

## **Dimitar Bogov: When pressures on prices are relieved, we will stimulate economic growth**

Interview with Mr Dimitar Bogov, Governor of the National Bank of the Republic of Macedonia, in “Kapital” weekly magazine, published on 8 November 2012.

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### **Bank affairs are always possible**

***In the countries in the region banking affairs have erupted, in connection with criminal activities of some banks in conjunction with politicians. What is the situation in Macedonia? Is everything under control in the banking sector?***

NBRM controls the banks in terms of their compliance with the regulations, the quality of corporate governance, and assesses the risks that banks undertake in their operations. Banking supervision is a strong prevention against criminal operation. But that does not mean that as anywhere in the world, banking affairs could not take place also in the banking sector in Macedonia.

### **Spasijka Jovanova**

***The National Bank of the Republic of Macedonia lowered the forecasts for the economic growth this year to 1 percent and raised the concerns of inflation. The condition when no growth is registered, i.e. there is a downturn, and there is higher inflation, is called stagflation, which is the worst stage of an economic crisis. Is the Macedonian economy in such a stage?***

I would not agree that the Macedonian economy is entering stagflation. However, there were unusual movements in the world economy. On the one hand, European economies are in recession, the US economy has been struggling to return to the path of growth, and more recently, fast-growing economies such as Brazil, India, China, Turkey have also slowed down. In such circumstances, it would be logical for the prices on the commodity exchanges worldwide to fall. But it is not happening. Prices of oil and basic agricultural products are not falling, but maintain the previously achieved high level or even continue to rise. In part, this is due to the overly relaxed monetary policy of the Fed, the ECB and the Bank of England, as well as the debt crisis in the Euro area, which “urge” investors to invest in real goods on the commodity exchanges. The rest is a consequence of the so-called supply shocks, i.e. political tensions in the Arab world and the Middle East, as well as the drought in the countries that are the largest producers of grain. In such conditions, despite the slowdown of economic growth, Macedonia is facing a higher imported inflation.

***In conditions of such an emphasized economic crisis, how will the monetary policy be put into operation to encourage economic growth? You claim that the NBRM can contribute only by keeping price stability, but obviously it is undermined.***

Price stability is neither undermined nor will it be. In August and September, a higher than usual monthly price increase for this time of the year was registered, due to one-off factors that I have already explained. Their effect will soon be exhausted and the increase will stop as pressures from the demand side have been completely absent. Temporarily higher inflation does not mean that price stability is undermined. Over the last two years, inflation in the Euro area has continuously been well above the ECB’s target, but no one gets upset about it, as it is clear that it is not a consequence of overheated domestic demand. Monetary policy cannot prevent the initial impact on prices from the supply shocks, but it can prevent the transmission effect on other prices. NBRM will not allow price stability to be undermined.

***You have recently admitted that monetary policy is facing several challenges, which call for contrasting reactions. Can you explain what you think specifically and how you would solve this problem in the monetary sphere?***

If there had not been price shocks of the global commodity exchanges, the NBRM would have had room for further easing of the monetary policy. However, due to the pressures from international prices we must give a clear signal that we will not allow undermining of price stability, while simultaneously adjusting the monetary policy to the slower economic growth. It is a great challenge, a difficult task, but not impossible. Now is the time when many central banks apply unconventional monetary policy measures to respond to the unusual economic trends. At the moment we are sure that risks to price stability undermining are eliminated, we will apply monetary measures appropriate for the slower economic growth.

***May pressures be coming from the fiscal policy?***

So far, they have not, and I hope it will remain that way. The best confirmation of that are the balances in the economy. After all, exactly because of that, we had room for the so far most relaxed monetary policy without jeopardizing the stability of prices, Denar exchange rate and the banking system.

***Banks' non-performing loans will decrease***

***This year, liquidity was the biggest problem of the companies. The figures showed that the indebtedness in the real sector is huge, over Euro 5 billion, with the country's debt to the companies being over Euro 220 million. In such circumstances, banks have reduced lending to firms to a minimum and they struggle with the growth of bad loans. Can we expect the situation to improve?***

In the statistics that are known to me I have not found such figures. However, when economic growth and exports slow down and budgetary payments are late, usually the liquidity of companies deteriorates. Therefore they are late in the settlement of obligations to the banks. Despite that, non-performing loans of the Macedonian banks amount to about 10 percent, which is the lowest share in the region from Slovenia to Greece. Announced debt repayments from the budget will contribute to the reduction of the debts among companies, and finally debts toward the banks. So it is logical to expect stabilization, and perhaps reduction of the level of banks' bad loans.

***Banks which have huge excess liquidity, have reservations regarding lending to companies, and they locate the reason in the emphasized risks. Is the placement of those funds in Treasury bills and Central Bank bills a solution, even at the cost of a decline in the economy?***

The monetary policy is trying to trigger a certain behavior of the banks which it considers is appropriate at a particular time. But banks independently manage excess liquidity and it is their decision whether more will be placed in the form of loans or in risk-free securities. At the beginning of the second quarter, with several measures we released substantial excess liquidity placed in CB bills over the level that we considered it was necessary to be maintained. It is a fact that banks placed only a small part of that surplus in loans. One of the reasons is certainly the perception of banks for increased risks in the domestic and global economy. But just as important, if not even more important reason are the corporate strategies of the banking groups in the Euro area that are owners of the Macedonian banks. Some of these banking groups have serious problems in their home countries. Although their banks in Macedonia have excellent capitalization and record liquidity, they must implement the strategy of their foreign parent banks, which due to the insufficient capital, refrain from lending in all countries where they are present. NBRM cannot require those banks to increase lending, but we undertake everything we can to prevent a reduction in their loan

portfolios. Obviously, this is another area where we have a spillover of the negative developments in the Euro area into our economy.

***What will be the credit growth this year, and what do you expect it to be next year?***

The estimate for this year is about 7 percent, and for the next year it is somewhat higher.

***In which direction will the interest rates on loans and deposits move next year?***

The downward trend is likely to continue, although at a slower pace.

***The European Central Bank reduced the basic interest rate to 0.75 percent in order to stimulate the economic growth. The National Bank of the Republic of Macedonia maintains it at 3.75 percent. Why not reducing it down to 1 percent in our country, too, which will reduce the interest rates on loans as well?***

In a highly euroized economy as the Macedonian, it is necessary to motivate economic agents to demand Denars, not Euros. Therefore, interest rate parity on Denars and Euros must be kept at an appropriate level that stimulates the demand for Denars. In the last three years we have reduced that parity from 8 percent to only 3 percent. Further reduction is a process that depends on the resilience of the economy.

**Macedonia will have to save more**

***What are your expectations for the Macedonian economy in 2013, which is expected to be perhaps more difficult and more turbulent than this year? What, according to you, will be the biggest economic challenges and problems next year?***

It will be another year full of uncertainty for the world and especially for the European economy. Thus, the export demand for Macedonian products is unlikely to improve. So, we cannot expect that to boost economic growth. However, our expectation for the economic growth in Macedonia is to be much better than this year, driven by diversification of the production into new export-oriented facilities that started to work this year, or will start to work in the next year, as well as infrastructural facilities for which funding has already been secured from foreign sources.

***Both politicians and economists globally are of a divided opinion in terms of the economic policy that should be conducted in order to emerge from the crisis. Some advocate austerity, others encourage spending to stimulate growth. Which policy you prefer and think is right for Macedonia?***

According to me, those are “false” discussions. If a country has a room for increased spending, certainly now is the time to stimulate the economy. But unfortunately, there are not many such countries worldwide. Developed economies were spending more than they could afford for years, and now they do not have any room for fiscal stimulus left. It is easy to say that now you have to encourage consumption in Greece, Spain, Italy, Portugal, USA, etc. Who will finance this consumption? Just as banks refuse to provide new loans to overindebted customers, investors are not willing to finance increased spending of budgets. In the economics there is a saying that “there is no free lunch.” In the end someone has to pay the bill. The time has come for the developed economies to pay the bill and now there is no other choice but austerity. This is a time of painful structural reforms, revision of the generosity of social care in accordance with the possibilities of the economy. As for Macedonia, as a result of many years of prudent fiscal policies, we had room for stimulus in these few years. But this room in the medium term will be exhausted and we will have to save more.

## **Macedonian companies lend to their parent companies in the Euro area**

***What are the expectations for the deposits in 2013? Can we expect further growth, especially of Denar deposits?***

Households' saving is likely to continue at the usual growth rate of at least 10 percent per year, mostly in Denars. It is harder to predict the trend with companies. This year there were significant capital outflows in the form of dividends and loans from foreign-owned companies to their parent companies abroad. Obviously, Macedonian companies are still profitable and they financially help their parent companies in the troubled Euro area countries. It negatively influences the deposit potential of companies. It is uncertain whether this trend will continue next year.

***Why do you always connect the issue of the exchange rate policy with devaluation? Is it possible to open a debate in the country, on the economic model, the effects that it provides and the exchange rate regime and its efficiency vis-a-vis the economy?***

Currently, we have a real exchange rate of the Denar. Demand and supply are balanced. NBRM very rarely intervenes in the foreign exchange market. As a result of the credibility of the Denar and the National Bank created over the past 15 years, we have completely eliminated the speculative demand for foreign exchange. But experience has shown that immediately when the change in the exchange rate is mentioned, a speculative demand for foreign exchange appears and disturbs the balance on the foreign exchange market. This would cause pressure on the exchange rate, higher inflation and ultimately much higher interest rates than the current ones. Who would benefit from that? You take a selected sample of countries with flexible exchange rate that have higher economic growth than Macedonia and you offer it as evidence that such policy gives better results. I will find another sample of countries with flexible exchange rate that have lower growth than Macedonia. It is not economic analysis, it is manipulation. I am still waiting for someone to offer a plausible analysis of how the change of the exchange rate regime will boost economic growth. Except naive statements in the media, so far no one has offered such an analysis. In the economic literature, it has long been concluded that the exchange rate regime does not affect economic growth.

***Do you think that Macedonia has an efficient economic model and exchange rate regime if it records economic growth rates which do not exceed 3–4 percent, and everybody agrees that it is necessary to have growth of over 8 percent?***

It is very naive to link economic growth only with the exchange rate regime. Economic growth is a very complex phenomenon that depends on about a hundred of factors. Competitiveness of an economy does not depend only on the exchange rate. Take the global competitiveness index of the World Economic Forum. It takes into account more than one hundred indicators for measuring the competitiveness of countries. If someone believes that Macedonia will realize an 8 percent growth rate only if the exchange rate regime is changed, I am left speechless. The change in the exchange rate is used as an instrument for improving the competitiveness only when the country has failed to improve other factors and there is no other choice. But it is only a short term solution that will quickly exhaust the effects, because devaluation will bring high inflation and in the end only the nominal exchange rate is changed, and the real exchange rate will remain the same. And then again demands for a new devaluation. Look at the history of the European Monetary Union. What was the exchange rate policy of Greece, Italy, Spain, before the introduction of the ECU (the predecessor of the Euro). Instead of structural reforms, they constantly corrected their weaknesses with a devaluation of the exchange rate. When they entered the Euro area it was no longer possible and it has led to what we see today. They require internal devaluation of about 30 percent to restore lost competitiveness. By contrast, countries such as Austria, the Netherlands (Denmark, which still has its own currency) have always led policy of a fixed exchange rate pegged to the German Mark. To be competitive, they had to increase their

efficiency with structural measures. Therefore these countries have no problems with competitiveness today.

***In a recent interview you gave for Banks and Businesses you recommended that the competitiveness of the Macedonian economy must be improved through complex reforms and dedicated work that includes everybody. Do you see such progress?***

Yes, I see such progress. The ranking of Doing Business, of the World Economic Forum, is a benchmark for what has been done in the area of ??improving the conditions for higher economic growth. It is the only way to create higher economic growth. It is a process that should never stop. Better ranking on these lists does not mean that we will immediately have higher economic growth. It takes time, we should continuously improve the conditions for doing business.