Republic of Macedonia.

In this context, what has been set as a task for the Central Bank on the medium-term is the further improvement of the instruments of monetary policy. Namely, following the shift to indirect market instruments, the continuous upgrading of the set of monetary instruments is expected to enable more efficient monetary regulation and improved performances of the banking sector. One of the biggest challenges for NBRM in the medium-term, in coordination with the Ministry of Finance, is the development of the equity market and the beginning of open market transactions with Government securities.

At the same time, the reforms of the payment system in the Republic of Macedonia, which were significantly intensified during 2000, are expected to be finalized in 2001, when the existing system will be replaced with a RTGS system (Real Time Gross Settlement System with the Central Bank). The transfer of the payment operations in the banking sector is expected to result in a more efficient and easier liquidity management by the banks. At the same time, this means a creation of standard financial infrastructure, which is widely accepted and distinguishable in the world.

Among the tasks, which are the permanent field of activity of the Central Bank, are the measures and activities aimed at improving the performances of the banking sector. Thus, the efforts in the sphere in 2000 resulted in the adoption of a new Banking Law in July 2000. With the adoption of this law, the legal framework of Republic of Macedonia in this area was harmonized with the corresponding one in the European Union, especially in regard to the harmonization of the prudential supervisory standards. At the same time, the new Banking Law is expected to result in the strengthening of the role of the bank management and to improve the efficiency in the operations of the banks.

At the same time, the registered inflow of foreign capital in the Macedonian banking sector and especially the sale of the largest bank to a foreign strategic investor in 2000 is expected to result in multiple positive effects for the entire banking sector and the Macedonian economy as a whole. In addition, besides the increase in savings, the qualitative improvement of the competition in the banking sector will lead to the development of greater array of banking products and services. Thus, the credit supply to the households sector is expected to increase, as well as the crediting of housing projects and small and medium size enterprises, as significant generators of the economic activity in the national economy. On the other hand, the increase in the credit supply, taking into consideration the improved competitiveness and increased deposit potential, is expected to result in an adequate decline in the banks' lending interest rates. The amendments to the legal framework directed towards an improvement in the collection of claims by the banks, together with the strengthened supervisory control by the Central Bank as well as the more efficient bank management, should result in qualitative improvements in the structure of the banks' credit portfolio. Even though, there was limited progress made on some of the above mentioned issues in 2000, continuous efforts are needed in order to create all necessary preconditions for efficient functioning of the banking sector. Only a sound and efficient banking and financial sector can provide adequate financial support to the real sector of the economy. Therefore, the NBRM is permanently oriented toward undertaking adequate measures and activities, which would help create an efficient banking sector, thus contributing towards dynamic economic growth sustainable on the long-run.

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*Ljube Trpeski, Ph.D.
Governor and President of the Council of
National Bank of the Republic of Macedonia*