

VI. External Sector

According to the macroeconomic policy for 1998, in the external sector a reduction in the deficit in the current account of the balance of payments was expected, primarily through a more rapid increase in the exports relative to the imports. Regular payments of the liabilities arising from accrued foreign loans was envisaged, at the same time it was expected that the established stable macroeconomic environment would initiate increased inflow of foreign direct investments. Growth of the gross foreign currency reserves of the NBRM was projected for 1998, so that they would eventually amount to the level of 2.3 months of imports. In line with the monetary strategy of the Central Bank it was envisaged that the exchange rate of the Denar against the Deutsche mark would be maintained at the level of 30.92 Denars per Deutsche mark.

6.1. Balance of payments

In 1998 it was expected that the deficit in the current account, expressed as a percentage of GDP, would be lower than the realized deficit in 1997. This was supposed to be realized primarily through the improvement in the trade account of the balance of payments, as a result of the expectations for further increase in the competitiveness of Macedonian goods at the world markets, having in mind the continuous increase in the labor productivity, the devaluation of the Denar in 1997, the administrative regulation of wages in the not fully privatized economic entities and the easier access to foreign markets after the signing of agreements between the Republic of Macedonia and the EU, and other regional trade agreements. The monetary and fiscal policies were directed toward the same aim, in line with the macroeconomic framework for 1998 agreed through the ESAF arrangement with the International Monetary Fund.

Contrary to the expectations that there would be a reduction in the deficit, the trend of a worsening current account of the balance of payments of the Republic of Macedonia continued in 1998. Namely, the registered current account deficit in 1998 was USD 289 million, which relative to the previous year deficit is by 4.7% higher. Running a deficit in the current account is a usual occurrence in countries in transition due to their need for more rapid economic growth in conditions of insufficient level of domestic saving. In 1998, the deficit in the current account of the balance of payments of the Republic of Macedonia amounted to 8,1% of GDP and compared to the deficits registered in 1997 and 1996 it is higher by 0,7 and 1,6 percentage points, respectively.

The component which determined the widening of the current account deficit was the trade account. The deficit in the trade account in 1998 was USD 400 million¹⁴

¹⁴ The deficit in the trade account of the balance of payments differs from the deficit in the foreign trade presented by the Statistical Office. The reason for this is that the imports in the balance of payments are presented on f.o.b. basis, while the official statistics presents imports on c.i.f. basis.

and compared to the previous year it increased by 3.6%. In addition to this, it should be taken into account that the increased deficit in the trade account, among other things, is a result of the imports of some goods (aircrafts) absent in 1997.

At the same time, the deficit in the net services increased by 17.0% and reached USD 172 million. This was mainly due to the increase in the “other net services” (aside from net services from tourism and transport) group, and primarily in business services.

Table 16
Balance of Payments

	1997				1997	1998 ¹				1998
	Q1	Q2	Q3	Q4		Q1	Q2	Q3	Q4	
I. Current Account	-89	-60	-20	-107	-276	-86	-61	-17	-125	-289
GOODS, net	-71	-83	-87	-145	-386	-74	-101	-71	-155	-400
Exports of goods, f.o.b.	275	299	313	350	1237	295	338	341	348	1322
Reported exports	275	299	313	350	1237	295	338	341	348	1322
o/w: processing	91	89	112	128	420	130	143	152	155	579
Imports of goods, f.o.b.	-346	-382	-400	-494	-1623	-368	-439	-412	-503	-1722
Reported imports, f.o.b.	-340	-377	-395	-489	-1601	-368	-439	-412	-503	-1722
Coverage adjustment	-6	-6	-5	-6	-22	0	0	0	0	0
Aid and grants	0	0	0	0	0	0	0	0	0	0
Individuals	-6	-6	-5	-6	-22	0	0	0	0	0
SERVICES, net	-29	-36	-32	-49	-147	-39	-45	-39	-49	-172
INCOME, net	-8	-2	-15	-8	-34	-8	3	-12	0	-17
o/w: interest, net	-13	-7	-20	-15	-55	-14	-3	-19	-9	-44
CURRENT TRANSFERS, net	19	61	115	95	290	34	81	105	80	300
Official /2	1	1	1	5	7	8	4	4	12	28
Other	18	60	114	90	283	26	77	101	67	272
II. Capital and Financial Account	58	76	99	100	333	80	74	16	165	335
CAPITAL ACCOUNT, net	0	0	0	0	0	0	0	0	-2	-2
Capital transfers, net	0	0	0	0	0	0	0	0	0	0
Official	0	0	0	0	0	0	0	0	0	0
Other	0	0	0	0	0	0	0	0	0	0
Acquisition/disposal of nonprod., nonfinan. assets	0	0	0	0	0	0	0	0	-2	-2
FINANCIAL ACCOUNT, net	58	76	99	100	333	80	74	16	167	337
Direct investments, net	3	2	2	9	16	1	21	40	56	118
Portfolio investment, net	0	0	0	2	2	1	2	1	4	8
Other investment, net	55	74	97	89	316	78	52	-25	106	211
Trade credits, net	42	72	56	97	267	27	19	-5	44	85
Loans, net /3	10	21	48	-2	77	29	25	42	88	184
Foreign currency and f.c. deposits, net	4	-19	-7	-7	-29	22	8	-61	-26	-57
o/w: Commercial banks, net	4	-19	-7	-7	-29	22	8	-35	-26	-31
III. Errors and omissions	6	-5	-29	0	-28	0	14	-1	-35	-21
IV. Total balance	-26	11	50	-6	29	-7	28	-2	5	24
V. Financing	26	-11	-50	6	-29	7	-28	2	-5	-24
Net change in official reserves /4	21	-11	-20	0	-11	7	-28	-2	-9	-32
Gross foreign assets /5	21	-24	-20	-13	-35	7	-40	0	-9	-42
IMF	0	12	0	12	24	0	12	-1	0	10
Changes in total arrears	-75	1	-30	0	-105	0	0	0	0	0
New arrears	5	1	0	0	6	0	0	0	0	0
Multilateral creditors	1	1	0	0	2	0	0	0	0	0
Bilateral creditors	0	0	0	0	0	0	0	0	0	0
Commercial banks - London Club	5	0	0	0	5	0	0	0	0	0
Other commercial creditors	0	0	0	0	0	0	0	0	0	0
Repayment of arrears	-80	0	-30	0	-111	0	0	0	0	0
Other multilateral creditors	0	0	0	0	0	0	0	0	0	0
Bilateral creditors	0	0	0	0	0	0	0	0	0	0
Commercial banks - London Club	-80	0	0	0	-80	0	0	0	0	0
EIB	0	0	-30	0	-30	0	0	0	0	0
Rescheduling	80	0	0	6	86	0	0	4	4	8

1/ Preliminary data

2/ Data from the Ministry for development

3/ Excluding the IMF

4/ End of period; an increase in assets is denoted by a negative sign; including the IMF

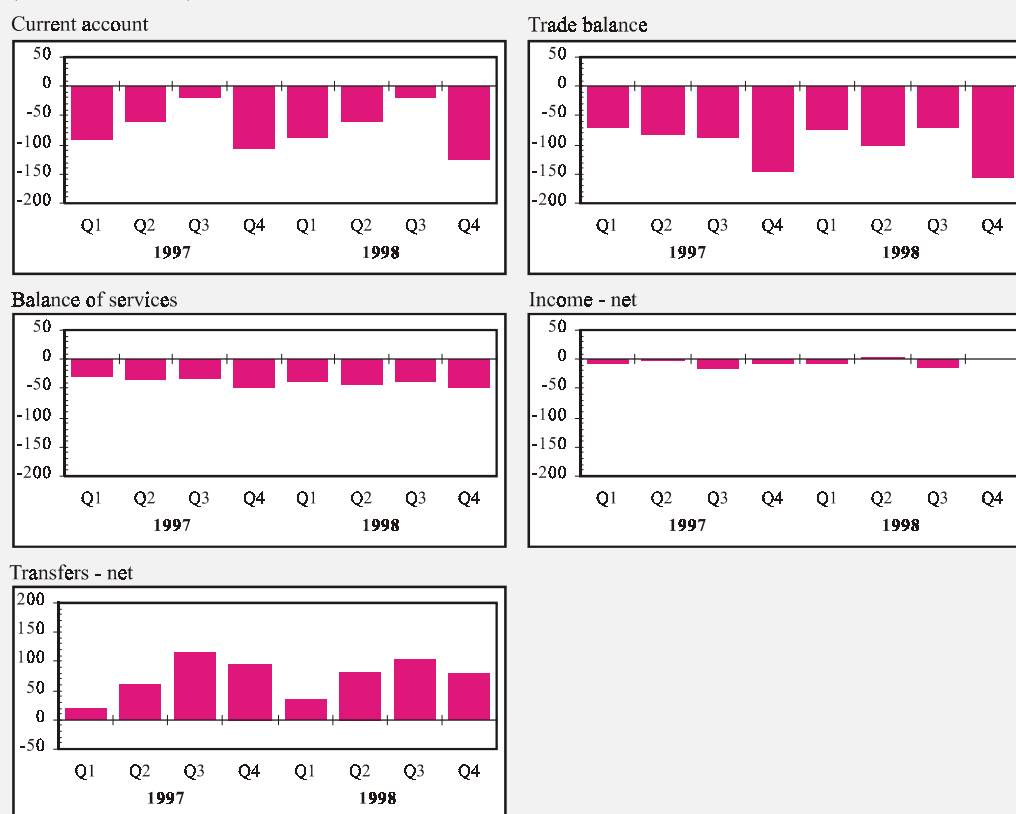
5/ Excluding the effects of exchange rate differentials

The components of the balance of payments of the Republic of Macedonia which experienced positive movements in 1998 are net income and net current transfers. The deficit in the net income was USD 17 million and compared to the previous year it is almost halved. This is a result of the reduced deficit in the net interest, due to the combined effects of the increase in inflows on the basis of interest on foreign currency deposited abroad and the lower amount of accrued interest on used medium-term and long-term loans in the course of the year.

Chart 15

Components of the Current Account of the Balance of Payments

(in USD million)



Net current transfer is a component of the balance of payments of the Republic of Macedonia which is continuously running a surplus. In 1998, the surplus amounted to USD 300 million and compared to the previous year is by 3.4% higher. This is a result of the increased net official transfers by USD 20.8 million, primarily due to the increase in the inflow of goods by USD 19,8 million. At the same time, surplus was realized in the net private transfers in the amount of USD 271.6 million, even though compared to the surplus from the previous year it is by USD 11,2 million, or 4.0% lower. In the context of private transfers, on the basis of transfers by individuals, the net inflow in 1998 was USD 49.4 million.

In 1998, the deficit in the current account of the balance of payments was financed solely through net financial transactions, because the net capital transactions account run a USD 2 million deficit. The large inflow of foreign direct investments in the amount of

USD 118 million, which is more than the cumulative inflow in the entire period from the monetary independence, represents the most significant change in the financing of the deficit in the current account of the balance of payments. The entire inflow of net financial transactions reached USD 337 million, out of which 62.6% are inflows from the “other investments, net” category (consisting of: trade credits, loans, foreign currency and deposits on net basis), followed by the net direct investments and net portfolio investments with shares of 35.0% and 2.4%, respectively.

Beside the “other investments, net” category, the deficit in the current account of the balance of payments in 1998 was financed through the increased inflow of net direct investments and net portfolio investments. In addition, net foreign investments in 1998 reached USD 118 million or 3% of GDP. The inflow of assets through foreign direct investments is the best alternative way of financing the domestic investment activity when the level of domestic savings is low and insufficient. At the same time, according to the experiences of the more advanced transition economies, it is expected that the inflow of foreign direct investments will boost exports growth and the economic growth in the following period.

The net portfolio investments in the Republic of Macedonia in 1998 were USD 8 million. This represents an increase of USD 6 million relative to the previous year. On one hand, the level of net portfolio investments is extremely low, which is primarily a consequence of the absence of government bonds and securities. However, on the other hand, the low level of these investments reduces the danger of major financial shocks and turbulence which may arise from their instability.

In the “other investment, net” category, in 1998 relative to 1997 there was a large fall in the net trade loans by USD 182 million, or 68.2%, which brought them down to USD 85 million. On the other hand, net loans (excluding net used assets from the International Monetary Fund and the rescheduling of the debts towards the London Club of Creditors) reached USD 183.9 million, which represents an increase by USD 107 million, or 139.0%.

Besides the financing of the deficit in the current account of the balance of payments in the amount of USD 289 million, the inflow of assets on the basis of net financial transactions in the amount of USD 337 million in 1998 caused an increase in the official reserves by USD 32 million. With the rescheduling of the liabilities arising from foreign loans in the amount of USD 8 million, the remaining part of the inflow of net financial transactions was leveled through statistical errors and omissions, which had a negative sign and amounted to USD 21 million. The value of statistical errors and omissions in 1998 was by 25.0% lower than in 1997, which shows the improvement in the statistical procedures in following the changes in the balance of payments.

In June 1998, the Republic of Macedonia accepted the obligations of Article VIII, parts 2, 3 and 4 of the Status of the International Monetary Fund. Hence, the convertibility of the Denar for foreign current payments was officially confirmed in the Republic of

Macedonia. This means that the Republic of Macedonia takes on the obligation not to impose restrictions on the foreign current payments. At the same time, the acceptance of the obligations stemming from Article VIII, parts 2, 3 and 4 represents an indicator for the international community that the Republic of Macedonia is implementing consistent economic policy, as a contribution to the more efficient functioning of the multilateral system of payments. Namely, for the economic entities working in the Republic of Macedonia, the official recognition of the convertibility of the Denar for foreign current payments means a possibility for free payments and transfers of the current liabilities in foreign currency. From the balance of payments viewpoint, the significance of the acceptance of Article VIII is that it enables an easier attraction of foreign direct investment, with respect to the benefits offered to foreign investors for a transfer of their profit without being taxed.

6.2. Foreign trade¹⁵

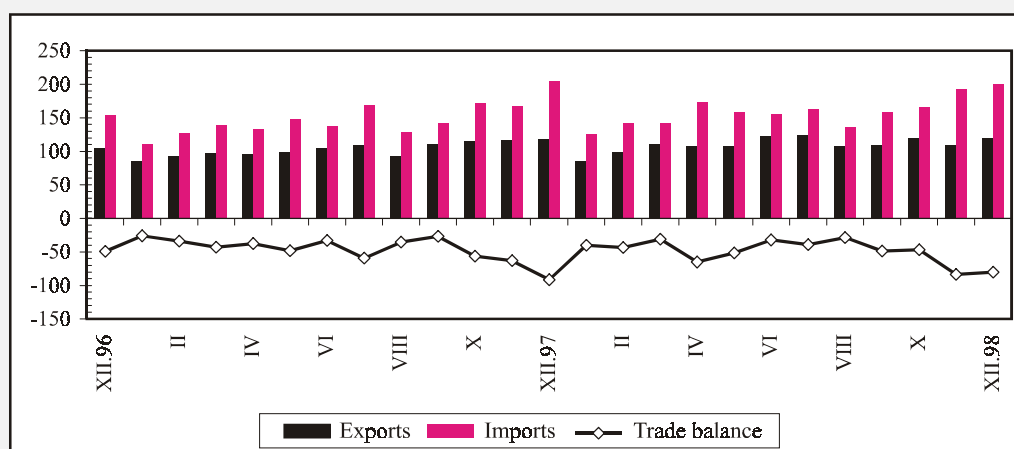
The total value of the exports realized by the Republic of Macedonia in 1998 was USD 1,322 million, which compared to the previous year is by 6.9% higher. The increase in imports was mainly a result of the easier access to the EU markets after the signing of the agreement for economic cooperation with this group of countries. Still, the most positive effect over the increase in the competitiveness of Macedonian products came from the continuous increase in labor productivity and the reduction of the unit labor costs.

However, the realized increase in exports in 1998 was below the projected level by 3.6 percentage points. This was primarily a result of external shocks: a) the unfavorable development of events in the closest vicinity (the unrest in Kosovo, FR Yugoslavia); b) the administrative measures that FR Yugoslavia implemented in the second half of the year, which is one of the biggest markets for Macedonian products, which discouraged exports to this country; c) the fall of prices of metals on the world markets.

Chart 16

Foreign Trade of the Republic of Macedonia

(monthly data, in USD million)



¹⁵ Preliminary data of the Statistical Office of the Republic of Macedonia.

On the other hand, in 1998 the imports of goods in the Republic of Macedonia equaled USD 1,913 million. Compared to 1997, this represents an increase in imports by 7.6%. The realized rate of growth of imports exceeded the projected one for 1998 by 2.6 percentage points. If the import of “incidental” goods is removed from the analysis, the rate of growth of imports in 1998 is 5.5% and exceeds the projected one only by 0.5 percentage points. The high rate of growth in imports shows the dependence of the Macedonian exports economy on the imports which determines a relatively high foreign trade deficit in the medium-term.

The net increase in imports in 1998 resulted in a deficit in the foreign trade of the Republic of Macedonia. The deficit reached USD 591.5 million and is by USD 49.7 million, or 9.2%, higher than the deficit realized in the previous year. The import-export coverage ratio was reduced from 69.5% in 1997 to 69.1% in 1998.

From the aspect of the structure of the foreign trade of the Republic of Macedonia in 1998, with respect to the production stage of the traded goods, the following conditions were registered. On the exports side, in 1998 compared to 1997, the value of goods which were processed increased by 37.7%. Hence, the share of these goods in the total value of exports increased from 34.0% to 43.8%. On the other hand, the regular export, not based on processing of imports in 1998 decreased by 9.0% relative to the previous year. As a result of this, the share of regular exports was reduced from 66.0% in 1997 to 56.2% in 1998. This shows that on the exports side, there is a growing dependence of the exports on the so-called “tolling manufacturing” arrangements, which are most frequently based on the exploitation of cheap labor force. This dependence makes the Macedonian exports sensitive to situations in which the foreign partners might find cheaper labor force outside the Republic of Macedonia.

Table 17

Foreign Trade of the Republic of Macedonia

(in USD million)

	EXPORTS			IMPORTS			BALANCE		
	total	goods for processing	excluding goods for processing	total	goods for processing	excluding goods for processing	total	goods for processing	excluding goods for processing
	1	2	3	4	5	6	7=1-4	8=2-5	9=3-6
1997	1236.81	420.12	816.69	1778.52	436.35	1342.17	-541.71	-16.23	-525.48
Q1	274.53	91.46	183.07	377.67	73.51	304.16	-103.14	17.95	-121.09
Q2	299.43	88.72	210.71	418.46	99.10	319.36	-119.03	-10.38	-108.65
Q3	313.01	112.05	200.96	439.38	112.45	326.93	-126.37	-0.40	-125.97
Q4	349.84	127.89	221.95	543.01	151.29	391.72	-193.17	-23.40	-169.77
1998	1322.06	578.58	743.48	1913.50	431.24	1482.26	-591.44	147.34	-738.78
Q1	294.81	129.86	164.95	409.41	94.31	315.10	-114.60	35.55	-150.15
Q2	337.96	142.88	195.08	487.43	135.89	351.54	-149.47	6.99	-156.46
Q3	341.16	151.61	189.55	457.77	102.43	355.34	-116.61	49.18	-165.79
Q4	348.13	154.23	193.90	558.89	98.61	460.28	-210.76	55.62	-266.38

On the imports side, in 1998 there was a fall in the imports of goods for processing and growth of regular imports, namely imports of goods not to be processed later on. In 1998 the value of imported goods for processing was USD 431.2 million and is by 1.2%

lower than the previous year. At the same time, the value of regular imports reached USD 1,482.3 million and is by 10.4% higher than the corresponding one in 1997. The fall in the imports of goods for processing in the course of the year has negative implications over the volume of exports.

Analyzed from the viewpoint of the economic use of goods, in 1998 the largest part of the exported goods (48.9%) are reproduction goods, out of which 75.8% are raw materials and semi-manufactures. Next category, according to the economic use of the traded goods, are consumption goods, with a share of 47.0% in the total value of exports. The largest part (64.0%) of the export of consumption goods are exports of clothing and shoes. Means of production account for only 4% in the structure of total exports. The structure of exports of the Republic of Macedonia, according to the economic use of the exported goods in 1998, reflected the permanent unfavorable structure of the Macedonian economy, which is represented on the world markets primarily with goods with a low level of processing, meaning low volume of value added. In 1998, some of the goods with the largest share in the total exports of the Republic of Macedonia are: hot-rolled iron products (6.0%), shirts for men (5.4%) and not-alloyed zinc (4.1%).

Table 18
Foreign Trade by Economic Use of Goods
(in USD 000)

Products	Exports			Imports		
	1997	1998	index 1998/1997	1997	1998	index 1998/1997
Republic of Macedonia (total)	1,236,807	1,322,052	107	1,778,514	1,913,475	108
1. Reproduction goods	650,018	645,922	99	1,087,656	1,242,491	114
raw materials and semi-manufactures	498,404	489,864	98	507,621	442,225	87
fuel	4,358	9,906	227	181,166	147,550	81
other reproduction goods	147,256	146,152	99	398,869	652,716	164
2. Means of production	42,099	52,924	126	188,526	247,314	131
plant machines	253	653	258	6,984	8,672	124
agricultural machines	142	166	117	5,450	8,612	158
metal processing machines	762	578	76	1,832	4,017	219
other machines and appliances	5,037	5,316	106	82,209	78,124	95
electrical machines and appliances	9,418	8,785	93	34,372	44,866	131
transportation means	11,146	19,325	173	11,524	56,404	489
other investment goods	15,341	18,101	118	46,155	46,619	101
3. Consumption goods	543,338	621,694	114	491,610	412,134	84
food	68,046	63,219	93	157,652	178,508	113
beverages and tobacco	113,796	94,213	83	8,603	10,188	118
clothes and shoes	294,184	398,078	135	144,223	24,023	17
furniture	2,607	3,127	120	10,235	11,738	115
textiles (excluding clothes)	20,174	20,209	100	9,521	6,636	70
medicine, pharmaceuticals and cosmetics	27,705	26,255	95	42,859	47,098	110
other consumption goods	16,826	16,593	99	118,517	133,943	113
4. Residual	1,352	1,512	112	10,722	11,536	108

On the imports side, the situation in 1998 was more favorable, because most of the imported goods are reproduction goods. Part of the imported goods for reproduction refers to import of fuel, purchased in greater quantities due to the fall of the price of oil at world markets. This is followed by imports of consumer goods (21.5%) and imports of means of production (12.9%). Compared to the previous year, in 1998 there was a positive

change in the structure of imported goods according to their economic use, with the reproduction goods and means of production increasing their shares by 3.7 and 2.3 percentage points, respectively, on the expense of the reduction in the share of the consumer goods by 6.1 percentage points. In 1998, the largest fall in the consumer goods was realized in the imports of clothing and shoes (USD 120.2 million, or 83.4%). Having in mind the reduction in the imports of goods for reprocessing, the increase in the imports of reproduction materials contributed to the boost of the production for the domestic market. Goods with the largest shares in the total import of the Republic of Macedonia in 1998 are as follows: oil (4.6%), motor vehicles (3.3%), aircrafts (1.9%) and wheat (1.8%).

From the viewpoint of the foreign trade by groups of countries, in 1998 there was an increase in the total value of foreign trade with all of the important economic groups of countries. With that, in 1998 relative to the previous year, the foreign trade deficit of the Republic of Macedonia realized in the foreign trade with developed and developing countries was reduced, while at the same time the deficit in the foreign trade with the countries from Central and eastern Europe, and the former Yugoslav republics, widened.

The volume of exchange of goods between the Republic of Macedonia and the developed countries in 1998 amounted to USD 1,749 million and compared to the previous year it is by 12.2% higher. At the same time, Macedonian deficit in the exchange of goods with these countries was reduced by 37.9% and brought down to USD 105 million.

Table 19

Foreign Trade of the Republic of Macedonia by Economic Groups of Countries
(in USD million)

Economic group of countries	1997			1998		
	Exports	Imports	Total	Exports	Imports	Total
1. Developed countries	695	864	1,559	822	927	1,749
1.1. European Union	462	659	1,120	584	694	1,278
1.2. EFTA	87	29	116	45	36	81
1.3. Other developed countries	146	176	322	192	197	390
2. Developing countries	24	113	137	33	114	147
3. Central and Eastern European countries	123	360	483	109	400	509
4. Former SFRY republics	393	420	813	355	465	820
5. Other countries	2	22	24	3	7	10
Total	1,237	1,779	3,015	1,322	1,913	3,236

In accordance with the intention of the Republic of Macedonia to increase the cooperation with the EU, the trade flow with this economic group of countries was increased by 14.1%, and its share in the total foreign trade of the Republic of Macedonia in 1998 reached 39.5%. Exports to the EU increased their share in the total Macedonian exports from 37.4% in 1997 to 44.2% in 1998, which shows that the agreement on economic cooperation that the Republic of Macedonia signed at the beginning of 1998 eased the export of Macedonian goods on this market. At the same time, the deficit in the foreign trade with the EU was USD 109 million and was by 44.4% lower than the corresponding one in 1997.

In 1998, the foreign trade of the Republic of Macedonia saw a striking increase in the deficit registered in the trade with the former Yugoslav republics. Even though the total volume of the foreign trade increased very little, the deficit increased from USD 27.4 million, realized in 1997, to USD 110.4 million in 1998. With the exception of Bosnia and Herzegovina, in 1998, the Republic of Macedonia realized deficit in the trade with all of the former Yugoslav republics, with the largest deficit being registered in the trade with Slovenia (USD 107.5 million). This shows that the trade agreements signed with these countries had counter-productive effects over the Macedonian foreign trade.

Observed from the point of view of individual countries, the most important trading partners of the Republic of Macedonia in 1998 were: Germany, FR Yugoslavia and USA, with respective shares of 16.6%, 15.0% and 8.6%. Major markets for the Macedonian exports in 1998 were Germany with a share of 21.4% in total exports, FR Yugoslavia with a share of 18.2% and USA with a share of 13.2%. Compared to the previous year, the shares of Germany and USA increased by 5.3 and 3.7 percentage points, respectively, while the share of FR Yugoslavia declined by 3.9 percentage points. The fall in the share of FR Yugoslavia in total exports is a consequence of the administrative measures imposed by the Yugoslav government in the second half of 1998, which in turn discouraged Macedonian exports to this country. On the other hand, countries with the largest shares in total imports in 1998 were Germany and FR Yugoslavia, with shares of 13.3% and 12.8%, respectively.

Table 20

Ten Largest Trading Partners

	Volume of trade in USD 000	Share	Exports in USD 000	Share	Imports in USD 000	Share	Imports - exports coverage ratio
I-XII 1998							
Total	3,235,557	100.0	1,322,051	100.0	1,913,506	100.0	69.1
of which:							
Germany	537,863	16.6	283,027	21.4	254,836	13.3	111.1
FR Yugoslavia	482,127	14.9	240,164	18.2	241,963	12.6	99.3
USA	274,914	8.5	175,105	13.2	99,809	5.2	175.4
Greece	205,905	6.4	96,823	7.3	109,082	5.7	88.8
Italy	196,320	6.1	83,339	6.3	112,981	5.9	73.8
Slovenia	190,145	5.9	41,339	3.1	148,806	7.8	27.8
Bulgaria	127,862	4.0	42,591	3.2	85,271	4.5	49.9
Ukraine	122,623	3.8	3,679	0.3	118,944	6.2	3.1
Croatia	118,496	3.7	54,052	4.1	64,444	3.4	83.9
Russia	117,122	3.6	26,098	2.0	91,024	4.8	28.7

In 1998, the Republic of Macedonia registered surplus in the foreign trade with only two of its ten most important trading partners, USA and Germany. The surplus in the trade with USA was USD 73.5 million, meaning an import-export coverage ratio of 172.4%. At the same time, the surplus realized in the exchange of goods with Germany was USD 28.0 million, and an import-export coverage ratio of 111.0%.

On the other hand, the largest deficit was realized in the trade with Ukraine in the amount of USD 115.2 million and an import-export coverage ratio of 3.1%. This deficit is caused by the imports of raw materials (tin) from this country, which after being reprocessed are exported to other markets. The second largest deficit was registered in the trade with Slovenia in the amount of USD 107.5 million and an import-export coverage ratio of 27.8%. This is due to the administrative and other non-tariff barriers which hamper the import of Macedonian goods at the Slovenian market, despite the free-trade agreement between the two countries.

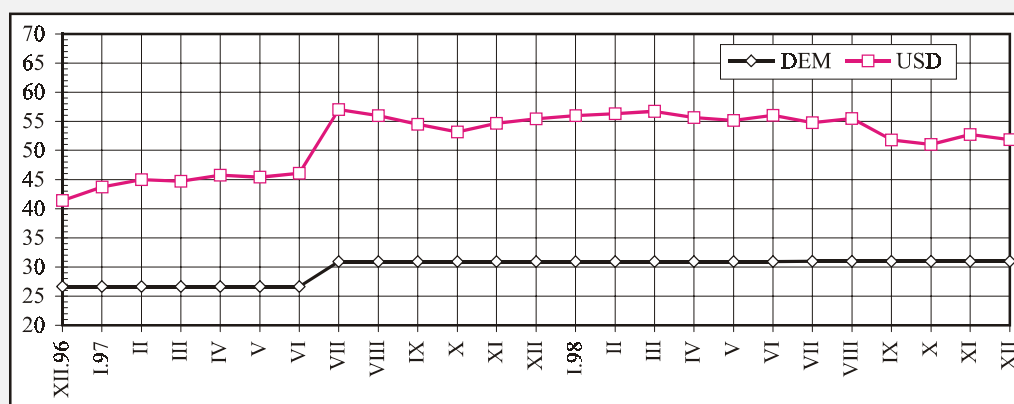
6.3. Denar exchange rate

The fixed nominal exchange rate of the Denar against the Deutsche mark was the main nominal anchor in 1998. In accordance with this, in 1998 the stability of the exchange rate of the Denar against the Deutsche mark was maintained at the level of 30.95 Denars per Deutsche mark. Hence, on the December 31, 1998, the nominal exchange rate of the Denar against the Deutsche mark was 30.98 Denars per Deutsche mark, which represents a 0.2% depreciation when compared to the level achieved at the end of the previous year.

Chart 17

Nominal Exchange Rate of the Denar Against the Deutsche Mark and the US Dollar

(end of period)



Dynamically observed, the biggest fluctuations of the nominal exchange rate of the Denar against the Deutsche mark were registered in October and November 1998. These fluctuations were the consequence of: a) the influence of the psychological factor before and during the regular elections in the Republic of Macedonia; and b) the relaxation of the fiscal policy prior to the elections (payment of increased retirement pensions, holiday bonuses of budget users and alike), which created conditions for greater demand for foreign currency at the foreign exchange market, and resulted with pressure for depreciation of the exchange rate of the Denar. The disproportion between the demand and supply of foreign exchange was especially manifested at the exchange offices market, where the value of the Deutsche mark reached 33.5 Denars per Deutsche mark, which represented a depreciation of around 8%. The turbulence on the exchange offices market were

transferred on the foreign exchange market of the enterprises and banks, where on certain days the Deutsche mark reached the level of 32.5 Denars per Deutsche mark.

In such circumstances, NBRM intervened in two phases. First, it reduced the money supply by reducing the amount of sold deposits to banks at the auction of deposits. Considering that the pressures exercised over the exchange rate of the Denar continued immediately after the elections, the Central Bank intervened by selling foreign exchange at the foreign exchange market. As a result of the interventions of NBRM the exchange rate of the Denar was brought back to the level before the start of the fluctuations at the foreign exchange market and its stability was maintained throughout the rest of the year.

The exchange rate of the Denar against other foreign currencies is formed in accordance with the cross-currency exchange rates of the Deutsche mark against these currencies at the Frankfurt foreign exchange market. Hence, the nominal exchange rate of the Denar against the US dollar on December 31, 1998, was 51.84 Denars per US dollar, which is a 6.5% appreciation of the Denar relative to the end of 1997. The appreciation of the Denar against the US dollar is a result of the appreciation of the German mark against the US dollar.

Table 21

Indices of the Real Effective Exchange Rate of the Denar¹

(indices)

	31.12.1993/ 31.05.1993	31.12.1994/ 31.12.1993	31.12.1995/ 31.12.1994	31.12.1996/ 31.12.1995	31.12.1997/ 31.12.1996	31.12.1998/ 31.12.1997	31.12.1998/ 31.05.1993
1. Nominal effective Denar exchange rate /2	186.57	96.36	97.31	104.78	124.90	96.92	221.90
2. Domestic industrial producers prices	165.40	128.56	102.16	99.36	108.60	99.87	234.10
3. Foreign industrial producers prices	100.46	103.04	102.27	100.93	99.71	97.98	104.39
4. Relative prices (2:3*100)	164.65	124.77	99.89	98.44	108.91	101.93	224.25
5. Real effective Denar exchange rate (1:4*100)	113.32	77.23	97.41	106.44	114.68	95.08	98.95

1/ The real exchange rate is an internationally and widely accepted indicator for the valuation of the appropriateness of the level of the exchange rate. It represents an average index of the movements of the domestic currency against currencies of the biggest trading partners of the domestic country, adjusted for the changes in prices in those countries and the domestic markets. In the calculation of the average exchange rate, equal weights for the Deutsche mark and the US dollar are given. Real exchange rate index above 100 represents an increase in competitiveness, while the same index below 100 means a decline in price competitiveness.

2/ The nominal exchange rate of the Denar is calculated as a weighted average of the exchange rates of the Denar against the Deutsche mark and the US dollar, at the end of period.

The real effective exchange rate of the Denar, calculated by adjusting the nominal effective exchange rate for the changes in the relative fall of prices at domestic and world markets, shows that in 1998, relative to the previous year, there was a reduction in the price competitiveness of Macedonian goods at world markets. This is primarily a consequence of the appreciation of the Denar against the US dollar. At the same time, the price competitiveness in 1998 is worsened as a result of the changes in relative domestic prices compared to world prices. This is due to the greater fall in foreign relative to domestic producer prices of industrial products.

6.4. Foreign exchange reserves

According to the projection for the balance of payments of the Republic of Macedonia it was expected that in 1998 the gross foreign exchange reserves of NBRM would grow by USD 60 million, which would bring them to the value of 2.3 months of imports. At the same time, in accordance with the decision for the foreign exchange policy and the balance of payments of the Republic of Macedonia, the projected growth in the net foreign exchange in 1998 was USD 35 million.

At the end of 1998, the gross foreign exchange reserves of NBRM reached USD 333.5 million, which is the highest level since the monetary independence and compared to the end of the previous year it is by USD 53.4 million, or 19.1% higher. With this, the gross foreign exchange reserves of NBRM amounted to 2.1 months of imports. The realized growth in the gross foreign exchange reserves of NBRM falls short of the projected one for 1998 by USD 6.6 million. This is due to the fact that prior to the parliamentary elections in October 1998, the International Monetary Fund postponed the approval of the second part of the second tranche of the ESAF arrangement in the amount of USD 12 million.

Table 22

Inflows and Outflows in the Gross Foreign Exchange Reserves of NBRM

(in USD million, end of period)

	Dec. 31, '97	IQ	IIQ	IIIQ	IVQ	Jan. 1, '98- Dec. 31, '98
Foreign exchange reserves (end of period)	280.1	271.5	310.1	318.6	333.5	
Monthly changes in foreign exchange reserves, net		-8.6	38.6	8.5	14.9	53.4
Inflows		40.2	73.8	56.9	79.3	250.2
Purchased foreign currency /1		17.8	37.3	34.6	57.3	147.0
Interest on foreign currency deposits		2.8	2.6	3.4	3.6	12.4
Extended foreign credits and grants		18.7	12.1	14.7	18.9	64.4
Others		0.0	20.0	0.0	0.0	20.0
Exchange rate differentials		0.9	1.8	4.2	-0.5	6.4
Outflows		48.8	35.2	48.4	64.4	196.8
Sold foreign currency		24.7	19.8	18.7	48.5	111.7
Servicing of foreign debt		21.1	11.9	32.9	19.1	85.0
Exchange rate differentials		3.0	3.5	-3.2	-3.2	0.1

1/ Including purchased gold

The inflows of foreign exchange in the amount of USD 250.2 million contributed towards the increase in gross foreign exchange reserves of NBRM. Out of this amount, 58.8% represent purchased foreign exchange by NBRM, almost entirely from operations at the foreign exchange market. Inflows on the basis of foreign loans and grants account for 25.7% of total inflows. The remaining part of the inflows are primarily inflows from the privatization process (USD 20 million) and received interest on foreign exchange deposited in foreign countries (USD 12 million).

On the other hand, the total outflows of foreign exchange in the amount of 196.8 million acted towards a decline in the gross foreign exchange reserves of NBRM. More than half of the outflows (56.8%) refers to sold foreign exchange by NBRM. The biggest

part of the sold foreign exchange (46.1%) are in fact interventions by the Central Bank on the foreign exchange market. Further down the list of outflows is the sale of foreign exchange for purchase of oil (USD 44.5 million). The remaining part of the outflows of foreign exchange of NBRM (besides the sale of foreign exchange on various basis) refers to the payment of foreign loans (USD 85.0 million)

The net foreign reserves of NBRM, expressed as the difference between the gross foreign exchange reserves and the liabilities towards the International Monetary Fund, at the end of 1998 amounted to USD 231.1 million. In the course of 1998, the liabilities towards the International Monetary Fund on net basis increased by USD 14.2 million¹⁶ and at the end of the year they reached USD 102.4 million. However, the increase in the gross foreign exchange of NBRM was more rapid than the increase in the liabilities towards the International Monetary Fund, which resulted with an increment in the net foreign exchange reserve in 1998 by USD 39.1 million. The increase in the net foreign exchange reserves of NBRM exceeded the projected increase for 1998 by USD 4.1 million.

At the end of 1998, the total foreign exchange assets of banks licensed to conduct international operations reached USD 324.0 million, which relative to the end of 1997 is by USD 67.2 million higher. The increase in banks' total foreign exchange assets is due solely to the increase in the deposits of economic agents at banks in the total amount of USD 103.6 million, while banks' own foreign exchange reserves¹⁷ decreased by USD 36.4 million.

Gross foreign exchange reserves of NBRM, increased by the amount of deposits with the Central Bank and total foreign exchange assets of banks licensed to conduct international operations form the total foreign exchange potential of the Republic of Macedonia. At the end of 1998, the total potential reached the level of USD 691.2 million, its highest level since the monetary independence. It is by USD 147 million higher than the total foreign exchange potential at the end of 1997.

6.5. Foreign exchange market

The foreign exchange market in the Republic of Macedonia comprises of two segments. On the first one only authorized banks, domestic legal entities and NBRM can participate. The second segment of the foreign exchange market is the so-called exchange offices market, where individuals can participate.

¹⁶ The net increase is due to new credits in the amount of USD 12.1 million extended by the International Monetary Fund, increased by USD 4.4 million from the change in the relation between the Special Drawing Rights and the US Dollar, and the payment of principal in the amount of USD 2.2 million.

¹⁷ The difference between foreign exchange assets and foreign exchange liabilities of deposit money banks, excluding the short-term and long-term liabilities of deposit money banks arising from foreign loans.

In the course of 1998, the total turnover at the foreign exchange market was USD 1,250.0 million, which relative to the turnover in the previous year represents a USD 197.8 million, or 18.8% increase. At the same time, USD 688.9 million, or 55.1% of the total turnover was realized in transactions between banks and enterprises. The turnover among enterprises in 1998 was USD 313.9 million, or 25.1% of the total turnover, while in transactions among banks the realized turnover was USD 55.3 million, or 4.4% of the total turnover for the year. The remaining part of the turnover (15.3%) refers to transactions of the Central Bank at the foreign exchange market.

According to the applied monetary concept, during 1998, NBRM intervened on the foreign exchange market when there was a need to preserve the stability of the Denar exchange rate. Broadly speaking, in 1998 the supply of foreign exchange exceeded the demand, which facilitated a net purchase of foreign exchange in the amount of USD 35.4 million.

From the aspect of dynamics, there was a net sale of foreign exchange only in the first quarter of 1998, while in the remaining three quarters the Central Bank realized net purchase of foreign exchange on the foreign exchange market. Thus, in the first quarter of 1998, the net sale of foreign exchange was USD 6.8 million, primarily because of the pressure exercised over the exchange rate of the Denar in February 1998, caused by the increased demand for foreign exchange following the purchase of tobacco. In the second quarter of the year, a substantially high amount of USD 17.4 million was purchased, as a result of the foreign exchange inflow realized through the privatization of the state capital in one enterprise. In the third quarter of the year, the Central bank purchased USD 15.9 million on net basis at the foreign exchange market, which is primarily due to the purchase of a portion of the funds from the pre-privatization of the Macedonian "Telecom". In the last three months of 1998, on net basis USD 9.0 million were purchased, as a result of the high purchase of foreign exchange in December 1998 in the amount of USD 15.1 million.

Chart 18

Transactions at the Foreign Exchange Market
(in USD million)



The total turnover at the exchange offices market in 1998 was USD 566.7 million, where USD 401.8 million were purchased from individuals, and USD 164.9 sold to

individuals. The realized net purchase of USD 237.0 million is by USD 11.7 million, or 5.2%, higher than the corresponding in the previous year. The largest portion of the net purchase, or 97.7%, was realized through exchange offices working on their behalf and for their own account, while the remaining part was realized through exchange offices working on their behalf but for the account of the NBRM.

6.6. Foreign debt of the Republic of Macedonia¹⁸

6.6.1. Medium-term and long-term debt in 1998

The indebtedness of the Republic of Macedonia on the basis of medium-term and long-term debt increased considerably in 1998. At the end of 1998, the total medium-term and long-term debt of the Republic of Macedonia reached USD 1,398.6 million, with the principal being USD 1,391.7 million. Compared to the total foreign debt in 1997, the debt in 1998 is by USD 224.8 million, or 19.2%, higher. At times when the Republic of Macedonia was regularly paying back its foreign debt, the large increase in indebtedness is due to the withdrawal of assets on the basis of extended loans.

Despite the increase in the indebtedness, the Republic of Macedonia remains in the group of medium indebted countries.¹⁹ However, the growth of the foreign debt, accompanied by continuing deficit in the trade and current accounts of the balance of payments, is an unfavorable combination of factors which determine the external position of the country.

In 1998, new credits in the amount of USD 273.8 million were withdrawn. Out of this, USD 168.1 million, or 61.4% were withdrawn from multilateral creditors. The largest share (31.9%) in the multilateral creditors group refers to credits from the International Financial Corporation (IFC). The credits withdrawn from this institution in 1998 reached USD 53.7 million and refer mainly to credits extended for the pre-privatization of the Macedonian "Telecom".

According to the volume of the extended credits, following IFC are two institutions - members of the World Bank group. From the International Development Agency (IDA) credits in the amount of USD 26 million, out of which USD 14.6 million refer to credits for the structural adjustment of the social sector, while USD 5.7 million refer to a financial credit for structural adjustment. The credits withdrawn from the International Bank for Reconstruction and Development (IBRD) in 1998 were USD 25.2 million and were related to the structural adjustment loan - SAL (USD 13.2 million) and two credits for the development of the private sector (USD 11.2 million).

¹⁸ Preliminary data from NBRM.

¹⁹ World Bank, Country Assistance Strategy for the Republic of Macedonia, 1999 - 2002.

In 1998, USD 17.6 million were withdrawn from the European Investment Bank (EIB), which were entirely used for financing road building projects. In the observed period, USD 17.0 million were withdrawn from the EU, out of which USD 16.3 million refer to a structural adjustment credit. The credits withdrawn from the European Bank for Restructuring and Development reached USD 15.6 million. The largest share of these funds is associated with the Flight Control of the Civil Air-Traffic Department (USD 7.7 million) and the financing of the project for development of small and medium-size firms (USD 3.2 million).

The last multilateral creditor, which extended considerably high amount of credits to the Republic of Macedonia in 1998 was the International Monetary Fund (IMF). New credits in the amount of USD 12.1 million were withdrawn from this institution, which represent the first installment of the second tranche of the ESAF arrangement. Due to the parliamentary elections in October 1998, the International Monetary Fund postponed the approval of the second installment of the second tranche of the ESAF arrangement in the amount of USD 12.1 million.

Beside multilateral creditors, the bilateral creditors belong to the group of official creditors, but in 1998 they did not represent a significant source of credits for the Republic of Macedonia. During 1998, only USD 0.7 million, or 0.3% of the total credits were withdrawn from bilateral creditors.

The amount of credits withdrawn from private creditors, as a separate group of creditors, in 1998 amounted to USD 104.9 million, or 38.3% of the total withdrawn credits. The debt towards the London Club of Creditors increased by USD 9.8 million, which is due to the capitalized interest. The largest share of withdrawn credits in the amount of USD 95.1 million is withdrawn from other private creditors, with USD 48.1 million referring to financial credits, USD 35.1 million to trade credits and USD 11.9 million to commercial credits.

With respect to the liabilities arising from due medium- and long-term foreign debt, USD 140.1 million were paid in 1998. Out of this, USD 83.9 million are payments on the basis of principal, while USD 56.2 million were payments on the basis of interest.

Observed by separate groups of creditors, in 1998, the largest share of the repayment of the medium and long-term foreign debt refers to repayment of the debt towards official creditors. In the course of the year, USD 100 million of due debt was paid. Out of this, USD 49.4 million is paid to multilateral creditors, with USD 29.5 million of those being liabilities on the basis of principal. From the aspect of separate multilateral creditors, the largest amount of USD 19.3 million was paid to the European Bank for Reconstruction and Development (EBRD). The International Bank for Reconstruction and Development (IBRD) follows with USD 9.5 million.

During 1998, USD 50.6 million were paid to the bilateral creditors, with USD 29.6 million being paid on the basis of principal, while the remaining on the basis of

interest. At the same time, USD 27.9 million were paid to the members of the Paris Club of Creditors, out of which the largest part (USD 18.2 million) is based on interest. In 1998, USD 20.4 million that refer to non-rescheduled debt were paid.

The liabilities towards private creditors in the amount of USD 40.1 million were paid in 1998, with USD 24.8 million referring to payment based on principal, which is entirely associated with credits from private creditors distinct from the London Club of Creditors. The payment on the basis of interest amounted USD 15.3 million, with the largest part in the amount of USD 10.4 million referring to liabilities on the basis of interest towards the London Club of Creditors.

6.6.2. Foreign debt structure by types of foreign creditors

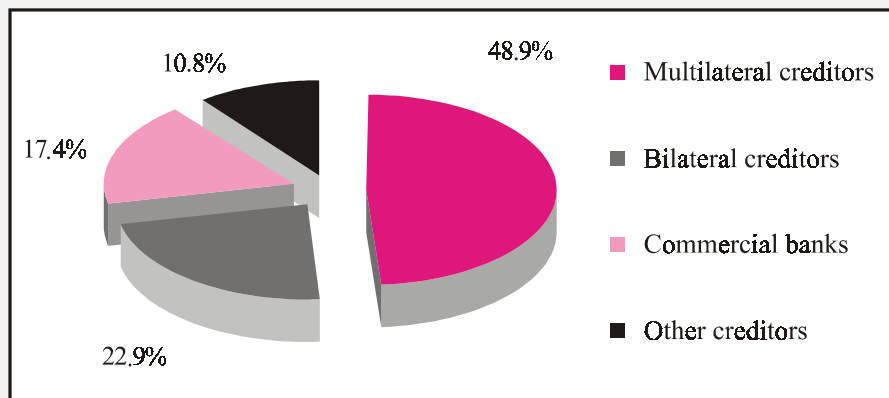
The structure of the foreign debt by the types of foreign creditors and their respective share remained almost unchanged. At the end of 1998, the official creditors have the largest share in the foreign debt of the Republic of Macedonia (71.8%), while 28.2% refers to private creditors.

At the end of 1998, the foreign debt towards official creditors was USD 1,004.2 million and comprised 71.8% of the total foreign debt. Out of that, USD 683.7 million, or 48.9% of the total foreign debt refers to multilateral creditors.

Chart 19

Structure of the Foreign Debt by Types of Foreign Creditors

(in %)

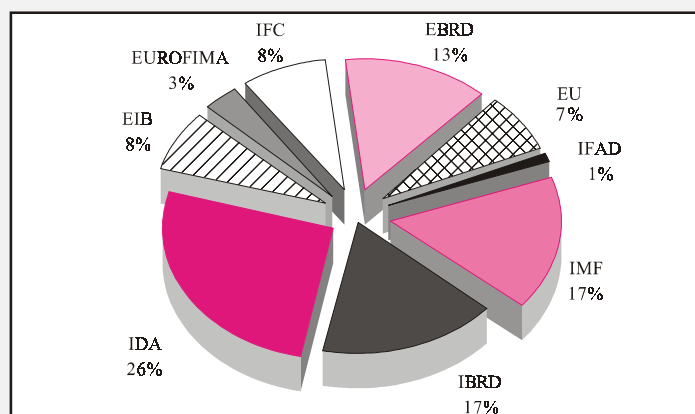


The analysis of the structure of the debt towards multilateral creditors at the end of 1998, shows that the credits taken from the International Development Agency (IDA) have the largest share in the total debt towards this group of creditors with 26.2%, followed by the International Bank for Reconstruction and Development and the International Monetary Fund each having an equal share of 16.7%. The fact that the credits from the International Development Agency dominate can be regarded as positive, since they offer most favorable conditions.

Chart 20

Structure of the Foreign Debt Towards Multilateral Creditors

(in %)

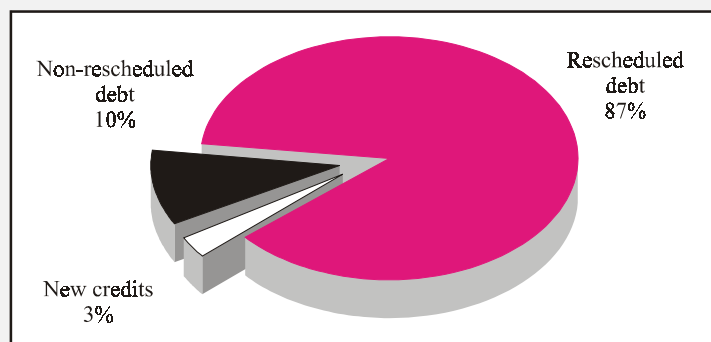


The debt towards bilateral creditors at the end of 1998 reached USD 320.5 million and participated in the total foreign debt with 22.9%. The largest share of the bilateral credits refer to rescheduled credits with the Paris Club of Creditors (87.4%), while the total share of the non-rescheduled debt and newly signed credits is 12.6%.

Chart 21

Structure of the Foreign Debt Towards Bilateral Creditors

(in %)



At the end of 1998, the debt towards private creditors was USD 394.4 million, or 28.2% of the total foreign debt. In the structure of the foreign debt towards private creditors, 61.6% refer to debt to the London Club of Creditors. However, a characteristic feature for 1998 was the significantly high increase of the share of medium- and long-term credits withdrawn from other private creditors in the form of financial, trade and commercial credits.