

Anita Angelovska-Bezoska: Macedonia – current macroeconomic developments, medium term outlook and challenges ahead

Speech by Ms Anita Angelovska-Bezoska, Vice-Governor of the National Bank of the Republic of Macedonia, at the Ministerial Dialogue on the Preaccession Economic Programs on EU Candidate Countries, European Commission, Brussels, 9 July 2013.

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Dear Ministers,

Dear representatives of the European Commission, European Central Bank and Eurostat,

At the beginning, let me express our gratitude to the European Central Bank, European Commission and Eurostat for their contribution in assessing our Preaccession Economic Program for the period 2013–2015. Within the PEP we already presented the proactive role of the National Bank of the Republic of Macedonia in dealing with the global crisis consequences, by undertaking a mix of conventional and unconventional measures, aimed at maintenance of the price stability, financial stability, as well as stimulating economic activity.

I will use this opportunity to point out several issues regarding the current macroeconomic developments, medium term outlook and challenges ahead.

The latest available data on Macedonian economy for the first quarter of 2013 indicated a gradual revival of the economy with real annual GDP growth of 2.9%, slightly higher than our expectations, being mainly driven by the investment and net export. Generally, Macedonian economy has been relatively successful in offsetting the crisis consequences which was mainly due to the solid initial conditions prior to the crisis without massive macroeconomic imbalances, the establishment of few new production capacities based on foreign capital that largely contributed to the export diversification, stable and sound financial system and adequate macroeconomic policy mix.

The environment for monetary policy implementation in 2013 is quite favorable, considering relatively stable inflation developments and comfortable foreign reserves level. In the first half of 2013, the average inflation was 3.6%, mainly due to higher food and energy prices. Our latest forecast for the average inflation rate in 2013 is 2.8%, with expected further slowdown to 2.3% (close to our historical level) in 2014, until when no pressures of higher significance by the demand side are being expected. However, there are risks related to this forecast, reflecting the uncertainty about energy prices as well as the world and domestic food prices dynamics and their direct and indirect pass-through to inflation.

The performances in the external sector in the first several months of 2013 and the latest estimates indicate quite favorable position in the balance of payments for this year. The reduced trade deficit is neutralizing the lower net inflows through private transfers. Therefore, the current account deficit in 2013 is expected to remain moderate at 4.2% of GDP, which is similar to the previous year. The financial flows (FDIs and borrowing of private and public sector) are projected to be sufficient to cover current account deficit and to provide some further accumulation of reserves. Thus the foreign reserves are expected to remain at comfortable level during 2013, indicating adequate capacity for maintaining the fixed exchange rate. In a medium run, we expect more positive effects of the FDI's in the tradable sector on the exports, thus lowering the trade deficit, which is one of the main structural problems.

The Macedonian banking sector has remained stable and sound despite the global financial and economic turbulences in the last few years reflecting orientation towards traditional banking activities at domestic market and stable domestic sources of financing. In May 2013, the total banks' deposits were higher by 3.3% on annual basis, and what is very important,

the trend of more pronounced growth in the Denar deposits relative to the foreign currency deposits from the previous three years continued. In May 2013, the Denar deposits were higher by 9.3%, while foreign currency deposits declined by 3.4%, on annual basis. Therefore, the level of euroization, measured through the share of foreign currency deposits in the total deposits went down from almost 55% in mid-2009 to 44% in May 2013, which is a positive indication for the confidence in the national currency and monetary policy credibility (providing more space for accommodative monetary policy).

The financial support through the banks' credit market during the crisis years has been moderate, but permanent, therefore supporting the economic recovery of the economy. Anyway, in May 2013, the annual credit growth was 3.7%, pointing to a gradually slowing pace during 2012 and first half of 2013. Possible reasons for such trends in the credit market are: effects of financial deleverage process of foreign parent banks, banks' deteriorating risk perceptions against the backdrop of still anemic economic activity and uncertainty regarding the global environment, and the present (though moderate) increase of credit risk in the system, as well as the potential. The NPL ratio reached 11.4% in the first quarter of 2013 being one of the main challenges for the banking system that is closely monitored by the NBRM. Still, it is among the lowest in the group of the EU candidate countries. Regarding the future prospects for credit flows it can be noted that stable funding sources (loan-deposit coverage ratio of around 90%), strong liquidity position, and capital adequacy ratio continuously being twice as high than the minimum required, point to room for further increase of lending in the domestic economy. The improvement of the banking sector regulation in view of further implementation of the Basle and EU standards will remain being a high priority on the agenda in this field.

In general, the current macroeconomic developments and the expected future outlook indicate a moderate recovery of domestic economy (considering expected developments for the economies of the most important trading partners and domestic drivers of growth), inflation rate in line with the expectations, a balance of payments position that ensures a comfortable level of foreign reserves and still slow credit flows. These assessments created an environment for monetary relaxation, as a contribution to higher credit growth and thus, support to the domestic economy. On that basis, in January, we reduced the key interest rate on CB bills from 3.75% to 3.5%, which is the historically lowest level. Since January 2013, the changes in the reserve requirement instrument came into force, through reduction of the base of banks' reserve requirements by the amount of newly approved loans, but only for credits to sectors whose growth reduces the external vulnerability of the economy (net exporters and energy sector). This non-standard measure will be in effect until the end of 2014, when the need for further application will be examined. These changes in reserve requirements have already started to contribute to higher lending to previously mentioned sectors in the economy. Just last week, we have done yet another change in the reserve requirement by reducing the reserve requirement ratio on Denar deposits from 10% to 8% and simultaneous increase of the reserve requirement ratio on foreign currency deposits from 13% to 15%, as well as introducing 0% reserve requirement ratio on banks' long term liabilities to nonresidents. By this measure, we are aiming to: support the process of de-euroization in the economy, inject liquidity in support of lending to the private sector and stimulate higher inflows from nonresidents especially from financial institutions.

Last, but not least, I would like to point out our efforts in strengthening our statistics in the last few years. In March 2013, the National Bank of the Republic of Macedonia started transmitting the quarterly balance of payments and annual international trade in services data to Eurostat, while in May 2013 additional data series on FDI flows and stocks disaggregated by partner countries and activities were submitted. Currently we are working on the establishment of new data warehouse system in the central bank that will contribute for improved data management in general, as well as enable the transmission of more demanding and detailed datasets in the future. In July 2012 we started with submission of a more detailed set of the external debt data to the World Bank within the Quarterly External

Debt Statistics Database in accordance with the requirements for SDDS countries, thus being among the first countries in the region fulfilling the overall data requirements in this field. In addition, just recently, we have received the first Annual Report by the IMF on data submission under SDDS, that we joined in November 2011, with positive annotations of the overall data submission under this system. Further improvement of our statistics, bringing it closer to the EU requirements, remains one of the key priorities of the central bank.

Just to summarize, in view of the global environment, the current macroeconomic performances of the Macedonian economy are relatively favorable. Anyway, just like in the previous years, the risks are still present and they are related to the expected recovery of the external demand, the sentiment on the global financial markets and the world prices development. Continuation with the structural reforms is a key in eliminating structural bottlenecks and paving a way for sustainable growth and faster EU integration process. The NBRM will continue with regular monitoring and analysis of the developments in the economy and remain prepared, if necessary, to undertake appropriate measures to preserve macroeconomic stability.