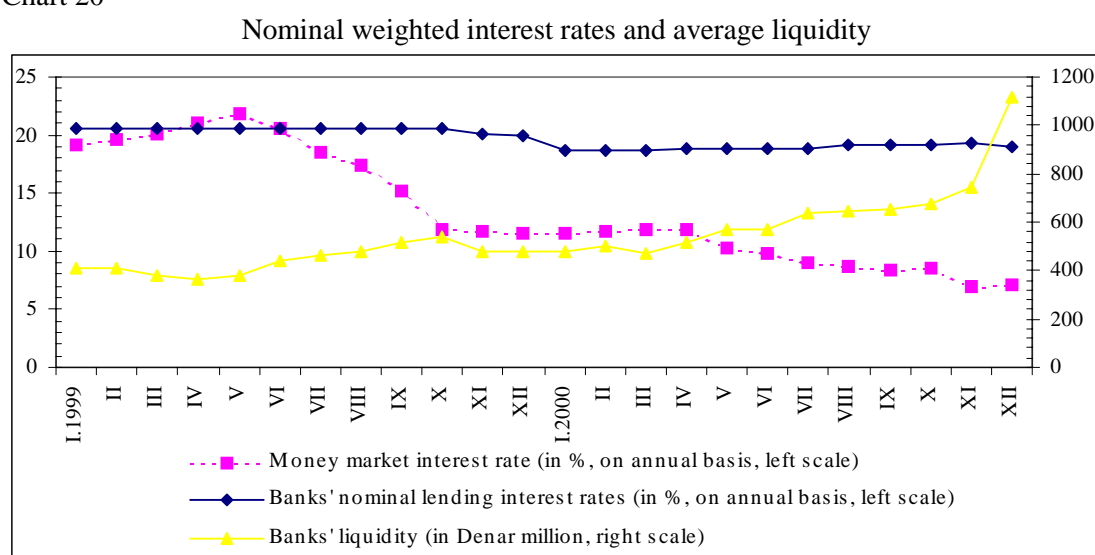


V. Interest Rate Policy

The high liquidity level of the banking system in 2000, had an exceptionally favorable effect on the interest rates movements. Thus, in presence of reduced demand for liquid assets, decrease in the money market interest rates was registered. At the same time, the high interest for placement of the liquid assets surplus into CB' bills resulted in respective fall of the interest rates at the CB' bills auction. On the other hand, the improved liquidity of the banking sector and the increased deposit potential did not result in a more significant decrease in the banks' interest rates, which confirms the high level of rigidity of the banks' interest rates.

Chart 20



The relatively high liquidity of the banks caused lack of significant necessity of the credits (deposits)¹⁷ auctions, as a monetary policy instrument. Namely, NBRM did not conduct auctions of Denar deposits in 2000, excluding March, April and October. In addition, the average weighted interest rate at the auctions in March 2000 equaled 11.4%, in April 13.0%, and in October 8.9%, on annual basis.

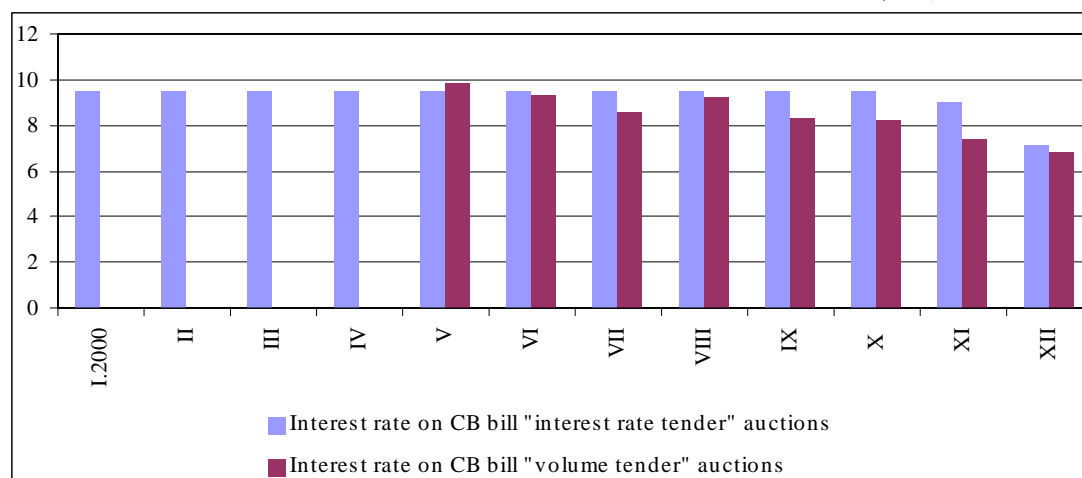
In 2000, NBRM reduced the discount rate and the lombard credits interest rate. Namely, in April 2000, NBRM reduced the discount rate from 8.9% to 7.9%, on annual basis. This change was made in order to generate the so - called “signal effect”, aiming to influence the reduction of the banks' interest rates. In May 2000, the lombard credits interest rate was reduced by one percentage point and it was set at a level of 17.5%, on annual basis. The decrement in this interest rate was aiming to reconcile it with the movements of the money market interest rates, which were registering permanent decrease.

¹⁷ As of April 15, 2000 The Decision on auction sale of Denar deposits is no longer in effect, and the Decision on auction sale of NBRM's credits entered into force (“ Official Gazette of the Republic of Macedonia “ No. 24, March 29, 2000)

Chart 21

Dynamics of the interest rates at the CB' auctions

(in %, on annual basis)

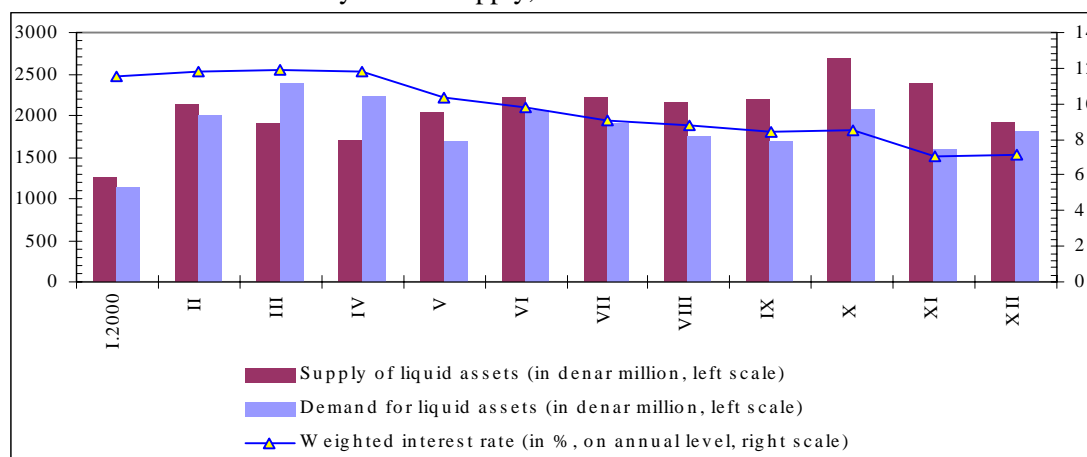


In addition, in 2000 NBRM made qualitative modification of the instruments for monetary regulation directed towards their modernization and complete conversion to market based monetary policy instruments. Namely, as of April 2000, at the CB' bills auctions two types of tenders are organized: “interest rates tender”, where the interest rate is market - oriented and “volume tender”, where the interest rate is set by the NBRM. The average weighted CB' bills interest rate at the “ interest rates tender” was tending to decrease and in December it was reduced to 6.8%, on annual basis. Relative to May 2000, when this tender became operational, this interest rate was reduced by 3.0 percentage points. At the “ volume tender”, the interest rate set by NBRM was higher and equaled 9.4%, on annual basis. Starting from November 2000 it was went over towards a more flexible approach regarding the setting of the CB' bills interest rates at the “interest rate tender”. Thus, in December 2000, the CB' bills average weighted interest rate at the “ volume tender” equaled 7.1%, on annual basis.

The money and short-term securities market movements in 2000, were correspondent with the changes in the level of the banking system's liquidity. In general, the relatively high banks' liquidity determined situation of excess supply relative to the demand of liquid assets at the money market, which influenced the interest rates movements at this market. Thus, the weighted annual money market interest rate in 2000 equaled 9.7%, on average and relative to 1999 was lower by 7.7 percentage points. Dynamically observed, the downward trend of the average weighted money market interest rate in the second half of 1999 was shortly interrupted in February and March 2000, reaching 11.9% in March, which represents the highest level in 2000. During the rest of the year, the money market interest rate was registering permanent decrease until November 2000, when it was reduced to the historically lowest level of 7.0%. In December 2000, a slight increase was registered, with average weighted money market interest rate equaling 7.1%, on annual basis.

Chart 22

Money market supply, demand and interest rates



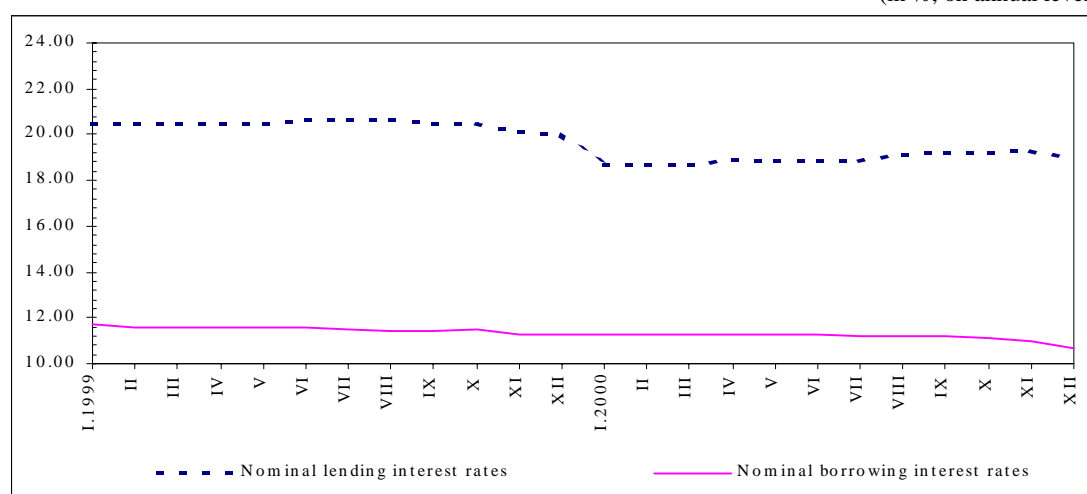
The considerably improved liquidity of the banking system in 2000, did not result in more significant decrease in the banks' interest rates, which represents an indicator of the high banks' interest rates non - responsiveness to the money market movements and the changes in the monetary policy. Namely, the nominal weighted lending interest rates of the deposit money banks in 2000 remained at a relatively high level, equaling 18.9%, on average. Relative to 1999, they are lower by 1.6 percentage points, which represents certain convergence to their level, relative to the several previous years (in 1999 the change equaled 0.5 percentage points, and in 1998 it equaled 0.4 percentage points). At the same time, the banks' nominal weighted deposit interest rates decreased by 0.3 percentage points and on average equaled 11.2%, on annual level. These movements determined decrement in the interest rates spreads by 1.3 percentage points, thus in 2000, equaling on 7.7 percentage points, on average. However, the interest rates spreads are still higher in comparison with other countries in transition by 3 - 4 percentage points.

With positive inflation rates on monthly level, especially the relatively high monthly inflation rate in April 2000, the banks' real lending and deposit interest rates registered relatively low levels and equaled 6.5% and -1.4%, respectively (21.6% and 12.6%, respectively, in 1999).

Chart 23

Nominal lending and deposit interest rates of the Deposit Money Banks

(in %, on annual level)



The maintenance of high interest rates and interest rates spreads in 2000 indicates that the interest rates policy of the banks is still influenced by systemic and fundamental factors, as follows:

a) The low level of domestic savings, despite the upward trend of the banks' deposits in the second half of 1999 and in 2000. It is primarily due to the relatively low - income level, which represents the main savings' constraint factor. The insufficient level of confidence in the banking system, problem which is mainly legacy from the past, also has negative effect to the domestic savings. However, the Law on Deposits Insurance Fund which entered into force in July 2000, by which higher percent of deposit insurance is provided (100% for deposit of individuals up to EURO 1,500, i.e. 90% for deposits between EURO 1,500 and EURO 7,500), the enhanced banking supervision and the issued government bonds for the old foreign savings are expected to result into gradual enhancement of the economic agents confidence and improvement of the level of savings mobilization in the banking system;

b) The high demand for banks' credits, which is derived from the traditional orientation of the enterprises for funds borrowing from the banks, despite the functioning of the stock exchange. The reforms in the enterprise sector and the more adequate positioning of the stock exchange in the structure of the Macedonian financial system are the necessary prerequisites for overcoming this situation, which have to act in direction of reduction of the banks' lending interest rates;

c) The financial indiscipline, reflected through the high share of the overdue claims in the banks' portfolio. The low quality of the banks' portfolio is determined by the economic situation as a whole, as well as by the disability of the banks for "complete control" over their clients, taking into account the current setting of the payment system. The payment system reform, directed towards complete transfer of the payment operations within the banks, along with the enhanced role of the banking management, in accordance with the new Law on Banks, entered into force in July 2000, are the key factors which will act in direction of more efficient credit portfolio management by the banks;

d) The inefficiency of the legal procedures regarding the collection of collateral. The new Law on Consensual Mortgage and the changes of the current Law on Executive Procedure in 2000, are expected to accelerate the process of collateral collection, by which the adverse effect of this factor on the banks' interest rate policy would be limited;

e) The insufficient competition in the banking system which induces existence of high interest rates spreads. The entrance of foreign capital in the banking system and especially in the largest bank, is expected to improve the competition in the banking system and to increase the supply of financial assets, by which it can act in direction of interest rates and interest rates spreads reduction.