

Petar Goshev: Overview of the Macedonian economy

Address by Mr Petar Goshev, Governor of the National Bank of the Republic of Macedonia, at the farewell reception, Skopje, 16 May 2011.

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Ladies and gentlemen, Your Excellences, dear friends!

I am immensely grateful that you are here tonight, at the end of my seven-year responsibility and seven-year pleasure to govern this exceptionally important institution.

I would also like to express my gratitude to those who gave me this opportunity to cope with an assignment which is incredibly challenging and highly responsible for every macro economist – to govern a central bank – a bank of the banks, bank of the state, a regulator and a supervisor of money deposit institutions and an entity responsible for the functioning of the payment systems.

I would also like to thank all those who have cooperated with us all these seven years – cooperation that have positive effects, directly or indirectly, on the conduct of my tasks and the overall legal term at the National Bank.

I particularly express my gratitude to the Bank's staff, the banks' managers and shareholders who were the first to experience the effects of our decisions, to the media which facilitated the necessary two-way interaction with the public, to the government authorities with whom we necessarily cooperate, to the international financial organizations, particularly the IMF, the World Bank and the EU Delegation, with whom we have exceptionally useful cooperation, to the business community, which, with some exceptions, showed high positive sensibility and understanding for the National Bank policy, to the diplomatic representatives in the country who, in their distinctive way, often expressed their support and understanding for the work of the National Bank. I also thank all the critics of the decisions we have made all these seven years who, regardless of their opinions, made us more cautious in the decision making process and helped expand the knowledge of the market participants, including the households, on the National Bank activities and on the importance of its decisions for the everyday life.

I know well that these special occasions are not suitable for longer speeches on our accomplishments. Actually, we were doing that regularly through the monthly reports, quarterly and annual reports, regular press releases of the sessions, through press conferences and the NBRM website which is becoming richer and better from day to day. In 2006, as most of you well know, we issued a monograph on the sixty years of central banking operations in Macedonia, and today we have made presentation of the report on the NBRM operations in the last seven years, discussing, on about 400 pages, its main activities and accomplishments. These two books are, de facto, a first attempt for aggregate presentation of the historical course of the central banking in Macedonia, since the World War II. I think that this will help the students, the monetary policy analysts, teachers and professors engaged in this issue, and certainly many others in the financial sector. Tonight you can see the hard copies in Macedonian and in English, and the electronic version of the second book, the seven-year report where we extensively discuss the period that ends these days.

Nevertheless, I assume that tonight many of you would like to ask to what extent am I (or are we) satisfied of what we have achieved, and, what would I, in few words, highlight as the most important? If there is such question, I would briefly say the following:

All decisions in the last seven years were made by the National Bank, with zero influence from the outside, regardless of the verbal suggestions and insistence coming from well known addresses. The decisions, which usually pass through internal professional filtrations,

and are made by the Governor and the NBRM Council, are within exclusive responsibility of those two bodies, and since the Governor is also a President (with the new law, a Chairperson) of the Council, I also consider these decisions, particularly if there were bad ones, as my personal responsibility.

I actually want to say that the statutory independence of the NBRM over the last seven years was completely preserved. This should remain in the future. The central bank independence is crucial to the macroeconomic stability and very important to the financial system stability.

With such position, I consider that we successfully pursued all assignments entrusted by the law:

(1) We preserved low and stable inflation as a primary objective of the central bank. The seven-year average (2004–2011, April) equals **2.2%**. I know what some may think of the so called “tolerant” or “useful” level of inflation. I leave it to them to “reconcile” their “tolerant” level of inflation and de facto fixed rate. In case they again oppose to the existing regime of exchange rate, to have even higher inflation, we will be decent enough to seek for an elementary analysis of its usefulness, i.e. of the advantages of such alternative.

(2) We maintained a stable exchange rate level, without registering misalignment between its level and the economic fundamentals.

(3) In 2004, the foreign reserves stood at **Euro 717 million**, and in 2011 (April) they climbed to **Euro 1 872 million**, which is by 2.6 times more, and always ample to respond to the occasional imbalances in the foreign exchange market.

(4) The crucial question would be: Was the banking system making enough credits i.e. was the National Bank disabling the “smooth” lending to the private sector, or was it the opposite? The figures speak for themselves! In the seven-year period from 1997 to 2003, the average annual credit growth equaled **11.6%** and in the seven-year period from 2004 to 2010, it equaled **23.1%**, which is by two times faster. The comparison between the credit growth and the GDP growth shows that in the 2004–2010 period, the nominal credit growth was by 3.12 times faster relative to the nominal GDP growth, while the credit real growth was by 5.7 times higher relative to the real GDP growth. Should this difference be even greater?

(5) The banking system also improved substantially. It remained undamaged even during the Great Recession.

i. The solvency remained high. The capital adequacy ratio was preserved to a very good level of **16.4%**. The liquidity, after the worrying downward trend (2007, 2008 and early 2009), was reestablished, thanks to the undertaken measures, to a very solid level. In March 2009, the liquid assets constituted 20.2% of the total assets, and in December 2010 it made up 30.7%. The household deposit-liquid asset coverage ratio increased from 44.6% to 61.9%. The quality of credit portfolio improved substantially.

ii. In the seven-year period from 1997 to 2003, the average share of nonperforming credits in the total credits equaled **19.2%**, and in the period from 2004 to 2010 it reduced to **10.8%**. At the end of 2010, it equaled **9%**, which is an improvement of more than twice.

iii. The average share of credits in the three riskiest categories (C, D and E) in the banks’ own funds reduced from **54%** (1997–2003) to **22%** (2004–2010), which is an improvement of 2.4 times. These achievements result from the improved bank governance and the advanced NBRM supervision based on the improving regulation.

iv. In the 1997 to 2003 period, the credit interest rate, on average for all maturities, equaled **18.6%**, and **10.8%** in the last seven years (2004–2010). Presently, the average interest rate on new credits equals **8.1%** (for Denar credits), which is a decrease of more than twice.

(6) Back in 2004, we started analyzing the financial system stability, six years before it became our second objective, defined by the new NBRM Law. This is the fifth subsequent year that we develop and publish an annual financial stability report.

(7) We significantly advanced the Bank's institutional capacity. We adopted new models, methodologies, analytical techniques, econometric analyses. The number of training courses for the staff, especially abroad, increases year after year. We dramatically improved the staff educational structure. In 2004, **44%** of the total staff number were university graduates. Today, this percentage is **63%**, which is by 81 persons more, with the total staff number being increased by roughly twenty, and the workload being significantly enhanced. In 2004, there were only 20 masters of science and one philosophy doctor, and presently, there are 46 masters of science and 7 philosophy doctors.

Distinguished,

When you summarize a stage which is over, you either ask yourself or other ask you what were the most exciting or most critical moments? First, the economy is a permanent intrigue, a constant unknown variable in an open equation for which you constantly seek for a solution. From this viewpoint, each single day and year is a real excitement for the professional analysts and a field that you never stop plowing. However, on this occasion, I would highlight three moments:

The first one happened at the beginning of my term. Stories were told about the devaluation of Denar, the abandonment of the stable exchange rate policy, on the usefulness of higher inflation. Professors were making statements that inflation ranging from 8 to 10% would be useful. Even, in the Macedonian Academy of Science and Arts (MANU) there was a debate on this issue, making points that very high percentages of inflation would, allegedly, be very useful. The trade deficit was high as usual, the current account deficit was also high. We intervened with foreign reserves to calm down the market, and consequently, their level went down. The IMF's Chief of Mission at that time asked me to meet "in six eyes": mine two and their four. He suggested a devaluation of at least 20%. I told him that I will answer tomorrow. The next day I told him that we will discuss again in autumn during his next visit. The situation calmed during the summer. We started purchasing foreign currency, and the favorable situation continued. Nobody ever opened this issue again. They gave up.

The second moment was the closing of Makedonska Banka and forcing few other shareholders to abandon the banking business. It was a very erratic experience. They played extremely unfairly. They were developing and managed to develop dirty plots. They also threatened. They made a mistake. The decisions we believed in were unchangeable. We cleaned the banking sector from shareholders who were not eligible, on any ground. We fixed several weak points in the system thanks to our decisiveness and integrity. And, as to the organizers of dirty campaigns, you know the information.

The third, extremely dramatic moment was the end of 2008 and the first half of 2009: the global recession. In that period we spent 500 millions of Euros defending the exchange rate – one third of their total level. We had to try our hardest, otherwise we were about to face an economic disaster. We were criticized for undertaking measures contrary to those undertaken by developed economies. They failed to see that such comparisons will not wash. They failed to see the nature of the exchange rate regime and that changing such concept could only make greater damage. We endured. The situation consolidated. The data on credit growth, which, even back then, was not within the negative zone, unlike most of the European countries, and the banking sector stability justified our beliefs.

Certainly, there are other sensitive situations. They will maybe take their turn on some other occasion. Not now during the pre-election period!

Dear all,

As I already said, the economy is an open equation with constant unknown variables. The financial crisis and economic recession denied many lessons developed to the level of a

dogma. The central banks started a new post-recession period. They will have to take care more of the financial stability, because it turned that the price stability is not sufficient to ensure financial stability.

It raises many new issues that will not be discussed now. I am convinced, however, that this institution becomes more capable to face all challenges.

I wish that Dimitar and all staff members achieve better results and certainly, a personal happiness.

I would like, once again, to thank you for being here tonight, for the cooperation we had, for each word of kindness that we exchanged and for everything that could join us in the future. I also wish you professional satisfaction and personal happiness.

Thank you.