

NATIONAL BANK
OF THE REPUBLIC
OF MACEDONIA

ANNUAL REPORT 1994

Contents:

I. ECONOMIC DEVELOPMENTS	2
II. PROJECTED AND ACTUAL MONETARY DEVELOPMENTS	14
III. MONETARY AND CREDIT DEVELOPMENTS	22
IV. DEVELOPMENT OF THE CREATION AND OF THE WITHDRAWAL OF RESERVE MONEY	35
V. INSTRUMENTS OF MONETARY AND CREDIT POLICY	47
VI. GOALS AND OBJECTIVES OF FOREIGN EXCHANGE POLICY	56
VII. REALIZATION OF FOREIGN EXCHANGE POLICY FOR 1994	59
Summary of the Annual Report for 1994	77

I. ECONOMIC DEVELOPMENTS

In January 1994, Government of the Republic of Macedonia adopted a program comprising general frameworks of the economic policy for the current year, financially supported by the International Monetary Fund agreement on the STF arrangement. This economic program had a determining impact on global developments of the national economy in the monitored period.

From the point of view of the effects on the real area of the national economy, the circumstances under which the 1994 economic program of the Government was implemented, were significantly changed on domestic and international level, compared to the previous years.

As from the external point of view, sanctions by the United Nations against our northern neighbor, SR Yugoslavia, continued, and, the Republic of Macedonia, being the regular member of this international institution, respected them completely. In addition, the consequences after the dissolution of the former Yugoslav market were not solved yet, which, having previously rather high level of integration, had a number of adverse implications on the Macedonian economy. For a short period of time, it appeared to be very difficult to substitute the former Yugoslav market with alternative markets for export of goods and services of the Macedonian economic subjects.

Additional element that significantly deteriorated the global economic activity of the Republic of Macedonia was the obstinate economic embargo against the country applied at the beginning of 1994 by our southern neighbor, Greece. Being combined with the sanctions against our northern neighbor, it ceased the normal flow of goods in North - South direction and led to a dramatic increase of transport costs, i.e., very serious deterioration of export-import activities of the Macedonian economy.

In 1994, in the country itself, there was a continuation of specific important changes in the economic and political environment under which the program of the Government was being implemented. There was a continuation of the initiated process of fundamental transformation of the national economy by abolishing the previous concept of self-management, so that the economic system in the Republic of Macedonia continued to create more characteristics of market oriented economy.

One of the basic channels for realizing the initiated structural reforms was the privatization process, meaning, the animation of the private initiative. The legal frameworks of the privatization is the Act on transformation of enterprises with social capital adopted in 1993, with various projected modalities for the transition of former self-managing enterprises from social to private ownership. During the monitoring period, small and medium enterprises had a central position in this process, with an obligation to submit programs on transformation of their ownership to the Agency of Privatization, until the end of the year. Until that period of time, the estimation of the values of small and medium enterprises was almost completed. Therefore, actual

effects of the privatization of the Macedonian enterprises can be expected in the following period. In that way, the Republic of Macedonia is considered to be in the group of countries of Central and Eastern Europe where the tendency to economic privatization is present the most.

In 1994, there was also a realization of the initial steps towards the commencement of the banking rehabilitation process as necessary prerequisite for financial stabilization of the economy. The intention was to make comprehensive preparations for this process and its intensification in 1995.

1.1. Gross Social Product

In 1994, the Gross Social Product of the Republic of Macedonia in nominal terms was Denar 126,941 million which is an increase of 110% compared to its level in 1993.

Presented in permanent prices (from 1990), in 1994 the Gross Social Product of the country was Denar 343 million. Compared to the position in the previous year, this was a decrease of the Gross Social Product in real terms by 6.2%.

Social Product

(in million denars)

	1989	1990	1991	1992	1993	1994*
Current prices	126	551	1.136	16.015	60,411	126,941
Permanent prices (from 1990)	608	551	492	426	366	343
Indices compared to the previous year:						
Current prices	1.576.0	436.2	206.4	1.409.7	377.2	210.1
Permanent prices (from 1990)	101.9	90.6	89.3	86.6	85.9	93.8

Source: Republic Bureau of Statistics

*) Previous data

Compared to 1989, the real gross social product was decreased by 43.6%. Analyzed by years, the decline of the real gross social product was 9.4% in 1990; 10.7% in 1991; 13.4% in 1992; 14.1% in 1993 and 6.2% in 1994. This implies that in the period of 1989-1993 there was a tendency of continued decline of the real gross social product, where the rhythm of its decrease was accelerating till end-1993. On one side, that was a result of the influence of external factors, such as the dissolution of former Yugoslav territory and the problems in entering alternative markets; the economic blockade by the international community against the northern neighbor - SR Yugoslavia - as well as the onside embargo against the country implemented by our southern neighbor according to its own will. On the other side, specific domestic factors had its influence on the decline of the real gross social product in this period, some of them being: deep economic recession, overemployment, fall of productivity, old technology of domestic enterprises, low domestic solvent demand and uncertainty of domestic economic subjects regarding the changes of structure and ownership.

In comparison with the actual developments in the period of 1989-1993, the increase of the real gross social product of 6.2% in 1994 presents a deviation from the trend, being a significant deceleration of its decline from the previous years. In fact, the intensity of decreasing the real gross social product in 1994 was the smallest one within the whole period of 1989-1994. Although it is a deceleration of real social product decline, and not ceasing the decline, it could still be considered as a signal of first positive trends in the Macedonian economy and it can be expected to be intensified in the years to come.

1.2. Domestic output

Economic activity decline in 1994 was determined by a decrease of the industrial output, since the agricultural output had an increase in the same period.

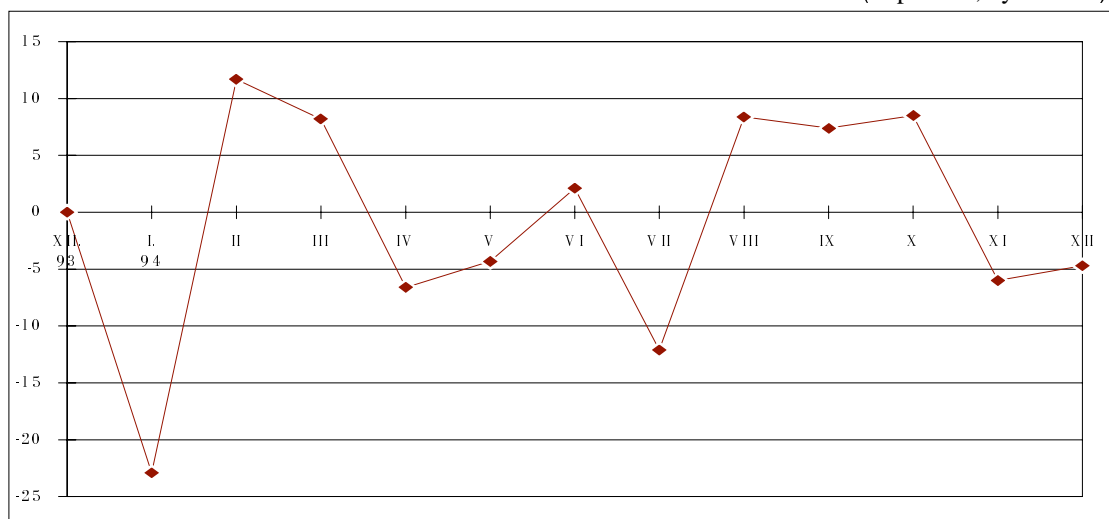
The natural scope of the total industrial output in 1994, compared to the position in 1993, was decreased by 10.5%. This decline was a further continuation of the trends that started in 1990 and was characterized year-by-year by a deceleration of the natural scope dynamics decrease of the total industrial output.

Monthly dynamics of the natural scope of the total industrial output in 1994 was very similar to the realized one throughout 1993.

Graph 1

Dynamics of the natural scope of industrial output

(in percent, by months)



Analyzed by months, in 1994, the number of months with an increase of the natural scope of the industrial output was equal to the number of months in which the output was decreasing. Most emphasized development throughout the whole year was in January 1994, when due to seasonal influences (connecting the New Year's and Christmas holidays which resulted in a small number of working days) there was a dramatic decline of the natural scope of the industrial output of 22.9%. In the other part of the year, the natural scope of the industrial output had an imbalanced dynamics. The animation of the industrial output, being almost throughout the whole

previous year (August - December), was shorter in 1994 (August - October), but with bigger intensity. Thus, although it was expected that in July 1994 there will be a realization of the lowest level of the industrial output decline, and, after that a permanent growth until the end of this year, the output was again lowered in November and December.

Industrial output: by purposes
- indices compared to the previous year -

	1989	1990	1991	1992	1993	1994
Means of labor	114.1	67.7	67.4	68.6	76.2	83.6
Means of reproduction	103.4	91.2	85.2	85.9	89.6	87.4
Goods for personal consumption	103.5	90.2	84.4	85.9	84.2	97.7
Total:	104.3	89.4	82.8	84.2	86.1	89.5

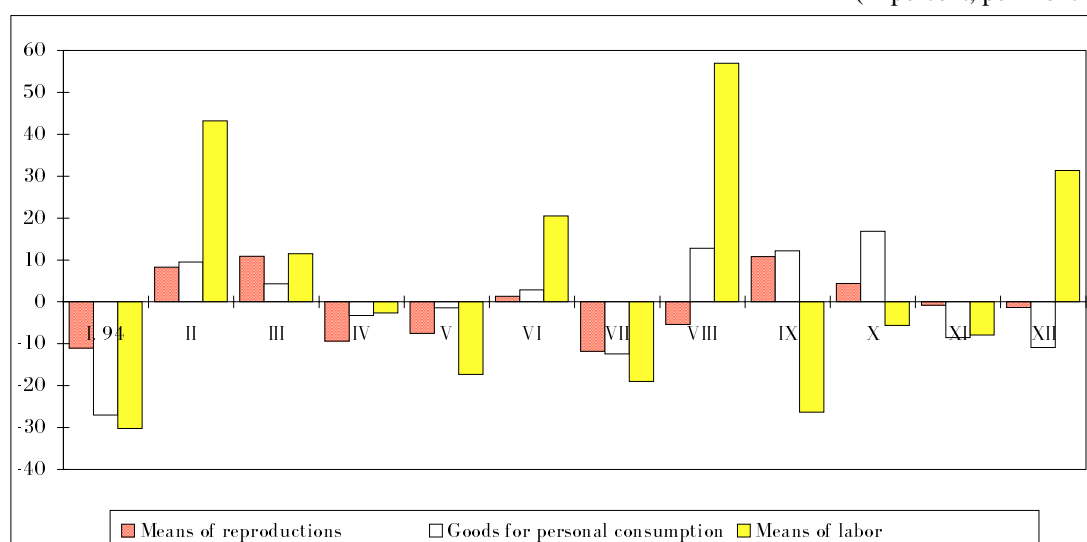
Source: Republic Bureau of Statistics

From the structural point of view, in 1994, the natural scope of the industrial output had different dynamics of changing. Therefore, in 1994, the output of the means of labor was decreased by 16.4% compared to the previous year, which is further deceleration of its tendency to decline starting from 1990. There was also unequal monthly dynamics, where the difference was in the months of January (30.2%) and September (26.3%), and the largest increase was in February (43.2%), August (57.0%) and December 1994 (31.4%).

Graph 2

Dynamics of the means of reproduction output, goods for personal consumption and means of labor

(in percent, per months)



1994 means of reproduction output was decreased by 12.6% compared to the previous year. The industrial output for this purpose only, realized acceleration of the decline compared to the one in 1993, confirming its own variability registered in the period of 1989 - 1993. Analyzed by months, the industrial output of means of

reproduction was changing permanently towards its own decrease, or increase, without any changes of special intensity.

In 1994, the scope of the industrial output of goods for personal consumption, compared to the previous year, declined by 2.3% being a radical deceleration of the fall which was 15.8% in 1993. Considered by months, except for January 1994, in the rest of the year, the dynamics of the industrial output of goods for personal consumption was mostly balanced. Its more significant animation was noticed in the period of August-October, when the average monthly industrial output of goods for personal consumption increased by 13.9%.

At the end of 1994, the industrial commodities were decreased by 14.6% compared to their position at the end of the previous year. At that time, the commodities of particular industrial products differed. The commodities of the means of labor were increased by 39.2%, and the commodities of consumption goods increased by 0.9%, whereas the commodities of the produced material for reproduction decreased by 25.0%. As a whole, the decrease of industrial commodities in 1994 was directly connected to the drop of the total economic activity of the country and to the liquidity problems economic subjects faced, which limited their potential for financing the commodities.

Unlike the industrial output decrease, the agricultural output in 1994 increased by 8.9% compared to the previous year, so that in 1994 the adverse realization of the 1993 agricultural output, being a result of strong and long-lasting drought, was overgrown.

Agricultural output
- indices compared to the previous year -

	1989	1990	1991	1992	1993	1994*
Agriculture - Total	104,4	89,8	117,6	100,4	79,6	108,9
Social sector	100,0	90,2	100,3	96,1	71,7	112,6
Private sector	106,6	89,6	124,9	101,9	82,2	107,9

Source: Republic Statistical Bureau

*) Estimation

In 1994, considered by sectors, there was agricultural output increase in the social and in the private sector. In this period, the agricultural output in the social sector increased by 12.6%, and the agricultural output in the private sector increased by 7.9%. It is specific that in 1994, the agricultural output increase in the social sector was higher than the comparable increase in the private sector, that happened only once back in 1990 in the period of 1989-1994, but not in the same extent.

Compared to 1989, total agricultural output decreased by 8.1%, the agricultural output in the social sector decreased by 29.8%, whereas the agricultural output in the private sector increased by 1.1%. Realized smaller increase of the

agricultural output in the social sector in the period of 1989-1994 presents the need to implement adequate reform in the social sector in the following period.

1.3. Labor market

Labor market developments are primarily determined by economic activity realization in the national economy. From that point, realized macroeconomic market contraction in the Republic of Macedonia in 1994 resulted in further increase of the unemployment.

At the end of 1994, the total number of employees was 389,302. Compared to December 31, 1993, it was a decrease of 4.7%, which was smaller than the fall of the real gross social product in 1994 (6.2%). It means that in 1994, there was additional decrease of labor productivity.

Total number of employees
- indices compared to December from the previous year -

	XII. 1994 Number of employees	1989	1990	1991	1992	1993	1994
Total	389.302	100,8	96,0	94,2	94,3	93,4	95,3
- Economic activities	304.074	100,7	95,4	93,4	93,5	92,0	93,9
- Non-economic activities	85.228	101,1	99,1	97,8	97,8	99,3	100,8
- Number of persons seeking employment	196.280	101,2	103,8	104,7	103,9	102,2	110,8

Source: Republic Statistical Bureau

There is an identical conclusion on the total period of 1989-1994, as for the fact that compared to 1989, the decrease in number of employees is 24.1% which is twice less than the fall of the real social product in the same period (43.6%).

From a structural point of view, in 1994, there was a realization of different changes of the number of employees in the economic, and, non-economic activities. At the end of 1994, the number of employees in the economic sector was 304,074 which is a fall of 6.1% compared to the end of 1993. Compared to 1989, their decrease was 28.0%.

At the end of 1994, the number of employees in the non-economic activities was 85,228 that, compared to the end of 1993, was an increase of 0.8%. The direction of the changes of the number of employees in the non-economic activities does not correspond to the fall of the real gross social product in 1994. Anyway, there is still unusual increase, for, compared to 1989, the number of employees in non-economic sector decreased by 5.1%. This presented that the cumulative decrease compared to the decrease of the number of employed persons in economic sector in the same period of time (28.0%), was significantly lower.

Number of persons seeking for employment at the end of 1994, was 196,280, being an increase of 10.8% compared to their number at the end of the previous year, whereas the number of unemployed persons, compared to their number in 1989 was increased by 27.9%. As a result of the initiated structural reforms, and, especially of the restructuring of the ownership of big social enterprises, it is expected to have significant increase of the number of persons seeking for job in the following years. Thus, large unemployment for a long period of time remains one of the most serious problems Macedonian economy is facing with.

1.4. Domestic consumption

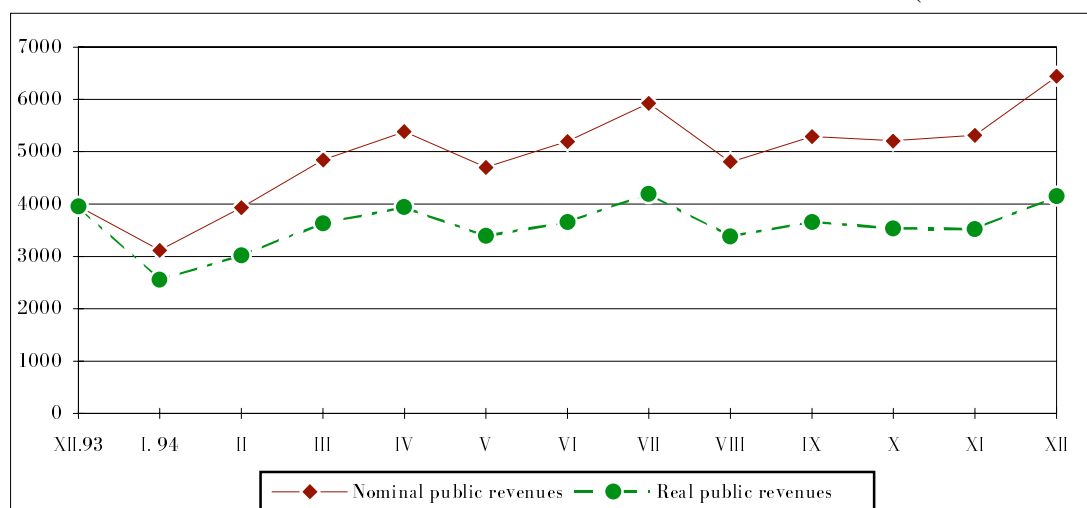
1.4.1. Public consumption

Throughout 1994, the fiscal sector made large adjustments, bringing the budget deficit from 11.1% of gross social product in 1993, to 2.6% of gross social product in 1994. The reduction of the budget deficit is a result of real increase of public revenues, whereas public revenues were always reduced because of financing the reforms. The budget revenues were increased as a result of extending the fiscal basis and regarding the improvement of efficiency in collecting the revenues.

Graph 3

Developments of nominal and real public revenues by months
- 1994 -

(in million denars)



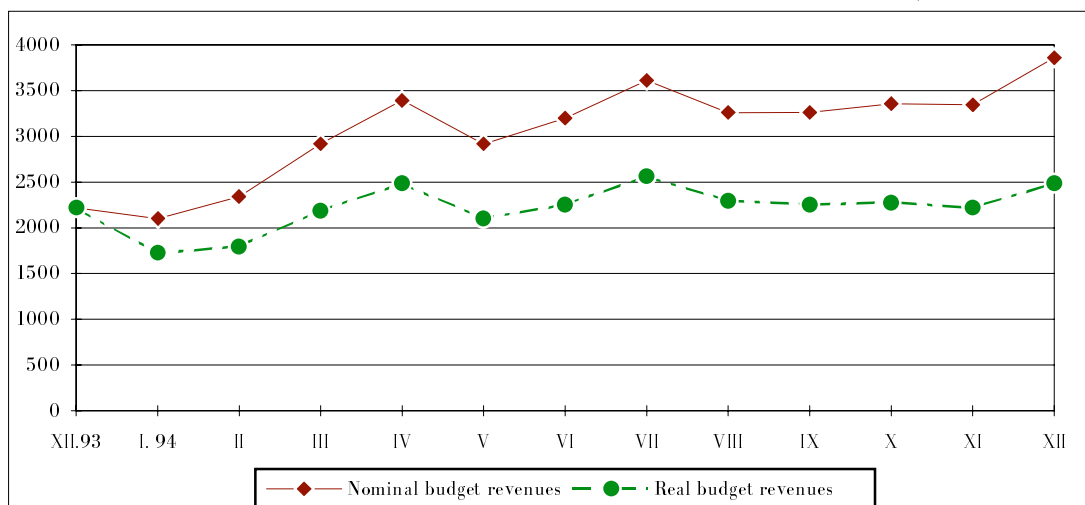
Total public revenues in 1994, compared to their amount in the previous year, increased by Denar 36,430 million, which is a nominal increase of 153.6%. In real terms, total public revenues in 1994 increased by 63.2%.

From a structural point of view, components of total public revenues in 1994 developed with a difference regarding their nature and intensity.

Graph 4

Developments of nominal and real budget revenues by months
- 1994 -

(in million denars)



Total budget revenues (various types of taxes, customs duties and other revenues) for 1994, increased in nominal terms by 188.7% compared to their average in 1993, i.e., there was real increase by 85.8%. Turnover tax participated the most in the total budget revenues in the analyzed period.

At the end of 1994, total social funds (Pension Fund and Disability Pension, Social Security Fund and Health Care) had a nominal increase of 110.9% compared to the end of the previous year. In the observed period, the increase of total social funds was 35.7% in real terms.

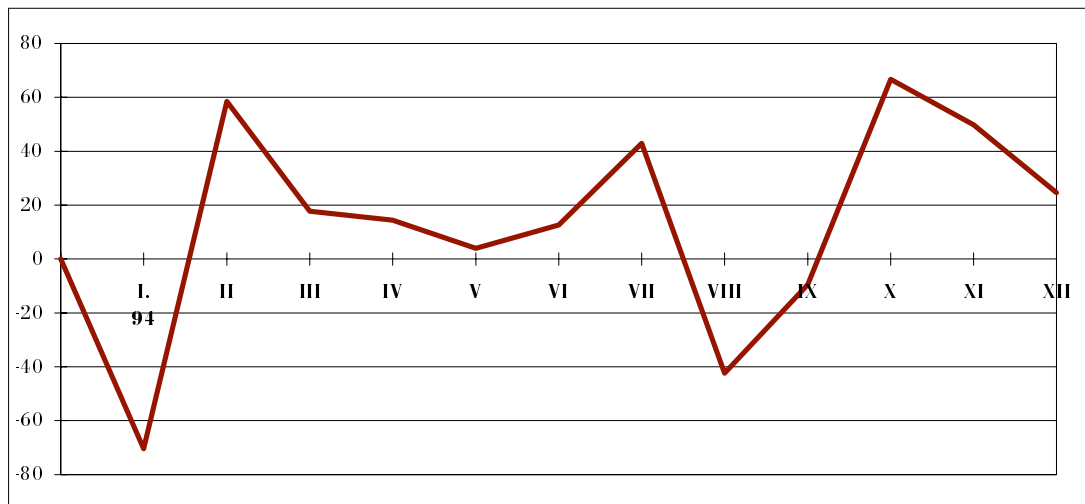
1.4.2. Investments in fixed assets

The developments of the investments in fixed assets is a significant indicator of the present and future dynamics of the economic activity of the economic subjects in the national economy. In 1994, the investments in fixed assets of the country increased by 68.8%, which was their real increase of 8.6%. Thus, the investments in fixed assets in 1994, participated with 2.1% of the nominal gross social product. Considered by months, they had an imbalanced dynamics of developments.

Graph 5

Dynamics of the nominal investments in fixed assets
- 1994 -

(in %, by months)



In the months of January, August and September, there was a decline of investments in fixed assets, where the decrease in the first month of the year was of great intensity (70.4%). Throughout the other months of the year, the investments in fixed assets increased, especially in February, July and October.

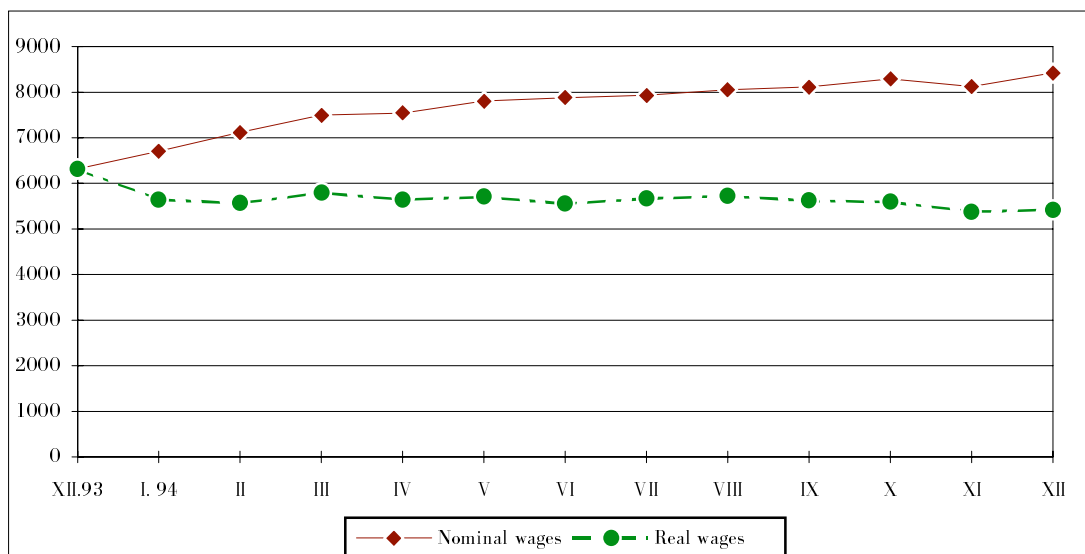
1.5. Income policy

Income policy was an important component of the global 1994 economic policy having stabilization measures that contributed to a great extent to reaching the projected macroeconomic goals. In 1994, the labor costs were regulated by the Law on paying the pensions and wages in the Republic of Macedonia, adopted on December 28, 1993. The Law had its constraints, for, it "covered" only the social sector of the national economy. In accordance with the provisions of this Law, developments of the wages in the social sector were only partly indexed in respect to the inflation rate.

Government's intention was to implement a mechanism that would compensate high real increase of the wages reached in 1992-1993 which was a significant disproportion to the real economic activity, and, to the real labor productivity in that period. In other words, the Government made an attempt to put out of action the intention of the social enterprises to protect the salaries in continuation from real disparity, separate from the achieved economic results. Also, the Law on paying the pensions and wages in the Republic of Macedonia was planned to be an urge for the socially-owned enterprises to intensify the transformation of their ownership in order to become a part from the private sector that is not a subject to the measures from this Law.

Graph 6

Dynamics of the nominal and real average net payment of wages per worker
- 1994 -



At the end of 1994, as a consequence of the implemented wage policy, the average net payment per worker reached Denar 8,424, being a nominal increase of 33.4%, compared to December 31, 1993. However, it was at the same time its real decline of 14.1%, i.e., there was a reindexation of the wages increase. Thus, the large and unjustified real increase of wages, accumulated in the previous years, was partly compensated. Through the mechanism of partial indexation of the wages, the recovering of the spiral wages - prices - ... was also ceased, and, there was a positive impulse on the monetary and foreign exchange policy in realizing their objectives.

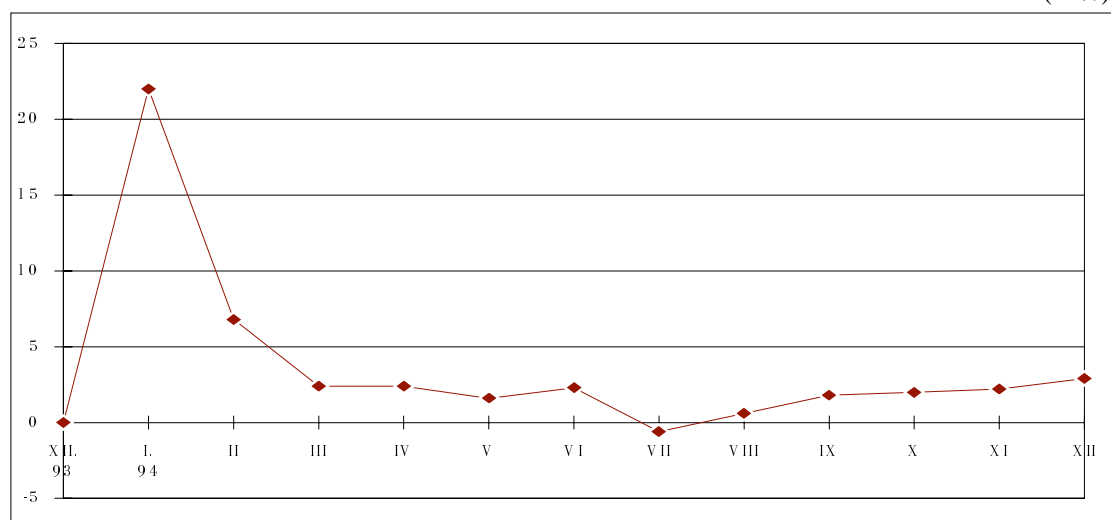
1.6. Price movements

The inflation rate in 1994 (presented through the retail prices) was significantly reduced and at the end of 1994 compared to the previous year (229.6%) was 55.4%. That was also a result of the adjusted effect of the measures implemented within the frameworks of special components of the macroeconomic policy.

Graph 7

Monthly dynamics of retail prices

(in %)



There are two different periods in the monthly dynamics of the retail prices movements. The first period comprises months of January and February with a relatively high inflation rate. In January, therefore, there was sharp increase of retail prices by 22.0%, whereas their increase in February was 6.8%.

In fact, macroeconomic policy measures on bringing down and stabilizing the inflation rate started to show the initial effects with a time delay of two months, in March 1994. In the other part of the year (March-December), the retail prices stabilized their movements and increased by an average monthly rate of 1.76%. In August 1994, there was a deflation of 0.6%.

Current increase of prices

- indices in December compared to December previous year -

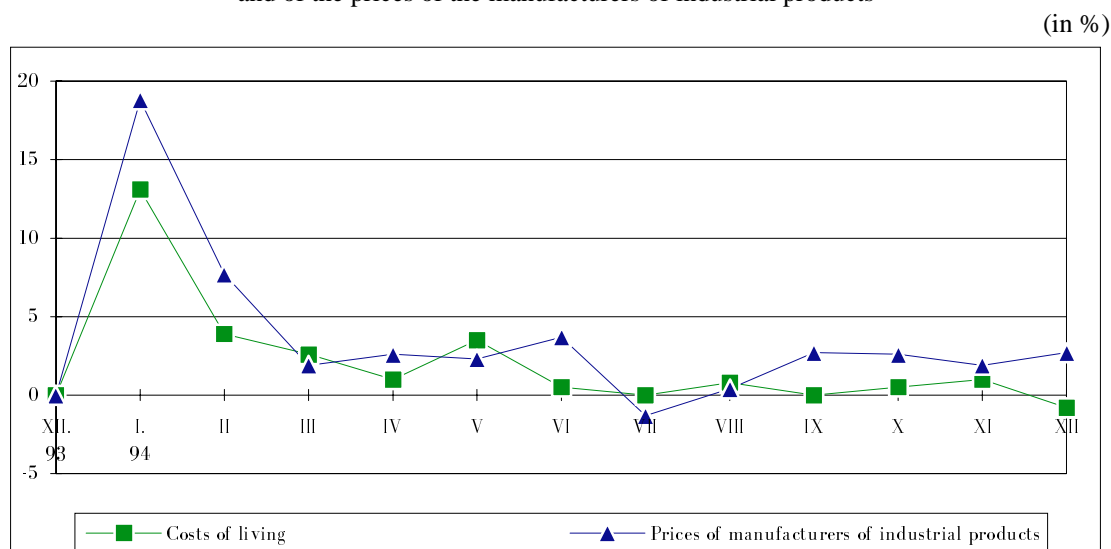
	1989	1990	1991	1992	1993	1994
Industrial products						
Retail prices	2.832.5	202.4	357.9	2.055.7	310.7	138.8
Manufacturers prices	2.957.8	141.8	381.5	2.248.6	276.1	128.6
Retail prices (total)	2.863.4	220.5	329.7	2.025.2	329.6	155.4
Retail prices of agricultural products	2.379.1	260.4	261.9	2.546.4	263.0	187.4
Prices of services	3.225.5	306.8	244.6	1.746.1	434.6	196.0
Costs of living	2.945.1	215.6	313.4	1.880.3	348.2	155.4

In the structure of retail prices increase, the participation of individual components was different. In 1994, the prices of services and the prices of agricultural products increased to a larger extent (96.0% and 87.4%, respectively) compared to the general retail prices, whereas the prices of goods and the prices of industrial products as a whole (43.0% and 38.8%, respectively) increased to a smaller extent compared to general retail prices.

At the end of 1994, current increase of the costs of living was 55.4%, which, as for the retail prices, was a significant deceleration of their increase in respect of the increase of 248.2% realized in 1993. Considered by groups of products with prices determining the structure of the costs of living, the prices of the rent and of services increased the most (175.6% and 111.9%, respectively). In 1994, monthly dynamics of the costs of living was characterized by the similar rhythm of the retail prices, with a differentiation of two characteristical periods: January - February, with a relatively high increase, and, March - December, with a moderate increase, or with a decline.

Graph 8

Monthly dynamics of the costs of living
and of the prices of the manufacturers of industrial products



Current increase of the prices of the industrial products producers was 28.6% in 1994, meaning that, in relation to their increase throughout the previous year (176.1%), there was a significant slower increase. In the structure of those prices, goods for personal consumption increased the most in the considered period (36.8%). Throughout 1994, monthly dynamics of the movements of the prices of the industrial products producers highly increased in January (13.1%); followed by a certain regulation in the period of February-May; and, their almost complete stabilization till the end of the year (June - December) with an increase from -0.8% to 1.0%.

II. PROJECTED AND ACTUAL MONETARY DEVELOPMENTS

2.1. Goals and objectives of the monetary and credit policy for 1994

Monetary policy for 1994 was projected to be realized as an integral component of the global stabilization program determined and financially supported by the International Monetary Fund through the agreement upon the STF arrangement. Basic goal of the monetary policy for 1994 was to affect the direction of the decrease of aggregate demand through restrictive dimensioning of monetary frameworks, in order to bring down the inflation being the final goal of the monetary and economic policy. Deceleration of the inflation rate, through the reduction of the global expenditure and its maintenance on a moderate level was not foreseen as a goal by itself, but as a function of an increase of the inclination of the economic subjects to saving in the long run. This should create sufficient financial ground for implementing the reforms, animation of the economic activity and realization of non-inflationary economic development of the national economy on a long run. The realization of this goal implicated fundamental refocusing of monetary and credit policy from sector support to a control over the inflation rate. In order to realize the basic economic and monetary goal, monetary policy measures were amended and coordinated by appropriate stabilization measures in the fiscal area and in the area of income policy.

In accordance with the goals of the stabilization program, at the end of 1993, there was a general projection of the monetary and credit policy for 1994, as well as detail monetary frameworks for the first half of 1994. The basic goal of the macroeconomic policy, and, within its frameworks the monetary policy for 1994, - was quantified as a decline of the inflation rate of 70% per annum. As a result of the disinflationary processes, the existence of significant macroeconomic imbalances, as well as of the deeper process of ownership and structural reforms in the national economy, the recession lasting for a number of years was expected to continue in 1994, though with smaller intensity, foreseeing the drop of the economic activity in the country by 8%. Other relevant assumptions on the movements of real variables, as well as on the projected values of the basic monetary aggregates for 1994, i.e., for the first half of the year, were the following:

Projection on real and monetary variables for 1994
and for the first half of 1994

(in percent)

	Projection for 1994	Projection for January - June, 1994
1. Inflation	70.0	38.0
2. SP	-8.0	-7.0
3. Exchange rate	<i>flexible</i>	<i>flexible</i>
4. Reserve money	83.6	30.9
5. New denar investments	35.3	11.1
6. Denar investments increase based on capitalized interest	-	16.9
7. Money supply M1 (including the Government sector)	80.7	28.6
8. Money supply M3 - denar amount	81.0	29.0

Basic intermediary goal through which the monetary policy should have influenced the profile of the global liquidity in the national economy for 1994, was the reserve money according to its narrowest definition (currency in circulation, holdings on the giro-accounts and assets in the vaults of the banks). At the same time, the movements of this monetary aggregate were the basic criterion for implementing the STF-arrangement in the monetary area. In 1994, therefore, the reserve money increase, according to the narrowest definition, was assumed to be 83.6%, and for the first half of the year there was an envisaged increase of this monetary aggregate of 30.9%.

Due to still undeveloped instruments for indirect regulation of money demand, and to the non-existence of strong financial discipline and deteriorated effect of the transmission mechanism obvious in non-flexible reactions of the economic subjects to the market signals, in 1994, it was envisaged to implement the instrument for direct control as well as to limit the increase of denar credits of the banks. Therefore, for 1994, net increase of bank denar credits of 35.3%, and, 11.1% for the first half of the year was allowed to entities from the private and social sector.

Monetary policy for 1994 was planned to be implemented under the conditions of flexible denar exchange rate regime, determined through free confrontation of the supply of- and demand for foreign exchange at the foreign exchange market. Although the foreign exchange rate was not a nominal anchor of the monetary policy, it was a basic indicator for its strength and for the feasibility of the projected restrictive exchange rate. Possible permanent real depreciation of the exchange rate was to be a signal of permanent decline of money demand, being an early indication for renewing the inflatory pressures, meaning that the existing course of the monetary policy was loose and needed tightening, i.e. more restrictive direction. On the other side, possible real appreciation of the exchange rate being a permanent one, would have indicated permanent increase of the real money demand, meaning that the monetary policy was too restrictive and should be loosened up. Anyway, primary goal towards which the monetary policy measures were directed in 1994, was to bring down the inflation.

The second indicator for implementing the monetary and credit policy in 1994 was to be the money supply M1. Throughout the increase of this monetary aggregate, the money supply was profiled to be sufficient enough for meeting the demand of the

population and of the economic subjects for money for transaction purposes. In accordance with the projected movements in the real and monetary variables, an increase of the money supply M1 for 1994 was projected to be 80.7%, and 28.6% for the first half of 1994. Money supply M3 - denar part, was projected to increase by 81.0%, and for the first half of 1994 the projected increase of this aggregate was 29.0%.

The discount rate of the National Bank of the Republic of Macedonia for 1994, was determined to be maintained on real positive level. Due to the lack of conditions for its market determination, it was concluded to determine the discount rate on model basis, where the realized average inflation rate is taken into consideration in the last two months on an annual level, increased by 5% per annum as a real part. The discount rate was not adjusted to the increase of the inflation rate being a result of the effect of the seasonal factors in the appropriate period.

In September 1994, with the initiation of the negotiations on extending stand-by arrangement, detail projection of the monetary and credit policy was determined for the second half of 1994. Considering the inflation rate brought down to a lower level than the projected one for the same period of the year, until the end of 1994, lower price target than the projected one was accepted, i.e., the inflation rate was foreseen to be 2.0% monthly average (or, 54.0% per annum, December 94/December 93). Thus, the acceleration of the inflation was avoided, as well as the need to decrease it more in the following period. It was determined that the reserve money, according to the narrowest definition, in the period of September-December 1994, to decrease by 20.9%, so that at the end of December 1994, without the influence of the seasonal factor they could amount Denar 4,810 million. In the last four months of 1994, cumulative increase of net denar credits of the banks to subjects from the private and social sector was projected to be 10.5%, and, at the end of the year the amount to reach Denar 21,058 million. In the period of September-December, 1994, money supply M1 (including the social sector) was expected to increase by 15.5%, so that at the end of 1994 it was assumed to be Denar 10,503 million (without the influence of the seasonal factors).

2.2. Actual goals and objectives of the monetary and credit policy in 1994

The monetary and credit policy in 1994 was realized under extremely difficult conditions. The most significant constraints for successful implementation of the monetary and credit policy and of the economic policy throughout 1994, were the following:

1. Economic embargo against the Republic of Macedonia, initiated at the beginning of 1994 by the southern neighbor, was impossible to be envisaged during the projection of the economic policy at the beginning of the year. The blockade of transport roads from South, accompanied by the implementation of the economic sanctions towards the northern neighbor and the dissolution of the traditional markets towards which the Macedonian economy was directed, resulted in continuation of the recession process in the country in 1994 as well.

2. Extremely high inflow of short-term capital as a result of the regional crisis, that determined permanently higher supply than the demand for foreign exchange at the foreign exchange market. This created a constant pressure on the appreciation of the denar exchange rate. The attempts of the National Bank of the Republic of Macedonia to prevent more intensive appreciation of the denar exchange rate through market interventions under limited monetary frameworks created conflicts in realizing the price stability target and the goal for preventing the appreciation of the exchange rate.

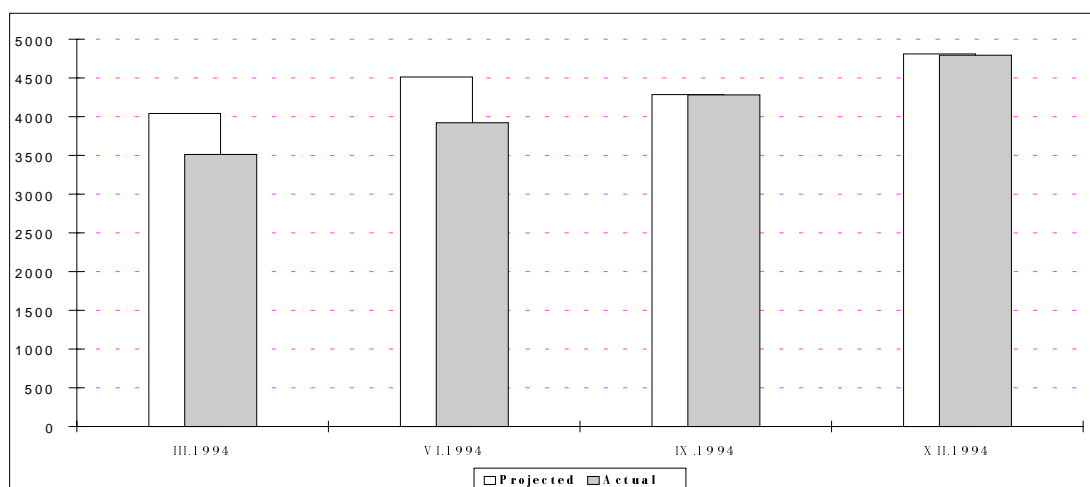
3. Unrehabilitated banking system of the Republic of Macedonia, which used to determine the illiquidity of certain banks under optimum global liquidity, i.e., the National Bank of the Republic of Macedonia was to intervene as for the additional measures for the liquidity potential.. This created difficulties in the realization of the monetary and credit policy presented in the contradictorial position of the liquidity, being the goal of the monetary and credit policy, on one side, and, the maintenance of the liquidity of individual banks, on the other. Simultaneously, in order to reach equal liquidity dispersion in the banking system, the National Bank of the Republic of Macedonia was acting as a broker in the distribution of liquid assets among separate banks.

Nevertheless, correct implementation of the restrictive course of the monetary and credit policy combined with complementary stabilization measures in the fiscal area and in the income policy, created also a possibility to realize basic stabilization targets under such economic conditions. Therefore, the inflation rate in 1994 was brought down to 55.4% per annum, which was by 14.6 percentage points lower than the projected increase for the beginning of the year (70% per annum). If the excessive increase of retail prices realized in January and February 1994 is excluded, in the rest of the year (March-December, 1994) there was an average inflation rate of 19.8% per annum, or, 1.8% monthly average. The dynamics of the decrease of the inflation was the most intensive at the end of the second and of the third quarter of 1994, so that the retail prices increase started to stabilize on 2.0% per month, which was maintained as such with a slight increase until the end of the year.

According to the narrowest definition, the reserve money, as the basic intermediary target of the monetary and credit policy in 1994, increased by Denar 2,120 million, or 62.7%. However, if this increase is adjusted to seasonal increase of currency in circulation at the beginning of the year of temporary and reversible character, deseasonable increase of reserve money in their narrowest sense in 1994, is Denar 1,724 million, so that at the end of 1994 this monetary aggregate was according to the projected position. Thus, there was a complete realization of the basic operative goal of the monetary policy for 1994: management and control over the reserve money increase, and, in the same time the criterion for meeting the STF arrangement in the monetary sphere was reached.

Graph 1

Projected and actual deseasonal positions of the reserve money according to the narrowest definition

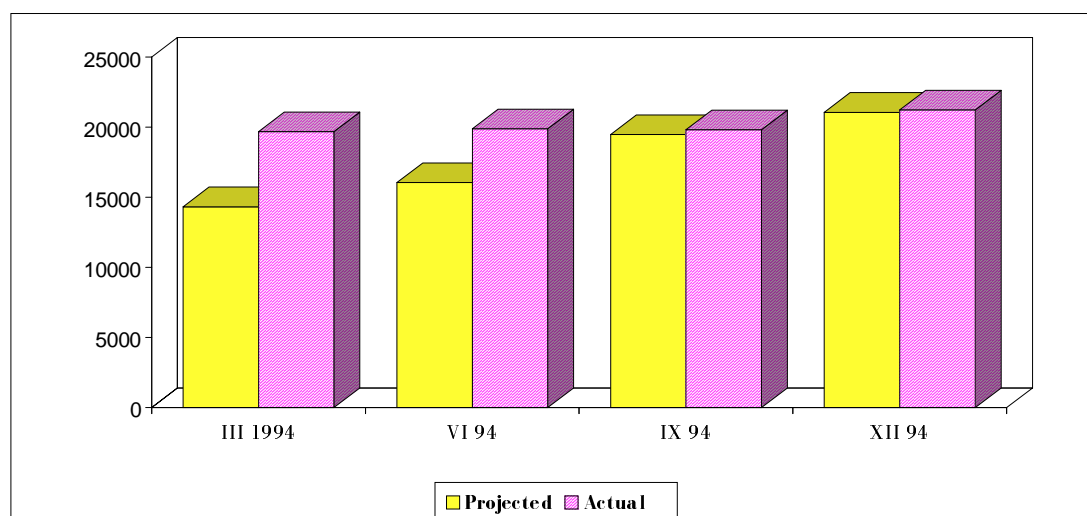


In the first half of 1994, there was an increase of reserve money in the narrowest sense of Denar 542 million, meaning 16.0%, which was under the projected increase in that period. The reason for realizing lower increase of the basic aggregate of the monetary and credit policy in the period of January-June, 1994 was that higher participation and currency in circulation increase were assumed during the projection at the beginning of the year, regarding the realized increase in the appropriate period. With the stabilization of the inflation rate and money demand, there was a change of the structure of money supply. There was a decline of the participation of currency in circulation and an increase of the participation of deposit money.

Denar credits of the banks, as the second important intermediary goal of the monetary and credit policy at the end of 1994, were Denar 21,232 million which is Denar 6,844 million, or by 47.6% more, compared to the same monetary aggregate at the end of 1993. The implementation of this instrument of direct examination of credit activity of banks in the monetary practice in the Republic of Macedonia throughout 1994, was being realized under great difficulties. Due to the remarkably rigid character of the demand for credits and the dependence of enterprises on credit funds, the credit activity of the banks in the Republic of Macedonia was hardly possible to be reduced to the projected limits in a short period of time. Nevertheless, discrepancy between the realized and projected (approved) increase of denar credits of the banks throughout 1994 was permanently decreasing. Thus, at the end of the year, the realized position of denar credits of the banks was Denar 174 million or only 0.8% higher than the approved and projected position at the end of 1994.

Graph 2

Projected and actual positions of new denar credits of banks



Exchange rate stability of domestic currency in small and open economies, as our economy is, is an essential factor for reaching and maintaining the stability of the general level of the prices. Hence, denar exchange rate was the basic indicator of the level of restrictive/expanded/ monetary and credit policy in the Republic of Macedonia in 1994. In the period of January-December, 1994, the denar depreciated in nominal terms compared to the German Mark by 1.8% only, whereas in the same period the nominal denar value compared to the US Dollar was increased by 9.1% (only as a result of the exchange relation between the Dollar and the German Mark on international foreign exchange markets). In the first quarter of 1994, denar value compared to the German Mark depreciated in nominal terms by 6.8%, whereas in the period of April-December, 1994, the denar exchange rate appreciated in nominal terms compared to the German currency by 4.7%.

Besides high nominal stability of the denar exchange rate, its real appreciation compared to the average of the Dollar and the German Mark in 1994 was 19.7%. Such movements were not appropriate to be treated as indicator for permanent increase of money demand in the national economy, meaning it was not possible to interpret them as a consequence of too high restrictive monetary policy. Denar exchange rate stability in 1994 was due to the influence of temporary factors, such as: a) high and permanent foreign exchange inflows in the country as a result of regional crisis, with a lack of appropriate capacity of the banking and economic system in order to direct them to profitable activities (increasing the demand for foreign exchange); b) unilateral temporary unfeasibility of credit obligations of the banks in the Republic of Macedonia towards foreign commercial banks, and; c) high nominal and real interest rates of denar savings deposits. In accordance with that, as a result of sudden decline of the inflation in 1994, it was estimated that real money demand on permanent basis was increased by 12% under real appreciation of denar exchange rate of 19.7%.

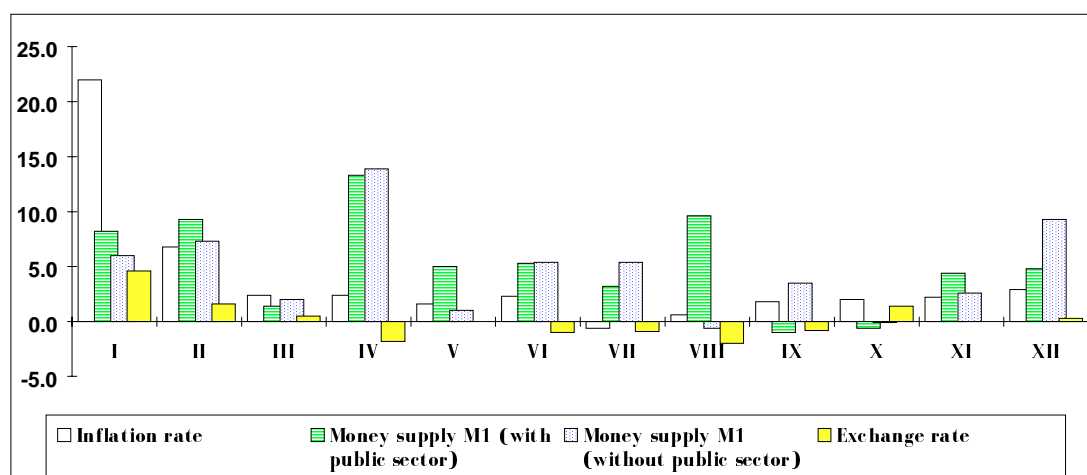
Second important indicator of the direction of the monetary and credit policy, i.e., of the supply and demand for money in the national economy - money supply M1 in 1994, together with the social sector increased by Denar 5,800 million, i.e., by

94.5%, which was 23.4 percentage points beyond the projected level. Besides the factors under the control of the monetary policy, the increase of money supply was influenced by factors where the monetary policy has no impact at all: a) excessive increase of currency in circulation at the end of the year of Denar 705 million, conditioned with the effect of seasonal factors (New Year and Christmas holidays); b) increase of deposit money of the Government beyond the projected level, on which accounts throughout the year, due to irregular inflow and outflow of funds, there was a significant amount that remained (with a movement that did not depend on the monetary policy measures, but on the fiscal policy measures - taxes, duties, contribution payments and usage of the budget funds). Without the Government deposits, the increase of money supply M1 in the private and social sector in 1994 was Denar 4,753 million, or 83.2%, and, c) the increase of real money demand in 1994 of 12% instead of the annual projected increase of 8.0%.

In the period of January - December 1994, money supply M3, being denar part together with Government deposits, reached an increase of Denar 7,168 million, or 63.3%. Out of that, in the first half of the year, the increase was Denar 4,726 million, or 41.7%, whereas in the second half of 1994, money supply M3, in its denar part, increased by Denar 2,442 million, or 15.2%.

Graph 3

Inflation rate movements. deseasonal money supply M1 and denar exchange rate



Efficient control over the increase of money supply is a needed prerequisite for the realization of stabilization targets of the monetary policy. In order to meet this prerequisite, there was a continuation of finalizing the process of reforms in the monetary area in 1994, initiated in 1993. Basic target of these reforms was to implement permanent control over money demand in the national economy, leading to permanent deceleration of the inflation rate and its maintenance in a long run. Most important changes in the economic area enabling efficient implementation of monetary and credit policy in 1994, were realized in three segments, as follows:

Firstly, with the abolishment of the selective credits of the National Bank of the Republic of Macedonia, the policy that lasted for years (policy of passive

adjustment of monetary measures on credit demand of economic subjects), ceased, i.e., the accommodative concept of the monetary policy was abolished. This fundamental change was also refocusing the monetary policy target to reducing the inflation and its maintenance on a low level, instead of supporting and meeting the needs of liquid assets of certain enterprises from sectors of priority.

Secondly, through the undertaken measures of consolidation in the fiscal sector at the beginning of 1994 (amended by corrective measures until mid-year), a significant decrease of the fiscal deficit in 1994 was expected of about 6% (throughout the year revised to 4.1% of GSP), in relation to high participation of budget deficit in the GSP of the country of 11.1% in 1993. Namely, throughout the previous years there was no explicit determination of budget deficit at the beginning of the year. Thus, in situation when the budget did not meet its regular obligations towards the users of budget funds, the users of these funds had two alternatives: a) to borrow from the banks, or b) to borrow from one another, extending the chain of illiquidity in the national economy. In both cases, such credit pressure had an adverse impact on leading the monetary and credit policy, i.e., it regularly forced relaxation of monetary frameworks (so called "accommodative concept"). At the beginning of 1994, for the first time, there was a projection of budget deficit for the current year, with estimated real (non-inflatory) financing resources. As a result of a significant rationalization of expenses, form one side, and extension of fiscal grounds and enlargement of the efficiency in collecting the income, on the other, - in 1994, there was a significant fiscal adjustment, and, the budget deficit was reduced to 2.6% of the Gross Social Product of the country. Thus, the pressure on the credit activity of the banks in this sense, was completely eliminated, as well as on the monetary and credit policy of the National Bank of the Republic of Macedonia.

Thirdly, proper implementation of the Law on wages and pensions in 1994, enabled to cease the tendency of constant protection of real wages, without paying attention to the productivity, efficiency and results, which was characteristic for the activities of economic subjects in the previous years. At the end of 1994, average wage per worker was nominally higher by 33.4% from the average net wage per worker at the end of 1993, meaning that throughout 1994, there was real decrease of 14.1%. Through the reduction of real spending capacity of the population in 1994 great disparity between real wages and labor productivity created in 1993, was partially compensated. Simultaneously, the control and real decrease of wages throughout 1994 enabled decrease of the pressure on the monetary and credit policy to a decrease of money demand for paying the personal income by economic subjects. This created real possibilities to cease the spiral that lasted for years: wages - money supply - inflation.

III. MONETARY AND CREDIT DEVELOPMENTS

3.1. Creation and withdrawal of money supply

The Central Bank can realize price stability as its objective in long run only indirectly, through the regulation of monetary supply. Hence, bringing down and stabilizing the inflation rate as ultimate objective of the 1994 monetary policy was based on optimum injection of money and credits in the national economy. They were nominal anchors highly connected with the inflation rate development.

Money supply is a main indicator of the cost potential of the economy and an indicator of further inflation rate development. As for better definition and control, from July 1, 1995, the National Bank of the Republic of Macedonia adopted new methodology for defining monetary aggregates, adjusted to the standards of the International Monetary Fund, where the timing of processed data started on December 31, 1993. According to the new methodology, the National Bank of the Republic of Macedonia defined the money supply through the usage of the following monetary aggregates: M1, M11, M2, M3, M4 and M5. Government deposits were excluded from all definitions of money supply, because of the specific social sector regarding the behavior compared to the other sectors of the national economy. Its specification is a result of the opportunity of the Government to spend more than the available liquid assets, by financing its expenditures through the creation of budget deficit.

Creation and withdrawal of money supply (M1)^{1/}

	Changes (in million denars)					Indices of money supply increase (in %)			
	I-III. 94	IV-VI.94	VII-IX.94	X-XII.94	I-XII.94	<u>III.94</u> XII.93	<u>VI.94</u> XII.93	<u>XII.94</u> XII.93	<u>XII.94</u> XII.93
M1 (social sector excluded)	912	1,409	680	1,752	4,753	16.0	40.6	52.5	83.2
Net forex assets ^{2/}	-679	3,177	3,570	517	6,585	-11.9	43.7	106.2	115.3
Domestic credits	10,585	6,745	2,428	10,173	29,931	185.3	303.3	345.8	523.9
Deposit banks	9,189	7,391	2,344	10,176	29,100	160.9	290.2	331.2	509.3
- denars	8,775	6,513	3,754	9,986	29,028	153.7	267.6	333.3	508.0
- forex ^{2/}	414	878	-1,410	190	72	7.2	22.6	-2.1	1.3
National Bank	1,396	-646	84	-3	831	24.4	13.1	14.6	14.6
Other items, net	-7,371	-6,233	-4,725	-8,720	-27,049	-129.0	-238.1	-320.8	-473.5
Non-monetary deposits (social sector excluded)	-1,623	-2,280	-593	-218	-4,714	-28.4	-68.3	-78.7	-82.5

1)(+) Creation of money supply (M1).

(-) Withdrawal of money supply (M1).

2) Positions evaluated according to the constant exchange rate (end December 1993 1USD = 44.4558), developments evaluated according to current exchange rate.

Nominal money supply (M1)¹, from the point of view of the definition of monetary aggregate, excluding the participation of deposits in the social sector, at the end of 1994, compared to December 1993, reached an increase of Denar 4,753 million, or, 83.2%. Thus, money supply (M1), considered by quarters, was characterized by uneven dynamics of increase, as for the fact that there was higher increase in the second and in the fourth quarter compared to the increase in the first and third quarter. In the first quarter, money supply (M1), increased by Denar 912 million (16.0%); in the second quarter by Denar 1,409 million (21.3%); in the third quarter by Denar 680 million (8.5%), and, in the fourth quarter by Denar 1,752 million (20.1%).

Throughout 1994, considered by months, i.e. quarters, money supply developments were determined by factors affecting its creation or withdrawal. So, factors that in 1994 had an impact on money supply creation (M1) were the transactions comprised in net foreign exchange assets of the monetary system and domestic credits in the monetary system. Regarding the foreign exchange assets, an exception was the first quarter of the year where the foreign assets declined and caused withdrawal of money supply (M1). Throughout the rest of the year, net foreign assets developments resulted in creating money supply (M1), although with uneven dynamics. Domestic credits of the monetary system were the main flow of building up money supply (M1) in 1994, being a result of the continuation and the intensity of their growth.

On the other side, transactions included in the frameworks under items "Others", "Net" and "Non-monetary deposits"- are developments of money supply (M1) withdrawal. Other assets, net, except for the fourth quarter, with their decrease, had relatively even and, regarding the intensity, most prominent effect on the money supply (M1) withdrawal. Non-monetary deposits development throughout 1994, compared to other net items, was less prominent development of money supply withdrawal (M1), also characterized with high variability.

Cyclic dynamics of money supply increase (M1) throughout 1994 was a reflection of the increase of its basic components: currency in circulation and deposit money.

Currency in circulation is an economic category whose development is determined first of all by the behaviors of the subjects from the non-financial sector, i.e., the understandings of the enterprises and population regarding the need to "hold" cash on their own portfolio. Furthermore, institutional resolutions had their influence on the developments of currency in circulation arranging the payment transactions and income and pension payments. In 1994, currency in circulation increased by Denar 1,955 million, or 69.2%. The tendency to gradual decrease of their average participation in money supply (M1) commenced in the previous years, continued throughout 1994, mostly highlighted in the period of May - December. In the first four months of the year, there was an average participation of currency in circulation in money supply (M1) of 47.5%, whereas in the rest of the year, it was brought to 44.4%. The decrease was a result of the fall of demand for cash, first of all because of

¹Money supply (M1) in its definition comprises currency in circulation + deposit money (giro- and current accounts) as financial obligations of the monetary system which could be used as legal tender.

bringing down and stabilizing the inflation rate, the efforts to increase the control over the financial developments, significant removal of inflatory expectations of the population, and, its increased confidence in the monetary policy of the Central Bank. The exceptions were the months of April, July and December, 1994, being three periods of strong seasonal influence. In those months, there was a sharp increase of the currency in circulation participation in money supply (M1), so that the increase in April was a result of the increase of demand for cash because of the Worker's Day and Easter holidays, whereas in July and December, regarding the summer and winter holidays as well as the new years holidays, respectively.

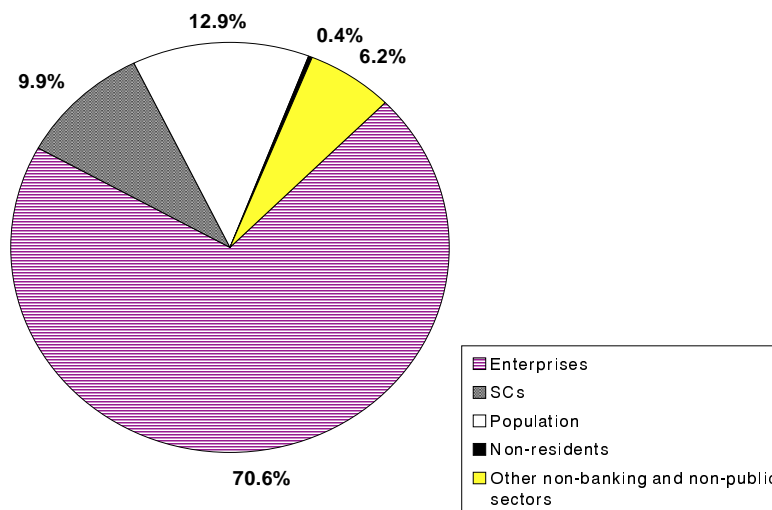
As a whole, besides the declining tendency of demand for cash throughout 1994, the entities from the non-financial sector reached high opportune expense by "holding" cash. This expense presented through the interest rate, possible to be received under the conditions of real positive passive interest rates in 1994, if the entities had substituted cash in their portfolios with deposits with deposit banks.

In 1994, deposit money (excluding the deposits from the social sector, as the monetary aggregate M1 is defined) had faster increase of currency in circulation, increasing by Denar 2,798 million, or 96.9%. Taken quarterly, they had an imbalanced increase, mainly in the second and the fourth quarter, and the least significant in the third quarter of 1994.

Graph 1

Sector division of deposit money in 1994

(average participation in %)



Sector division of deposit money in 1994 shows that they are still in the biggest part in the assets of the enterprises, an average amount of 70.6% of the total deposit money, increasing by Denar 2,253 million or 114%, in the observed period. In the area of enterprises, deposit money reached their biggest increase in the last quarter of 1994, although their participation in percentage in total amount of deposit money was the highest (75.3%) regarding the first quarter of the year. In the population area, deposit money are on the second place according to their participation in total deposit money, which was an average amount of 12.9% throughout 1994. During the observed period, the participation of deposit money of the population was significantly

decreased at the end of the first quarter, reaching its peak at the end of the second quarter of the year and total increase of Denar 46 million, (8.8%) in the complete period. Under deceleration of the inflation rate and attractive interest rates of deposits with lower liquidity than deposit money, preferences of the population were to decrease as much as possible the participation of the items of the portfolio that bring the lowest profit. Therefore, in the second half of 1994, there was continued decrease of deposit money participation of the citizens in the total amount of deposit money, so that, at the end of the year, it was 10.0% compared to 18.0% at the end of 1993. Throughout 1994, other sectors (Self-managing Communities, non-residents and other non-government and non-banking entities) had a slight increase of their deposit money compared to total deposit money, reaching an average participation of 9.9%, 0.4% and 6.2%, respectively.

3.2. Net foreign assets

Net foreign assets of the monetary system in 1994 were increased by Denar 6,585 million or 48.5%, being a result of the actual increase with the National Bank of the Republic of Macedonia and with the commercial banks. Net foreign assets of the National Bank of the Republic of Macedonia increased from Denar 1,248 million (24.3%), so that the foreign assets increased by Denar 2,009 million, or by 37.9%, whereas the foreign obligations were increased by Denar 761 million or by 455.7%. In the observed period, net foreign assets of banks increased by Denar 5,337 million, or by 28.5%, as a result of the increase of their foreign assets of Denar 3,315 million, or by 47.1%, and, a decrease of their foreign exchange obligations towards non-residents by Denar 2,022 million, or by 7.8%. Not meeting credit obligations of the banks towards the foreign commercial banks was the basic factor that had an impact leading to maintenance of foreign exchange obligations of the banks abroad on an almost unchanged level. Single bigger payment abroad in 1994, was the payment of accrued obligations of the banks towards the World Bank, whose obligations had been undertaken and paid by the Government. In the balance sheets of the banks, this decrease of their obligations abroad was present in the position from September 1994, where the part of the obligations towards the World Bank undertaken by the Government was deducted from the foreign exchange claims of the banks on the Government.

Quarterly speaking, net foreign assets of the monetary system had a drop in the first quarter 1994, and, in the rest of the year it grew, resulting in slowing down in the last quarter. The decrease of the first quarter was Denar 679 million (5.0%), whereas the increase was Denar 3,177 million (22.3%) in the second quarter, Denar 3,570 million (32.2%) in the third, and, Denar 517 million (6.9%) in the fourth quarter.

As a creation/withdrawal of money supply (M1), foreign exchange operations of the monetary system included in its net foreign assets, appear as one of the two developments in building money supply in 1994. Development of net foreign assets of the monetary sector is presented without taking into account the variations in the denar foreign exchange, excluding the effects of exchange rate deviations and presenting only real monetary effects on the creation, or withdrawal of money supply (M1). Except for the first quarter of the monitored period when the changes of net

foreign assets of the monetary system resulted in withdrawal of money supply of 11.9%, in the rest of 1994 (especially in the second and third quarter), it generated an increase of money supply. So, the increase of net foreign assets of the monetary system in the second quarter of the year determined money supply (M1) creation of 55.6%, 62.5% in the third quarter, and, 9.0% in the last quarter.

3.3. Bank investments

Domestic credits are residual development of creation and withdrawal of money supply. Through this development the effects of creation, or, withdrawal of money supply are neutralized from other development (net foreign assets, other net items, non-monetary deposits). The Central Bank influenced the credit activity of the banks through the profile of the liquidity of the banking system. However, due to the inflexibility of the credit activity of the banks compared to their liquidity, ceilings in denar investments of the banks were used as an instrument for reaching the projected increase of money supply (M1) in 1994.

Domestic credits of the monetary system were the main component of building up money supply in 1994, in order to neutralize high withdrawal of money supply (M1) to other items net and non-monetary deposits. Quarterly speaking, the increase of domestic credits of the monetary system determined the creation of money supply (M1) of 185.3% in the first quarter, 118.1% in the second, 42.5% in the third quarter and 178.1% in the last quarter of the year. In the first quarter of the monitored period, domestic credits were the only development of money supply creation in the national economy, as for the fact that in this period, foreign transactions (net foreign assets in the monetary system) resulted in withdrawal of money supply in order to meet the obligations towards the World Bank. Domestic credits were the most intensive component of creating money supply in 1994, except for the third quarter of the year, when the foreign exchange transactions of the monetary system acted with greater impact.

Domestic credits extended within the frameworks of the monetary system in 1994, increased by Denar 29,931 million, or by 66.5%. The foreign exchange component of domestic credits was presented in a way that shows real monetary effects on the creation/withdrawal of money supply (M1), excluding the changes of the denar exchange rate, meaning the effects of the actual exchange rate deviations. Domestic credits increase in the monetary system was irregular by nature. High increase from the first quarter was followed by a significant deceleration throughout the year until the repeated jump in the last three months. Thus, in the first quarter, there was an increase of Denar 10,585 million or 23.5%; Denar 6,745 million in the second quarter or 12.1%; only Denar 2,428 million in the third quarter or 3.9%; resulting in sharp increase of Denar 10,173 million, or 15.7%. These developments were the consequence of changes that appeared with the domestic credits extended by deposit banks, as well as with domestic credits of the National Bank of the Republic of Macedonia.

Therefore, in 1994, deposit banks increased their domestic credits by Denar 29,100 million, or, 65.7%, so that there was an increase of Denar 9,189 million or

20.7% in the first quarter, Denar 7,391 million or 13.8% in the second quarter, Denar 2,344 million or 3.9% in the third, and Denar 10,176 million or 16.1% in the last quarter of the year.

Domestic credits of deposit banks

	Position (in mill. den..)					Changes (in mill. den)				
	31.12.93	31.03.94	VI.94	IX.94	XII.94	I-III.94	IV-VI.94	VII-IX.94	X-XII.94	I-XII.94
Domestic credits	44,295	53,484	60,875	63,219	73,395	9,189	7,391	2,344	10,176	29,100
Denar credits	25,047	33,822	40,335	44,089	54,075	8,775	6,513	3,754	9,986	29,028
Claims on Government, net	-129	-264	-639	-1,111	-926	-135	-375	-472	185	-797
- credits	87	72	84	83	78	-15	12	-1	-5	-9
- interest	229	427	541	654	786	198	114	113	132	557
- Government deposits	-445	-763	-1,264	-1,848	-1,790	-318	-501	-584	58	1,345
Claims on subjects from social and private sector	25,176	34,086	40,974	45,200	55,001	8,910	6,888	4,226	9,801	29,825
-credits	14,388	16,277	18,152	19,813	21,232	1,889	1,875	1,661	1,419	6,844
-interest	10,788	17,809	22,822	25,387	33,769	7,021	5,013	2,565	8,382	22,981
Forex credits */	19,248	19,662	20,540	19,130	19,320	414	878	-1,410	190	72
Claims on Government, net	10,849	11,038	11,042	9,650	9,414	189	4	-1,392	-236	-1,435
Claims on entities from social and private sector	8,399	8,624	9,498	9,480	9,906	225	874	-18	426	1,507

*/ Positions valued according to a constant exchange rate (end-December 1993 IUSD=44.4558); developments calculated according to the current exchange rate.

From the point of view of the currency in which the claims were nominated, total denar investments had a dominant place in the increase of total domestic credits of the banks. Claims based on new credits and capitalized interest from economic entities from the social and private sector and the Government were included, whereas the claims on Government were presented on net basis. Total denar investments in 1994 increased by 29,028 million or by 115.9%, enlarging therefore their participation in total domestic credits of the banks by 56.5% at the end of 1993, and, by 73.7% at the end of 1994. Starting from the first quarter of 1994, quarterly defined, total denar claims increased of Denar 8,775 million or from 35.0%; Denar 6,513 million or 19.3%; Denar 3,754 million or 9.3%, and Denar 9,986 million or 22.6% respectively.

Considered by sectors, the increase of total denar claims by the banks (new credits and capitalized interest), resulted first of all from the claims of the banks on economic entities from the private and social sector. Denar claims of the banks on this sector in 1994 increased by Denar 29,825 million, or, 118.5%, having a quarterly deceleration of the increase of Denar 8,910 million or 35.4% in the first quarter, Denar 6,888 million or 20.2% in the second, Denar 4,226 million or 10.3% in the third, resulting in acceleration gain of the increase in the last quarter of the year in amount of Denar 9,801 million or 21.7%. The actual increase was determined within the

increase of this sector mostly by the increase of the claims based on capitalized interest, that throughout 1994 increased of Denar 22,981 million or 213.0%. The increase by quarters was the following: Denar 7,021 million or 65.1% in the first quarter; Denar 5,013 million or 28.1% in the second; Denar 2,565 million or 11.2% in the third and Denar 8,382 million or 33.0% in the last quarter of the year. Thus, claims based on capitalized interest enlarged their participation in total denar claims on entities from the private and social sector in amount from 42.9% on December 31, 1993 to 61.4% at the end of the year.

Developments of new denar credits of the banks extended to economic entities from the private and social sector as the next important intermediary objective of the monetary policy, was especially important throughout 1994. In cumulative terms, throughout the considered period these credits increased by Denar 6,844 million or by 47.6%. Quarterly, there was an increase of Denar 1,889 million or 13.1% in the first quarter; Denar 1,875 million or 11.5% in the second; Denar 1,661 million or 9.2% in the third, and, Denar 1,419 million or 7.2% in the last quarter of the year. Although there were certain constraints of the increase of investments (in the first half of the year the constraint referred to the principal and to the interest, and in the second half of the year only to the principal), the actual effects were of suboptimal character. On one side, the reason for that is the rigid character of demand for credits of the enterprises and their lack of financial discipline presented in a high amount of not fulfilled obligations towards the banks. On the other side, facing the lack of qualitative investment programs offered to enterprises and with a desire to enable the enterprises to pay back the non-performing loans, banks continued to extend new credits.

Denar claims of the banks on social sector analyzed on net basis, resulted in negative change of Denar 797 million in 1994, due to a great extent to the significant increase of Government deposits with the banks. Government deposits with the banks increased by Denar 1,345 million or by 302.2%, so that in the first quarter there was an increase of Denar 318 million or 71.5%; an increase of Denar 501 million or 65.7% in the second, and, in third quarter there was an increase of Denar 584 million or 46.2%, whereas in the last quarter of the year there was a decrease of Denar 58 million or 3.1%. The highest participation in the increase of deposits of the social sector was in Government deposit money with a determined development by the measures of the fiscal policy (collecting taxes, duties, using budget funds, etc.), that, throughout 1994, especially due to higher efficiency in collecting taxes, were increased by Denar 1,047 million or by 245.2%. Claims of the banks on social sector, based on extended credits on December 31, 1994 reached Denar 78 million, lowering the level compared to the position at the end of 1993 by Denar 9 million or by 10.3%. On the other side, claims of the banks on social sector based on capitalized interest throughout 1994 increased by Denar 557 million or 243.2%. Quarterly, there was relatively equal increase starting from the first quarter of Denar 198 million or 86.5%; Denar 114 million or 26.7%, Denar 113 million or 20.9%, and, Denar 132 million or 20.2% respectively.

Unlike denar claims, in 1994, foreign exchange claims of the banks increased only by Denar 72 million or by 0.4%, having rather imbalanced developments. In the first quarter of the year, foreign exchange claims of the banks increased by Denar 414 million or by 2.2%, in the second quarter they increased by Denar 878 million or by 4.5%; in the third quarter there was a significant decline of Denar 1,410 million or

6.9%, and, in the last quarter of the year there was an increase again of Denar 190 million or 1.0%. Decrease of foreign exchange claims in the third quarter of 1994 was a consequence of a decrease of claims in foreign exchange of the banks on the Government, based on the realized payment of the obligations of the banks to the World Bank by the Government. From a point of view of sectors, this was a reason of a decrease of foreign exchange claims of the banks on the Government in 1994 in amount of Denar 1,435 million or 13.2%, as for the fact that, the decline in the third quarter of Denar 1,392 million or 12.6% by adding the decrease in the fourth quarter of Denar 236 million or 2.4%, was big enough to go beyond the limits of the small increase of Denar 193 million or 1.8% realized in the first quarter of 1994. On the other side, claims in foreign exchange of the banks on economic entities from the private and social sector increased by Denar 1,507 million or by 17.9%. The actual increase of these claims of the banks of 39.9% was mostly a result of the increase of accrued claims of banks on these entities.

Domestic credits of the National Bank of the Republic of Macedonia (claims on Government, net) throughout 1994 increased by Denar 831 million or by 115.3%, also having imbalanced development as it was the case of deposit banks. So, in the first quarter, there was an increase of Denar 1,396 million or 193.6%, a decrease in the second quarter of Denar 646 million or 30.5%, again, in the third quarter there was an increase of Denar 84 million or 5.7%, and, in the last quarter of the year there was a decrease of insignificant Denar 3 million or 0.2%.

3.4. Other net assets

Other net items are a heterogeneous category comprising interbanking transactions recorded in the balance sheets of the banks on capital accounts; claims of the banks on the Government based on frozen foreign exchange savings deposits of the citizens and mutual claims and commitments on the banks from former SFR Yugoslavia, being a subject of the succession of assets and liabilities. The category "Other items, net" was realized directing continuing decrease throughout 1994 reaching cumulative decline of Denar 27,049 million or 122.7%. The decline was Denar 7,371 million or 33.4% in the first quarter; Denar 6,233 million or 42.5% in the second; Denar 4,725 million or 55.9% in the third, and Denar 8,720 million or 134.3% in the last quarter of the year. From the point of view of the creation/withdrawal movements of money supply, transactions under category "Other items, net" throughout 1994, were a withdrawal of money supply, that with almost equal intensity influenced in an opposite direction than the transactions of domestic credits affecting the monetary system, almost neutralizing, through this movement, the effects of money supply creation. Quarterly speaking, the increase of "Other items, net" determined withdrawal of money supply (M1) of 129.0% in the first quarter, 109.1% in the second, 82.7% in the third, and 152.6% in the last quarter of 1994.

3.5. Non-monetary deposits

In 1994, total non-monetary deposits of the monetary system (excluding public sector) expressed a withdrawal of money supply (M1), reaching Denar 52,477 million

till the end of the year, which, compared to the beginning of the year was a cumulative increase of Denar 4,714 million or 9.9%. Foreign exchange component of non-monetary deposits was presented so that it gave only real monetary effects on creation or withdrawal of money supply (M1) excluding denar exchange rate changes, i.e., excluding the effects of the realized exchange rate deviations. The increase of non-monetary deposits in 1994 was considered by quarters with an unequal dynamics. In the first quarter, there was an increase of Denar 1,623 million or 3.4%; in the second quarter there was an increase of Denar 2,280 million or 4.6%. In the second half of the year, there was a deceleration in the increase of Denar 593 million or 1.1% in the third quarter, and Denar 218 million or 0.4% in the last quarter of 1994.

Changes created throughout the non-monetary deposits movements, regarded from the point of view of their effects on the creation and withdrawal of money supply (M1), show the overflow in the relation between money supply (M1) - non-monetary deposits. Thus, the non-monetary deposits increase is a withdrawal of money supply (M1) and vice versa. Hence, the continuing increase of non-monetary deposits in 1994 had a monetary impact resulting in an overflow from money supply (M1) to the non-monetary deposits, i.e., money supply (M1) withdrawal amounting Denar 4,714 million (82.5%), or by quarters: 28.4% in the first quarter, 39.9% in the second quarter; 10.4% in the third and 3.8% in the last quarter of 1994. Out of that, Denar 3,644 million of money supply (M1) were overflowed on the basis of the increase of total foreign exchange non-monetary deposits with a constant increase throughout the whole year, or by quarters: Denar 580 million in the first quarter, Denar 1,737 million in the second; Denar 870 million in the third quarter, and, Denar 457 million in the last one. On the other side, denar non-monetary deposits increased as a withdrawal of money supply (M1) only in the first half of 1994, in amount of Denar 1,043 million in the first and Denar 543 million in the second quarter of the year. In the second half of 1994, there was a decrease of denar non-monetary deposits of Denar 277 million in the fourth quarter, as an overflow to the opposite direction, from the denar non-monetary deposits to the monetary aggregate M1. That was a money supply creation, compensated by a bigger increase of total foreign exchange non-monetary deposits, which actually only decreased money supply (M1) withdrawal realized in the second half of the year.

Changes of total non-monetary deposits can be analyzed from a different point of view, when they are presented through definitions of monetary aggregates M2, M3 and M4. Within the frameworks of total non-monetary deposits presented this way, their foreign exchange component is shown according to the current denar exchange rate, without eliminating the effects of the exchange rate deviations

Non-monetary deposits

	Positions (in million denars)					Changes (in mill. denars)				
	31.12.93	3.94	6.94	9.94	12.94	01-03.94	04-06.94	07-09.94	10-12.94	01-12.94
(M1-M2)total:	7948	8983	9300	8924	8465	1035	317	-376	-459	517
a) in denars	3560	4596	4843	4502	3784	1036	247	-341	-718	224
Demand deposits	506	385	462	531	563	-121	77	69	32	57
Short-term denar deposits	2426	3157	2996	2474	1981	731	-161	-522	-493	-445

	Positions					Changes				
	(in million denars)					(in mill. denars)				
Short-term credits of non-financial entities	628	1054	1385	1497	1240	426	331	112	-257	612
Securities	0	0	0	0	0	0	0	0	0	0
a) in foreign exchange	4388	4387	4457	4422	4681	-1	70	-35	259	293
New foreign exchange short-term deposits	4388	4387	4457	4422	4681	-1	70	-35	259	293
Foreign exchange short-term securities	0	0	0	0	0	0	0	0	0	0
(M3-M2) total:	51	53	68	59	73	2	15	-9	14	22
Denar time deposits	51	53	68	59	73	2	15	-9	14	22
(M4-M3) total:	1552	1590	1915	1959	2485	38	325	44	526	933
a) in denars	1552	1557	1867	1911	2433	5	310	44	522	881
Long-term time deposits	1552	1547	1863	1907	2429	-5	316	44	522	877
Long-term credits from non-financial entities	0	10	4	4	4	10	-6	0	0	4
Securities	0	0	0	0	0	0	0	0	0	0
b) in foreign exchange	0	33	48	48	52	33	15	0	4	52
Long-term deposits	0	33	48	48	52	33	15	0	4	52
Securities	0	0	0	0	0	0	0	0	0	0

Demand deposits, quasi deposits, short-term credits to entities in non-financial sector and the obligations from their issued short-term securities, being the substance of monetary aggregate M2, after eliminating monetary aggregate M1, reached total increase of Denar 517 million or 6.5% in 1994. Their development in the respective period was changeable. In the first half of the year they increased: Denar 1,035 million or 13.0% in the first, and, Denar 317 million or 3.5% in the second quarter, changing to a decrease throughout the rest of the year, being Denar 376 million or 4.0% in the third, and, Denar 459 million or 5.1% in the fourth quarter.

Denar component of the mentioned categories of monetary aggregate M2² followed the tendency completely, growing in the first half of the monitored period and declining throughout the rest of the year. Demand deposits developments in 1994 was without any significant impact on the increase of the total denar component. Their total increase was Denar 57 million or 11.3%, decreasing significantly in the first quarter by Denar 121 million or 23.9%, whereas in the second, third and the fourth quarter they increased by Denar 77 million or 20.0%, Denar 69 million or 14.9% and Denar 32 million or 6.0%, respectively.

Major determinators of the denar component were the short-term deposits (deposits with the maturity of less than a year), and, the funds granted as short-term credits from non-financial entities, being to opposite directions in 1994. Short-term denar deposits, after their sharp increase in the first quarter (Denar 731 million or 30.1%), were declining rapidly until the end of the year, which by quarters amounted, as follows: Denar 161 million or 5.1% in the second quarter; Denar 522 million or 17.4% in the third quarter, and Denar 493 million or 19.9% in the fourth quarter. This

²Monetary aggregate M2 (liquidity assets) definition comprises monetary aggregate M11 and other financial instruments with maturity up to 1 year. They include quasi deposits (deposits up to 1 year), liabilities on basis of issued securities and credits up to 1 year from non-financial sector.

was a consequence of the presented sharp decrease of short-term denar deposits in all sectors in amount of Denar 590 million or 32.2% (public sector not being included in the monetary aggregates definition) except for the sector of citizens with short-term denar deposits increased by Denar 145 million or 24.5%.

On the other side, obligations of the banks regarding the extended short-term credits from non-financial entities (enterprises) in 1994 had significantly large part in the increase of the portion of monetary aggregate M2 which results after excluding the aggregate M1. They increase by Denar 621 million or 97.5%. These credits are specific deposits with an interest rate being a subject of internal agreement between the bank and the enterprise as a depositor. Throughout the first half of 1994, the Central Bank acted with a "moral persuasion" towards the deposit banks in order to have them their interest rate adjusted according to the signals sent by the Central Bank. This resulted in implementation of the so-called "gentlemen" agreement (in May 1994) on interest rate policy of deposit banks. In order to extend their deposit basis, deposit banks started the indebtedness with economic subjects from non-financial sector (enterprises) in credits with an interest rate possible to be agreed on a higher level than the projected one with the interbank agreement.

It is characteristic that the foreign exchange quasi deposits in 1994 increased faster than the denar component of this monetary aggregate. Throughout the year they increased by Denar 293 million or 6.7%. Foreign exchange quasi deposits increased mainly in the last quarter of the year (Denar 259 million or 5.9%). Considered by sectors, the increase of foreign exchange quasi deposits in total is due to continued and stable increase of deposits of the citizens from Denar 511 million on December 31, 1993 to Denar 803 million on December 31, 1994, since the foreign exchange quasi deposits of the enterprises at the end of 1994 remained on the same level as on December 31, 1993.

In 1994, time deposits, being the difference between the monetary aggregates M2 and M3³, increased by Denar 22 million or 43.1%, without a significant effect on global developments of total non-monetary deposits.

Long-term deposits, long-term credits from subjects in non-financial sectors and the obligations regarding issued long-term securities, as a difference between monetary aggregates M3 and M4⁴, in 1994, compared to all the other non-monetary deposits, reached the biggest increase of Denar 933 million or 60.1%. This was determined, primarily, by the dynamics in long-term denar deposit increase of Denar 877 million or 56.5% so that, besides the minimum fall in the first quarter of the year (of Denar 5 million), increased throughout the year. Regarded by sectors, the enterprises increased their long-term deposits by Denar 111 million or by 132.1%, and

³Monetary system total liquidity assets are shown with monetary aggregate M3. It comprises monetary aggregate M2 and restricted deposits. Restricted deposits are short term monetary system instruments with special purposes use (letter of credit, assets used as guaranties and e.t.c.).

⁴Monetary aggregate M4 represents the total deposit potential of the monetary system of the Republic of Macedonia. In its definition, this aggregate comprises the contents of the monetary aggregate M3 and financial instruments of the monetary system with the maturity over a year. This also includes long-term borrowed assets as credits from economic subjects from the non-financial sector and the obligations regarding issued long-term securities.

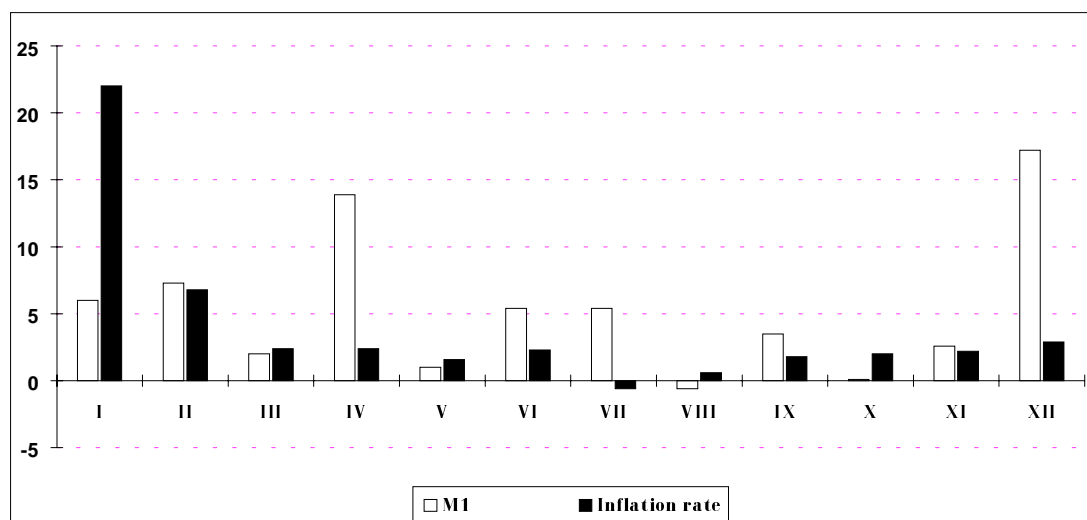
the population increased their deposits by Denar 732 million or 49.8%. Such a development was a result of high real positive interest rates of this kind of deposits, being rather attractive under the realized stability on general level of prices throughout 1994. Long-term foreign exchange deposits, belonging strictly to the citizens, in the same period increased by Denar 52 million, as a result of the increase in the first half of the year.

3.6 Relation between the money supply and the inflation

Each of the monetary aggregates in 1994 reached different level of connection to the inflation rate development. Considered separately, the average increase of the monetary aggregate M1 in 1994 was 5.3% monthly speaking, and, the average inflation rate increase per month was 3.9%. Therefore, the ratio between the monetary aggregate M1 and the inflation rate was 1.36 : 1.

Graph 2

Monetary aggregate M1 movement and the inflation rate
- 1994 - in %



In 1994, the average monthly increase of monetary aggregate M2 was 2.9% which, with an average monthly inflation rate of 3.9%, showed that there was a ratio between this monetary aggregate and the inflation of 0.74 : 1.

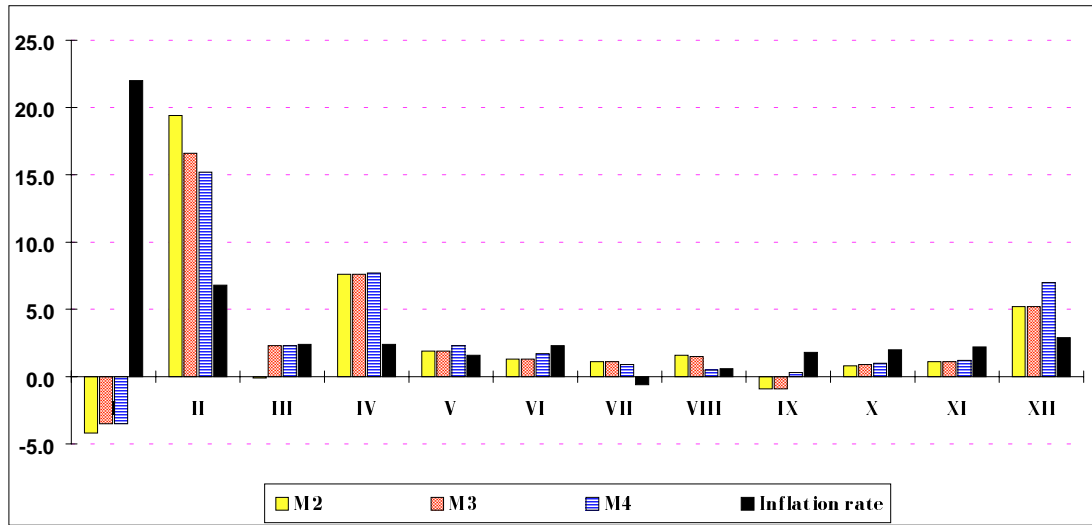
Monetary aggregate M3 in 1994, had an identical average monthly increase of 2.9%, as well as the monetary aggregate M2, and, it consequently reached the same ratio with the inflation of 0.74 : 1.

Approximately, monetary aggregate M4 in 1994, increased by 3.1% that, with the realized average monthly inflation rate of 3.9% was a ratio of 0.79 : 1 between this aggregate and the inflation.

Graph 3

Developments of monetary aggregates M2, M3 and M4 and the inflation rate
- 1994 -

in %



IV. DEVELOPMENTS OF THE CREATION AND OF THE WITHDRAWAL OF RESERVE MONEY

4.1. Reserve money

In the narrowest sense of the term, the reserve money (currency in circulation, assets on giro-accounts and assets in the vaults of the banks) is the category in the balance sheet of the NBRM in 1994. They are legal tender in the national economy. Under the conditions of undeveloped financial market and the deteriorated function of the transmissional mechanism in the monetary sphere, reserve money management is the most efficient strategy for monetary regulation out of two reasons: firstly, it is an aggregate with the most direct impact and control of the monetary authorities, and secondly, with a direct reserve money management, the monetary authorities (by interacting relations in the monetary area) also profile the quantity of total money supply affecting real macroeconomic performances in the national economy as well.

In the period of January - December, 1994, reserve money, in its narrowest sense, as the basic intermediary target of the monetary policy increased by Denar 2,120 million or 62.7%. If the influence of the seasonal factor from the beginning and at the end of the year, that was extremely emphasized in the currency in circulation development, is excluded, - monetary aggregate in 1994 increased in amount of Denar 1,724 million or 56.1%.

Reserve money according to the narrowest definition^{1/}

(in million denars)

	Changes					Indices for reserve money increase in %			
	I quarter	II quarter	III quarter	IV quarter	Total	III 94 XII 93	VI 94 XII 93	IX 94 XII 93	XII 94 XII 93
Reserve money according to the narrowest definition	130	412	358	1,220	2,120	3.8	16.0	26.6	62.7
- Currency in circulation	219	479	388	869	1,955	6.5	20.6	32.1	57.8
- giro-accounts and assets in vaults	-89	-67	-30	351	165	-2.7	-4.6	-5.5	4.8

1/ + is creation of reserve money

- is withdrawal of reserve money

In the first six months of 1994, following their narrowest definition, the reserve money reached the highest increase of Denar 542 million or 16.0%. Deseasonal increase of this aggregate (increase after the correction of the basis for the influence of the seasonal factor which determines an excessive increase of currency in circulation, and reserve money as well, at the end of 1993), in the period of January - June 1994 was Denar 851 million or 27.7% being only by 0.9 percentage points under the projected increase for the first half of 1994. In the second half of 1994, reserve money, in its narrowest sense, increased by Denar 1,578 million or by 40.2%. The increase of the basic monetary aggregate corrected by seasonally conditioned increase

of cash at the end of the year (because of Christmas and New Year's holidays) in the period of July - December, 1994 was Denar 873 million or 22.2%. Thus, in the period of January - December 1994, the target of the amount of reserve money according to the narrowest definition was completely reached, and, at the same time, the criterion for realization of the STF arrangement in the monetary sphere, was met.

Basic forms for holding reserve money are: currency in circulation and deposits of the banks with the National Bank of the Republic of Macedonia. Movements of currency in circulation, as the most important component of reserve money depend on the preferences of the citizens and enterprises for holding part of their property in non-interest form. The choice of a form in which these sectors will keep their property, and the preference for holding cash is due to a number of reasons. First of all, demand for cash is under an inverse correlation with the level of real interest rate of savings deposits. From that point of view, maintenance of high nominal and real interest rates of denar savings deposits throughout 1994 (implying high opposite cost of the part of the property in cash), had a strong adverse impact on demand for cash in the Republic of Macedonia in the monitored period. Function of the institutionalized foreign exchange market and the low level of economic activity of the country in 1994 are factors, that also influenced a decrease of demand for cash.

On the other side, rapid deceleration of inflation (particularly pointed out in the period of March-August 1994) had an effect to an increase of real demand for money, and, at the same time to real demand for cash. Simultaneously, certain sub-optimal solutions in the payments operations in the Republic, wages and pension payments, the growing risk in the mutual payment and lending among enterprises; deepening of the differentiation of revenues among social groups as a consequence of the inclination for savings of groups on the lower level of revenue being extremely low; as well as, the high percent of cash payments among private entities motivated by speculative transactions, - are factors that throughout 1994 maintained the unacceptable high participation of currency in circulation in the transactions of the national economy.

In some periods of the year, currency in circulation was also characterized by some seasonally affected fluctuations. Throughout the year there were three strong seasonal shocks on the quantity of currency in circulation. That was in April (before Easter and Labor Day in May), than in July/August (regarding the period of summer vacations and before the 2nd of August - Ilinden), and, in December (before Christmas holidays). Within each month, there are oscillations in cycles regarding the movements of the currency in circulation, especially pointed out in the beginning and at the end of the month (when paying the wages and pensions), as well as during the collection of Budget revenues. The influence of these factors is in a short run and reversible character, and the initial effect of their effect on the liquidity of the banking system in 1994 was successfully anticipated and smoothed by the monetary policy measures.

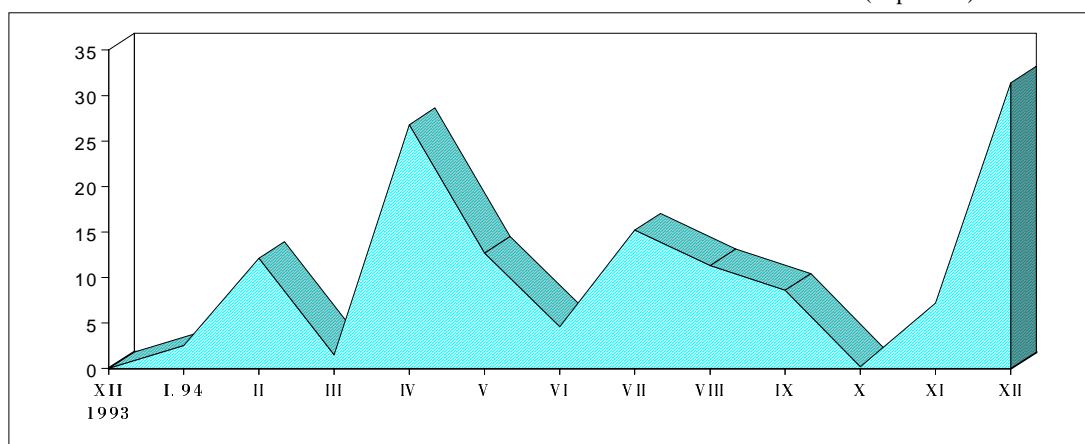
Complementary effect of the factors, on which the currency in circulation movements depends, resulted in 1994 in an increase of Denar 1,955 million or 69.2%. Such an increase of currency in circulation also arised an increase of reserve money according to their narrowest definition in 1994 of 57.8%. If the oscillations, being a

result of an influence of seasonal factors at the beginning and at the end of the year, are excluded from the increase, seasonal increase of currency in circulation in 1994 was Denar 1,559 million or 62.0%. At the end of 1994, the participation of currency in circulation in the narrowest sense of reserve money, reached 84.9% which is by 1.4 percentage points higher than the participation at the end of 1993.

Graph 1

Increase of currency in circulation

(in percent)



Regarded from the point of view of dynamics, the increase of currency in circulation was most intensive in the second and in the fourth quarter of 1994 (Denar 479 million or 15.7%, and, Denar 869 million or 22.2%, respectively). In the first and the third quarter of the year, currency in circulation increased by Denar 219 million or by 7.8%, and, Denar 388 million or 11.0%, respectively. Accordingly, the increase of currency in circulation (as the most important form of holding reserve money) enabled creation of reserve money of 6.5% in the first quarter, 13.2% in the second, 9.5% in the third quarter, and, 19.5% in the last quarter of 1994.

The analysis of the deseasonal increase of currency in circulation, shows that the dynamics of the increase was more pointed out in the first half of 1994, with a realized increase of Denar 528 million or 21.0% in the first quarter, and, Denar 479 million or 15.7% in the second quarter. With the stabilization of the inflation rate, the demand for cash was stabilized as well, so that in the first half of 1994, there was a realization of significantly more moderate increase. In the third quarter of the year, currency in circulation increased by Denar 388 million or by 11.0%, whereas in the last quarter of 1994, the deseasonal increase of currency in circulation was Denar 164 million or 4.2%.

4.2. Liquidity of the banks

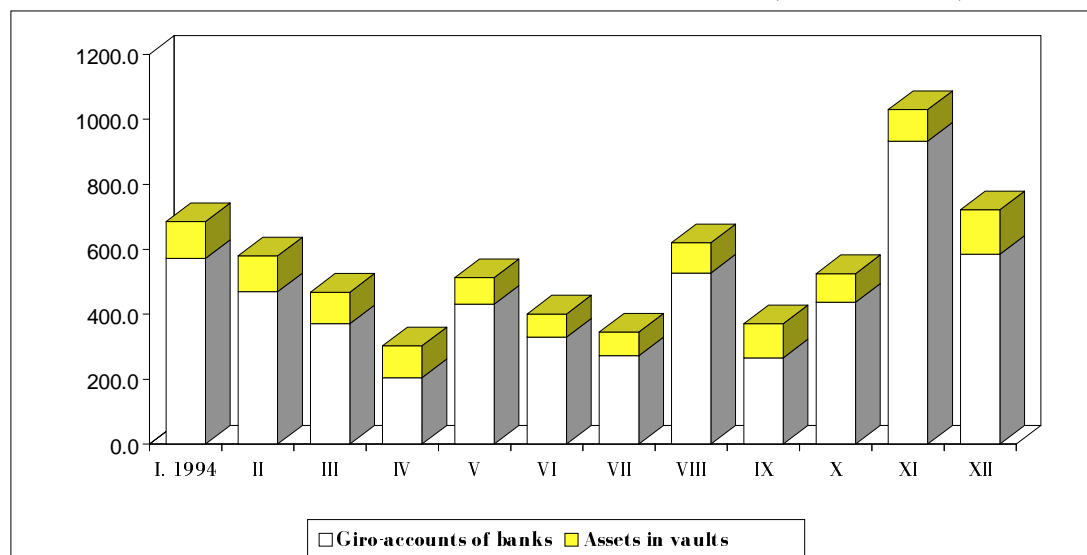
The liquidity of the banking system in the Republic of Macedonia presented through giro-accounts of the banks and the amount in vaults in 1994, considered as a whole, was maintained on a satisfactory level. The level of global liquidity that was reached set grounds for the projected increase of money supply needed for normal trade transactions, and, at the same time, it was consistent with the intentions of the

monetary policy to reduce the aggregate demand through a reduction of the global liquidity level.

Graph 2

Position of liquidity assets of the banks

(in million denars)

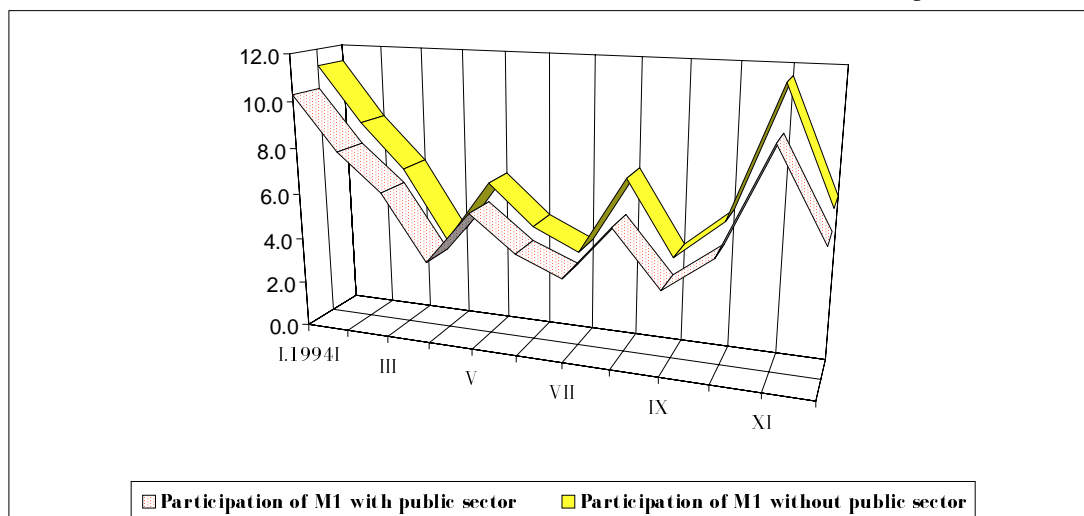


At the end of December 1994, the banks had an amount of Denar 722 million on their giro-accounts and in their vaults, being by 29.6% more than the appropriate level at the end of 1993. Considering the dynamics, the liquidity assets of the banks, at the end of the first three quarters of the year, were on a lower level compared to the position at the end of the previous quarter, by Denar 89 million, Denar 67 million and Denar 30 million, respectively. In the last quarter of 1994, the assets on the giro-accounts and the assets in vaults of the banks increased by Denar 351 million. This was due to the injection of liquidity assets by the National Bank of the Republic of Macedonia at the end of the year regarding the seasonally increased demand for liquid assets in this period.

The average participation of liquid assets of the banks in money supply M1 (excluding the public sector) in 1994, was 6.9%, whereas in some periods of the year, the assets on the giro-accounts of the banks and the assets in vaults oscillated significantly beyond and below this average figure (from 4.0% in April to 11.5% in November, 1994). Simultaneously, the average participation of the assets on giro-accounts of the banks and the assets in vaults in the total money supply M1 (with Government deposits) were exactly on the projected level of 6.0% (with amplitudes mostly pointed out in April, July and September - 10.3%).

Graph 3

Participation of liquid assets of banks in money supply M1
(in percent)



Considered by its dynamics, in certain period of 1994, liquid assets of banks showed a significant oscillation. That had an adverse influence on the stability and predictability of the monetary multiplier, and consequently, on the possibility for dimensioning and managing the money supply in the national economy. Thus, significantly high level of bank liquidity was in the first quarter of 1994, when the assets on giro-accounts and assets in vaults were about an average number of 37.2% over the projected liquidity level. With an objective to absorb the surplus of liquidity assets, the National Bank of the Republic of Macedonia intervened with indirect instruments for sterilizing the surplus of liquid assets with the banks through auctions of deposits and treasury bills. In the second quarter of the year, with instruments for direct and immediate acceptance of the surplus of liquidity, as a marginal compulsory reserves, the National Bank did the same. By implementing those corrective measures, the global liquidity of the banking system in the Republic of Macedonia was brought to the projected frameworks.

In 1994, however, the dispersion of liquid assets among the banks in the Republic was extremely uneven. This caused difficulties in leading monetary policy due to the contradictorial situation from time to time on a global level of liquid assets in the banking system (being a goal of the monetary and credit policy. On the other side, there was the (il)liquidity that certain banking institutions faced. Problems regarding maintenance of sound liquid assets of banks in the Republic, was deepened by their inappropriate credit activity as well, particularly outlined in the first half of 1994. This had an adverse impact on the liquidity and on the stability of the banking institutions themselves, but also on the possibilities of the National Bank of the Republic of Macedonia for optimum dimensioning of total liquidity as a goal of the monetary and credit policy. Through an adequate combination of auctions on buying deposits and selling treasury bills, and, auctions on selling deposits, the National Bank of the Republic of Macedonia succeeded in fulfilling these two opposite goals: to withdraw the surplus of liquidity of liquid assets on a global level, and, in the same time to maintain the liquidity of particular banks.

The analysis of creation and withdrawal of reserve money without their adjustment to the effect of the seasonal factor resulted in conclusion that the most significant category for reserve money creation in 1994 were the domestic credits. Therefore, in the period of January-December 1994, domestic credits increased by Denar 1,577 million which determined reserve money creation of 46.6%. This was 74.4% of the reserve money growth in 1994. However, if the domestic credits increase is corrected regarding the seasonal increase of deposits sold to banks on auctions at the end of the year (amounting Denar 606 million)), deseasonal increase of this monetary aggregate in 1994 was Denar 971 million. So, net foreign exchange assets of the National Bank of the Republic of Macedonia had a dominant role among the reserve money creation movements in 1994.

Creation and withdrawal of reserve money ^{1/}

(in million denars)

	Changes					Indices of reserve money increase in %			
	I quarter	II quarter	III quarter	IV quarter	Total	III.94 XII. 93	VI.94 XII.93	IX.94 XII.93	XII.94 XII.93
Reserve money according to the narrowest definition	130	412	358	1,220	2,120	3.8	16.0	26.6	62.7
Net forex assets ^{2/}	-1,583	2,395	310	126	1,248	-46.8	24.0	33.2	36.9
-Forex assets	-764	2,370	302	101	2,009	-22.6	47.5	56.4	59.4
- Forex liabilities	-819	25	8	25	-761	-24.2	-23.5	-23.2	-22.5
Domestic credits	1,452	-670	311	484	1,577	42.9	23.1	32.3	46.6
Other net items	559	-1,227	58	313	-297	16.5	-19.8	-18.0	-8.8
Instruments	-281	-83	-307	324	-347	-8.3	-10.8	-19.8	-10.3
Other deposits	-17	-3	-14	-27	-61	-0.5	-0.6	-1.0	-1.8

1/ + reserve money creation

- reserve money withdrawal

2/ Positions evaluated according to the stable exchange rate (end December 1993 1USD = 44.4558); movements evaluated according to the current exchange rate.

4.3. Net foreign exchange assets of the National Bank

In the period of January-December 1994, net foreign exchange assets of the National Bank of the Republic of Macedonia increased by Denar 1,248 million or by 24.3%. It effected the reserve money creation of 36.9% which was 58.9% of the actual growth of reserve money according to its narrowest definition in 1994. Regarding the dynamics, in the first quarter of 1994, net foreign exchange assets of the National Bank of the Republic of Macedonia decreased by Denar 1,583 million, because of the unfulfilled payment of credit obligations towards the World Bank. The National Bank extended a credit to the Government in February 1994. This determined net foreign exchange assets in the first quarter of the year towards reserve money withdrawal of 46.8% (with an increase of reserve money of 3.8% in the taken period). Simultaneously, being a result of the extended credit to the Republic by the National Bank, as well as of the extended rediscount credits of banks (in the first quarter of 1994), there was an extension of new selective credits for the last time, in amount of

Denar 140 million), increasing domestic credits by Denar 1,452 million. This determined reserve money increase of 42.9%. In total, the effects of the extended credits by the National Bank of the Republic of Macedonia to the Government on domestic credits and on the decrease of net foreign exchange assets in the period of January-March 1994, were compensated, in order to regulate the obligations towards the World Bank.

The analysis of the net foreign exchange assets of the National Bank of the Republic of Macedonia, as the basic movement of creation/withdrawal of reserve money, in the period of April-December 1994, shows its permanent growth. Thus, in the second quarter, net foreign exchange assets of the National Bank, increased by Denar 2,395 million; in the third quarter of the year the growth of this monetary category amounted Denar 126 million. Accordingly, in the period of April-December 1994, net foreign exchange assets of the National Bank of the Republic of Macedonia affected permanently reserve money creation, as follows: by 133.1% in the second quarter; 7.4% in the third quarter, and, by 2.8% in the last quarter of 1994.

Net foreign exchange assets increase of the National Bank of the Republic of Macedonia in 1994, was due to the permanent inflow of foreign exchange in the country, which resulted in constantly higher foreign exchange supply than the foreign exchange demand throughout the year (at the foreign exchange market, and at the exchange market as well). As a result, foreign exchange assets of the National Bank in 1994 increased by Denar 2,009 million, determining the reserve money creation of 59.4%. Except for the first quarter of the year, regarding the payment towards the World Bank in behalf of the Republic, there was a decrease of foreign exchange assets of the National Bank in amount of Denar 764 million, in the rest of the year, foreign exchange assets were constantly increasing, as follows: by Denar 2,370 million in the second quarter; by Denar 302 million in the third, and by Denar 101 million in the fourth quarter of 1994. Decrease of foreign exchange assets of the National Bank in the first quarter of the year, had an effect to reserve money withdrawal of 22.6%. In the second quarter of 1994, foreign exchange assets increased by Denar 2,370 million with a monetary effect to reserve money creation of 90.6%. At the same time, by paying back the credit by the Republic, there was an adequate withdrawal of reserve money, so that the total effect of the transaction was zero. In the third and in the fourth quarter of the year, the increase of foreign exchange assets of the National Bank of the Republic of Macedonia determined reserve money creation of 6.0%, and 1.9%, respectively.

Foreign obligations of the National Bank of the Republic of Macedonia in 1994 cumulatively increased by denar 761 million, being a result of the extended STF arrangement by the International Monetary Fund in February, in amount of SDR 12.4 million. This increased the foreign exchange obligations by Denar 819 million in the first quarter of the year, with an effect towards reserve money withdrawal of 24.2%. In the other three quarters of 1994, foreign exchange obligations of the National Bank were insignificantly changed by the amount of payments abroad, as well as according to the changes of the exchange rate throughout this period.

4.4. Investments of the National Bank

In 1994, domestic credits increased by Denar 1,577 million, determining the reserve money creation of 46.6%. In the first quarter of the year, as a result of short-term indebtedness of the Government with the National Bank of the Republic of Macedonia, domestic credits reached an increase of Denar 1,452 million in order to meet the obligations towards the World Bank. This resulted in reserve money creation of 42.9% with an effect that was neutralized in the same period through an adequate reserve money withdrawal by decreasing the net foreign exchange assets of the National Bank. In the second quarter of 1994, domestic credits declined by Denar 670 million, due to the repayment of the extended credit to the State in the previous quarter. Therefore, changes of this monetary aggregate were directed to reserve money withdrawal of 13.7% in the second quarter. In the third and in the fourth quarter of the year, domestic credits increased by Denar 3111 million, and Denar 484 million, which determined reserve money creation of 7.5% and 10.8%, respectively.

Domestic credits ^{1/}

(in million denars)

	Changes					Indices of reserve money increase in %			
	I quarter	II quarter	III quarter	IV quarter	Total	III.94 XII.93	VI.94 XII.93	IX.94 XII.93	XII.94 XII.93
Domestic credits	1,452	-670	311	484	1,577	42.9	23.1	32.3	46.6
a/Credits to banks	56	-24	227	487	746	1.7	0.9	7.7	22.0
- selective credits	140	-38	-4	0	98	4.1	3.0	2.9	2.9
- Sale at auctions of deposits	-121	-35	0	606	450	-3.6	-4.6	-4.6	13.3
- liquidity credits	28	64	87	1	180	0.8	2.7	5.3	5.3
- other credits	9	-15	144	-120	18	0.2	-0.2	4.1	0.5
a/ Republic, net	1,396	-646	84	-3	831	41.3	22.2	24.7	24.6
- Credits to the Republic	1,404	-639	86	42	893	41.5	22.6	25.2	26.4
- Government deposits	-8	-7	-2	-45	-62	-0.2	-0.4	-0.5	-1.8

1/ + reserve money creation

- reserve money withdrawal

Within the frameworks of the domestic credits, in 1994, bank credits increased by Denar 746 million, or by 58.5%. This resulted in reserve money creation of 22.0%. Refinancing the bank credits by the National Bank of the Republic of Macedonia, being the most important component of bank credits was, in the previous year, the basic movement for issuing and withdrawing reserve money. However, regarding the rigid character of this instrument of the monetary policy, at the end-March 1994, it was definitely abolished and replaced by more market like and more flexible instruments of the monetary and credit policy. Banking credits refinancing (the so-called selective lending) by the National Bank, was for the last time issued in the first quarter of 1994, from the primary issue in total amount of Denar 140 million. There was reserve money creation of 4.1% in the first quarter of 1994. Starting from March 1, 1994, selective credits of particular activities of priority were abolished, and the amount of selective credits was gradually declining following their maturity. Accordingly, in the third and fourth quarter of the year this aggregate determined the reserve money withdrawal of 1.1% and 0.1%, whereas in the last quarter there was neither withdrawal nor creation of reserve money.

Auction on selling deposits were used as a flow of reserve money creation in the last quarter of 1994, as well as in the particular periods of the year when there was a need of neutralizing seasonal oscillations in money demand. However, bringing back these assets to the National Bank by the commercial banks affected the reserve money withdrawal. At the end of the first and the second quarter of 1994, auctions on deposits resulted in reserve money withdrawal of 3.6%, and 1.0%. In the third quarter, through the auctions on selling deposits, there were no effects regarding the change of reserve money. The most intensive issue of reserve money through this movement was made in the last quarter of 1994, through auctions by issuing (selling to the banks) Denar 606 million with an aim to neutralize the effects of the seasonal growth of currency in circulation in that period of the year. Thus, in the period of October-December 1994, there was an influence on reserve money creation of 18.8%.

As for the problems regarding the maintenance of liquidity manifested with separate banks and the impossibility to have them regularly servicing their obligations towards the depositors, throughout 1994, there was reserve money issue, on the basis of activating the guarantee by the National Bank of the Republic of Macedonia on denar savings deposits of the citizens with the banks. At the end of December, 1994, the total amount of the used assets from the primary issue by banks was Denar 180 million with a reserve money creation of 5.3%.

At the end of 1994, claims of the National Bank of the Republic of Macedonia on the Government were in net amount by Denar 831 million higher compared to the position at the end of 1993. This determined reserve money creation of 24.6%. In addition, in the period of January-December 1994, the Government credits increased by Denar 893 million. In the same period, Government denar deposits with the National Bank, increased by Denar 62 million with an effect to reserve money withdrawal of 1.8%.

In the first quarter, net Government credits increased by Denar 1,404 million as a result of the extended credit from the National Bank in order to close the credit obligations towards the World Bank. That affected reserve money creation of 41.5%. In the second quarter of the year, the Government paid back the credit to the National Bank, so that the transaction was closed. However, there was simultaneously an increase of claims of the National Bank on the Government on different basis. Therefore, net credits of the Government in the second quarter decreased by Denar 639 million. So, in the period of April-June 1994, there was a smaller effect (13.5%) towards reserve money withdrawal compared to the initial effect towards reserve money creation in the first quarter (41.5%). Until the end of 1994, credits extended by the National Bank to the Government increased by Denar 128 million, resulting in reserve money creation of 2.1% in the third quarter and 1.0% in the last quarter.

4.5. Other net assets

Other categories on the assets and liabilities sides of the balance sheet of the National Bank of the Republic of Macedonia (where more important categories are the capital, exchange rate deviations and claims on the National Bank of Yugoslavia),

considered on net basis in 1994, decreased by Denar 297 million. This determined reserve money withdrawal of 8.8%. In the first quarter of the year, other net items of the balance sheet of the National Bank increased by Denar 559 million, whereas in the second quarter they decreased by Denar 1,227 million. In the third and in the fourth quarter of the year, this category increased in amount of Denar 58 million and Denar 313 million, respectively. Accordingly, in the first, third and in the fourth quarter of 1994, this monetary aggregate affected reserve money creation of 16.5%, 1.2% and 11.2%, respectively. In the second quarter, other net items influenced reserve money withdrawal of 31.2%.

Other deposits on the liabilities side of the balance sheet of the National bank in 1994, increased by Denar 61 million, affecting reserve money withdrawal of 1.8%. Throughout all quarters in 1994, there was a permanent, but insignificant growth of: Denar 17 million in the first, Denar 3 million in the second, Denar 14 million in the third and Denar 27 million in the last quarter of the year. Their impact towards reserve money withdrawal was: 0.5% in the first, 0.1% in the second, 0.4% in the third and 0.8% in the fourth quarter of the year.

4.5.1. Instruments of monetary regulation

Basic instruments of the Central Bank for withdrawing liquid assets from the banking system were: the compulsory reserves, auctions on deposits (in case when the National Bank buys deposits from the banks) and auctions on treasury bills. Through the instruments of the monetary and credit policy in 1994, there was a withdrawal of liquid assets in amount of Denar 347 million, resulting in reserve money withdrawal of 10.3%.

Instruments of monetary and credit policy ^{1/}

(in million denars)

	Changes					Indices of reserve money increase in %			
	I quarter	II quarter	III quarter	IV quarter	Total	III.94 XII.93	VI.94 XII.93	IX.94 XII.93	XII.94 XII.93
Instruments	-281	-83	-307	324	-347	-8.3	-10.8	-19.8	-10.3
- compulsory reserves	-193	-121	90	-123	-347	-5.7	-9.3	-6.6	-10.3
- Buying deposits on auctions	-34	-16	-327	377	0	-1.0	-1.5	-11.1	0.0
- auctions on treasury bills	-54	54	-70	70	0	-1.6	0.0	-2.0	0.0

1/ + reserve money creation
- reserve money withdrawal

Through the instruments of monetary and credit policy in the first three quarters of 1994, there was reserve money withdrawal, whereas in the last quarter of the year, their effect was towards reserve money creation. So, in the first quarter, through the instruments of monetary and credit policy there was reserve money withdrawal in amount of Denar 281 million. In the second quarter the amount was Denar 83 million, and in the third quarter Denar 307 million. This influenced in the first three quarters through the instruments of the monetary policy towards reserve

money withdrawal of 8.3%, 2.7% and 10.1%, respectively. In the last quarter of 1994, in respect to bringing back previously bought deposits of banks, there was a decrease of the amount of liquid assets, being sterilized before through the instruments of the monetary policy by Denar 324 million. This had a monetary effect towards reserve money creation of 11.8%.

Compulsory reserves is commonly implemented instrument of the monetary policy by the Central Bank for limiting the issuing potential of commercial banks through absorbing part of their liquid assets on separate account. At the end of 1994, based on compulsory reserves, there was sterilization of liquid assets of banks in total amount of Denar 758 million, being by Denar 347 million higher than the amount of assets separated accordingly, at the end of 1993. Thus, the compulsory reserves in 1994, as an instrument, had an impact on reserve money withdrawal of 10.3%.

In respect to its dynamics, in the first two quarters of the year, using this instrument of the monetary policy, there was reserve money withdrawal in amount of Denar 193 million and Denar 121 million, respectively. In the third quarter of 1994, as a result of the autonomous drop of deposits where this obligations was calculated, there was an issue (payment back) of reserve money into the banking system through the compulsory reserves, in amount of Denar 90 million. In the last quarter of 1994, the instrument of compulsory reserves had an effect towards liquid assets withdrawal from banks in amount of Denar 123 million. Thus, through the separation of assets as compulsory reserves in the first, second and fourth quarter of 1994, the influence was towards reserve money withdrawal of 5.7%, 3.8% and 4.0%, respectively. In the third quarter, this instrument of the monetary policy resulted in reserve money creation of 3.0%.

In the frameworks of the monetary instruments implemented in the monetary practice of the Republic of Macedonia in 1994, auctions on buying deposits from banks reached a role of the most significant operative instrument for regulating the general liquidity in the banking system. In various periods of the year, the intensity of the implementation of this instrument of the monetary and credit policy was different, regarding the ratio of the current and projected level of the liquidity of the economy. In the first quarter of 1994, liquid assets from the banking system in amount of Denar 34 million were absorbed through this instrument of the monetary policy (in the first quarter), and, Denar 16 million in the second quarter. The most intensive absorption of the liquid surplus of banks through buying bank deposits at auctions by the National Bank, was made in the third quarter of 1994 by withdrawing additional amount of Denar 327 million. Therefore, the instrument of Auctions on deposits, in the first three quarters of the year, had an effect on reserve money withdrawal of 1.0%, 0.5% and 9.7%, respectively. In the last quarter of the year, because of the high demand for liquid assets regarding the seasonal needs, there was no withdrawal of new liquid assets through this instrument. Instead, banks were given back the assets sterilized through buying their deposits at auctions in the previous period, in total amount of Denar 377 million. This affected reserve money creation in the period of October-December, 1994 of 12.5%.

Auctions on treasury bills of the National Bank of the Republic of Macedonia were introduced in our monetary practice on February 14, 1994. This market and

flexible instrument of the monetary policy was used for sterilization of the liquid surplus of banks in the Republic of Macedonia in the first and the third quarter of the year. At the end of the first quarter of 1994, by using this instrument, there was a withdrawal of reserve money in amount of Denar 54 million, whereas at the end of the third quarter of the year, through selling treasury bills of the Central bank to the commercial banks, there was sterilization of Denar 70 million. It resulted in reserve money withdrawal of 1.6% in the first and 2.0% in the third quarter of the year. By paying back the withdrawn assets from the banks according to the maturity of the treasury bills, in the second and in the fourth quarter of 1994, there were equivalent effects of an opposite character, i.e., towards reserve money issue of 1.6% and 2.0%, respectively.

V. INSTRUMENTS OF MONETARY AND CREDIT POLICY

5.1. Bank refinancing

Throughout 1994, the process of restructuring the instruments of monetary policy continued, commenced already in 1993. Starting from April 1, 1994, under the effort to modernize the range of instruments for operational implementation of monetary policy, the National Bank of the Republic of Macedonia ceased the operations of banking credits restructuring (the so-called selective credits), being basic direction for issuing and withdrawing reserve money. Namely, by rediscounting credits extended by banks to final users from areas of priority, the National Bank of the Republic of Macedonia had a selective (parafiscal) function, besides its quantitative function presented in creating the shape of money supply. Extending assets from the primary issue for financing sectors of priority was not based on market criteria, meaning that it most frequently made by following subsidiary, negative real interest rates. As for the rigid character of the discount mechanism (previously extended funds were granted to banks with no regard to their current liquidity), the initiative for reserve money creation was present among economic subjects that used to receive the credits, and not at the Central Bank. Under such conditions, rediscount credits lost their image of residual instrument meant to compensate monetary effects caused by the activity of the National Bank of the Republic of Macedonia at the foreign exchange market as autonomous flow of the issue and withdrawal of reserve money.

Due to these reasons, in the first quarter of 1994, there was a completion of the process of gradual abolishment of selective credits as an instrument of monetary and credit policy commenced in 1993. In the first quarter of 1994, as the last period when rediscount credits were extended to banks, the assets granted from the primary issue for refinancing credits from banks to entities in the agricultural sector, amounted Denar 140.0 million. Out of that amount, Denar 50.0 million were extended for refinancing the sowing of wheat, and, Denar 90.0 million for refinancing the repurchase of tobacco. At the end of 1994, the amount of selective credits previously extended by the National Bank of the Republic of Macedonia was Denar 659 million.

5.2. Instruments for open market operations

The instruments for open market operations as auctions on deposits and auctions on treasury bills by the National Bank, were the basic way to issue and withdraw reserve money in 1994. The reforms in the issuing mechanism realized through the implementation of auctions on deposits and on treasury bills in the monetary practice in the Republic of Macedonia, were aimed to implement market, flexible and transparent instruments for injecting and absorbing liquid assets into and from the banking system. By implementing these indirect instruments of monetary policy, there was direct management with separate items of the assets and liabilities side from the balance sheets of commercial banks. At the same time, the

implementation of sophisticated instruments was to create a core for more intensive development of primary and secondary market of money and securities in the Republic of Macedonia.

Flexibility and market basis, being general attributes to these operative instruments of monetary policy are to create sufficient capacity for the National Bank to neutralize seasonal oscillations in demand for money movements. In addition, they are planned to compensate monetary effects caused by the influence of separate movements of the creation and withdrawal of reserve money. Flexibility of the instrument of auctions is an opportunity of the monetary authorities to make changes of the conditions for implementing this instrument of the monetary and credit policy, any time, without high costs, and, in short terms. The Central Bank has an opportunity to follow permanently the position of the liquidity potential of the banking system and to react promptly with these instruments directing it, according to the objectives of the monetary policy. Moreover, the National Bank of the Republic of Macedonia can adjust the terms for investing or withdrawing the funds, according to the dynamically determined targets of the monetary and credit policy by particular monetary aggregates. Market basis of the instrument of auctions means that buying or selling liquid assets at auctions is made on market criteria, i.e., on the basis of the offered price (interest rate) by the participants in the auction. At the same time, the interest rate, where supply of and demand for money are met at the market, is the basis for defining other interest rates in the national economy.

Auctions on buying and selling deposits were introduced as an instrument of the monetary and credit policy at the end of 1993. This instrument was of extremely quantitative function, directed towards regulating the liquidity potential of the banking system. This instrument of the monetary and credit policy was used for two purposes: when the Central Bank buys deposits from banks, the auction on deposits is an instrument for sterilizing the surplus of liquidity assets (with an impact on the items on the liabilities side of the balance sheet of the Central Bank); when the Central Bank sells deposits, there is an issue of assets into the banking system, i.e., the auction on deposits is regarded a reserve money creation (on the assets side of the balance sheet of the Central Bank).

In 1994, the National Bank implemented the instrument of auctions on deposits for creation, as well as for withdrawal of reserve money. In the period of January-December, 1994, the National Bank of the Republic of Macedonia implemented 106 auctions on deposits, with a turnover of Denar 5,018.8 million. Out of that, on 45 auctions there was a withdrawal of money through buying deposits from the commercial banks by the National Bank, in total amount of Denar 3,548.0 million (an average amount per auction being Denar 78.8 million). Simultaneously, at 17 auctions, in respect to the current shortage of liquid assets in the banking system, there was an issue of reserve money (sold by the National Bank to the commercial banks) in amount of Denar 1,470.8 million (or average Denar 86.5 million per auction). On 44 auctions throughout 1994, there was no success in matching the offers for buying and selling money assets, meaning that the liquidity of the banks was not on a sufficient level and there was no need of intervention of the monetary authorities.

In the first four months of the year, auctions on deposits were made every two weeks, and in the period of April 28-September 13, 1994, the auctions were organized and implemented once a week (with a possibility for more frequent implementation, according to the goals of the monetary policy and the particular level of liquidity). From mid-September till the end of the year, auctions on deposits were organized and implemented every day, with an aim to reach their more efficient operational effect and to initiate more intensive participation of banks on auctions on deposits.

Terms for buying and selling assets on auctions on deposits were from 2 to 28 days. The most usual time for buying deposits by banks were 5 and 7 days. As for selling them, the most usual time was of 3 days. The interest rate on the auctions on deposits permanently decreased throughout the year (parallel to the decrease of the inflation rate). So, from the monthly level of 14.0% (auctions in February), the interest rate on auctions on deposits dropped to 1.80% (last auctions at the end-December 1994). As for the way of creating the prices of money assets on auctions on deposits, in the first half of 1994, there was an implementation of system of the so-called "equal" interest rate, according to which the complete trade at the auction is based on one price established (reached) at the auction. Due to the weaknesses of this system, in respect to the possibility for speculations with high interest rates by particular banks (most frequently such offers were from banks with the worst liquidity performances), starting from June 30, 1994, there was a turn to the so-called system of many interest rates, according to which each successful participant pays or collects the price (interest) of bought or sold assets, defined in the bid for the auction.

Auctions on securities (treasury bills) of the Central Bank, as an efficient and widely used instrument of the monetary regulations in developed market economies, were introduced within the set of monetary instruments of the National Bank of the Republic of Macedonia on February 14, 1994. This is a flexible and market based instrument suitable, first of all, for sterilization of the surplus of the liquid assets in the economy. At the same time, this instrument can be successfully implemented for issuing reserve money through an opposite operation of repurchase of previously sold treasury bills before their maturity. This alternative, as well as the possibility for all legal and natural persons to buy treasury bills through authorized banks, and to sell them at the secondary market, give an attribute to the treasury bills of extremely transparent and sophisticated instrument for short-term regulation of the liquidity potential of the banking system.

Regarding the existing regulations, auctions on treasury bills are implemented at an invitation by the National Bank of the Republic of Macedonia, in accordance with the projected and current liquidity of the banking system. Each bank, with a bid accepted at the auction on purchased treasury bills, pays the price which is specified in the bid for participation. The maturity period of treasury bills, during the implementation of this instrument, was defined on 7, 15, 30, 60, 90, 120, 150 and 180 days. Starting from August 31, 1994, maturity of treasury bills is a discretionary right of the National Bank of the Republic of Macedonia.

In the period of February 14-December 31, 1994, the National Bank implemented 10 auctions on treasury bills, through which it withdrew liquid assets from the banking system in different periods of time in total amount of Denar 361.0

million. The interest rate of purchased treasury bills was between 12.7% per month, at the first auction, to 1.58%-2.00% per month (in accordance with the terms) at the last auctions held in December 1994.

5.3. Compulsory reserves

Compulsory reserve is traditionally implemented instrument in the monetary practice, used by the Central Bank to influence the ability of the commercial banks for creating money through a prescription of the level of compulsory reserves of a part of liquid assets of the bank on separate account, as well as of a type of deposits included in the basis on which this obligation is calculated.

Throughout 1994, the level of the compulsory reserves was unchanged compared to end-1993, i.e., it was 8.0% of demand deposits and time deposits up to 3 months; and, 3.5% on time deposits over 3 months. A single change in the regime of calculating and separating assets as compulsory reserve in 1994, was made at the end of May, when the deposits of the Government were excluded from the basis on which the obligation was calculated.

With an aim to reach equal operating conditions for all financial institutions in the Republic of Macedonia, starting from February 7, 1994, the savings houses also had an obligation to calculate and separate compulsory reserves, according to the following:

- on savings demand deposits and time deposits up to 3 months with an interest rate of 4.0%, and
- on savings time deposits over 3 months with an interest rate of 1.5%.

In the first three months of 1994, bank liquidity in the Republic of Macedonia was significantly beyond the projected level (the average participation of the assets on the giro-accounts of the banks in money supply M1 was 37.2% beyond the projected level). The excessive amount of liquid assets with the banks was intended to be sterilized by the National Bank by implementing indirect instruments, i.e., by implementing auctions on buying deposits and auctions on selling treasury bills. However, because of the sluggishness of the banks in relation to the market oriented instruments and also regarding the signals from the monetary and credit policy, at the beginning of March 1994, the National Bank had to implement the instrument of marginal compulsory reserves. This is inflexible, but prompt instrument for direct withdrawal of the surplus of liquidity from the banking system. Thus, banks having on their giro-accounts an amount higher than 3.5% of the average amount of deposit money regarded every ten days, were obliged to separate 25% of that liquidity surplus as marginal compulsory reserves. The initial effect of the implementation of this instrument was manifested in the withdrawal of Denar 53.9 million from the giro-accounts of the banks. The use of the marginal compulsory reserves as an instrument of the monetary policy in order to reduce directly the global liquidity potential of the banking system in the Republic of Macedonia was abolished at the beginning of June 1994.

As for the assets that commercial banks hold on separate accounts with the National bank of the Republic of Macedonia as compulsory reserves, the National Bank pays an interest in a particular percentage of the level of discount rate. Through that interest, it is planned to compensate the expense that the commercial banks have while collecting deposits as interest paid to their clients. In the first five months of 1994, the interest on the compulsory reserves was defined in two categories:

- on demand deposits, on assets separated as marginal compulsory reserves, and, on time deposits up to 3 months, being 30% of the discount rate, and
- on time deposits over 3 months with an interest rate paid by the National Bank being 70% of the discount rate.

Commencing on May 31, 1994, the National Bank of the Republic of Macedonia pays an interest according to the unique interest rate of 60% of the discount rate on the funds that banks and savings houses separate as compulsory reserves. From December 1, 1994, the National Bank pays to the banks an interest rate of 38.8% of the discount rate on separated assets as compulsory reserves.

5.4. Minimum liquidity

In order to maintain minimum liquidity, banks in the Republic of Macedonia are obliged to hold constantly certain percentage of their short-term denar sources of assets on their accounts. The basic aim of such obligation is to provide constant minimum amount of liquid assets to neutralize daily oscillations on giro-accounts of the banks, resulting from every day banking transactions.

As a result of the decline of oscillations, i.e., more equal relation between the inflow and outflow of assets into and from the giro-accounts of the banks, in the past three years, there was a reduction in dynamics of the minimum liquidity level. Thus, from 7% in 1992, the minimum liquidity level in 1993 was decreased by 4.0%, but reducing it to 3.2%, in March 1994. At the same time, in order to stimulate the development of market oriented instruments of monetary and credit policy, in 1994, there was a possibility given to the banks to use 70.0% of their minimum liquidity for buying treasury bills at the auctions organized by the National Bank of the Republic of Macedonia.

5.5. Interest rate policy

Discount rate management is an efficient instrument of monetary control used in monetary practice in all developed economies. Through changes of basic interest rate, the Central Bank had a direct impact on the ratio between the supply and demand for reserve money, directly creating the dimension of the total money supply in the national economy. In countries with diversified financial structure, discount rate changes are a clear signal for changes of the exchange rate of monetary and credit policy and they are an indicator of the movements of other interest rates in the banking system.

In fact, the discount rate is to show the marginal expenses of the banks for mobilizing assets from the primary issue, as well as the level of the strength that monetary authorities plan to implement in leading the monetary policy. However, incompletely developed mechanism of reserve money issue through the open market operations in the Republic of Macedonia does not allow creation of discount rate on market regulations. Under such conditions, discount rate is more a reflection of the realized inflation rate in the previous period, than a reflection of the actual ratio of supply and demand for assets from primary issue.

As for the above-mentioned reasons, in 1994 also, the discount rate of the National Bank of the Republic of Macedonia used to be determined on the basis of a model, where the referring factor for defining the discount rate was the actual average inflation rate tendency in the past two months, increased by 5% as a real part. By implementing the existing technology throughout 1994, the discount rate of the National Bank was changed six times, i.e., each month in the period from January-May, whereas the last change was in August 1994. In the period of August-December, 1994, the discount rate was on a constant level.

Discount rate movements

(in percents)

Period	Discount rate		Real discount rate on monthly level
	annual level	monthly level	
I 1994	329.0	12.9	-7.5
II	429.0	14.9	7.6
III	247.2	10.9	8.3
IV	80.0	5.0	2.5
V	38.0	2.7	1.1
VI	38.0	2.7	0.4
VII	38.0	2.7	3.3
VIII	33.0	2.4	1.8
IX	33.0	2.4	0.6
X	33.0	2.4	0.4
XI	33.0	2.4	0.2
XII	33.0	2.4	-0.5

Determination of the discount rate according to the existing methodology in 1994 (except for the first quarter), was successful in function. In the period of January-December 1994, there was an average discount rate of 86.2% per annum, that corrected by the increase of the inflation rate in the same period, was an average real positive discount rate of 19.8% per annum.

In the first quarter of 1994, due to extremely high oscillations of the inflation rate, real discount rate was in high positive and negative amplitudes. Thus, in January, the discount rate was with a real negative value of -7.5% on monthly level, whereas in February and March, because of the sharp decline of inflation, the discount rate had real positive values (7.6%, 8.3% per month, respectively). After the stabilization of the inflation rate, the discount rate of the National Bank, established according to the existing methodology, resulted in low, real positive values. In the period of April-December, 1994, the average real discount rate was 13.9% per annum, and, 1.1% per month.

The discount rate is a basic interest rate used as basis for determination of all other interest rates of the National Bank of the Republic of Macedonia. There are certain parities among the interest rates and the discount rate, so that the change of the discount rate implicitly means a change of other active and passive interest rates implemented by the National Bank of the Republic of Macedonia. However, in accordance with the direction of the monetary policy in certain periods, the Central Bank can make changes of the parities between the discount rate and all other interest rates. At the beginning of February, 1994, the National Bank of the Republic of Macedonia reduced its active interest rates, as follows: the interest rate on lombard credits was reduced from 130% to 30% higher than the discount rate; the interest rate on regular liquidity credits was reduced from 187.5% to 100% above the discount rate, and the penalty interest was reduced to 200% above the discount rate (previously being by 225% higher than the discount rate). At the end of May, 1994, there was unification of passive interest rates that the National Bank pays to banks for the compulsory reserves at the level of 60% of the discount rate for all the categories of deposits being the basis for the appropriation. Starting from December 1, 1994, this was 38.8% of the discount rate.

In 1994, changes of the discount rate of the National Bank were reflected on the interest rates of banking deposits and loans but only partially and with a delay. Basic reasons for the lack of coordination of the interest rate policy of commercial banks with the interest rate policy of the Central Bank, are the following:

a/ lack of developed financial market for trading liquid assets among banking institutions with a surplus or shortage of assets, and, for creation of market price through free confrontation of supply of and demand for money assets. Instead, there are only relatively closed financial circles of certain banking institutions with rather uncoordinated and non-market price establishment (or of interest rates) for particular categories of money assets. This, would actually mean, that there is no free overflow of assets between entities to extent and in a way that would enable creation of *prima rate*. The insufficient flow of free financial assets among banks and among transactors in particular periods, resulted in high and economically irrational levels of interest rates.

b/ existence of extremely high lack of financial discipline, so that a large number of users of bank loans borrow from banks without an intention to pay back the borrowed assets. As a result of that, there is a concentration of high amount of bad investments in the bank credit portfolio. Banks calculate high interest rates on those assets, so that the economic entities are not in a position to pay them back. Thus, following a system of a spiral, the financial position of the banks as well as of the economic entities, is deteriorating.

c/ high level of rigidity of demand for credits due to the large dependence of economic entities on banking credits. Under such conditions, economic entities react irrationally to the high nominal and real interest rates, meaning that they continue to borrow from the banks (the so-called inflexibility) regardless of the interest rates.

The interest rate policy of commercial banks in 1994 is characterized by two qualitatively different periods: the first one is January-April 1994, and, the second one is May-December, 1994. In the first four months of the year, banks maintain extremely high nominal and real interest rates, which was not correspondent to the fundamental factors of the economy, that determined the interest rate policy of commercial banks in developed economies meaning first of all to bring down the inflation, decrease of productivity and decrease of the general level of economic activity, as well as global liquidity of the national economy. Simultaneously, the interest rate policy of the banks in this period was not synchronized and it was inert compared to the changes of the discount rate (policy) of the National Bank of the Republic of Macedonia.

Interest rates of commercial banks

(in %, monthly level)

1994	inflation rate on monthly level	nominal interest rates of time deposits over 3 months	real interest rates of time deposits over 3 months	nominal interest rates of short-term investments in agricultural area	real interest rates of short-term investments in agricultural area
January	22.0	13.0 - 15.0	(-7.4) - (-5.7)	12.0 - 19.0	(-8.2) - (-2.5)
February	6.8	13.0 - 15.0	5.8 - 7.7	12.0 - 19.0	4.8 - 11.4
March	2.4	11.0 - 15.0	8.4 - 12.3	11.1 - 17.0	8.5 - 14.2
April	2.4	7.0 - 11.0	4.5 - 8.4	8.0 - 15.4	5.4 - 12.7
May	1.6	2.7 - 2.8	1.1 - 1.2	5.0 - 9.5	3.3 - 7.7
June	2.3	2.7 - 2.8	0.4 - 0.5	5.0 - 9.7	2.6 - 7.2
July	-0.6	2.7 - 2.8	3.3 - 3.4	5.0 - 5.7	5.6 - 6.3
August	0.6	2.5 - 2.7	1.9 - 2.1	5.0 - 5.7	4.4 - 5.1
September	1.8	2.4 - 2.7	0.6 - 0.9	5.0 - 5.7	3.1 - 3.8
October	2.0	2.45 - 2.75	0.4 - 0.7	5.0 - 5.75	2.9 - 3.6
November	2.2	2.45 - 2.77	0.2 - 0.5	5.0 - 5.75	2.7 - 3.5
December	2.9	2.45 - 2.77	(-0.4) - (-0.1)	5.0 - 5.75	2.0 - 2.8

Except for January, when because of unexpectedly high inflation rate, there were high real negative interest rates from -7.4% to -5.7% on monthly level on time deposits over 3 months as a representative deposit category, i.e., from -8.2% to -2.5% on monthly level on short-term investments of the banks; in February, March and April 1994, there was a realization of high real positive interest rates. Thus, time deposits over 3 months with interest rates on monthly level were: 5.8% to 7.7% in February, 8.4% to 12.3% in March, and 4.5% to 8.4% in April, 1994. At the same time, real active interest rates on short-term credits on monthly level were: 4.8% to 11.4% in February, 8.5% to 14.2% in March, and, 5.4% to 12.7% in April, 1994.

High passive interest rates of the banks, with a relatively stable level of the denar exchange rate had a positive impact on encouraging the denar savings deposits of the citizens in the first four month of 1994. However, high real active interest rates of banking credits in the same period of time, under decline of the economic activity and under moderate inflation rate and exchange rate movements, were several times higher than the rate of the profit that could have been reached by the most successful economic entities. Thus, through high interest rate burden, already exhausted financial investment potential of the economic entities, was completely used.

As a result of the interventions of the bearers of the economic policy on one side, and the economic subjects on the other, at the beginning of May 1994, within the frameworks of the Banking Association in the Chamber of Commerce of the Republic

of Macedonia, there was an agreement on the basic criteria for leading interest rate policy of commercial banks. By implementing this contract (with some exceptions) in the period of May-December 1994, the interest rates of commercial banks reached more moderate real positive values. The interest rate on time deposits over 3 months in this period, reached real positive values of 0.2%-0.5% on monthly level (in November), to 3.3%-3.4% on monthly level (in July 1994). Simultaneously, real interest rate of short-term banking credits in the period of May-December 1994, was between 2.0% and 2.8% on monthly level (in December), and, 5.6%-6.3% on monthly level (in July 1994).

The characteristic of the interest rate policy of commercial banks in 1994 was also the existence of high interest rate margins between active and passive interest rates. High interest rate margins were a result of the concentration of bad investments in the assets of the banks, where the interest rate was calculated but mostly not collected (because of the extremely large lack of financial discipline caused by the difficult financial situation in which most of the economic entities, users of the credits, were). The banks tried to transfer the overburden of the balance sheet regarding these non-performing loans, on successful economic entities through maintenance of unjustifiably high active interest rates, bringing them into difficult financial position, also.

Thus, in the period of January-April, 1994, there was an average interest rate margin between active interest rates of short-term credits and passive interest rates on time denar deposits with the maturity over 3 months of 22.1 percentage points on annual level, being significantly over the usual annual interest rate margin of 2-3 percentage points in developed market economies. The interest rate policy of commercial banks in the first four months of the year, was characterized by a high level of divergence among the interest rates on same financial categories with different banks, against the expected approach needed under the conditions of sound market competition. Such a case in the analyzed period addresses to an existence of non-market criteria in the concept of the interest rate policy by particular banks in the Republic of Macedonia. Changes in leading the interest rate policy commenced from May 1994, did not result in shrinking the interest rate margins. In the period of May-December, interest rates margins between active and passive rates of equal categories on the assets and liabilities side of the balance sheets of the commercial banks were about 46.4 percentage points on an average annual level. Anyway, in this period of time, a sufficient level of conversion of interest rate was reached, on the same financial categories with particular banks in the Republic of Macedonia.

VI. GOALS AND OBJECTIVES OF FOREIGN EXCHANGE POLICY

The goals and tasks of foreign exchange policy for 1994, were established by the Decision on Foreign Exchange Policy and Projection of the Balance of Payments for 1994 (Official Gazette number 78/93). The basic objectives and tasks are in accordance with agreed policy with the IMF (International Monetary Fund) within achieved agreement for STF (System Transition Facility) arrangement with IMF in January 1994.

Within the policy of denar exchange rate, it was projected to continue with the implementation of floating regime through establishing the denar exchange rate in accordance with supply of- and demand for foreign exchange on foreign exchange market. In accordance with the established proportion in balance of payments and other measures of economical policy as well, the maintenance of the stable level of the denar real exchange rate was projected.

As a result of projected balance of payment movements for 1994, the growth of US\$ 20 million of net foreign exchange reserves disposable to the National Bank of the Republic of Macedonia, was foreseen. The increase of foreign exchange reserves and the deficit in current account as well, were supposed to be covered by using new loans from abroad, as well by financing through delaying the repayment the major part of the obligations for taken middle and long term loans, maturing in 1994. The projected minimum level of foreign exchange reserves by quarters was according to the following: at the beginning of the 1994, US\$ 115 million, at the end of first quarter US\$ 120 million, at the end of the second quarter US\$ 125 million, at the end of the third quarter US\$ 130 million, and, at the end of the fourth quarter of 1994 US\$ 135 million.

In 1994, the policy of foreign credit and financial relations was projected to normalize the relations with foreign lenders, as first and ultimate condition for further use of foreign capital. The first objective was to clear the arrears to multilateral lenders, above all to the World Bank. From this institution and its affiliation, the IDA (International Development Agency), it was projected to use two loans: for economical recovery and for structural adjustment of enterprises and of the financial sector.

In the same time, it was planned to intensify negotiations with official bilateral lenders (Paris Club) and foreign commercial banks (London Club) for rescheduling the outstanding debt obligations of the Republic of Macedonia against official bilateral lenders (Paris Club) and foreign commercial banks (London Club).

6.1. Realization of 1994 Foreign Exchange Policy in the first half of 1994

In the first half of 1994 the foreign exchange policy was realized in accordance with projected determinations of the Decision on Foreign Exchange Policy and

Projection of Balance of Payments for 1994. (Official Gazette number 78/93), that incorporated the goals and objectives of foreign exchange policy concluded with the STF arrangement with the IMF.

In the first half of 1994, the policy of floating exchange rate adopted and implemented in May 1993, together with the adoption of other essential laws and regulations in the sphere of foreign exchange and external trade, continued. The benefits from this policy (noticed in 1993), continued in the first half of 1994, especially in realization of positive balance of payments, expressed through existence and normal functioning of foreign exchange market and foreign exchange offices, as well in constant growth of foreign exchange reserves of the country.

With the Decision on Foreign Exchange Policy for 1994, it was expected that the denar exchange rate will follow the inflation, i.e., the stable level of the real effective rate will be maintained. In the same time the foreign exchange reserves disposable to National Bank of the Republic of Macedonia were expected to increase by US\$ 5 million each quarter. In the first half of the year by US\$ 10 million, through purchase of the excess of foreign exchange on foreign exchange market and on the exchange market. For realizing the objectives, a reserve money creation in countervalue of US\$ 10 million, was projected. The expected results in the reporting period were far exceeded, as a result of the necessity to purchase the excess of foreign exchange, occurred on the foreign exchange market and on the exchange market as well. The necessity to purchase that excess, was in function of slowing and halting the tendency of appreciation of the domestic currency. In this period, through foreign exchange offices, the significantly large supply versus demand of foreign exchange, occurred. The National Bank of the Republic of Macedonia created US\$ 1.453 million through foreign exchange transactions, representing an excess of 36 % from the projected total reserve money creation for the reporting period (Denar 1.068 million). The National Bank of the Republic of Macedonia was forced to sterilize the excess of the created reserve money in amount of Denar 385 million by other monetary instruments at its disposal. Besides such efforts for neutralizing the factors which had determined the appreciation of Denar, the real effective denar exchange rate decreased by 28.6 % in comparison with the rate at the beginning of the year, meaning that the denar exchange rate movement stagnated behind the rate of inflation. Also, have be pointed out that in January, only the real exchange rate have decreased by 13.1 % as a result of high level of the price increasing in that month, whereas in the following 5 months the exchange rate decreased by 11.8%.

The fact that the economic entities did not meet their obligations regarding the extended foreign loans, indirectly influenced the high level of supply of foreign exchange in this period

In the part of the implementation of the policy of foreign credit and financial relations the main objective for clearing the arrears towards the World Bank, in total amount of US\$ 109 million, was achieved. Besides the fact, that the planed financial aid in total amount of US\$ 80 million from donor countries was not realized, the financial construction to meet those obligations was closed, above all by using loans granted by the World Bank and by its affiliation the IDA, in total amount of US\$ 80 million. An amount of 30 million of these loans was immediately used for paying the

debt, as well as the loan granted by Mr. Soros in amount of US\$ 17.5 million, and, US\$ 17,1 million by the IMF, the humanitarian aid in amount of US\$ 20 million from a number of donors and US\$ 24 million from the foreign exchange reserves.

It should be noticed that, as a result of the undertaken activities by the National Bank of the Republic of Macedonia in cooperation with certain import companies (by submitting to the National Bank of the Republic of Macedonia, the complete documents for realized merchandise import), the total amount of US\$ 80 million extended from the World Bank was purchased within a very short period of time (till end of June 1994). Through this operation, part of foreign exchange reserves that was used to meet the obligations, was compensated, as well as the part of the credit from Mr. Soros in amount of US\$ 10 million and US\$ 17 million for servicing the maturing debt to the World Bank.

In the first half of 1994, there were negotiations for clearing the debts towards other financial institutions, whereas for solving the matured obligations towards the countries-members of the Paris Club, the agreement on stand-by arrangement with the IMF was considered as the prerequisite.

VII. REALIZATION OF FOREIGN EXCHANGE POLICY FOR 1994

In terms of adopting the 1994 foreign exchange policy, it was evaluated, that the denar exchange rate movements, in accordance with the adopted foreign exchange policy of free market establishing, will follow the inflation rate, so that, the competitiveness of export prices will be maintained. The main and basic objective of the program for macroeconomics stabilization, agreed and supported by the IMF through the STF arrangement, was a significant reduction of the inflation rate, as the basic condition for long-term economical growth. The achievement of such objective, meant the implementation of tight monetary and fiscal policy in 1994, resulting in an increased demand for money, and in, as reflection of that, a significantly high level of supply of the foreign exchange on the foreign exchange market. Besides, on the basis of supply of foreign exchange on foreign exchange market (being a result of the general situation in the region), the inflow of foreign exchange from other unidentified sources, had a significant impact.

The high gap between the supply of- and demand for foreign exchange, increased especially in the second quarter of the year, with a strong tendency to nominal denar appreciation. Under such circumstances, the National Bank of the Republic of Macedonia intervened by purchasing the excess of foreign exchange on the foreign exchange market and on the exchange market as well, in order to smooth the pressures on appreciating and stabilizing the denar exchange rate. In this quarter, the foreign exchange reserves managed by the National Bank of the Republic of Macedonia increased by US\$ 52 million, resulting especially from the high level of reserve money creation, by jeopardizing the achievement of the projected target for monetary base growth, agreed within the STF arrangement with the IMF. The National Bank of the Republic of Macedonia, considering the small number of monetary instruments at its disposal, with ultimate efforts, succeeded in sterilizing the major part of the reserve money creation and in finishing the first half of the year with the achieved target of monetary policy.

In the second half of 1994, the National Bank of the Republic of Macedonia continued with its policy of intervention with an aim to maintain the stable level of foreign exchange rate, through purchasing the excess of foreign exchange on foreign exchange market and on the exchange market, with a simultaneous withdrawal of reserve money through selling foreign exchange on the foreign exchange market, in accordance with the adopted targets of the monetary policy. In 1994, the National Bank of the Republic of Macedonia purchased US\$ 67.6 million and sold US\$ 97.5 million on the foreign exchange market. Simultaneously, the excess of US\$ 74.3 million was purchased on the exchange market.

In 1994, the total growth of foreign exchange reserves held by the National Bank of the Republic of Macedonia, was US\$ 46 million, whereas net foreign exchange reserves established as foreign exchange reserves subtracted for obligations towards the IMF increased by US\$ 31 million. The agreed target with the IMF was achieved.

In 1994, the foreign exchange reserves with commercial banks authorized for transactions abroad, increased by US\$ 72 million. Out of that, an amount of US\$ 52 million was an increase of their own foreign exchange reserves and US\$ 20 million was a result of the growth of foreign exchange liabilities towards their customers.

In the area of the policy of foreign credit and financial relations, the established objective to clear the arrears towards the World Bank in amount of US\$ 109 million, was achieved in February 1994. The planned financial aid from donor countries in total amount of US\$ 80 million was not realized, but the financial construction to meet those obligations was closed. By using the loans granted by the World Bank (ERL) in total amount of US\$ 80 million, a sum of US\$30 millions of those loans, was immediately used for repaying the debt. Then, with using the loan granted by Mr. Soros in amount of US\$ 17.5 million, US\$ 17.1 million by the IMF, the humanitarian aid in amount of US\$ 20 million from various donors and US\$ 22 million from the foreign exchange reserves.

In the second half of the 1994, the maturing financial obligations in amount of US\$ 13 million, towards the World Bank, were paid, as well as the rest of the loan from Mr. Soros in amount of US\$ 7.5 million. Besides the obligations towards the World Bank, in this period, the maturing obligations towards the IMF were also repaid. Simultaneously, the additional aid from donors in cash amount of US\$ 10 million, was also realized.

It should be mentioned, that the National Bank of the Republic of Macedonia services its obligations towards the World Bank and the IMF regularly, by using the foreign exchange reserves. Detail regulation of the relations between the ultimate beneficiaries and debtors of loans, granted by international financial institutions, followed in September 1994, with the approval of Law on regulation the relations for repayment of loans extended by international financial institutions" (Official Gazette of the RM, number 48/94). According to that Law, the National Bank of the Republic of Macedonia will debit in denar countervalue, the account of the Budget in the paid amount. Therefore, at the end of 1994, the claims on the Budget would amount Denar 826 million.

In 1994, through the regulation of the arrears, the Government of the Republic of Macedonia initiated contacts with other multilateral lenders, first of all, with the Eurofima and the EBRD, in order to find solutions for normalizing the relations. Meanwhile, the obligations towards those institutions, maturing in 1994 were bilaterally suspended. Simultaneously, the contacts with the Paris Club were commenced, though meeting the obligations towards the countries-members of this club, would be in context with the announced stand-by arrangement between the Republic of Macedonia and the IMF in 1995.

7.1. Movements of the Denar Exchange Rate

In 1994, the denar exchange rate was established in terms of a system of floating exchange rate regime, established from May 14, 1993, determined by " the

free game" of supply of- and demand for foreign exchange on the foreign exchange market. Establishing the exchange rate under the influence of market rules, was expressed significantly, due to the policy of intervention on the foreign exchange market, defined by the National Bank of the Republic of Macedonia, as a consistent part of the stabilization program of the Government. The policy of the Central Bank interventions on the foreign exchange market was established to be in accordance with the monetary policy, for achieving the ultimate objective of macroeconomics policy, i.e., by reducing the inflation rate. According to the policy, the nominal denar exchange rate, commencing from September 1994, was allowed to depreciate to the level of the projected inflation rate or less, if the realized monthly inflation rate from the previous month is lower than the projected for the current month, in order to maintain the price competitiveness of the export, but in accordance with the achievement of the monetary policy objectives.

Throughout 1994, in context with the realization of such objectives, the nominal denar exchange rate, with mild oscillations, had relatively stable movements. The appreciation of German Mark in 1994 had a significant influence on the denar rate movements (in 1994, on Frankfurt foreign exchange fixing, the German Mark against US Dollar appreciated by 11%), as well as the increased foreign exchange supply in comparison with the demand on foreign exchange market, especially significantly manifested in the second and third quarter of the year. The increased supply of foreign exchange was in its major part a result of: a) unpaid obligations to the foreign creditors, regarding the extended loans by the users of the credits; b) decrease of the output; c) tight monetary policy led to increasing real money demand; d) non-defined inflow of foreign exchange in the country impossible to be used for profitability, having an unefficient banking system.

Under such relation between the supply of- and demand for foreign exchange, and in terms of limited Central Bank's interventions on foreign exchange market as well, at the end of 1994, the nominal denar effective foreign exchange rate¹⁾ in comparison with the beginning of the year, achieved the nominal rate of decrease of 3.6%. Though, throughout the year, the average nominal rate of the increase was 1.34%. The denar exchange rate against the German Mark achieved a nominal rate of increase of 1.8%, whereas against the US Dollar, the exchange rate was decreased by 9,1%.

In 1994, the price competitiveness of the Macedonian export, monitored through the movements of the real denar effective exchange rate have decreased. In comparison with 1993, when the price competitiveness of the Macedonian export, was maintained at constant level from the beginning of the foreign exchange market, with increasing in the fourth quarter of the year. In 1994, the price competitiveness, compared to December 1993, was lower by 19,7%, whereas in comparison with the beginning of the function of the foreign exchange market, it was lower by 10.9 % (Table 1 and Graph 1)

¹⁾ The Nominal effective exchange rate is established as ponderous of arithmetic average of the Denar's exchange rate against German Mark and US Dollar, with their equal percentage participation.

Table 1

Movements of price competitiveness of exports, monitored through the movement of the real effective Denar exchange rate

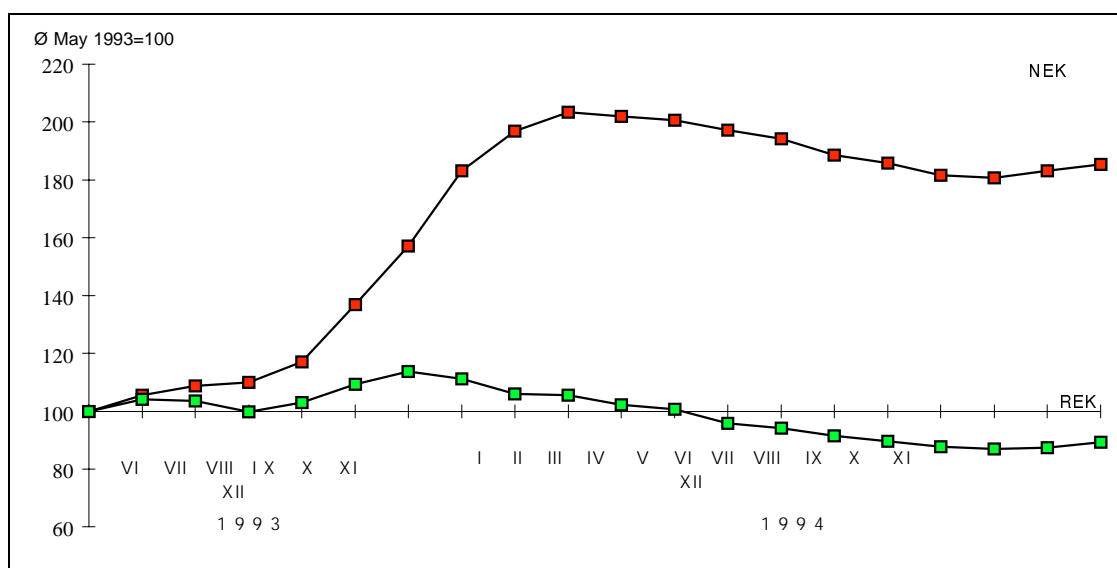
index	31.12.1993	31.12.1994	31.12.1994
	31.05.1993	31.12.1993	31.05.1993
1. Nominal effective Denar exchange rate ¹⁾	183,01	101,34	185,46
2. Index of domestic retail prices	165,44	128,60	212,75
3. Index of foreign retail prices	100,30	101,44	102,24
4. Relative prices (2:3*100)	164,95	126,15	208,18
5. Real effective Denar exchange rate (1:4*100) ²⁾	110,95	80,33	89,13

1) The nominal effective Denar exchange rate is calculated according to average monthly exchange rates.

2) The index of real effective exchange rate is used as internationally accepted and generally implemented indicator for evaluation of the reality of the exchange rate of a currency of one country, representing the average index of domestic currency movements against a number of foreign currencies of the countries-largest export partners, and at the same time adjusted to the price movements in the particular countries and on the domestic market. As weights for calculating the average rate, the equal participation of US Dollars and German Mark was taken. The real effective exchange rate index over 100 represents an increase of price competitiveness, and index below 100 represents a decrease of price competitiveness.

Graph 1

Movement of the nominal and real effective denar exchange rate, from the beginning of the function of the foreign exchange market

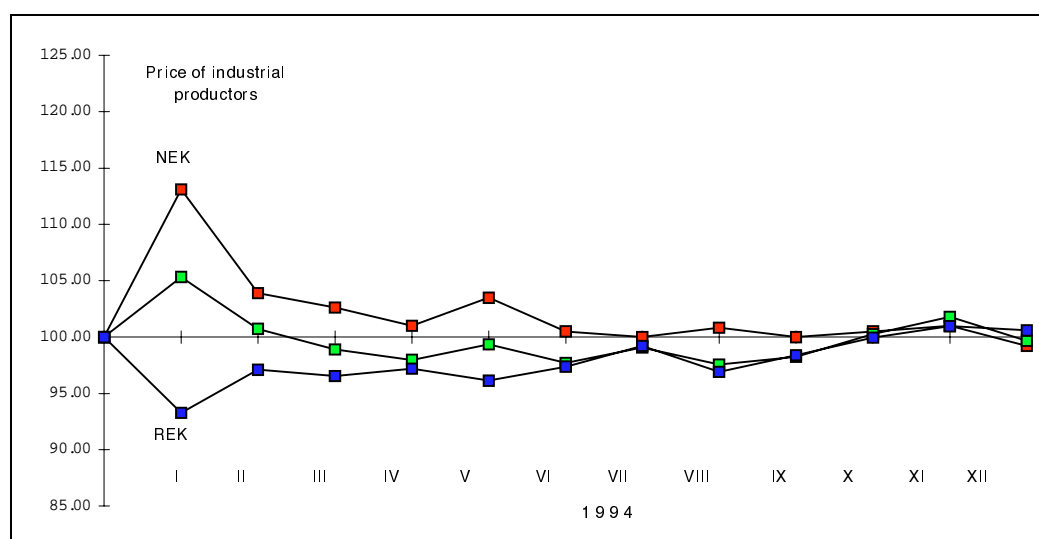


The decrease of the competitiveness in 1994, was mainly due to high increase of manufacturers' prices in January (13.1%) and February (3.9%), i.e., in the period before reaching the agreement on the STF arrangement with the IMF. In this period, the National Bank of the Republic of Macedonia, in accordance with the adopted foreign exchange policy, intervened on the foreign exchange market, by selling foreign exchange, mainly for paying the import of oil and wheat, resulting into an increase of 5.5% of the nominal denar exchange rate in January, and, in the same month, there was an appreciation of the real denar exchange rate of 6.7 % (Graph 2).

In the period after reaching agreement for the STF arrangement with the IMF under the policy of the Central Bank interventions on foreign exchange market, the competitiveness of the exports, was basically maintained at the level agreed within the STF arrangement with the IMF, reflecting the relation between the supply of- and demand for foreign exchange on the foreign exchange market. In 1994, extremely high supply of foreign exchange on the foreign exchange market and from exchange offices, had an impact on the decrease of the real denar exchange rate.

Graph 2

Monthly index of nominal and real denar exchange rate and manufacturers' prices



7.2. Functioning of foreign exchange market and the exchange market

7.2.1. The Foreign exchange market

In 1994, the foreign exchange market continued to exist as a market organized within banks, authorized for transactions abroad. Trading of foreign exchange was realized between customers only; between customers and banks and between banks only. In the terms of floating exchange rate regime established from the beginning of this market, the supply of- and demand for foreign exchange were basic principles on the foreign exchange market. In 1994, especially the second quarter of the year was characterized by a significantly high level of supply of foreign exchange in relation with the foreign exchange demand.

Throughout 1994, the tendency of permanent growth of the turnover on the foreign exchange market, which appeared from the beginning of the existence of the market continued. In the first quarter of the year, the total turnover was in amount of US\$ 135 million with daily average of US\$ 2.2 million; for the second quarter, the total turnover was increased to the level of US\$195 million with a daily average of US\$3 million. The tendency of continuous increase was maintained also in the third quarter, when the level of total turnover in amount of US\$222 million was achieved,

with daily average of US\$3.5 million. In the fourth quarter, the total turnover achieved the level of US\$250 million with daily average of US\$4 million.

Besides the existing tendency of permanent growth of the turnover on foreign exchange market, the seasonal factors had also an influence upon the turnover. Analyzing the turnover by months, it should be noticed that, in early months the level was lower, compared to the summer months when there was an increase. In the last months of the year the turnover had reached its peak. The peak of monthly turnover (US\$87 million) was reached in December, as a result of particularly high import of goods, and maturity of a large number of obligations for payments before the end of the fiscal year.

The average monthly turnover on the foreign exchange market in 1994, was US\$66.9 million, with a daily average value of US\$3.2 million. Throughout the first year of the foreign exchange market existence, the average monthly turnover was US\$49.4 million, with an average daily turnover of US\$2.1 million.

In 1994, the total turnover on foreign exchange market achieved the level of US\$803 million, where the majority part (67.65%) of the turnover was realized between clients and authorized banks for transactions abroad, than 31% was realized through direct trade among the clients and only 1.3% among the authorized banks.

Out of 17 banks, authorized for cross-bordering transactions, the major part of the turnover was realized through Stopanska Banka,j.v., Skopje, being 39.7%; through Komercijalna Banka,j.v., Skopje of 17.85%; through Ljubljanska Banka-Makedonska Banka,j.v., Skopje of 11.3%; and through Kreditna Banka,j.v., Skopje of 9.36%. In comparison with the previous year, the other banks also had a stable turnover with a tendency of permanent growth.

In 1994, having such a foreign exchange market, the payments operations abroad were realized mainly within the banking system of the country. From the beginning of January, till the end of December 1994, the average sale on the foreign exchange market, represented approximately 40.8% of average monthly payments for import of goods and services. The rest of the payments were realized from the foreign exchange inflows of the exporters.

The National Bank of the Republic of Macedonia purchased an excess of foreign exchange of US\$97.5 million, and sold a net amount of US\$ 29.9 million. The selling of the National Bank of the Republic of Macedonia was mainly for paying the import of oil, oil derivatives and other raw materials and semi-manufacturers, as well as for maintaining the monetary base within the projected frameworks.

7.2.2. The system of the foreign exchange offices

In 1994, the system of the exchange market as well as of the foreign exchange market, continued to exist within the frameworks of the established legislation from May 1993, upgraded in May 1994 with additional liberalization of 100% sale of previously purchased foreign currencies to domestic private entities. The elimination

of the compulsory acquisition of the purchased foreign currencies was determined by increased supply of foreign exchange in the foreign exchange offices, with an aim of softening up the monetary effects from previously high level of purchasing.

In the present environment of the activities in the foreign exchange offices, a significantly high level of turnover in amount of US\$211 million was achieved in 1994. Out of this, US\$155.9 million of foreign currency were purchased, and US\$55.1 million were sold. The major part of the turnover on exchange market was realized through exchange offices, acting on their name and their behalf. These offices purchased US\$108.9 million and sold US\$ 52.4 million. The exchange offices, acting on their name and on behalf of the National Bank of the Republic of Macedonia, purchased US\$46.9 million and sold US\$ 2.7 million to private entities.

The movement of the turnover, expressed the tendency to increase, especially after the implementation of the Decision on 100 % sale of foreign currencies previously purchased within the same period of ten days to private entities. Thus, in the first quarter, the sale of foreign currencies was in amount of US\$2.9 million, than, in the second quarter increased to US\$8.5 million, and to US\$25.6 million in the third quarter. In fourth quarter, apart from the decrease, the sale was still high and reached US\$18 million. As for the purchase, besides the growth determined as a result of changing the regulations by possibility for increased sale, the influence of seasonal factors was obvious through higher purchasing in the summer months and in the last months of the year.

The major part (US\$74.3 million) of purchased foreign exchange from foreign exchange offices was incorporated into the foreign exchange reserves disposed to the National Bank of the Republic of Macedonia. The rest of the amount of US\$26.5 million was in function of increasing the foreign exchange potential of the commercial banks. In the last two quarters of the year, as a result of the especially high level of supply of foreign currencies from foreign exchange offices, as well with the obligatory responsibility of the National Bank of the Republic of Macedonia to absorb the excess of purchased foreign currencies, the inflow of foreign currencies into foreign exchange reserves managed by the National Bank of the Republic of Macedonia was very high. The total inflow in amount of US\$44.2 million from foreign exchange offices into foreign exchange reserves managed by the National Bank of the Republic of Macedonia was realized through foreign exchange offices acting on their name and on the behalf of the National Bank of the Republic of Macedonia, whereas the rest in the amount of US\$30.1 million was an inflow of foreign currencies from foreign exchange offices, acting in their name and their behalf, as an excess of purchase versus sale.

In 1994, the legal and private entities were interested in participating in the system of foreign exchange offices. During 1994, 328 licenses were issued for establishing foreign exchange offices. Out of this number, 235 are foreign exchange offices, acting in their behalf and their name, and 84 are acting in their name and on the behalf of the National Bank of the Republic of Macedonia, and, only 9 foreign exchange offices are acting on the behalf of a commercial bank. With the increasing of number of foreign exchange offices, the irregularity in their working was also

increased. During 1994, 133 licenses were withdrawn as a result of discovered irregularities.

7.3. Foreign Exchange Reserves of the Republic of Macedonia

At the end of 1994, the total foreign exchange reserves of the Republic of Macedonia achieved the amount of US\$253.88 million, representing the accumulation of new foreign exchange throughout the year, in amount of US\$97.71 million, i.e. in comparison with the previous year it was an increase of 62.56%.

On December 31, 1994, the foreign exchange reserves managed by the National Bank of the Republic of Macedonia were in amount of US\$165.4 million. US\$80 million from that amount represented permanent reserves, and the rest of the amount of US\$85.4 million were current or operative foreign exchange reserves. In comparison with the end of 1993, the foreign exchange reserves with the National Bank of the Republic of Macedonia increased by US\$46.17 million, or by 38.73%. Considering those US\$15 million of this growth, it was due to net increase of liabilities towards the IMF, so that, the net growth of foreign exchange reserves with the National Bank of the Republic of Macedonia was US\$31 million. The higher growth of foreign exchange reserves with the National Bank in comparison with the projected growth by the Decision on Foreign Exchange Policy and Projection of Balance of Payments for 1994 (Official Gazette number 78/93) was a reflection of higher supply of- versus demand for foreign exchange. The higher supply of- versus demand for foreign exchange, together with the policy of intervention on foreign exchange market of the Central Bank, as an instrument of the monetary policy for achieving the projected inflation rate, was the main characteristic of the reporting period.

During 1994, the main inflows realized into foreign exchange reserves with the National Bank of the Republic of Macedonia, were basically from foreign exchange offices (34.%) and from purchasing the excess on the foreign exchange market (31.4 %), with a realized total inflow in amount of US\$215.5 million.

Simultaneously, the foreign exchange reserves with the National Bank of the Republic of Macedonia were used for repayment of arrears towards the IBRD, as well for payments for maturing obligations for usage of loans undertaken and guaranteed by the Government of the Republic of Macedonia (34%), for interventions on the foreign exchange market (57.6%), for import of oil, as well for other payments by a Decision of the Government of the Republic of Macedonia (8.4%), in total amount of US\$169.37 million.

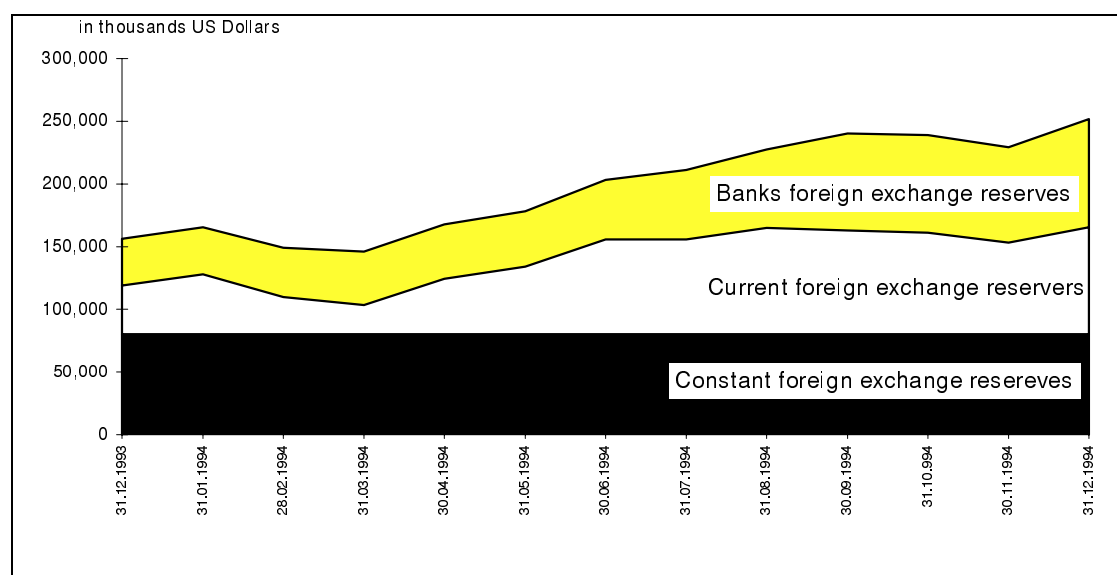
From the participation in the structure of inflows and outflows, it is noticeable that the major part of the realized inflow, which could be said arised from the export part of the economy, was absorbed again in the channels of the economy through the interventions of the National Bank of the Republic of Macedonia, by selling foreign exchange on the foreign exchange market.

The dynamics of changes in foreign exchange reserves with the National Bank of the Republic of Macedonia, was determined by payments of obligations regarding guaranteed loans, as well by supply of- and demand for foreign exchange on foreign exchange market (Graph 3).

During the first quarter of 1994, foreign exchange reserves decreased by US\$16 million, first of all being a result of the participation of the reserves (in amount of US\$22 million) in closing the financial construction for repayment of arrears towards the IBRD, as well for further regular repayment of maturing obligations towards this international financial institution and towards the IMF.

In the second quarter of the year, the growth of the foreign exchange reserves in amount of US\$53 million was reached, as a result in this period of purchasing the major part (US\$48 million) of the Loan for Economical Reconstruction, extended by the World Bank.

Graph 3
Dynamics of the growth of foreign exchange reserves in reporting period



Despite the intervention of the National Bank of the Republic of Macedonia on the foreign exchange market, the net inflow in this period basically arised from the extraordinary high inflow of foreign currencies from foreign exchange offices (in this period, the realized inflow from foreign exchange offices was in amount of US\$28 million).

In the fourth quarter, when the major part of the loan granted by Soros Foundation was paid, the net inflow of US\$2 million was achieved again, as a result of high inflow of foreign currencies from foreign exchange offices.

The current reserves with the commercial banks authorized for payments transactions abroad were at the level of US\$88.48 million, which, in comparison with the end of 1993 was a growth of US\$51.53 million or 139.46%. It is obvious that the

commercial banks were actively involved in purchasing the excess of foreign exchange.

In accordance with the Decision on terms and conditions for trade of foreign exchange between legal entities in the Republic of Macedonia (Official Gazette of RM, number 30/93), the exporters were allowed, to hold the foreign exchange earned by their own exports of goods and services on their deposit accounts with commercial banks, for 90 days. On that basis, at the end of 1994, on their accounts the exporters held US\$58.72 million. In the same time, foreign exchange deposits of other customers were US\$81.94 million. Considering that these foreign exchange funds represented the foreign exchange liabilities of the banks, it could be concluded that, at the end of 1994, the total foreign exchange potential of the Republic of Macedonia was US\$394.54 million.

7.4. Balance of payments

The National Bank of the Republic of Macedonia started to publish balance of payments data in 1994. For the first time, after the monetary independence of the Republic of Macedonia the data was completed with trade data. As sources for balance of payments compiling, preliminary data from Bureau of Statistics were used, than payment operations data from banking sector further processed in the NBRM, as well as, external debt data also provided by the NBRM.

Regarding Macedonian balance of payments methodology, in the beginning of 1993, the initial steps were being made with the assistance of the statistical mission of the IMF, aiming the implementation of balance of payments methodology in accordance with the fifth edition of the Balance of Payments Manual. Such methodology and classification of balance of payment transactions, enabled further adjustments to categories of other national statistics, i.e. with the System of National Accounts. Meanwhile for the implementation of this methodology, further work and cooperation with other data providers are required.

7.4.1. Balance of payments movements in 1994

In 1994, further deterioration of the economic environment of the Republic of Macedonia continued. Completely closed border and imposed embargo from the sought neighbor, besides already existing sanction towards our north neighbor, resulted in enormous increase of transportation costs related to the export and import of goods, and in general, totally deteriorated communications with regard to inadequate road traffic infrastructure on the east-west connection.

Decline of the value of US Dollar on foreign exchange markets with regard to high participation of this currency in receipts for exported goods and services, had an adverse impact, so that further deterioration of economic situation continued, first of all in the export sector. In 1994, on the domestic foreign exchange market, the value of the US Dollar declined against the denar by 9.1%.

Despite unfavorable external environment, the achieved balance of payments results in 1994, could be evaluated as favorable, reflected mainly through an increase in foreign exchange reserves of the Republic of Macedonia. The foreign exchange reserve increased by US\$46 million exceeding the expectations, whereas the foreign exchange reserves with the authorized banks increased by US\$52 million. Meanwhile, in the balance of payments structure, high current account deficit was unfavorable, as the main consequence of high trade deficit.

Current account deficit was financed through the use of new credits from abroad, primarily from the World Bank, the IMF, and, through the use of trade credits for import of goods. At the same time, cash inflows in form of donations were used. Hence, the highest item in credit and financial account was their exceptional financing which is in fact going into arrears.

Table 2

Balance of payments of the Republic of Macedonia

in millions USD	1993	1993				1994				1994
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	
Current account - balance	-36	7	-27	41	-57	9	-88	-34	-55	-168
Trade balance	-172	16	-54	-11	-123	-52	-149	-109	-107	-417
Processing/1	25	-21	4	23	19	-30	-42	-27	-31	-130
Other trade	-169	37	-44	-27	-135	-7	-94	-75	-68	-244
Aid	-28		-14	-7	-7	-15	-13	-7	-8	-43
Exports*	1055	268	251	258	278	235	275	257	300	1067
Processing/1	95	22	28	24	21	16	16	17	38	87
Other exports	960	246	223	234	257	219	259	240	262	980
Imports*	1227	252	305	269	401	287	424	366	407	1484
Processing/1	70	43	24	1	2	46	58	44	69	217
Other imports	1129	209	267	261	392	226	353	315	330	1224
Aid	28		14	7	7	15	13	7	8	43
Services, net	-11	-20	-2	2	9	7	24	26	8	65
Transfers, net/3	147	11	29	50	57	54	37	49	44	184
Capital account - balance	-62	-25	-12	-4	-21	-72	15	-15	6	-66
Capital transfers						20		5	5	30
Direct investment								5		5
of which: in financial organizations								5		5
Medium and long term capital	-79	-30	-13	-28	-8	-105	33	-20	-15	-107
Disbursed/4						32	48	2	0	82
Repaid/2/4	79	30	13	28	8	-28	-14	-22	-15	-79
Repayment of arrears						-109	-1			-110
Multilateral creditors						-109	-1			-110
- from which: banks						-57				-57
Official bilateral creditors										
Short term capital, net	17	5	1	24	-13	13	-18	-5	16	6
Errors and omissions	33	-20	59	-61	55	-5	108	31	31	165
Overall balance	-65	-38	20	-24	-23	-68	35	-18	-18	-69
Changes in official reserves, net/5	-66	-8	-45	-25	12	33	-53	-8	-3	-31
Assets	-59	-5	-43	-24	13	16	-53	-7	-2	-46
Liabilities	-7	-3	-2	-1	-1	17	0	-1	-1	15
Changes in total arrears	131	46	25	49	11	35	18	26	21	100

* Trade data for 1994 provided by Bureau of Statistics are preliminary.

- 1) Goods imported for processing and subsequent export according to contracts with foreign enterprises.
- 2) Interest and amortization owing on debts that are taken over by former SFRJ (Official gazette No. 83/89) are excluded, except for the loans from IBRD guaranteed by Government of the Republic of Macedonia.
- 3) Data for official transfers in 1994 are provided by Ministry of Development.
- 4) Excluding IMF.
- 5) End-of-period; increase in assets denoted by a minus sign; includes IMF.

According to the methodology of standard presentation of the balance of payments, there were all obligations according to the maturity for payment of foreign credits, and, the amount of the unpaid obligations abroad was added to the newly extended credits, being an additional financing. In analytical presentation of the

balance of payments, this item was presented as an off-balance item regarding the lending based on matured but unpaid financial obligations.

Caused by general condition in the region and certain failures in balance of payments statistics, large positive "errors and omissions" item was shown being in fact non-registered and undistributed inflows from abroad.

7.4.1.1. Current account

The current account showed a deficit of US\$168 million in 1994, compared with a deficit of US\$36 million in the previous year.

Current account deficit primarily resulted from high trade deficit of US\$417 million, which is higher by US\$245 million from the last year trade deficit. High trade deficit (especially expressed in the second and third quarter), was mainly due to higher increase in import than increase in export, which is the main characteristic of Macedonian foreign trade in the reporting period. Thus, compared with the previous year, the import of goods in 1994 increased by 12.8%, whereas the export increased by 1.1% only.

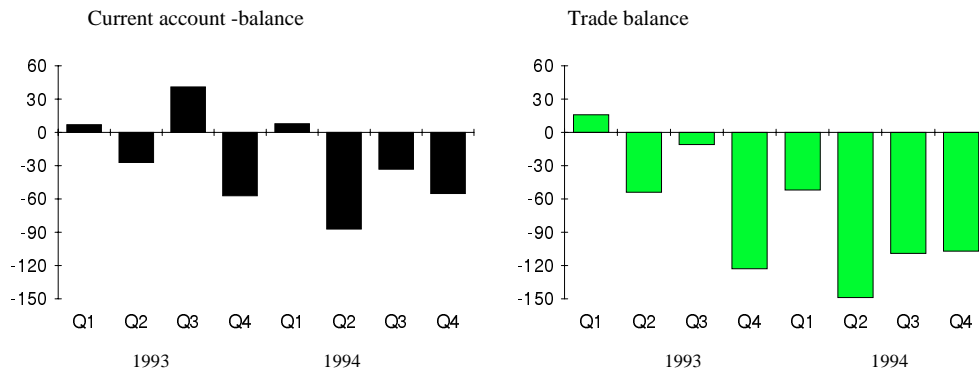
The balance of services showed tendency of increased surplus attributed to increased net inflows almost in all services items. Thus, tourism recorded a net inflow of US\$8 million, which may intend to be an increased participation of tourism related to total services receipts. Such inflow item, traditionally represented a high share of total services inflows in years before the dissolution of former Yugoslav community. Net inflows from other services recorded US\$122 million which compared to the previous year were an increase of 144%. Sizable increase in inflows was recorded in construction services, agency commission, telecommunication services and other business services. It should be mention that, as a result of increased transportation costs caused by current situation in the region, higher deficit in transportation services was recorded, which from US\$5 million in 1993, increased to US\$19 million, in 1994.

In reporting period, net interest outflow recorded US\$46 million, out of which, US\$42 million were repaid interest arrears, and, US\$10 million were regular interest paid to the World Bank and to the International Monetary Fund.

Balance of payment current transfers showed surplus of US\$184 million resulted from increased inflows in the private as well as in the official transfers. Increased inflows in private transfers, were especially expressed in cash exchange and currency deposits. In accordance to data available to the National Bank of the Republic of Macedonia, official transfers included US\$18 million of aid from FHARE and ECHO programs, and US\$25 million as donors contribution from European Union's member countries and other aid.

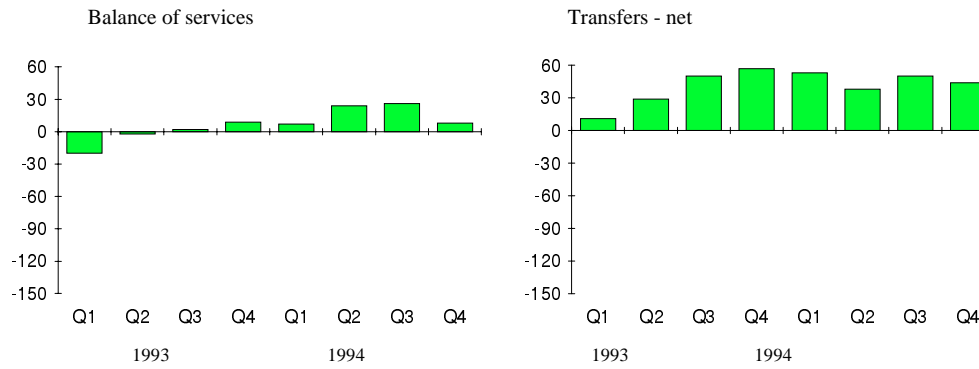
The influence of current transactions on current account balance (in million US Dollars)

part 1



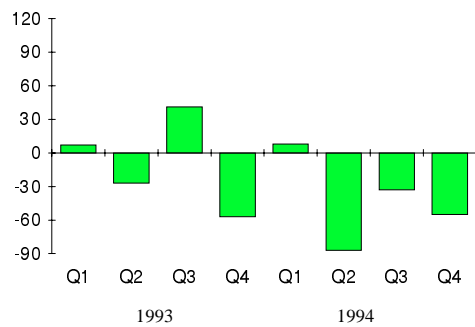
The influence of current transactions on current account balance (in million US Dollars)

part 2

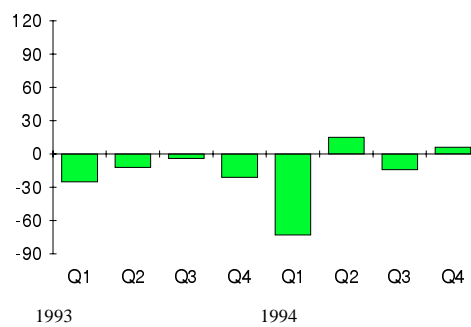


The influence of balance of payments transactions on official reserves (in million USD)

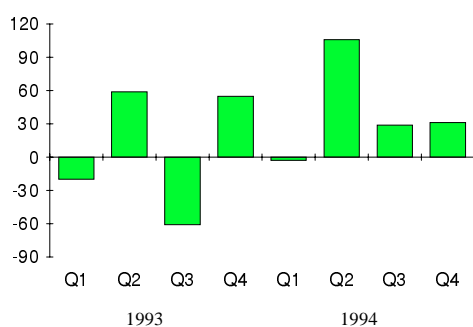
Current account - balance



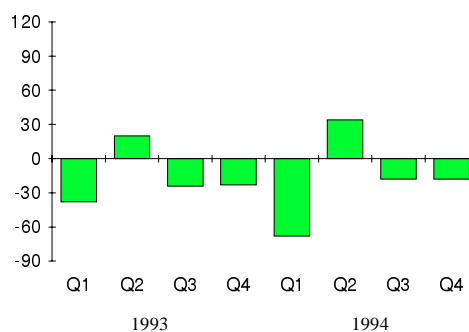
Capital account -balance



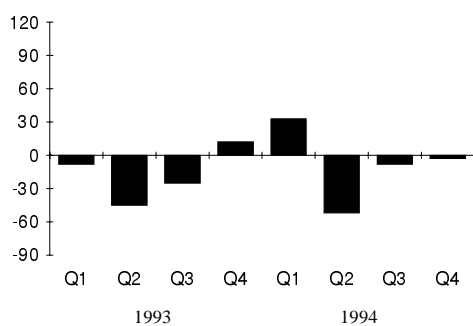
Errors and omissions



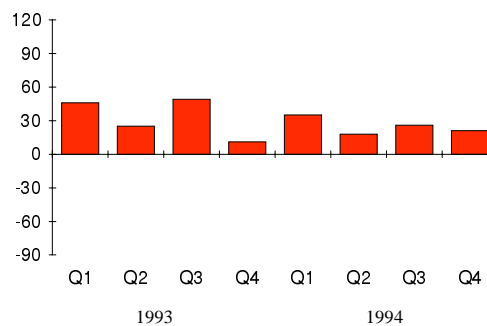
Overall balance



Changes in official reserves



Change in total arrears



7.4.1.2. Credit and financial transactions

Credit and financial transaction in 1994 recorded deficit of US \$ 66 million. This deficit in the first quarter of 1994 amounted US \$ 72 million, mainly as a result of repayments of arrears to the International Bank for Reconstruction and Development accumulated from monetary independence of the Republic until February 14, 1994, in the amount of US \$ 108.7 million. With the repayment of total arrears to this international financial institution, the conditions for disbursements of new Economic Recovery Loan/Credit approved by the International Bank for Reconstruction and Developments and the International Development Association on February 14, 1994, were fulfilled. At the same day, US \$ 32 million were disbursed as retroactive financing of which US \$ 30 million were used for repayment of intra-day credit from Bank for International Settlements (BIS) used as part of financial construction for repayments of arrears to the IBRD. The rest of the assets of the Economic Recovery Loan (US \$ 48 million) was disbursed in the second quarter of the year..

STF arrangement with the IMF in the amount of US \$ 17 million was approved at the same time with repayments of arrears to the IBRD, where the assets were used for financial construction.

The new short-term loan from Mr. Soros in the amount of US \$ 17.5 million, which was also used in financial construction for repayments of arrears to the IBRD, was repaid in total until the end of the year, pursuant to the Credit Agreement concluded between him and the Republic of Macedonia.

For repayment of arrears and for regular payment of obligations to the World Bank, donors contribution as capital transfers were used, in total amount of US\$30

million (US\$20 million for repayments of arrears and US\$10 million for regular payments). Thus, the biggest contributions came from the Netherlands - US\$14.97 million, USA - US\$5 million, Austria -US\$3 million, Italy - US\$2.5 million, Sweden - US\$1.9 million, Switzerland - US\$1.4 million, Turkey - US\$1.0 million. To this financial institution in the reporting period US\$23.1 million were repaid as principle, and, US\$10.2 million, as regular interest.

As a consequence of current and capital account flows, official reserve assets increased by US\$46 million with a simultaneous increase in liabilities by US\$15 million (US\$17 million for the STF arrangement and US\$2 million repayment of obligations to the IMF).

High "errors and omission" item resulted in substance from unrecorded trade credits for import of goods which according to our legislation is subject to registration, if payment is made after 180 days, and from unrecorded inflow from export of goods in official statistics.

7.5. The medium and long-term external debt stock of the Republic of Macedonia on December 31, 1994

The external debt of the Republic of Macedonia arising from medium and long-term external loans amounted US\$ 737.11 million at the end of 1994. Interest due on this loans amounted US\$ 428.09 million.

Interest and amortization on loans used by Macedonian firms taken over by former SFRY pursuant to "Act on assuming Federal obligations by particular external loans and on indebtedness of the National Bank of Yugoslavia abroad on account of the Federation" ("Official Gazette of SFRY" No. 83/89), are not included in the external debt stock. The Republic of Macedonia's debt stock on these loans amounted US\$ 139.47 million, and accompanying interest of US\$ 56.47 million. However, by membership of the Republic of Macedonia in the International Bank for Reconstruction and Development, the interest and amortization due on loans from this international financial organization used by Macedonian firms are accepted and guaranteed by the Government of the Republic of Macedonia. Thus, from the undertaken obligations, only the debt based on the loans from the International Bank for Reconstruction and Developments in amount of US\$ 10.25 million and accompanying interest in amount of US\$ 2.30 million, are included in the Republic of Macedonia's debt stock.

In this debt stock a part of unallocated debt of the former SFR, is not included . If allocation of this debt by former republics is made using the criteria implemented for membership of each republic in the IMF (5.4%), the Republic of Macedonia's part for repayments is estimated of around US\$139.59 million amortization and US\$ 66.18 million interest.

The presentation of the Republic of Macedonia's external debt stock in this sense is in accordance with the external debt policy set forth by the Government of the

Republic of Macedonia that undertook the obligations, should be subject of the succession of assets and liabilities of the former SFRY.

A part (US\$ 187.41 million) of the amount of US\$ 737.11 million external debt stock of the Republic of Macedonia on December 31, 1994, is in principal arrears. Interest arrears amounted US\$ 139.87 million. If interest arrears are concerned as debt, than, including this interest, the total debt stock of the Republic of Macedonia amounted US\$ 876.98 million. However, it should be mentioned that late interest on principal arrears is not calculated in such interest arrears. There is no actual data on the amount of this interest, but some assumptions indicate the amount of approximately US\$ 40 million as late interest.

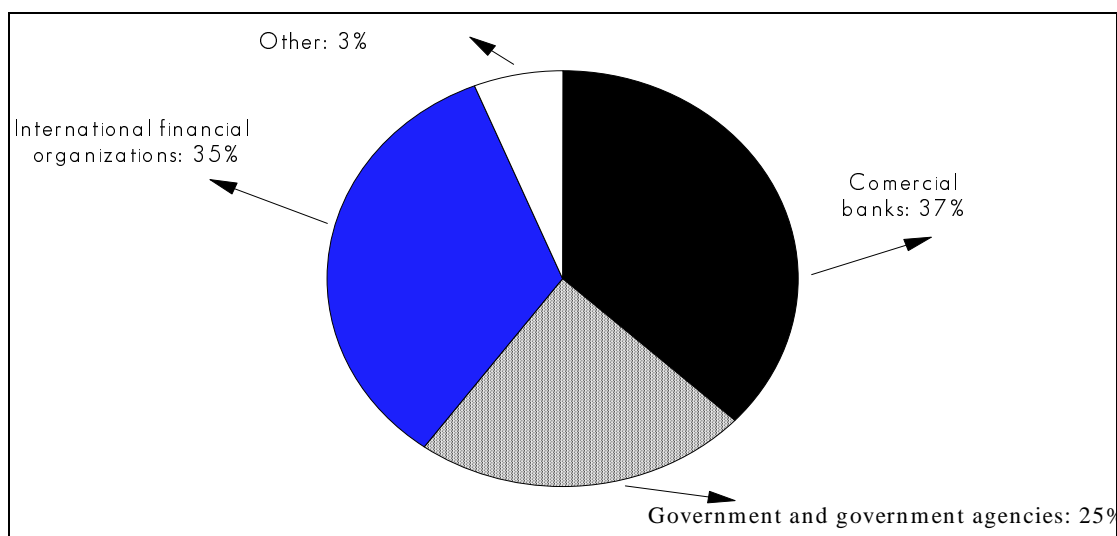
Out of the total arrears, US\$ 60.58 million are arrears until 1991, US\$ 84.19 million arrears in 1992, and, US\$ 84.53 million in 1993. The arrears in the reporting period amounted US\$ 97.99 million of which US\$ 55.62 million are principal arrears and US\$ 42.37 interest arrears.

7.5.1. External debt structure by different creditors

The biggest share of the Republic of Macedonian's external debt of US\$ 737.11 million, is to the commercial banks in the amount of US\$ 272.51 million. Accumulation of arrears to this creditors continued in the reporting period, as on interest basis as well as on principle basis matured in 1994 for the refinanced loans. The total arrears for the loans from these creditors amounted US\$ 20.62 million principle and US\$ 87.09 million interest on December 31, 1994.

Total debt arising from the Paris Club of creditors loans amounted US\$ 181.72 million, out of which, US\$ 125.81 million are principle arrears. The arrears of interest to these creditors amounted US\$ 27.15 million. Since the end of 1993 some activities for resolving the problem with accumulation of arrears to these creditors have been undertaken, there is no principle and interest repayments in 1994.

The medium and long-term debt of the Republic of Macedonia on 31 Dec. 1994

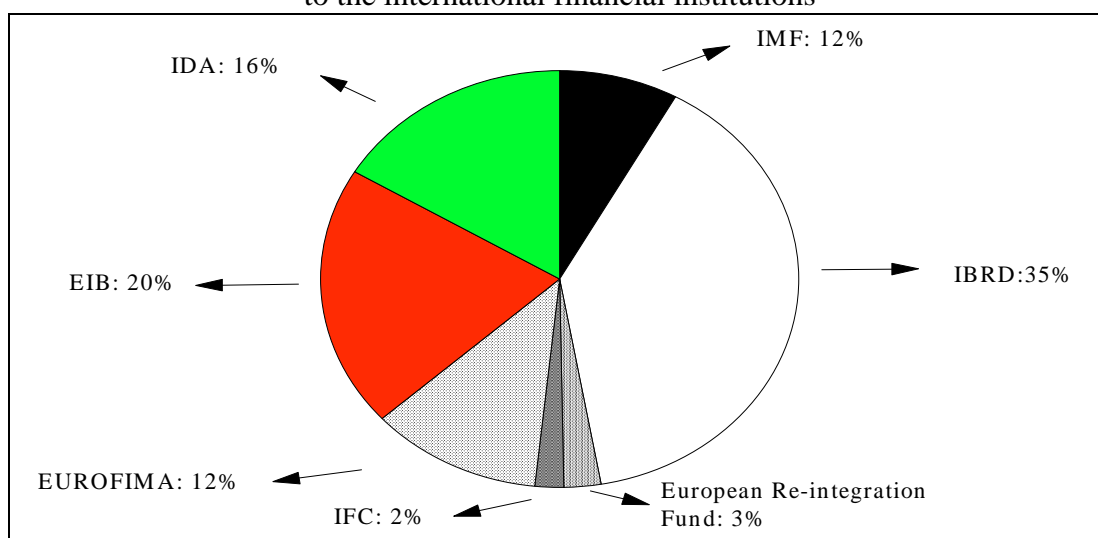


However, Paris Club in negotiations for resolving such liabilities asked for acceptance of the Republic of Macedonia a part of unallocated debt of the former SFRY using the same criteria and percentage set up in allocation of debt with the IMF, as well as acceptance of undertaking Federal obligations.

The Republic of Macedonian's debt, arising from medium and long-term loans from the international financial institutions amounted US \$ 260.24 million, or 35% of the total external debt. The biggest share is debt to IBRD - US \$ 91.03 million, than to EIB - US \$ 52.58 million, IDA - US \$ 42.34 million, IMF - US \$ 32.71 million, EUROFIMA - US \$ 30.24 million, European Re-integration Fund - US \$ 6.58 million and IFC - US \$ 4.76 million.

The arrears with these creditors amounted US \$ 19.32 million in principal and US \$ 19.37 million in interest. In addition, in 1994 only liabilities to IMF and IBRD were serviced. To these financial institutions, in the reporting period US \$ 23 million were repaid as principal and US \$ 10 million as regular interest.

The medium and long-term debt
to the international financial institutions



Repayment of arrears to the International Bank for Reconstruction and Development was a prerequisite for approval of new loans from this international financial institution. Therefore, such arrears were repaid in whole amount of US \$108.6 million on February 14, 1994. Financial construction for repayment of these arrears was: US \$ 20 million as donors contribution; US \$ 24 million from the official reserves of the Republic of Macedonia; US \$ 17.5 million SOROS Foundation's short-term credit; US \$ 17.5 million STF arrangement with the IMF and US \$ 30 million intra-day credit facility by the Netherlands Bank in cooperation with the Bank for International settlements (BIS).

At the same time, with the repayment of arrears, the condition for using a new loans was fulfilled and Economic Recovery Loan (ERL) was signed in the amount of US \$ 80 million of which US \$ 40 million from the IBRD and SDR 29 million (40 million in US Dollars terms) from the IDA. Therefore, US \$ 32 million as retroactive financing were disbursed on the same day and used for repayment of intra-day credit to the BIS. The rest of the assets up to US \$ 80 million, were disbursed until the end of June 1994 out of which, US \$10 million were used for principal repayment of the credit from the Soros Foundation pursuant to the Credit Agreement.

Summary of the 1994 Annual Report

Basic objective of the monetary and credit policy in 1994 was the realization of macroeconomic stability and bringing down the inflation rate from 229% on an annual level, as it was in 1993, to 70% on an annual level in 1994. The realization of this aim was foreseen to be within the frameworks of the complete stabilization program. Besides the monetary and credit policy, fiscal policy and income policy were also integral components of the program. The stabilization program in 1994 was confirmed and financially supported by the International Monetary Fund through the agreement on the STF arrangement.

Bringing down the inflation rate and maintaining price stability as an objective of the monetary and credit policy in a long run, can be realized indirectly, through monetary supply regulation. Hence, money and credits in the national economy are two most significant aggregates, so that through their restrictive dimensioning, monetary authorities could have an impact on the reduction of the aggregate demand, resulting in bringing down the inflation as the final goal of the monetary and credit policy and of the economic policy in the Republic of Macedonia.

Basic intermediary objective, through which, monetary and credit policy was to influence the profile of the global money supply in the national economy in 1994 was reserve money in their narrowest sense (currency in circulation, assets on giro-accounts and assets in the vaults of the banks). The increase of this monetary aggregate, which was at the same time the basic criterion for implementing the STF arrangement in the monetary area, was projected to be 83.6% in 1994.

Due to still non-developed instruments for indirect regulation of money supply and to the lack of firm financial discipline, in 1994 it was planned to implement also an instrument for direct control, which is the constraint of the increase of denar credits of the banks. With the projection of the monetary and credit policy for 1994, the increase of denar credit extended by banks to entities from the private and social sectors, was limited to 35.3%.

In 1994, monetary policy was determined to be implemented under the conditions of a flexible regime of denar exchange rate which was to be created on the basis of foreign exchange supply and demand on the foreign exchange market. Although the exchange rate was not a nominal anchor of the monetary policy, it was an indicator for its strength and for the maintenance of the projected restrictive exchange rate.

Money supply M1 is the basic indicator of the potential of expenditure in the national economy and an indicator of the future inflation rate movements. Hence, the increase of this monetary aggregate was determined to be a second indicator of the

efficiency in implementing the monetary and credit policy in 1994. In accordance with the projected movements of real and monetary variables, an increase of money supply M1 of 80.7% was projected for 1994.

The discount rate of the National Bank of the Republic of Macedonia in 1994, was to maintain moderate real positive level. Due to the lack of conditions for its market determination, the discount rate was decided to be determined on the basis of a model according to which the actual average level of the inflation rate is taken regarding two preceding months on an annual level, increased by 5% per annum, as its real part.

In 1994, monetary and credit policy was realized under extremely difficult conditions. The most significant limiting factors for successful implementation of the monetary and credit policy and of the economic policy as well, throughout 1994, were the following:

1. The economic embargo against the Republic of Macedonia implemented at the beginning of 1994 by the southern neighbor, impossible to be foreseen during the projection of the economic program at the beginning of the year. Combined with the sanctions against the northern neighbor and with the dissolution of the traditional markets to which the Macedonian economy used to be directed, it resulted in continuation of recession movements in the country.

2. Extremely large inflow of short-term capital in the country as a result of the regional crisis determined permanently higher supply than demand for foreign exchange at the foreign exchange market, meaning that it created pressure on the denar exchange rate appreciation. The attempts of the National Bank of the Republic of Macedonia to prevent the denar exchange rate appreciation through the foreign exchange market interventions, within limited monetary frameworks, resulted in conflicts in the realization of the price stability goal and the goal to prevent the exchange rate appreciation.

3. Still non-rehabilitated banking system, which was determined under the conditions of an optimal level of global liquidity of particular banks that were illiquid. This involved the National Bank in interventions in order to correct their liquid potential. It brought difficulties to the realization of the monetary and credit policy, because of occasional collision between the general level of liquidity as a goal of the monetary and credit policy on one side, and, maintenance of liquidity of particular banks, on the other. Simultaneously, in order to reach better dispersion of the liquidity of the banking system, the National Bank of the Republic of Macedonia acted as an intermediary in the distribution of liquid assets between separate banks.

Nevertheless, consistent implementation of the restrictive course of the monetary and credit policy and the complementary stabilization measures in the area of fiscal and income policies, enabled to reach stabilization targets, under such conditions of economic activities. The inflation rate in 1994, was brought to 55.4% on annual level, being by 14.6 percentage points lower than the projected level at the beginning of the year (which was 70.0% per annum). If there is an exclusion of excessive increase of retail prices, reached in January and February 1994, throughout

the rest of the year (March-December, 1994) an average inflation rate of 19.8% per annum or 1.8% per month, can be noticed .

The economic recession in the country that lasted for years, still continued in 1994 as well, but with the most lower dynamics of decrease of real social product, which could be noticed in the previous five years. The real gross social product of the Republic of Macedonia in 1994, decreased by 6.2%, being by 1.8 percentage points less than the projected decrease (8.0%). As a result of the undertaken corrective measures in the fiscal policy, there was a considerable fiscal adjustment in 1994. Budget deficit of 11.1% of the gross social product in 1993 was reduced to 2.6% of the gross social product in 1994. Through a strict implementation of the Law on pensions and wages payments, 1994 real wages per worker were decreased by 14.1%, partially compensating the high imbalance between the wages and labor productivity cumulated throughout the previous years. Further deterioration of the external economic environment of the Macedonian economy in 1994, resulted in creation of deficit of trade transaction of the country abroad in amount of Denar 168 million.

Money supply M1, being a form of money supply in the national economy in 1994, increased by Denar 5,800 million or by 94.5%. Apart from the factors which were under the control of monetary policy, the money supply increase was also determined by the factors on which monetary policy does not have an influence at all, such as: a/ excessive seasonal growth of currency in circulation at the end of the year; b/ overprojected increase of deposit money in the country, not being conditioned by the monetary policy measures, but by fiscal policy measures (payment of taxes, duties, revenues, as well as spending budget assets). Money supply M1 increase, without the Government deposits in 1994, was Denar 4,753 million or 83.2%, and c/ the increase of real money demand in 1994 was by 12.0%, instead of the projected increase of 8.0% per annum.

At the end of 1994, denar credits of the banks amounted Denar 21,232 million, being by Denar 6,844 million or by 47.6% more than the position at the end of 1993. Direct constraints on credit activity of the banks in the Republic of Macedonia throughout 1994, were under significant difficulties. Namely, in respect to the rigid character of demand for credits and of the high level of dependence of the enterprises on credit assets, the credit activity of the banks in the Republic in a short run was hardly to be reduced within the projected limits. Simultaneously, the realization of higher denar credits increase compared to the projected values was a result of lower dynamics of the increase of net foreign exchange assets of the monetary system, regarding the expectations. Hence, the difference between the actual and projected positions of denar credits, permanently decreased throughout 1994, so that denar credit position was only 0.8% higher than the projected one on December 31, 1994.

Net foreign exchange assets of the monetary system (regardless of the effect of the exchange rate changes) throughout 1994, increased by Denar 6,585 million or by 48.5%. Net foreign exchange assets of the National Bank of the Republic of Macedonia increased by Denar 1,248 million or by 24.3%, increasing the foreign exchange assets by Denar 2,009 million or by 37.9%; whereas the foreign exchange obligations abroad increased by Denar 761 million or by 455.7%. Net foreign exchange assets of banks in the analyzed period, increased by Denar 5,337 million or

by 28.5%, as a result of their foreign exchange assets increase of Denar 3,315 million or by 47.1%, and decrease of foreign exchange obligations towards non-residents of Denar 2,022 million or by 7.8%. Decrease of the foreign exchange obligations of the banks abroad in 1994, was a result of the fulfilled payment of arrears towards the World Bank in amount of USD\$ 108.7 million, undertaken and paid by the Government of the Republic of Macedonia in the first quarter of the year.

Denar foreign exchange rate, being the most important indicator for the exchange rate of the monetary policy in 1994, appreciated in real terms, compared to the weighted average value of the Dollar and of the German Mark by 19.7%, under conditions of a deficit in the balance sheet in the current transactions of the country abroad, in amount of USD\$ 168 million. The balance of the current transactions shows an existence of fundamental imbalance of the inflow and outflow movements of foreign exchange assets based on export and import activities on goods and services in 1994. However, the foreign exchange inflow of a temporary character, on different basis in the same period of time, was not only sufficient for covering the trade deficit, but, at the same time, it determined permanently higher supply of foreign exchange at foreign exchange market in relation to the demand. This made pressure on denar exchange rate appreciation. The most significant factors in a short run, determining high supply of foreign exchange than the demand at the foreign exchange market in 1994, were the following: a/ high inflow of foreign exchange in the country as a result of regional crisis; b/ temporary unfulfillment of credit obligations of the banks in the Republic of Macedonia towards foreign commercial banks, and c/ high nominal and real interest rates on denar savings deposits.

In the area of credit and financial relations abroad, in February 1994, there was a payment of arrears towards the World Bank in amount of USD\$ 108.7 million, being the basic condition for normalizing the relations with the foreign creditors and for further usage of foreign capital. Foreign exchange reserves of the Republic of Macedonia at the end of 1994 were USD\$ 253.9 million. Out of that, US\$ 165.4 million were foreign exchange reserves handled by the National Bank of the Republic of Macedonia, which is by US\$ 46.2 million more than the amount at the end of 1993. As for the fact that US\$ 15 million of this growth were because of the increase of the obligations towards the IMF, the net increase of foreign exchange reserves handled by the National Bank of the Republic of Macedonia in 1994, was US\$ 31.2 million. Foreign exchange reserves handled by the banks authorized for payment transactions abroad, at the end of 1994, were US\$ 88.5 million, which, compared to the previous year, was an increase of US\$ 55 million.

Reserve money according to the narrowest definition, as basic intermediary target of monetary and credit policy in 1994, increased by Denar 2,120 million or by 62.7%. Excluding the seasonal increase at the beginning and at the end of the year, deseasonal increase of reserve money in the narrowest sense in 1994, was Denar 1,724 million. Accordingly, on December 31, 1994, reserve money in their narrowest sense amounted Denar 4,849 million, i.e., they were exactly within the projected limits. So, the basic operative goal of the monetary and credit policy in 1994 was completely realized, regarding management and control of reserve money increase, being at the same time fulfillment of criterion for implementing the STF arrangement in the monetary area.

Basic forms of holding reserve money are the currency in circulation and bank deposits with the National Bank of the Republic of Macedonia. As a result of the complementary action of factors on which the currency in circulation movements depend, in 1994, they increased by Denar 1,955 million or 69.2%. Deseasonal currency in circulation increase in 1994, (an increase corrected by the action of the seasonal factors at the beginning and at the end of the year) was Denar 1,559 million or 62.0%.

Liquidity of the banking system through the assets on the giro-accounts of the banks and through assets in vaults in 1994, was maintained on a satisfactory level, enabling realization of an appropriate increase of money supply for normal transaction of goods and money. At the same time, it provided a reduction of the aggregate demand following the projected aggregate values. At the end of 1994, banks had a total amount of Denar 722 million on their giro-accounts and in vaults, being by 29.6% more than the adequate level at the end of 1993. The average participation of the assets on the giro-accounts of banks and assets in vaults in the total money supply M1 (including the Government deposits) in 1994, was 6.0%, which was exactly on the projected level. However, high oscillations of the liquid potential of the banks in certain periods of time, as well as extremely unequal dispersion of assets among banks in the Republic throughout 1994, created a conflict of the goals on macro and micro level, making the realization of the monetary and credit policy more difficult.

Net foreign exchange assets of the National Bank of the Republic of Macedonia had a dominant role in the flows of reserve money creation in 1994. In the period of January-December, 1994, net foreign exchange assets of the National Bank of the Republic of Macedonia increased by Denar 1,248 million or by 24.3%. This resulted in reserve money creation of 36.9%, being 58.9% of the realized increase of reserve money in 1994. As a result of extremely high short-term inflow of foreign exchange in the country which determined permanently high supply of foreign exchange in relation to the demand, foreign exchange reserves of the National Bank of the Republic of Macedonia increased by Denar 2,009 million in the analyzed period. Foreign exchange obligations of the National Bank in 1994, cumulatively increased by Denar 761 million, as a result of the agreed STF arrangement by the International Monetary Fund, in amount of SDR 12.4 million, in February.

Domestic credits in 1994, increased by Denar 1,577 million, which determined reserve money creation of 46.6%. Within the frameworks of domestic credits, credits extended by the National Bank of the Republic of Macedonia to banks in 1994, increased by Denar 746 million or by 58.5%. This influenced reserve money creation of 22.0%. The refinancing of banking credits by the National Bank (the so-called selective lending), which was throughout the previous years a basic movement of issue and withdrawal of reserve money, at the end of March 1994, was definitely abolished and replaced by more market instruments of the monetary and credit policy.

Auctions on buying and selling deposits, and auctions on treasury bills were basic instruments for creation and withdrawal of reserve money in 1994. Auctions on buying and selling deposits, as an efficient market instrument for regulating the liquidity potential of the banking system were implemented in the monetary practice

of the Republic of Macedonia at the end of 1993. This instrument of the monetary and credit policy is used twice: when the Central Bank is a buyer of bank deposits, the auction on deposits is an instrument for sterilization of the surplus of liquid assets; when the Central Bank sells bank deposits, there is an issue of liquid assets into the banking system.

In 1994, the National Bank of the Republic of Macedonia implemented the instrument of auctions on deposits in order to create and to withdraw reserve money. In the period of January-December 1994, the National Bank implemented 106 auctions on deposits, with a total turnover of Denar 5,018.8 million. Out of that, on 45 auctions, there was a withdrawal of reserve money through buying deposits by the National Bank of the Republic of Macedonia from the banks, in total amount of Denar 3,548.0 million (or, an average amount of Denar 78.8 million per auction). Simultaneously, on 17 auctions in the analyzed period, regarding the current lack of liquid assets in the banking system, there was an issue of reserve money (sold by the National Bank to commercial banks) in amount of Denar 1,470.8 million (or an average amount of Denar 86.5 million per auction). On 44 auctions throughout 1994, there was no successful matching of bids for buying and bids for selling money assets, or, the liquidity of the banks in the particular period was on a satisfactory level and there was no need the monetary authorities to intervene. The interest rate at the auctions on deposits in 1994, was constantly decreasing (parallel to the decrease of the inflation rate). So, from 14.0% on monthly level of auctions held in February, the interest rate of auctions on deposits in December 1994, was brought to 1.80% per month.

Auctions on securities (treasury bills) of the Central bank, were introduced in the monetary regulations of the National Bank on February 14, 1994. This flexible and market based instrument was suitable, first of all for sterilization of the surplus of liquid assets in the banking system. At the same time, auctions on treasury bills can be successfully used in the opposite direction (i.e., to issue reserve money) through the repurchase of previously sold treasury bills to banks by the Central Bank, before their maturity period. Throughout 1994, auctions on treasury bills were implemented in combination with the interventions of the National Bank of the Republic of Macedonia at the foreign exchange market. Namely, through auctions on treasury bills, there was a neutralization of monetary effects caused by the interventions of the National Bank at the foreign exchange market towards prevention of more significant appreciation of denar exchange rate. In the period of February 14-December 31, 1994, the National Bank of the Republic of Macedonia implemented 10 auctions on treasury bills, withdrawing liquid assets from the banks in total amount of Denar 361.0 million. The interest rate of purchased treasury bills was from 12.7% on monthly level at the first auction, to 1.58%-2.00% on monthly level (regarding the terms for buying) at the last auctions held in December, 1994.

Determination of the discount rate by following the existing methodology in 1994, (except for the first quarter) functioned successfully. In the period of January-December 1994, the discount rate of the National Bank of the Republic of Macedonia was changed six times, each month in the period of January-May, and the last change being in August, 1994. The average discount rate in 1994 was 86.2% per annum, so

that corrected by the increase of the inflation rate in the same period, was a realization of real positive discount rate of 19.8% per annum.

The interest rate policy of commercial banks in 1994 was characterized by two qualitatively different periods: the first one, January-April, 1994, when the interest rates used to create freely, and the second one, May-December 1994, when the determination of interest rates was according to the interest rates of the banks and savings houses. In the first four months of the year, banks maintained extremely high nominal and real interest rates. The average nominal interest rate of time savings deposits on 3 months, in this period of time, amounted 11.2% per month (257.5% per annum), whereas the average nominal interest rate of short-term credits was 12.7% per month (319.8% per annum). This determined a realization of average real interest rate of denar savings deposits on 3 months of 42.6% per annum. The average real interest rate on banking credits was 69.9% per annum. In the second period (May-December 1994) the average nominal interest rate of time savings deposits on 3 months was 2.6% per month (36.1% per annum), whereas the nominal interest rate of short-term credits in the same period was 6.1% per month (103.5% per annum). In real terms, in the period of May-December, 1994, the average interest rate of time deposits on 3 months was 12.7% per annum, In the same period, the average interest rate of banking credits was 67.7% per annum.

* * *

Basic goals and objectives of the foreign exchange policy, incorporated in the Decision on foreign exchange policy and in the Projection on the balance of payments for 1994, was a realization of foreign exchange reserves increase in the Republic of Macedonia, an inflow of foreign capital and gradual creation of conditions for balancing the current transaction abroad.

The inflow, on the basis of used foreign credits, donations of foreign countries, private and official transfers as humanitarian and other aids, as well as other inflows, and under conditions of a moratorium on payments of the significant part of foreign credits was to result into coverage of the deficit in the balance of payments, and, in the same time, into an increase of net foreign exchange reserves managed by the National Bank of the Republic of Macedonia by US\$ 20 million. All that was supported by the agreed STF arrangement with the International Monetary Fund, through the purchase of the first tranche in amount of US\$ 17 million.

In the credit and financial policy abroad, the goal of priority was to clear the arrears against the multilateral creditors, first of all towards the World Bank, with a projected usage of two loans: Economic Recovery Loan and Financial Economic Structural Adjustment Loan for the financial and economic sector. At the same time, there was projected intensification of the negotiations with the official bilateral creditors (Paris Club), as well as with foreign private commercial banks (London Club) regarding the way of meeting the credit obligations of the Republic of Macedonia towards them.

When implementing the foreign exchange policy for 1994, it was estimated that the denar exchange rate movements, following the agreed policy for its free determination, would follow the inflation, thus, maintaining complete competition of the export. However, as a result of the high foreign exchange inflow under the conditions of regional crisis and not meeting the credit obligations towards the biggest part of the foreign creditors, there was a constant higher supply of- than demand for foreign exchange on the exchange market in 1994. As a result of this, the denar exchange rate for 1994 appreciated in real terms by 19.7% compared to the weighted average value of the US Dollar and the German Mark.

High foreign exchange supply on the foreign exchange market in 1994, resulted in enormously large increase of trade deficit abroad, from US\$ 172 million in 1993 to US\$ 417 million in 1994. Deficit in foreign transactions abroad increased from US\$ 36 million in 1993 to US\$ 168 million in 1994.

Nevertheless, besides the negative movements in the current transactions abroad, the actual results in the balance of payments in 1994 can be regarded as satisfactory as a whole. First of all, this was obvious in the increase of foreign exchange reserves of the Republic of Macedonia. Foreign exchange reserves managed by the National Bank of the Republic of Macedonia increased by US\$ 46 million, whereas the foreign exchange reserves with the authorized banks increased by US\$ 52 million.

With an aim to prevent the pressures on denar appreciation as a result of higher supply than the demand for foreign exchange on the foreign exchange market, the National Bank intervened by repurchasing the surplus of foreign exchange at the foreign exchange and exchange markets. Thus, there was an amount of purchased surplus of US\$ 74.3 million on the exchange market, whereas, at the foreign exchange market the amount was US\$ 67.6 million. Simultaneously, in accordance with the goals of the monetary policy, there was withdrawal of reserve money through selling foreign exchange at the foreign exchange market in amount of US\$ 97.5 million.

In the area of the credit and financial policy abroad, there was fulfillment of the projected target to clear the arrears towards the World Bank in amount of US\$ 109 million. From this institution, in the first half of 1994, there was a complete purchase of the Economic Recovery Loan in amount of US\$ 80 million. In order to clear the obligation towards the World Bank, there was an assistance from donor countries in amount of US\$ 20 million, a short-term credit from Mr.Soros in amount of US\$ 17.5 million, and, the first tranche from the STF arrangement with the International Monetary Fund in amount of US\$ 17.1 million.

In 1994, regular obligations were met towards the World Bank, regarding previously used credits in amount of US\$ 30 million, whereas towards the IMF, there were regular payments in amount of US\$ 3 million. Until the end of 1994, additional assistance from donor countries in amount of US\$ 10 million, was also provided.

In 1994, the Government of the Republic of Macedonia initiated contacts with other multilateral creditors, first of all, with EUROFIMA and with the European

Investment Bank, in order to find solutions for normalizing the relations with them through the regulations of arrears. In the meantime, obligations that matured towards these creditors in 1994, were in moratorium. At the same time, there was an initiation of contacts with the Paris Club, where the solution of the debt towards member countries of this Club, was to be considered in conception with the announced stand-by arrangement extended to the Republic of Macedonia by the International Monetary Fund in 1995.