

## **Petar Goshev: Central banking in Macedonia – a brief review of the first 60 years**

Welcome speech by Mr Petar Goshev, Governor of the National Bank of the Republic of Macedonia, at the opening ceremony of the 60th anniversary of central banking in the Republic of Macedonia, Skopje, 20 October 2006.

\* \* \*

Honorable President of the Republic of Macedonia, Mr. Branko Crvenkovski,  
Honorable President of the Parliament of the Republic of Macedonia, Mr. Ljubisha Georgievski,  
Honorable President of the Government of the Republic of Macedonia, Mr. Nikola Gruevski,  
Honorable former President of the Republic of Macedonia, Mr. Kiro Gligorov,  
Honorable Ministers former and present,  
Distinguished representatives of the judicial, public and cultural institutions of the Republic of Macedonia,  
Your Excellencies,  
Distinguished leaders of religious communities'  
Honorable Mayor of the City of Skopje,  
Dear colleagues, leaders of the banking and business community,  
Dear friends from other countries, colleagues governors, representatives of central banks and other international financial institutions, present here tonight from four continents, dear Malcolm Knight, General Manager of the Bank for International Settlements (BIS),  
Ladies and Gentlemen,

I wish you all the warmest welcome to this event, that is so important to all of us!

On October 19, 1946, on the basis of a "Decree for merging of public sector credit enterprises", of the federal state of that time, and a Decision of the Macedonian authorities of that time, "Makedonska Stopanska Banka" merged with the National Bank of the former Federal Yugoslavia. Thus it became an official unit, called Head Office for the National Republic of Macedonia, supposed to perform part of the central banking activities. Therefore, we have decided this year to commemorate those 60 years dedicated to central banking, i.e. 60 years dedicated service to the state. From a historical viewpoint, it is not a long period. For us, however, it is fundamental, since it de facto means fulfillment of the centuries-long endeavors of our people to have their own state with all attributes - in this case also with accomplishment of full financial sovereignty.

Why is the role of central banking important for an economy? Because it is responsible for maintaining the purchasing power of the currency aimed at the general stability of the economy, as the main prerequisite for its sustainable growth and development. Such responsibility is not always easy to fulfill, since the response to this challenge surely lies in the multitude of social and cultural factors, in the extent to which they support the idea that price stability is an indispensable, yet insufficient factor for achieving those objectives. It would have been nice had we found only successful stories in the history of central banking in the Republic of Macedonia. However, in the largest part of the past 60 years, facts are different. Both successes and failures are evident. Starting from the fact that the role of central banking in the development of the economy is best seen in the development of the institution itself, please allow me to draw your attention to some of the more significant moments of that development.

At the very beginning, the Bank was conducting only a few central banking operations: distribution of cash, payment operations, control, i.e. in today's language, supervision of banks. Its first manager was Dr. Todor Mirovski, at that time manager of Makedonska Stopanska Banka, while from the beginning of 1947 until June 1950, Aleksandar Bogoev.

From a functional viewpoint, the central banking in the past 60 years may be conditionally divided into three periods.

We could call the first period pre-institutional (1946-1970), the second was a period of formal institutionalization (1971-1991), and the third was a period of monetary independence (1992-2006).

We denote the first period as pre-institutional since there was an institution established only on a federal level - central bank. And, as you are well aware, the main feature of post-war life in all spheres, including banking as a whole, was centralization. Consequently, all communal banks immediately

became branches of the National Bank of, at that time, Federal Yugoslavia - Head Office of NRM, engaged in attracting funds, extending credits in the amount of the funds attracted, performing limited activities in the international payment operations, performing vault activities for executing the budgets of the local units, etc. The Head Office, i.e. the rudiment of the Central Bank continues to distribute banknotes and coins, attract funds, extend credits to banks, organize international payment operations.

As late as in the sixties of the preceding century the competences of the National Bank, i.e. the Head Office in Macedonia started to be distinguished from the competences of the commercial banks. At the same time, however, the dependence of the Head Office in Macedonia on the National Bank of Yugoslavia of that time, increased - a process which was the same for all former Yugoslav republics. In fact, the activities of the Head Office of the Republic of Macedonia were reduced to performing only routine operations of executive and operational character. All policies, decisions and regulations were created and adopted in Belgrade.

The second period, period of institutionalization, represents some kind of a turning point in central banking. In 1971, instead of head offices of the former Yugoslav republics, national banks of the republics and provinces were established, including the National Bank of the Republic of Macedonia. In 1972, the Parliament of the Republic of Macedonia adopted for the first time a law on the National Bank of Macedonia on the level of the Republic, while in 1974 it was defined also with the Constitution of the Republic of Macedonia. The first Governor, appointed in 1972, was Stojan Kjosev, who was until then a member of the Executive Council of the Republic of Macedonia.

In the Law, the National Bank of Macedonia was defined as an institution of the single monetary system of former Yugoslavia, with a status of a legal entity. Established as such, it was independently executing the projections of the credit policy for the Republic of Macedonia. However, the setting of the monetary, credit and foreign exchange policies was still within the competence of the National Bank of former Yugoslavia, but a growing number of the decisions of its bodies were adopted by a consensus of the representatives of the republics and provinces. Five years later, in 1977, the National Bank of Macedonia earned new competences: bank licensing, conducting international payment and credit operations. It was also given more rights and responsibilities with respect to maintaining banks' liquidity. These functions and competences remained almost the same in the following 15 years.

The third period, period of complete monetary independence, followed by the constitution of the independent state - Republic of Macedonia, is definitely the most important period in the central banking from all aspects. This is a period of sweeping transformations, which constitute the NBRM as an institution with all explicit attributes of an independent central bank, hence as one of the key attributes of the statehood of the Republic of Macedonia.

In this period the following had to be done:

- introduce the new Macedonian national currency - Denar;
- surmount inflation, which at the time of the monetary independence equaled around 1.200 percent on annual level;
- overcome the accumulated problems in banking, managed primarily by debtors;
- repay the so-called "frozen" foreign currency deposits to the depositors, as the first precondition for restoring the confidence in banking;
- build capacity in the Central Bank itself for pursuing an independent monetary policy and efficient banking system supervision;
- establish a modern payment system.

Many of these issues were successfully solved. Many of them are still being successfully treated. The national currency was successfully introduced, inflation was surmounted, and in the past 12 years it has been on average on the level of only 2.2 percent, annually. The function of prudential supervision has been established, which is continuously being improved and upgraded. Payment operations are conducted smoothly. So is the function of the government's fiscal agent.

The capacity for conducting the monetary policy is in constant progress. From April 1992 until December 1995, the National Bank applied a monetary targeting strategy, with the money supply M1 being the intermediate target. At that time, mainly direct instruments were used: selective credits, minimum liquidity, compulsory CB bills, discount rate and reserve requirement. The choice made was

imposed by the circumstances: lack of developed financial instruments and institutional financial structure; absence of the interest rate transmission mechanism, and high interdependence between the aggregate demand and money supply.

In October 1995, NBRM made a shift towards monetary strategy of targeting the nominal exchange rate against the German Mark, and later against the Euro, with the Denar exchange rate stability being the intermediate monetary policy objective. Such a strategy, applied in a small and open economy such as ours, has proved to be very successful for maintaining the price stability until present day.

All reforms in the monetary policy instruments since the independence have been directed towards introducing indirect, market-oriented instruments for enabling efficient monetary policy conduct. Therefore, in 1993 deposit and credit auctions were introduced, and at the end of 1994 CB bills auctions were introduced. The initial development and strengthening of the financial system of the Republic of Macedonia, especially of the government securities market, enabled us to include new instruments, following the example of the modern central banks. In April 2005, we promoted the over-the-counter market for government securities. In the same year, we launched the general repo agreement and we started with repo operations when concluding lombard credits. In March this year, together with the Ministry of Finance we introduced Treasury bills for monetary policy purposes.

The transition of the monetary strategy and of the monetary instruments would not have been successful without adequate banking reforms. Therefore, rehabilitation and privatization of banks were undertaken, Deposit Insurance Fund was established and new regulation on prudential operations in line with Basel Principles for Efficient Banking Supervision was adopted and implemented.

Ladies and Gentlemen,

We said that this approach of looking back at the past six decades actually means considering of central banking from a functional viewpoint on the basis of which, with all risks of arbitrariness, we have distinguished among three developmental stages for the institution upon whose invitation you bestowed us to organize this grand meeting of excellencies, honorable guests and friends of the Central Bank and of the Republic of Macedonia.

If we consider the development of central banking from another aspect, conditionally calling it a reflection of the environment, i.e. from the aspect of the social system in which central banking and banking in general have been developing until now, then undoubtedly there are only two stages. The first one took place in the period from 1946 until 1991, and the second one, from 1991 until present day. This classification is important and extremely didactic from a historical point of view. In the first stage, central banking, just as everything else, was established on a negation of the fundamental principles of market economy, i.e. on a negation of the ownership which in the beginning was defined as state ownership, then as workers' ownership, which least was, and later it was defined as self-management ownership, which was impossible to define even with the best formulations. It turned out to be "everybody's and nobody's" but de facto it belonged to those with the largest political power. In line with those principles of the system, credit plans directed the reserve money issuance, rather than it to be determined by economic fundamentals: economic growth, internal and external balances, supply and demand, real market values. Printing of money was also dictated by the debtors, which did not repay the credits, but issued bills of exchange which at the end were borne by the reserve money issuance, then the extremely soft budget constraints, direct lending to whole economic sectors, and even certain companies, from the reserve money issuance, at interest rates significantly below the inflation rate. Instead of the debtors, often their creditors went bankrupt, with the intention to preserve social rest, or to postpone social unrest. Therefore, the end of 1980s and the beginning of 1990s, followed by the development since then until present day, have been years of Schumpeter's destruction, positive destruction - regardless of our dissatisfaction with the slow pace of the reforms and jeopardized social security, which, I would agree, did not have to erode to such an extent, before the new solutions started to give better results.

However, we must emphasize that the Republic of Macedonia is finally back on the right track: back to the main mega-trends of the most developed part of human civilization, to the building and practicing of a functional market economy; to the competition on the open international market; to the dominance of the individualism as opposed to the general and omnipresent collectivization; to the painstaking establishment of institutions responsible to the people; to the difficult road of providing the rule of law.

And have we learned the lessons?

- that we should stay away from the revolutionary methods which suddenly stop it all and start building it all over;

- that there is no efficient system in which ownership and rights deriving from it are not known;
- that there is no efficient system which denies the differences in the capabilities, dividing the social wealth on the basis of their harsh negation;
- that there is no sustainable economic growth by continuously spending more than we earn;
- that there is no strong economy without developed institutions and judicial system.

Ladies and Gentlemen,

The Central Bank completely distinguishes between the principles of the previous and of today's system in creation. Therefore, today it is a successful and modern institution, with a satisfactory trend of development of its institutional capacity. It is successful as we copy the institutional setup of the central banks of the developed countries, where the independence of central banking is recognized as one of the main preconditions for efficient conduct of the monetary policy and the exchange rate. Fortunately, political institutions in the country understood that, too, and therefore it is general assessment that today NBRM enjoys a significant level of independence, both formal and actual. However, it is most important that we are aware where and how much we lag behind the central banks of developed countries, how much we must work in order to reduce the gap and where we should arrive at.

We should improve a number of contemporary analytical and research models and practices. We should expand our knowledge in the area of economic modeling and econometric techniques. As a matter of fact, in a month or two we start with regular training of the NBRM employees in this area, in a systematic and permanent manner.

We are already preparing for outlining and implementing other monetary strategies, as it is imposed by the processes of globalization and integration of markets, the forthcoming very close full liberalization of the capital account, justifiably anticipated larger inflows of capital, which create new environment for our economy, together with the risks from instability and speculative pressures. This is imposed also by our strategic determination for admission of the Republic of Macedonia to the EU - which ultimately means reaching an institutional capacity adequate to the criteria of the Maastricht Agreement from 1992 in order to be prepared to join the European System of Central Banks.

We should even further increase the capacity of supervision. Therefore, new regulations, which we develop together with the Ministry of Finance are already underway, as well as new intensive activities for gradual shift towards risk-based supervision, as a basis for implementation of the New Capital Accord - Basel 2. At the same time, we should improve our capacity for analyzing the financial stability of the country - activities we have started, but which require great efforts and dedication.

I would like to express my gratitude on behalf of the National Bank to all of you who in various circumstances and under serious challenges contributed to the development of an institution such as the National Bank of the Republic of Macedonia. The Monograph we prepared on this occasion - 60 years of central banking in the Republic of Macedonia, is primarily a tribute to them.

I would like to thank all of you who are here tonight, deeply feeling the historical significance of this jubilee!