

## V. Interest Rate Policy

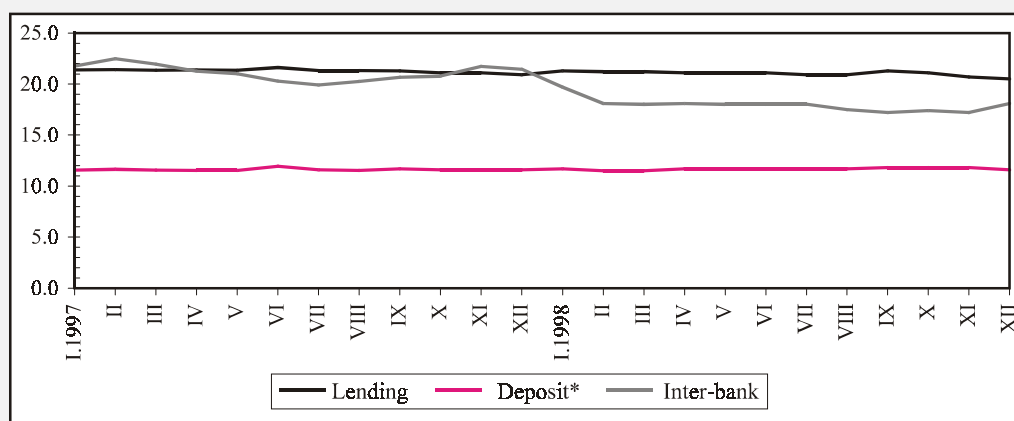
Under unchanged fundamental factors and systemic conditions, interest rates in 1998 remained on high and economically unreasonable level. In that way, interest rates continued to be a factor that constrains the investment activity, and respectively the rate of growth of Macedonian economy.

The average weighted nominal lending rate in 1998 was 21.0% on annual level, that is only 0.4 percentage points lower than in 1997. Average weighted deposit rate in 1998 was 11.7% per annum, compared to 11.6% in 1997. Having in mind the low and stable rate of inflation (deflation, on some indicators of prices), high nominal rates resulted in high real interest rates. Real lending rate in 1998 reached in average 21.4%, and average real deposit rate was 12.0% on annual level.

Chart 13

### Lending, Deposit and Inter-bank Interest Rates

(in %, on annual level)



The main factor of high interest rates in the Republic of Macedonia is the low saving rate, determined by low disposable income. The low supply of available funds, compared to increasing demand for loans, inevitably leads to high lending rates. The situation worsened in the last few years, due to the negative experience of depositors with the so-called “old foreign exchange deposits” (foreign exchange deposits captured by former SFR Yugoslavia Central Bank), and failure of some banks and savings houses. As a result of these factors, even high deposit rates were not sufficient to attract more depositors and to increase significantly the saving rate. The establishment and well functioning of the Deposit Insurance Fund, together with the improved supervision of the banks, are necessary but not sufficient conditions for improvement of the situation with respect to saving. The resolution of the problem of “old” foreign exchange saving and expected entrance of foreign banks, can be significant factors for restoring the public confidence in the banking system.

Beside low saving rate and undermined credibility of the banking system, important factor that has a negative impact on the interest rate policy is lack of financial discipline. Slow resolution of disputes on mortgages by courts, and problems in collection of claims that Macedonian banks are facing with, resulted in anticipation of high risk premiums, that are built in the lending rates. High banks' costs make additional pressure on interest rates. In order to help banks in reducing some of these costs, in April 1998, the NBRM increased the interest rate paid on required reserves, from 3.4% to 6.3% per annum.

Interest rate margins reached 9.3 percentage points on average in 1998, that is by 0.5 percentage points lower than in 1997. High interest rate margins are an indicator for banks' inefficiency, and for the lack of competition in the banking system. Therefore, the restructuring of the banking institutions, together with the entrance of foreign capital, are necessary preconditions for increasing the competition in the banking sphere, reduction of high interest rates, and improvement of the efficiency of the financial intermediation.

The credit auction rate plays the role of basic interest rate in the Central Bank interest rate policy. The minimum interest rate on the credit auctions was set by NBRM at 11% on annual level. However, the average weighted interest rate realized on the auctions of credit with maturity of 7 days, as a most representative one, reached 14.9% per annum. This rate is by 1.2 percentage points higher than the average rate realized in 1997. However, it is lower by 3.0 percentage points than the average rate realized on the money market in the same period.

Table 15

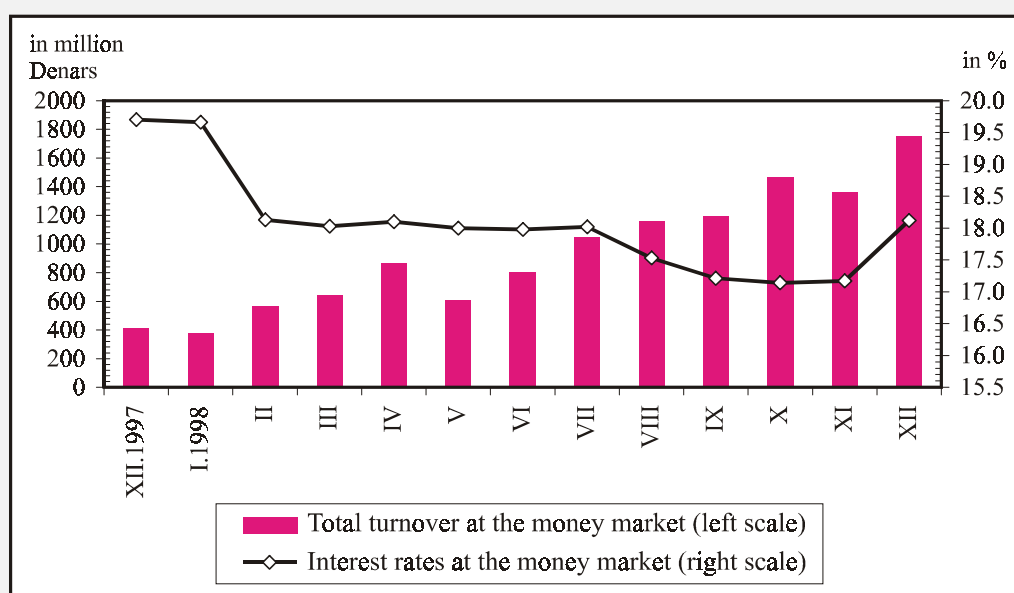
**Maturity and Interest Rates on Credit Auctions**

Weighted interest rates (annual) and maturity (in days) of deposits sold at auction (in %)		
1998	7 days	14 days
January	14.77	11.57
February	15.31	11.57
March	14.25	11.57
April	14.06	
May	13.70	11.57
June	13.86	11.57
July	13.66	
August	14.45	
September	14.42	
October	15.58	
November	16.06	
December	18.59	18.77

In respect of dynamics, movements of credit auction's interest rate were determined by the supply of credits by the NBRM. In the first quarter of 1998, the amount of credits sold at auction declined, as there was a need for neutralization of the excess liquidity

injected at the end of 1997. Therefore, interest rate achieved on credit auctions in the first quarter of 1998 (14.9% on annual basis) was higher than in the second quarter of last year (13.9%), when supply of credits increased. The amount of credits sold at auction again declined in the third quarter of 1998, leading to interest rate rise to 14.2%. In the last quarter of 1998, contrary to the increased volume of credits offered for sale on auction, interest rates rocketed, to level of 16.7% on annual basis. In December 1998, interest rates on credit auctions reached on average 18.6%. The relaxation of fiscal policy in the election period implied the need for strengthening the monetary policy, in order to preserve the exchange rate stability, according to the accepted monetary strategy. This led to an increase of interest rates at credit auctions. The increased demand for currency in circulation at the end of 1998 also had negative influence on the banks' liquidity, affecting simultaneously interest rates on credit auctions.

Chart 14

**Total Turnover and Interest Rates at the Money Market**

In the first year of operation (it started to operate in November 1997), money and short-term securities market achieved solid results. Total turnover realized in 1998 amounted to Denar 11,843 million. Excluding May and November, total turnover was constantly increasing. The realized turnover on the money and short-term securities market in December 1998 was higher compared to December 1997 by Denar 1,339 million, or by 4.2 times. The average annual weighted interest rate on the money market in 1998 was 17.9%. The highest point was reached in January 1998 (19.7% on annual basis), while in the period February - July 1998, the interest rate circulated around 18.0%. In the next four months, interest rate on the money market had a declining path, reaching 17% on annual basis. However, in December 1998, it rose again to 18.1% on annual level.

The increase of interest rates at credit auctions and on the money market in the last quarter of 1998, imposed the rise of lombard credits rate in order to adjust its' level with market determined interest rates. Thus, lombard credit rate in November 1998 was

increased from 14.4% to 18.5% on annual basis. The determination of lombard rate on the higher level than market interest rates enables these loans to perform the function of instrument used as a “last resort”.

In order to increase the attractiveness of the Central Bank bills, in November 1998 NBRM increased the interest rate on its bills. Thus, 30-day bills’ interest rate was increased from 8.24% to 10.0% on annual basis. Interest rates for bills with other maturity structure were increased respectively. This should create conditions for Central Bank bills to have greater role in banks’ balance sheets, expanding the base for collateralized lending when performing the function of “lender of last resort”.