

### III. Monetary Policy

#### 3.1. Monetary policy goals

Within the global setup of the macroeconomic policy for 1998, the main goal of the monetary policy was to maintain low and stable inflation rate, which was not to exceed 3.0% p.a. In order to realize this goal, it was projected that in 1998 NBRM should continue the implementation of the monetary strategy of targeting the Denar exchange rate against the Deutsche mark. Implementation of the concept, in which maintaining of the exchange rate stability is intermediate target of the monetary policy, proved to be successful in achieving and maintaining the price stability in the Republic of Macedonia. Positive experiences are based on the importance of the stable exchange rate of the domestic currency in a small and open economy with a substantial degree of currency substitution, where it acts towards suppressing of the economic agents' inflationary expectations.

By maintaining the stability of the prices and exchange rate, in 1998 monetary policy was supposed to create an environment in which structural changes in both financial and real sector of the economy would result in acceleration of the economic growth. Main objective in the banking system in 1998 was to strengthen its credibility, as a precondition for increase in the domestic saving and credit support to the economy. In this context, the efforts to improve financial discipline and collection of the claims from the debtors, increased supervision by the Central Bank and increased competition among the banks, due to the expected entrance of foreign well-known banks, were supposed to result in improvement of the quality of the banks' assets, which is a precondition for increased credit support to the economy. Gradual reforms in the payment system, improvement of the deposit insurance system, as well as the development and affirmation of the money market, were also supposed to enable more efficient operations of the banks in the Republic of Macedonia.

When the monetary policy is designed in such a manner, the Central Bank subordinates the money supply to the maintenance of a stable exchange rate. According to the Projection for the balance of payments and projected increase in the exports and imports by 10.5% and 5.0% respectively, as well as the expected purchase of foreign currency based on foreign investments, for 1998 a net purchase of foreign currency on the foreign exchange market in the amount of USD 27 million was expected. Based on these assumptions, a nominal money supply M1 growth of 9.3% p.a. was projected.

Maintaining the established price stability in the Republic of Macedonia in 1998 assumed continuity in the coordination of the monetary and fiscal policy. Thus, in order to support the projected purchase of foreign currency, the Projection of the macroeconomic policy for 1998 specified that depositing of funds from the Budget into a special fund with NBRM should continue. For this purpose, depositing of Denar 1,200 million was projected.

### 3.2. Realized monetary movements in 1998

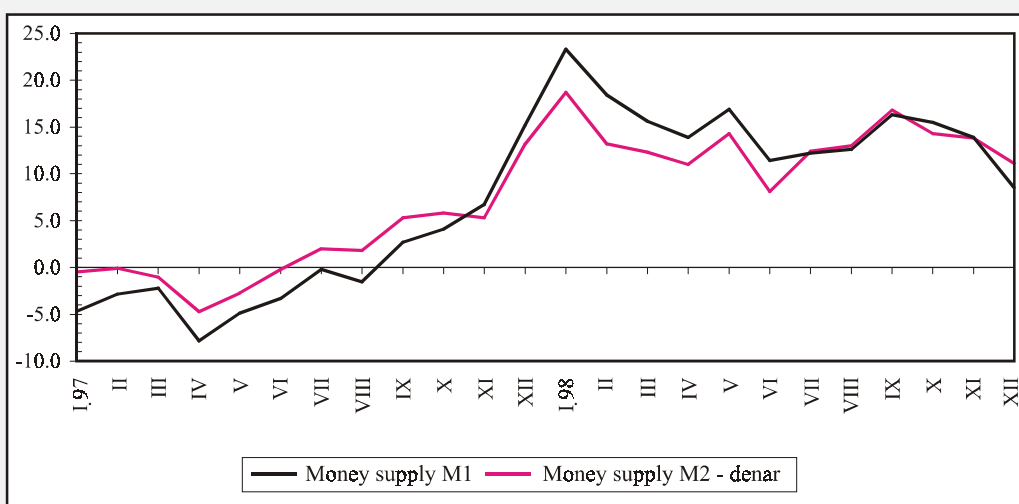
Like in the previous years, price stability, being the ultimate goal of the monetary policy, was also realized in 1998. Thus, the average annual inflation rate in the Republic of Macedonia was 0.8% in 1998, which is within the projected maximum increase in the prices. Low inflation rate indicates the credibility of the monetary policy, as the Central Bank managed to suppress substantially the inflationary expectations through the realization of the goals of the monetary policy in the recent years, and also reflects the decrease in the prices of oil and metals on the world markets, and the decrease in the prices of the agricultural products.

In 1998 NBRM maintained the price stability through realization of the intermediate target of the monetary policy - stability of the Denar exchange rate. In the course of the year, excluding the deviations during the parliamentary elections, Denar exchange rate against the Deutsche mark was maintained on the targeted level. NBRM used all available monetary policy instruments to keep the stability of the Denar exchange rate.

In 1998 NBRM realized a net purchase of foreign currency in a total amount of USD 35.4 million. Realized net purchase of foreign currency exceeds the projected one by USD 8.4 million. Substantial portion of the purchased foreign currency came from the inflow of foreign currency from the selling of several large enterprises to foreign investors. Throughout the year, movements on the foreign exchange market resulted in increase of the Central Bank's foreign reserves and realization of the projected growth rates of the monetary aggregates.

Chart 6

#### Movements of the Money Supply M1 and Money Supply M2 - Denar Component (in percent, on annual level)



Money supply M1 realized an average annual growth rate of 14.9% in 1998. At the end of 1998, this monetary aggregate realized a growth rate of 8.5% on December basis, which is within the projected growth.

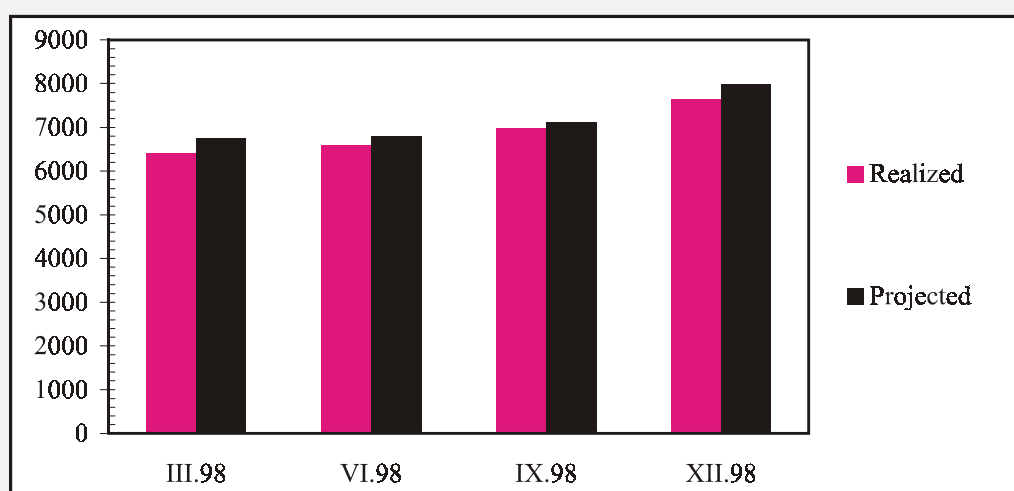
At the end of 1998 the money supply M2 - Denar component increased by 11.1% on annual level, which exceeded the projected increase by 1.9 percentage points. Throughout the year, this monetary aggregate had high and relatively balanced growth rates. The average annual growth rate equaled 13.2%.

Realized monetary growth created preconditions for increased lending activity of the banking system. Thus, in 1998 total banks' placements to the non-Government sector (denominated both in Denars and in foreign currency) increased by Denar 2,253 million or by 9.0% on annual level. Credits denominated in foreign currency increased by Denar 838 million or by 16.1%, where the Denar credits increased by Denar 1,415 million or by 7.2%. However, qualitative improvements in the term structure of the banks' Denar credits did not take place in 1998. Namely, in this year banks again extended mostly short term credits, while the financing of the long term projects was insufficient.

Chart 7

**Projected and Realized Levels of the Reserve Money in 1998**

(in million Denar)



Reserve money issuance was determined by the movements on the foreign exchange market. In 1998 the average growth rate of the reserve money equaled 13.4%, although at the end of the year (December 1998 / December 1997) it slowed down to 1.4%. In December 1998, slowdown in the reserve money growth is due to the changes in the money multiplier and impact from seasonal factors.