Dimitar Bogov: Recent financial and economic developments in Macedonia

Interview with Mr Dimitar Bogov, Governor of the National Bank of the Republic of Macedonia, in *The American Times*, October 2013.

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Please offer our readers a brief on the functions of the National Bank of the Republic of Macedonia (NBRM)

Our primary goal is price stability with a secondary goal of financial sector stability. Without jeopardizing the primary goal NBRM should support economic policies. The way in which we execute the primary objective is by pegging the exchange rate with the Euro. Pegging our currency has been our long term strategy since 1995, originally with the Deutsche mark. When one compares our inflation with that of the European Monetary Union the result is relative alignment; to put it in real terms, EMU inflation is at about 1.9% with Macedonia hovering at 2.2%.

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How has the global recession and currently, the strength of the Euro, especially when compared to the US dollar effected your ability to maintain price stability, if at all?

It affected our economy because our largest export markets are EU countries, equating to 60%, whose demand for our products dramatically reduced. When one additionally considers our many exports to neighboring, non-EU countries, but who maintain a Euro-centric policy we can see an indirect detrimental effect; which in turn means roughly 90% of our exports were hit by the crisis. For example, we experienced a decline in GDP of 1% in 2009 with a recovery of 3% in the next two years before declining again by –0.4% in 2012; which is reasonably low when compared to other countries in the region. Although this does not mean the effects from the Euro Zone crisis were not harsh, they clearly were; however, there were compensating policies such as a fiscal stimulus from the government which substantially mitigated the negative impact which is most likely why Macedonia had the slowest decline in the region.

What were some of those hedging fiscal policies?

Traditionally, Macedonia has had low fiscal deficits, ranging from –1% to +1%, but during the crisis in 2009 this grew initially to 2.5% then to 2.8% with our highest in 2012 at 3.8%. This year, due to the financial stimulus we are forecasted at 3.5%. We were able to mitigate successfully because our public debt was low at around 20% of GDP which afforded us room for expansion which we used during this crisis period.

Apart from the macro-economy concerns, the crisis with the Euro as a currency helped boost confidence in our domestic currency [MKD denar]. This is because people naturally began to wonder what would happen with Europe; therefore, its primary currency. As a result, some people began to orient more towards the MKD. Traditionally our country, like most former Yugoslavian countries are highly Euro-rized, which means people save and use credits in Euros, with a 65% Euro to 35% MKD ratio. During the crisis and continuing today, the ratio of households and their propensity to save in MKD has elevated to 50%.

You have been in your post for 2 years with 5 more remaining. How do you view the future development of the economy based on the government's FDI promotional campaigns that are taking place currently across the globe?

We have witnessed in the past 4–5 years several very important foreign direct investments. Some of them are so large that they already equate to roughly 17% of our exports, with the majority of the companies focused on component manufacturing for the automotive industry. There are also several large firms that are in the pipeline which have shortlisted Macedonia for their capacities. Importantly, these incoming large-scale investments are also bringing diversification to our exports, which are traditionally based in textiles, agriculture and metals. It is worth noting that several of these firms not only made the decision to enter Macedonia but are currently in expansion mode based off their operational successes here, to the degree that I predict in 3 years the current and pending FDIs can equate to 30% of our exports.

Of course strong and growing exports are a main target for most countries due to their balancing of payments. In our case, these FDIs in automotive and electronics have contributed primarily to our economic growth in regards to manufacturing. Other manufacturing sectors are struggling due to their continued dependence on the European Union's growth; as such, their success is dependent upon overall growth and stabilization within the EU, which is showing signs of alleviation.

Clearly a growing focus is a diversification of export markets. This can be remedied by establishing further value-added capacities in manufacturing which can allow for non-EU exports.

Is it safe to assume that the growth factors mentioned previously are a result of the Economic Zones established within Macedonia?

Yes, most of these FDIs in production of tradable goods and their resulting benefits to the overall Macedonian economy are located within the Economic Zones.

We have been speaking about the EU and its effect on Macedonia's economy. Compared to the US, if only marginally, the EU is experiencing a more stagnant rate of growth. You mentioned you see the EU beginning to recover slightly. What is your outlook on the future of the Euro Zone?

This is true; the US is ahead in terms of growth. The EU economy in Q2 of this year went out of recession but remains in a fragile state and questions certainly remain regarding its long term stability. They are not out-of-the-woods yet but are heading in that direction. So, although growth will not be very strong I do not see them entering a recession again.

Even the hardest hit Southern European and Mediterranean countries have the potential to see growth as early as next year. Which is a positive indicator for our more traditional export firms; as several of these countries act as their largest trading partners. Our confidence is building. If this year we will see a 2.2% increase in overall growth we predict next year can yield 3.5% and it can certainly grow from there to over 4% in ensuing years.

First-movers entering this market will be the ones benefiting from the immediate and privileged market access

Do you see Macedonia's current inability to enter the EU due to the naming dispute with Greece as a component that is putting a relative cap on the growth figures you just mentioned?

If we look from an economic point of view, judging from rating agency criteria that takes into consideration political uncertainties such as the ongoing naming issue, it is safe to assume that our rating is lower than what it could be. The resolution of this dispute and the resulting increase in rating will certainly lead to greater investor confidence as well as better terms on financing in the international markets. There would also be access to more EU funds that could be used for critical infrastructure developments.

Speaking domestically, as the mega-regulator of the financial sector, how do you view the strength of the banking segment in terms of contributing to domestic growth?

Following the crisis the Macedonian banking sector proved to be quite resilient. No banks failed and all were well capitalized. Our prudential regulation has always kept banks from entering into risky investments as we have a conservative banking system. As a result, we were not exposed to some exotic instruments from abroad before 2008 which is why they did not suffer directly.

Indirectly, yes, through reduced economic activity which created some problems with companies in the real sector where they could not repay their loans which in turn raised the Non-Performing Loan (NPL) ratio to around 12%. But again, comparing regionally from Slovenia to Greece it is probably the lowest and more importantly, fully covered with provisions. Liquidity is very high at 30%. So after stabilization the goal is to promote lending activities once more.

A second channel of exposure was through the fact that 90% of Macedonian banks are foreign owned and parent banks were primarily oriented to handling problems in their home country. Sometimes they make decisions at a group level without paying specific attention to their Macedonian operations, which affects our banks negatively, depicted by years with no growth. I do have to point out, however, that Macedonian banks do not rely on funds from their parent banks; our Loan-to-Deposit (LTD) ratio is 90%. So, from this point of view it means they can operate as a stand-alone but due to parent bank strategies they are inhibited.

Do you think there is opportunity for more entrants in the banking sector?

Currently at 16 banks, we have too many.

In that case, do you see more mergers and acquisitions occurring?

Yes, absolutely, in fact it is a process that I have been encouraging in the last 2 years, sending signals and urging banks towards this end. 7–10 banks would be ideal. There is another strong possibility that parent company banks may decide to sell their Macedonian subsidiaries, which are very solid banks, possibly resulting in some strong international brands entering the market.

Based on your position and knowledge of the Macedonian marketplace. Please offer a personal message to our American Investor readers.

Macedonia's market is not yet saturated and there is room for investors at the earliest stages. We are actively pursuing and obtaining EU standards and EU accession is certainly something to benefit from when it does occur. First-movers entering this market will be the ones benefiting from the immediate and privileged market access. The beauty is that there are strong returns available now, not just after accession!