

### **III. Monetary Policy**

#### **3.1. Monetary Policy Goals**

In accordance with the macroeconomic policy of the Republic of Macedonia, the favorable economic conjuncture from the second half of 1999 was expected to continue in 2000, which will result in achieving the real GDP growth of 6.0%. As a result of the lowered political risk in the region and the announcements for its reconstruction, a creation of favorable investment climate and a restoration of the confidence of the domestic and foreign investors were expected. The upward trend of the labor productivity in industry and the decline in the real costs should have resulted in increased competitiveness of the Macedonian economy at foreign markets. Simultaneously, the further intensification of the structural reforms in the real and financial sector was anticipated, thus creating preconditions for accelerated process of transition and intensified economic growth.

The conduction of consistent macroeconomic policies was expected, over again, to result in maintaining the inflation within the zone of low and one-digit rates. Thus, in 2000 the rate of inflation, measured through the increase of retail prices, was anticipated to reach 4.0% on December basis. In addition, continuation of the strategy of targeting the exchange rate was anticipated in 2000. Through maintaining the stability of the nominal Denar exchange rate against the Deutsche mark, as a nominal anchor in the economy, the monetary policy should have achieved the price stability, as the most favorable macroeconomic environment for long-term sustainable economic growth. The prevention of the uncontrolled inflationary movements was particularly significant in terms of expected price increase, determined by the anticipated VAT introduction, as well as the increased energy prices at domestic and foreign market.

Thus, in the monetary policy projection for 2000 the projected increase of money supply M2 – Denar equaled 13.5% on annual basis. The monetary effects of the foreign exchange transactions of the NBRM, according to expected net purchase of foreign exchange at the foreign exchange market of US Dollar 55.4 million, should have been sterilized through depositing Denar 1,300 million from the budget with the NBRM, aimed at monetary policy support.

Within the framework of preparations for signing the IMF arrangement, in mid-2000 the projection of the macroeconomic policy was revised, according to the movements registered in the first half of the year. In addition, the retail prices were replaced with the costs of living, as a measure of the rate of inflation. Thus, based on the trend in the first half of the year, in 2000, the inflation, measured through the costs of living, was projected to reach 4.9% on December basis, while primarily projected real GDP growth of 6.0% remained unchanged.

Having in mind the favorable movements at the foreign exchange market in the first half of 2000, for the second half of the year an excess of foreign exchange in amount of US Dollar 60.5 million was projected. In accordance with the high inflows in the Government budget after the VAT introduction, it was anticipated that the trend of intensive increase of Government deposits with the NBRM would continue in the second half of 2000. Projected favorable movements at the foreign exchange market, together with the expected increase of deposits with the banks, enabled the annual growth rate of money supply M2 – Denar, according to the revised projection, to equal 19.1% at the end of 2000.

In 2000, improved banks' liquidity was anticipated, as well as more equivalent distribution of liquid assets within the banking system. This is in accordance with the continuous efforts for development and improvement of the monetary instruments, complete

affirmation and going over to indirect market instruments for monetary regulation, as well as with the anticipated intensification of the payment system reforms. The entrance of the foreign investor in the largest bank was expected to result in increased competitiveness within the banking sector, and improved efficiency of the banks. It should have enriched the supply of banks' products and services, with the simultaneous decrease of banks' interest rates and interest rate margins. In 2000, the strengthening of the supervision of the banks, together with the activities for improvement of the legislation in case of default of the borrowers, was expected to result in improved quality of the banks' credit portfolio. The functioning of the deposit insurance fund and the efforts for resolving the problem with the old foreign currency deposits was expected to create the preconditions for further increase in domestic savings.

### **3.2. Report on Monetary Developments in 2000**

By subordinating the money supply to the maintenance of stability of Denar exchange rate as a nominal anchor in the economy, i.e. by maintaining the fundamental factors in the economy on a sound basis, in 2000 the monetary policy restricted the unfavorable influence of the non-monetary factors on the level of prices. This kind of monetary policy, and its coordination with the fiscal and wage policy, resulted in inflation rate (measured through the costs of living) of 6.1% on December basis. Hence, the monetary authorities succeeded to maintain the price stability in the economy, as an ultimate monetary policy goal.

According to the strategy of targeting the foreign exchange rate, in 2000 through adequate interventions at the foreign exchange market, the NBRM maintained the stability of the nominal Denar exchange rate against the Deutsche mark, as an intermediate target of the monetary policy. The stability of the foreign exchange rate as nominal anchor in the economy, had huge importance for maintaining the price stability, contrary to the numerous inflationary pressures caused by the non-monetary factors. The favorable movements at the foreign exchange market in 2000 enabled a net-purchase of foreign currency by the Central Bank in total amount of US Dollar 190.1 million. The high foreign exchange inflow registered in 2000 mainly comes from foreign creditors, donations, assets from the privatization, and increased export activity. Dynamically observed, shortage of foreign exchange at the foreign exchange market was registered only in the first two months of 2000, as a consequence of increased demand for foreign currency, due to the import of excise goods prior the VAT introduction. To defend the targeted level of the foreign exchange rate, the Central Bank in this period intervened at the foreign exchange market with net-sale of US Dollar 9.0 million.

In sterilization of the monetary effects from the foreign exchange transactions, the monetary authority was supported by the fiscal policy. Namely, the significant amount of created reserve money as a result of high purchase of foreign exchange at the foreign exchange market during 2000, was sterilized mainly through the increase of the Government deposits with the NBRM, which in the January – November 2000 period increased by Denar 12,339 million, or by 2.3 times. According to the budget supplement and anticipated usage of the budget surplus for different purposes, in the last month of the year the Government deposits with the NBRM decreased by Denar 5,323 million.

The favorable movements at the foreign exchange market in 2000 had a positive impact on the level of foreign exchange reserves and on the dynamics of the money supply increase. Thus, the money supply M2 – Denar component, at the end of 2000 registered an annual growth rate of 17.5%, which is within the projected increase. In addition, this monetary aggregate in 2000 achieved high average annual growth rate of 23.2%, mainly due to the movements in the first half of the year. In the second half of 2000, the money supply registered relatively lower annual growth rates, as a result of the high comparison base from the previous year.

The increment in the money supply registered in 2000, is a result of the reserve money increment and enhanced monetary multiplication process. In addition, the movements in the foreign exchange market and Governments deposits with the NBRM determined the reserve money movements in 2000. The average annual growth rate of reserve money equals 11.2% in 2000. The decline of Government deposits at the end of the year, enhanced by the seasonally increased demand for currency in circulation prior the New Year holidays, resulted in exclusively high December increase of reserve money of 42.0%.

The average level of monetary multiplier of money supply M2 – Denar reached 3.20 in 2000, and was significantly higher relative to the average from the previous year (2.89). The increased monetary multiplier reflects the increased deposit potential of banks, as a base for monetary and credit multiplication.

The high liquidity level and increased deposits with the banking system during 2000 created preconditions for increased banks' placements to the non-Government sector. Especially intensive credit activity of the banks was registered in the second quarter of the year, after the abolishment of the credit ceilings of banks' Denar placements. Thus, in 2000 total banks' placements to the non-Government sector increased by 17.2% on annual basis. In addition, banks' Denar placements increased by 27.8%, while banks' foreign currency placements decreased by 17.2% on annual basis.