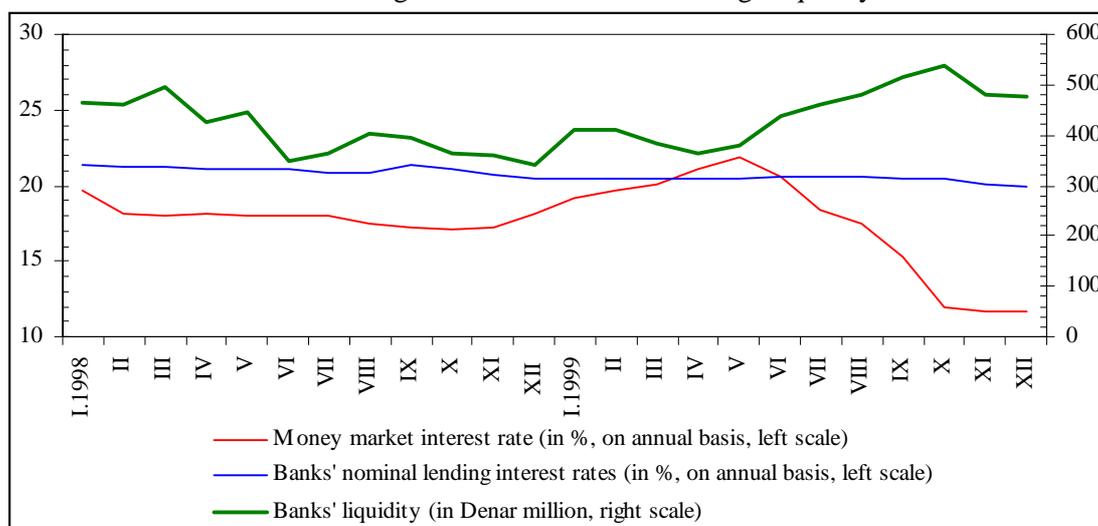


V. Interest Rate Policy

In 1999, one of the main characteristics of banks' interest rates movements was their high rigidity. Namely, banks' interest rates remained unchanged during 1999, regardless of the character of the monetary policy and the fluctuations of the economic movements in the country. This shows that the interest rate policy of deposit money banks, as in the previous years, was not guided only by market principles, but also by systemic and fundamental factors: a/ domestic savings within the banking system (despite the registered increase of deposits in the second half of 1999) are still at a relatively low level. The banking supervision, the Deposit Insurance Fund, and the entrance of foreign banks play the key role in the process of restoring the public confidence and in mobilization of the savings in the banking system; b/ high demand for loans, due to the traditional orientation of the enterprises towards borrowing from the banks. Bearing in mind the underdeveloped capital market, high demand for bank loans drains out the banks' deposit potential, determining high level of lending interest rates; c/ high share of "bad" loans in the banks' portfolios, due to the difficulties in the collection of the banks' claims on their borrowers, reflecting the situation in the real sector. This situation emphasizes the need for more efficient credit portfolio management by banks; d/ inefficient legal procedures, regarding the collection of collateral. In terms of slow collection of collateral, the non-collected assets from the borrowers are compensated by high interest rates; e/ inefficiency and high costs of the banks, that reflects the insufficient competition in the banking sector and determines high interest rate margins.

Chart 19

Nominal weighted interest rates and average liquidity



The average weighted nominal lending rate of deposit money banks in 1999 was 20.5% per annum, which is by only 0.5 percentage points lower compared to 1998. At the same time, the average weighted nominal deposit rate equaled 11.5% on annual level, compared to 11.6% in 1998. Having in mind the high price stability, lending and deposit rates in real terms remained relatively high, 21.6%, and 12.6%, respectively. In that manner, interest rate margin remained high as well, and equaled 9 percentage points, which is by only 0.5 percentage points below its level in 1998.

High lending rates of deposit money banks were a significant constraint for intensification of the economic activity in the Republic of Macedonia. Thus, in 1999, the necessity for further reforms of the banking system remained, accompanied with banks internal restructuring, entrance of foreign capital in the domestic banking sector, and finally,

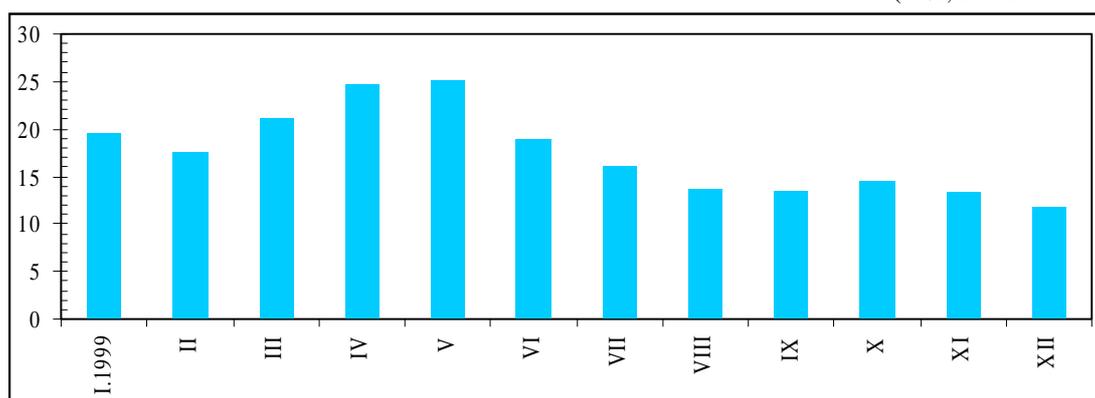
establishment and implementation of the relevant law regulation. These are fundamental pre-conditions for creation of stimulative working ambience, and reduction of the banks' interest rates.

The average weighted interest rate achieved on auction of deposits with 7-day maturity was high in 1999, and equaled 17.9% on annual level. Compared to the corresponding one in the previous year, it was higher by 3.0 percentage points. The minimum interest rate on deposit auctions, that is set by NBRM, during 1999, compared to 1998, was unchanged, and equaled 11.0% per annum.

Chart 20

Average weighted interest rates created on auction of deposits with 7-day maturity

(in %, on annual level)



With respect to dynamics, the changes of the weighted interest rate achieved on deposit auctions were determined by the supply and demand of deposits at auction. In the first quarter of 1999, the interest rate on deposit auction's was higher and equaled 19.5%. It was due to the increased demand for liquid assets, determined by the significant deposits outflow from the banking system, because of the increased political risk and the psychological factors in the period prior to the beginning of the military actions in Kosovo. Additional pressure was made by the implementation of more restrictive monetary policy, caused by the need for maintaining stable Denar exchange rate against the Deutsche mark, despite the shortage of foreign exchange on the market. In the March - June 1999 period, the liquidity of the banking system deteriorated, due to the large outflow of funds from the banks and difficulties with the collection of the claims, because of the war in FR Yugoslavia. This resulted in an increased demand for deposits on auctions, and even higher increase of the average interest rate on deposit auctions in the second quarter (23.0%). In addition, on certain days in May 1999, this interest rate reached the highest level of 29.9%. After the end of the war in the neighborhood (June 1999), a period of normalization of the interest rates began. Namely, in the second half of the year, the banks' demand for liquid assets declined, as a result of more relaxed monetary policy determined by the high purchase of foreign exchange on the market. Improved liquidity of the banking system in the third quarter of 1999 resulted in lower demand for liquid funds on deposit auctions, and the average weighted interest rate was brought down to 14.4%. This significant interest rate decline, even at a faster pace, continued in the last quarter of the year, when the average interest rate was brought down to 13.2%. In addition, its lowest level of 11.8% was registered in December 1999.

During 1999, a total turnover of Denar 19,795 million was realized on the money and short-term securities market, which is by 67.1% more relative to the previous year. The movements on the money market corresponded with the changes in the liquidity of the banking system. With respect to dynamics, in the first half of 1999, excluding April, the total turnover on the money market had an increasing tendency, and in June 1999 it reached the highest level (Denar 2,392 million). However, in the second half of the year, excluding

October, the total turnover had a declining path, and in December 1999 it was brought down to Denar 1,160 million, which is the lowest level registered since the beginning of 1999. The average annual weighted interest rate on the money market in 1999 was 17.4%. In the first two months of the year it equaled 19.3%, on average, while in the March - June 1999 period, due to the increased demand for liquid funds, it remained at the level of 20.9%, on average. In the second half of the year, due to the normalization of the situation and decreased demand for liquidity, the average weighted interest rate on the money market had a downward trend and in the last two months of the year it was brought down to 11.6%, on annual basis.

Table 15

Maturity and interest rates of NBRM bills

January - October 1999		November - December 1999	
Maturity (in days)	Interest rate (in %, on annual basis)	Maturity (in days)	Interest rate (in %, on annual basis)
7	6.5	7	6.0
14	8.0	14	7.5
30	10.0	28	9.5
40	10.5	42	10.0
60	11.0	56	10.5
90	12.0	91	11.0

In November 1999, the maturity of the NBRM bills was changed, and their interest rates were reduced. The discount rate and interest rate on Lombard credits during 1999 remained unchanged and equaled 8.9%, and 18.5% per annum, respectively. Reduction of the NBRM bills' interest rates was a result of the necessity for their adjustment with the level of the interest rates on deposit auctions and money market, because of their continuous downward trend. Hence, since the interest rate of NBRM bills, as low risk securities, was higher than the interest rates of financial instruments with higher risk level, a reduction of the interest rates on NBRM bills' was conducted.