

Dimitar Bogov: Republic of Macedonia – celebrating monetary independence

Opening address by Mr Dimitar Bogov, Governor of the National Bank of the Republic of Macedonia, at the gala event on the occasion of the 20th anniversary of the monetary independence of the Republic of Macedonia, Skopje, 26 April 2012.

* * *

Honorable President of the Parliament of the Republic of Macedonia,

Honorable fellow Governors of central banks,

Distinguished guests, ladies and gentlemen,

Let me wish you all a very warm welcome and thank you for accepting our invitation to attend this gala event on the occasion of our landmark anniversary – twenty years of the monetary independence of the Republic of Macedonia.

On this day, April 26, we recall the numerous challenges that we faced, the numerous difficulties we have gone through in the past twenty years exactly.

On this day, we are reminded that the beginnings were not easy and that those beginnings emerged in a period of, I can say without false exaggeration, huge enthusiasm of all individuals involved in creating our own independent state with all attributes that this state should have.

In this reminiscence of the persons who were involved in the monetary independence, I especially feel the need to point out the name of the first Prime Minister of the independent Republic of Macedonia, the academician Nikola Kljusev, who played one of the leading roles not only for the monetary independence, but also for many other decisions of that time, important for the completion of statehood. On his initiative, on December 19, 1991, the Government adopted a Decision which obligated the National Bank to start printing value coupons. This Decision, adopted in greatest secrecy, was a legal basis for all operational actions that allowed the new currency, the Denar, to be presented to the public on April 26, the following year, 1992. On this day, also on the initiative of the academician Kljusev the systemic laws were adopted, as well as the document on the Anti-inflationary program, which, unfortunately, did not survive the fall of his Expert Government.

On this day, besides recollecting the past, we are called to look towards the future. Here we look at the importance of low inflationary expectations for the efficiency of the economy and the role of the National Bank in maintaining these expectations. In fact, academician Kljusev had devoted his entire scientific work to the issue of efficiency of economic policies.

For the central bank, as well as for the commercial banks that the central bank closely cooperates with, basically there is only one true treasure on which the effectiveness of its policies is based and that is the confidence of the public. It is impossible to imagine a stable bank without having to imagine the confidence of citizens who are its customers. Also, it is impossible to imagine confidence in a central bank without simultaneously having confidence in its objectives. Consequently, the essential question for the monetary independence comes down to whether it contributed to building confidence in the specific context in which it was accomplished.

The answer to this question in the last fifteen out of the twenty years that have passed since the monetary independence is an unambiguous YES. Even though we lost a lot of effort in dealing with the consequences of premature abandonment of the said Anti-inflationary program, the National Bank has been successful for fifteen years in achieving its main objective – maintaining price stability.

Stable exchange rate is an intermediate objective for achieving the main objective. The interest rate on the main instrument of the National Bank is an operational signal that we are truly determined to maintain the stable exchange rate. Of course, there were and there will be speculations on the currency market, as there were and there will be debates, to some extent caused by partial economic interests, regarding the overall structure of the monetary policy. The former are an integral part of the market economy, and the latter are part of the public debate. The National Bank has the capacity to respond to a speculative attack on the exchange rate and at the same time it is an active participant in theoretical debates and empirical studies.

For example, we successfully dealt with three major attacks on the Denar exchange rate, in the spring of 2001, in the autumn of 2004 and in the spring of 2009, although these attacks were caused by quite different reasons. With this action we justified the confidence of citizens, the confidence that is the greatest treasure, the greatest reserve of the National Bank.

Also, the careful study of economic theory leads to the perception that the conditions under which the weakening of the domestic currency would lead to improved net exports are not all present in the Republic of Macedonia. The increased sales of Macedonian goods and services abroad, but at lower prices expressed in Euros, would not lead to foreign exchange inflows, which could offset the more expensive imports of energy and machinery. In the imports of the latter, we depend almost exclusively on the world rather than on the domestic prices of production, so the result could be even worsening, instead of improving the balance of goods and services. To the same end are the different, but more emphasized arguments based on empirical studies: the competitiveness of the Macedonian economy is not reduced and the research of the effective exchange rates continuously shows their adequacy.

This policy of stable exchange rate has caused the inflation in the Republic of Macedonia in the last fifteen years to average 2.1 percent, versus 1.9 percent in the countries of the Eurozone. With a difference of only 0.2 percentage points, the Republic of Macedonia is among the most successful countries in transition.

In this context, it is worth emphasizing one more comparison from the past fifteen years. The Republic of Macedonia has avoided the continuous appreciations of several years that during the crisis were followed by depreciations, a cycle to which the countries of the region of Central and Eastern Europe with fluctuating exchange rates had been exposed to. Thus we avoided the illusion of increased productivity – an illusion that these countries had to pay for in the crisis years.

Given this background of successful monetary independence and the Denar as a means for building confidence, I believe it is fair to point out that in the past fifteen years, the attracting of savings in Denars and the impartial and rigorous channeling of those savings to the most efficient and most effective economic projects by the commercial banks have also been achieved to the extent possible.

This "to the extent possible" is partly a result of the trauma caused by the numerous devaluations of the domestic currency in the not so distant past, when savings became almost worthless. But this past means that in the previous fifteen extremely successful years for the monetary policy, there is an expected, though irrational stigma on the Denar, which however becomes rational because it is rewarded. In other words, depositors believe that they need very high nominal interest rates in Denars, in order to have a real return on savings, which leads to high interest rates on loans. This phenomenon was not and is not a result of the mistrust in the banking system. Mistrust of depositors comes from the fear that due to possible devaluation followed by inflationary transmission effects, saving in Denars would be insufficiently compensated if interest rates on savings deposits in Denars come too close to the interest rates on deposits in Euros.

The stability of the exchange rate which established the idea that price stability is a public good one cannot live without, is the reason why depositors are no longer so much under the

influence of this phenomenon. The latest data on the increased saving in Denars, compared to saving in Euros, point to this conclusion.

The expectation that the stable exchange rate level will be maintained simultaneously indicates that the difference between real interest rates in Denars and real interest rates in Euros continues to decrease gradually, certainly without any of them remaining on negative territory for a longer time. The National Bank will continue not to hesitate to intervene in the foreign exchange market and increase the interest rate on the main instrument which represents an operational signal. Through these policies the National Bank confirms its capacity and institutional determination. Market participants recognize this successful defense of the exchange rate in the past fifteen years, although in a short run any change may cause, through the transmission effects, only temporary increase of the nominal, and thus of real interest rates in the economy.

A logical consequence of all this is that a possible reflation in the Eurozone means that the Republic of Macedonia will not become an isolated island doomed to disinflation and, vice versa, that if the Euro continues to prove effective in delivering low inflation in the Eurozone, in the Republic of Macedonia internal depreciation will be the preferred course of adjustment. The differences between inflation rates in the Republic of Macedonia and the Eurozone will remain temporary and limited.

In fact, this marks the success of the stable exchange rate as an intermediate target of the monetary policy which consists of the aforementioned difference of 0.2 percentage points between the inflation in the Republic of Macedonia and the inflation in the Eurozone. In the long run, this enables economic agents to have more definite expectations about the general price level and denotes support to the economic environment.

In such monetary policy setting it should be noted that the National Bank, as a public institution, constantly needs to cooperate with the Government without undermining the autonomy of any of these two institutions. From the perspective of the National Bank, this means that the Government is trying to anticipate the policies that we implement to maintain the level of the exchange rate and it takes them into consideration when adopting the budget. It is clear that the National Bank and the Government may adopt essentially good decisions in their respective spheres of action if they cooperate even during the discussions which precede the decisions.

The cooperation with the Government would also be in terms of creating conditions for the social dialogue to take into account the challenge we face in conducting the monetary policy. This actually means that the inflationary pressures which in themselves would result in faster development of the domestic economy, as well as more positive output gap compared with the countries of the Eurozone, would also lead to more pronounced interaction with the increase in unit labor costs. The perception of close coordination between the Central Bank and the Government in dealing with this challenge would mean that both public institutions are aware of the need to adjust to the conditions that the maintenance of price stability through the exchange rate brings. This adjustment would prompt the Government, through dialogue with social partners, to advocate a moderate growth of wages, i.e. wage growth which will take into account productivity in both the tradable and non-tradable sectors. This would lead to increased employment, while simultaneously improving the competitive position of enterprises, which would alleviate the emergence of imbalances in the economy as a whole.

Finally, I would add that we, at the National Bank, have learned a lot from the mistakes that economic policy-makers have done in the past. But, as confirmed by the history of our institution, monetary independence is perhaps the decision that best helped us to contribute to the improvement of the efficiency of the economic policies, and thus improve the living standard generally, in a state-making, institutional, economic and practical way.

Long live this great anniversary!