

## **Dimitar Bogov: Creating an environment for sustainable economic growth in Macedonia**

Opening address by Mr Dimitar Bogov, Governor of the National Bank of the Republic of Macedonia, at the 13th Macedonian Stock Exchange Annual Conference, Skopje, 4 May 2012.

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Honorable Mr. Zoran Stavrevski, Deputy President of the Government of the Republic of Macedonia and Minister of Finance,

Honorable Mr. Ivan Steriev, Manager of the Macedonian Stock Exchange,

Distinguished ladies and gentlemen,

During my last year's address at this conference I announced that "the National Bank will create environment for sustainable economic growth through price stability, stable Denar exchange rate and stable, competitive banking sector which will produce sound credit growth. In order to achieve this, I will seek to conduct policy of optimal level of reference interest rate and optimal level of prudential banking regulation. In my view, optimal interest rate is the lowest interest rate that provides Denar exchange rate stability and price stability, and optimal prudent banking regulation is a regulation that provides necessary bank liquidity and solvency, without being a regulatory burden on the banks' balance sheets".

Concerning the latter, in September last year, we integrated the Denar and foreign currency liquidity rate in a single liquidity rate. Simultaneously, we recognized a long-term character of twenty percent of time deposits that fall due, promising that this percent will increase in future. With these measures, we ensured larger liquidity management flexibility and higher income for the banks without deteriorating liquidity indicators.

The recent redesign of monetary instruments and the yesterday's cut of reference CB bills interest rate from 4% to 3.75% are aimed towards conducting of policy at optimal level of reference interest rate. Allow me to elaborate.

We were preparing the monetary instruments redesign for a longer time period, and made the actual redesign when we considered that the time was right. The economic activity decelerates because the euro area demand is lower and the credit growth rate is below expectations. Moreover, data on the foreign exchange market and foreign reserves and on the trade deficit in the first quarter indicate balance of payments deficit lower than projected. The inflation rate reduced to around 2%, as expected for this year's average. The banks, instead of investing the household savings, that increase faster than expected, in lending, purchased CB bills, the amount of which increased by Denar 10 billion, i.e. one third in only three months, even though the capital adequacy and liquidity are at exceptionally high levels. The net external borrowing of the country decreased by Euro 220 million only in the last quarter of the last year, and by Euro 280 million, or by one fourth, over the entire last year. Finally, immediately prior to our decision to redesign the monetary instruments, the Ministry of Finance announced cut of budget expenses by 5%. To summarize, we face low level of risk in the external and the banking sector, low to moderate level of risk in the public sector, the Denar exchange rate is stable, the inflation is lower than in the euro area, and the economic activity decelerates. What would be more suitable in a situation like this than to send signal that there are conditions for enhanced banking activity without jeopardizing the stability?

This is exactly the goal of our measures. It is not our intention just to conclude that the credit growth does not develop as expected, and to revise the rate downward all over again. We consider that the credit growth could range around 7–8% without jeopardizing price and financial stability, and we clearly signalize this.

The question is whether the banks will follow our signal? The promptness and intensity of banks' response depend on the power of monetary policy transmission. The recent researches conducted by my coworkers show that the power of monetary policy transmission in our banking system is limited. This was yet another reason to redesign the monetary policy instruments. We hope that the new monetary framework will improve the monetary transmission. Otherwise, we will keep on advancing the monetary instruments setup.

CB bills are the National Bank basic instrument used to absorb excess liquidity by banks. CB bills are not investment vehicles. In many countries there are no CB bills. When the National Bank intends to absorb more liquidity it could make the interest rate more attractive for the banks. But, if it considers that it should not sterilize such excess liquidity, it will make the interest rate less attractive or will restrict the amount allowed for the banks to subscribe.

Distinguished ladies and gentlemen,

At this very conference last year, I also said that the National Bank will not build its relations with the banks from the position of arrogance. Quite contrary, the banks are our partners. Therefore, the National Bank will keep on informing and consulting with the commercial banks about the regulatory measures. In this respect, presently we analyze the latest request of the Banking Association concerning the treatment of foreclosures and we will soon launch a dialogue to find solution in favor of the Macedonian economy. Hence, there should not be any doubt that in future the National Bank will "hear the voice" of the banks. But, also, it should be clear that the National Bank does not discuss the monetary policy measures with anybody, not even the banks, before it makes a decision to adopt them. They are at the absolute discretion of the National Bank. This is a worldwide practice. Neither the European Central Bank, nor the Czech Central Bank, nor any other central bank throughout the world consults or informs the commercial banks on the monetary policy measures before it makes the decision.

Distinguished ladies and gentlemen,

I dedicated most of my last year's speech arguing that the stable Denar exchange rate is still the best solution for the Macedonian economy. In the public debate concerning this issue last year, on many occasions, I presented additional arguments that underpin my view. On this occasion I will discuss the two theses recently presented by the advocates of floating Denar exchange rate. The first thesis is that the floating exchange rate will ensure more relaxed monetary policy, and accordingly, higher economic growth. The second thesis is that the Denar exchange rate is not realistic, i.e. it is overrated. Yet, so far, I still have not heard any explanation of how would the floating exchange rate relax the monetary policy, nor arguments supporting the view that the Denar is overrated.

Considering the first thesis, note that the exchange rate regime does not determine whether the monetary policy will be restrictive or relaxed. You could have floating rate and restrictive monetary policy, or fixed exchange rate and relaxed monetary policy. What is important for the monetary policy is whether there are imbalances in the economy or not. Just because of the absence of imbalances in the Macedonian economy, as I elaborated at the beginning, we can afford relaxed monetary policy. Conversely, due to the nature of our economy, the floating exchange rate would fuel uncertainty and create imbalances and high inflation, the alleviation of which would require extremely restrictive monetary policy.

Concerning the overrating of Denar exchange rate, I have presented, on several occasions, data on Denar real effective exchange rate that indicate quite the opposite. On this occasion I will only refer to the market. It is the market that determines whether a commodity is overrated or not. Since the beginning of August last year, the National Bank has only once sold euros on the foreign exchange market in the amount of Euro 4.5 million, and has purchased euros, approximately twenty times, on the foreign exchange market in the amount of Euro 170 million. Even countries that apply floating exchange rate much frequently intervene by selling foreign currency on the foreign exchange market, in order to defend their currency.

Distinguished ladies and gentlemen,

Euro area debt crisis is our greatest challenge in the period ahead. Due to the large scale trade, the recession in the euro area which is very likely, has adverse effects on the real sector of our economy. In such circumstances, other than the maintenance of inflation rate at the level of the euro area, we will use the monetary policy together with the macro-prudential policies to preserve the balances in the external and the banking sector.

In a medium run, the challenges of the banking sector again arise from the euro area, related to the implementation of Basel 3 standards. It is very likely that it will cause “deleveraging” in the European banks, hitting seriously the lending activity of banks in the South East Europe. We closely monitor this process and get ready to respond adequately in order to protect the Macedonian economy against severe impacts. Therefore, the cooperation between the National Bank and the commercial banks will be even more important.

Thank you for your attention.