



Macedonian experience: Currency Peg in times of perpetual crises

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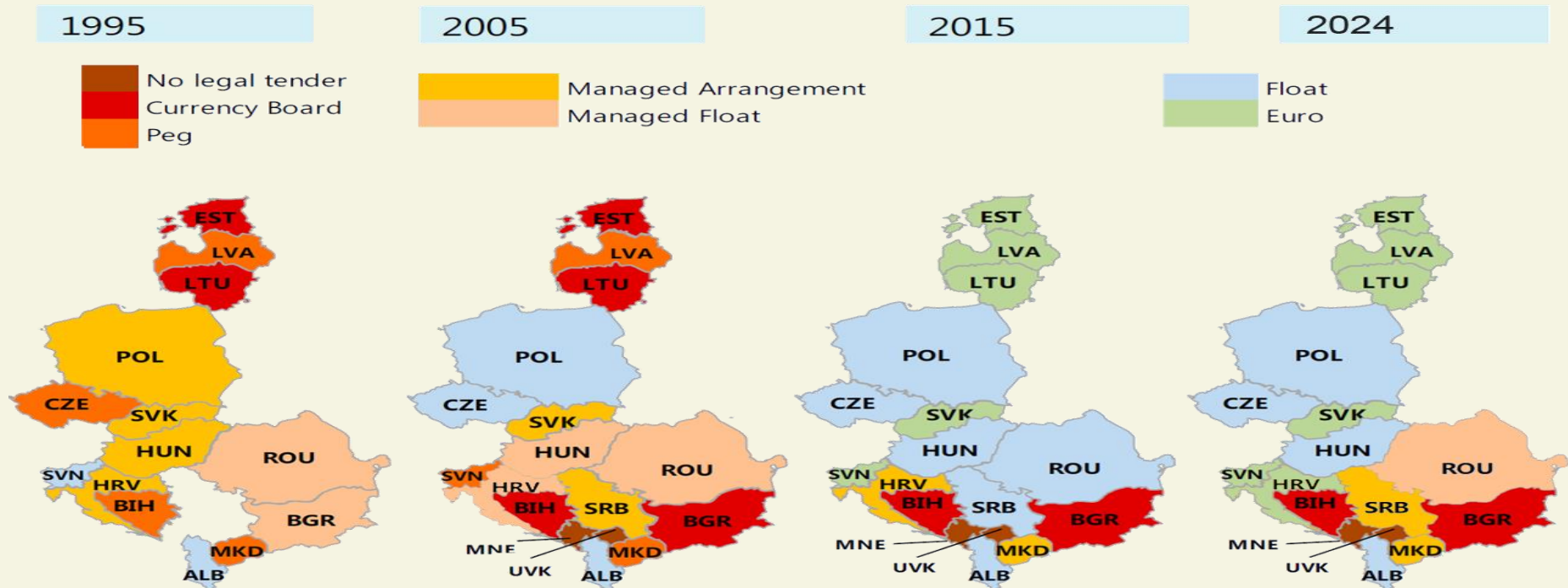
Content

- What is the rationale behind the choice of our exchange rate strategy?
- How well has this strategy served the economy?
- What have been the challenges in preserving the stability of the peg in times of subsequent crises?
- What are the future challenges?



What is the rationale for choosing the stable exchange rate strategy?

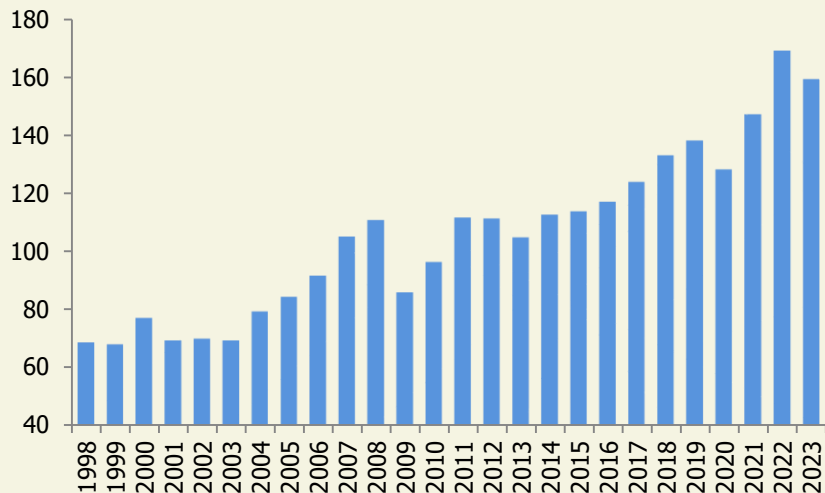
- At the early transition, like many other CESEE economies, we adopted a stable exchange rate strategy to tame hyperinflation stemming from price and wage liberalization
- Once price stability was achieved, unlike many other economies in CESEE, we did not shift to flexible exchange rates, similar as most of the WB economies (highest hyperinflations in CESEE)
- The degree of flexibility to this day is closely tied to inflation experience in 90's





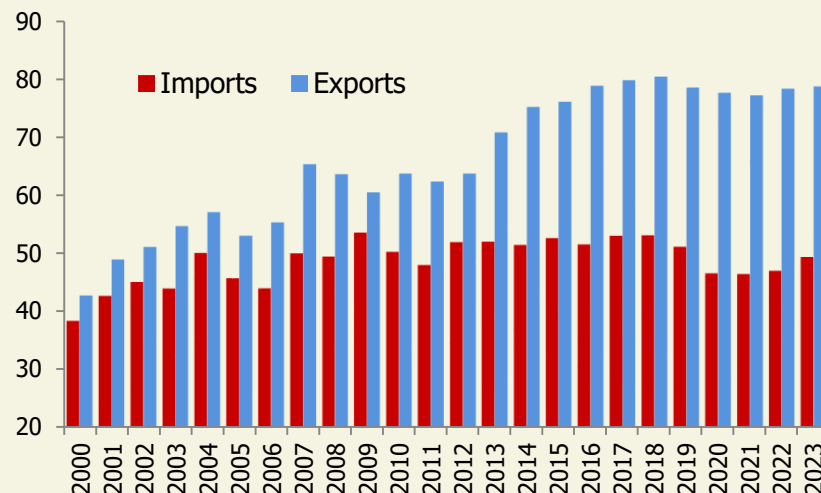
Why we have continued using the exchange rate anchor (fear of floating)?

Trade openness, % of GDP



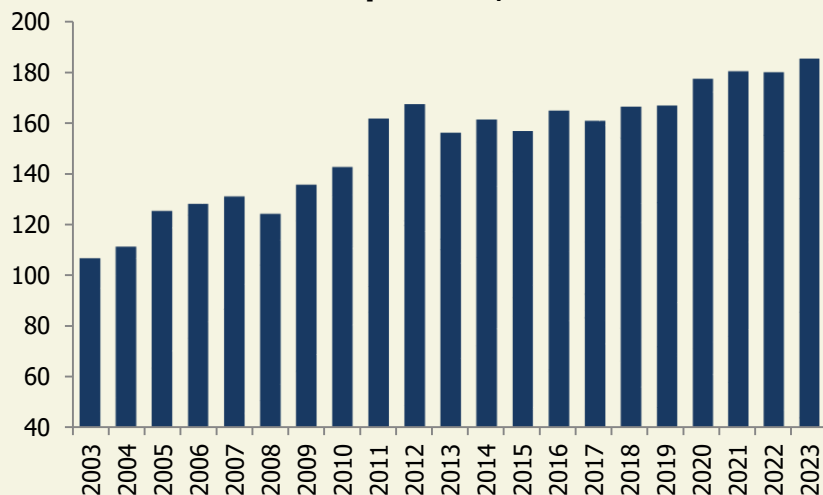
Source: NBRNM.

N.Macedonia - EU trade, % of totals



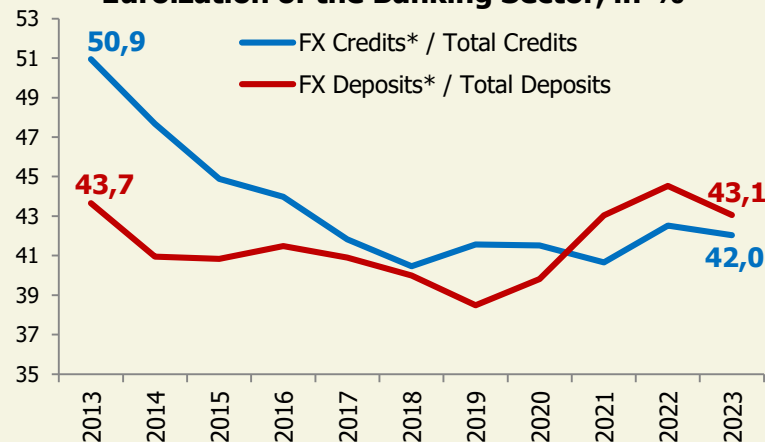
Source: NBRNM.

Financial openness, % of GDP



Source: NBRNM.

Euroization of the Banking Sector, in %

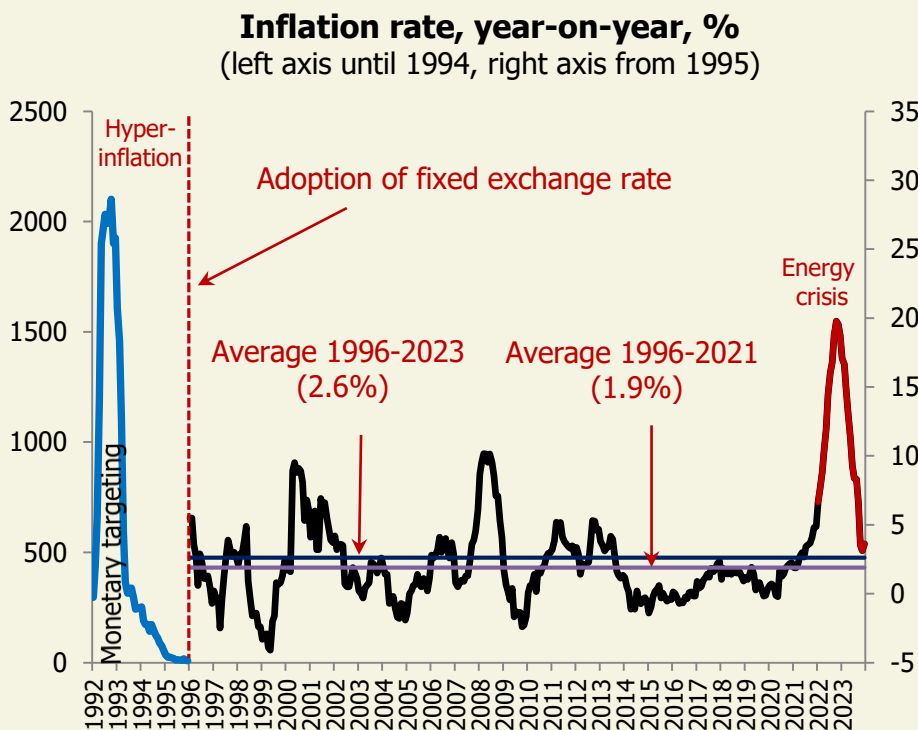


*includes credits and deposits in foreign currency and in domestic currency with FX clause.

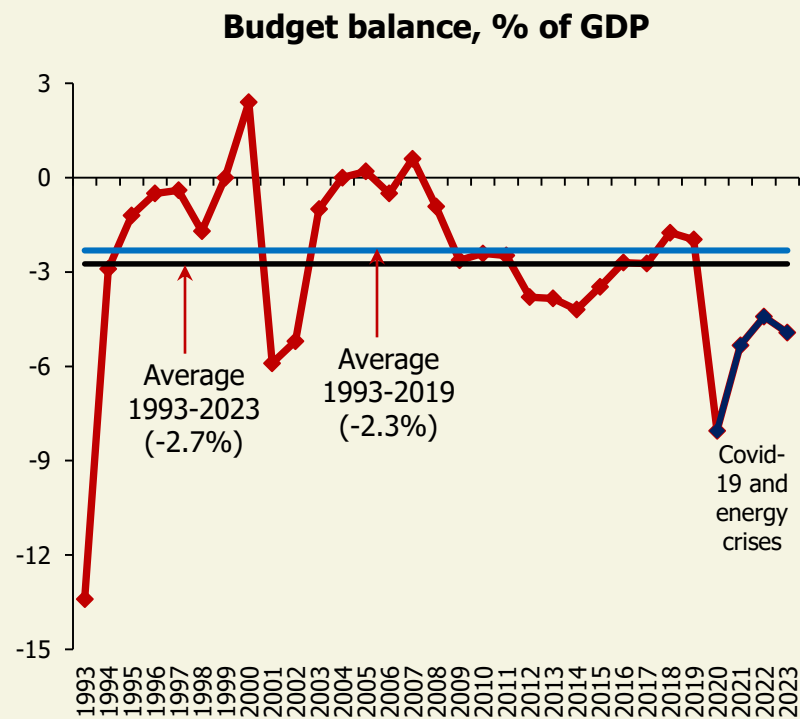


How well has this strategy served the economy?

- **It proved a successful tool** in achieving and maintaining critical function of any regime - delivering price stability, as well as disciplining fiscal and other policies



Source: SSO.



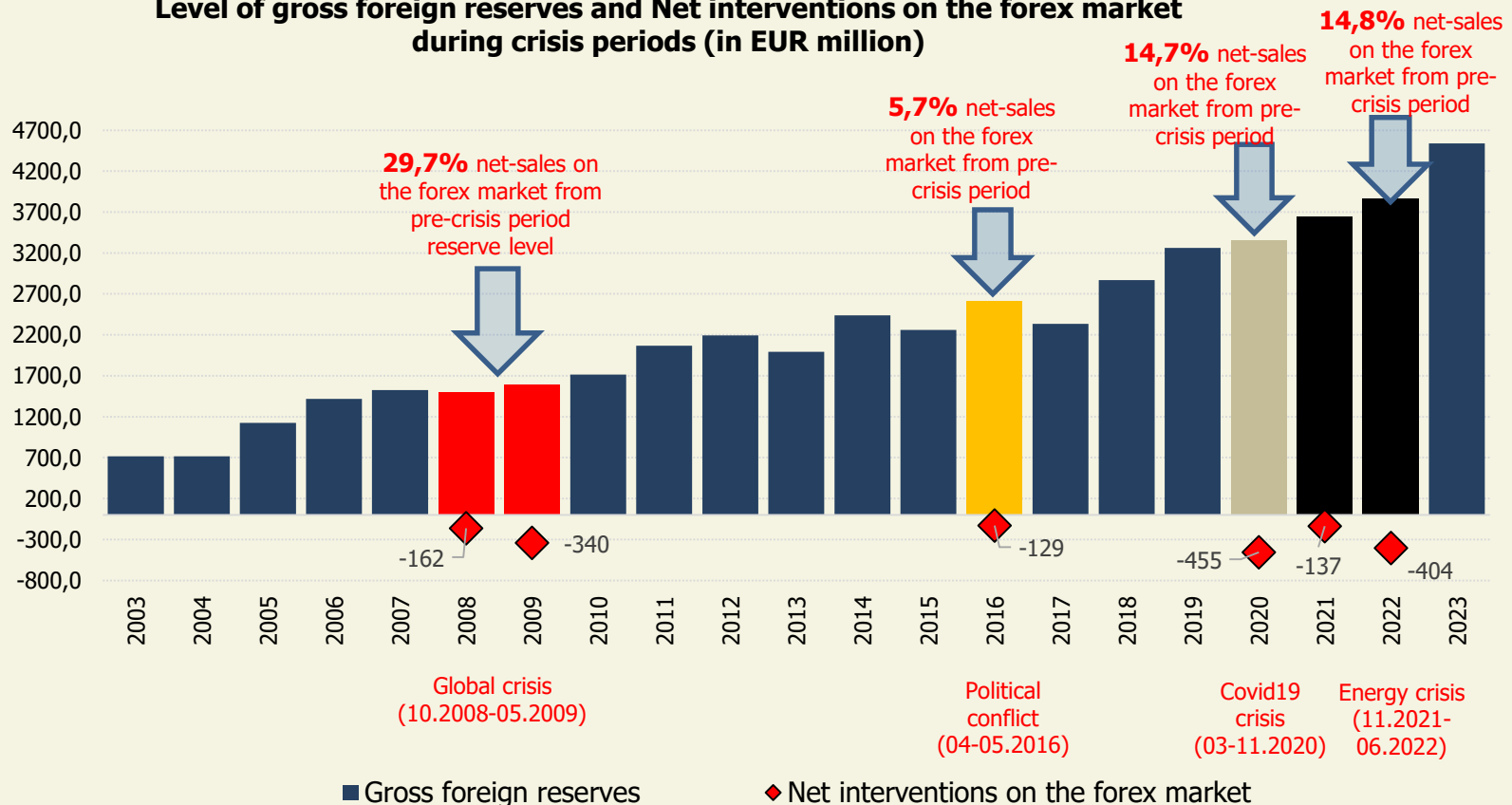
Source: MoF.



Still, many challenges in implementing the strategy, especially during crisis periods

- On historical grounds, shocks have resulted in **non-negligible loss of reserves** to maintain the stability of the exchange rate - 15% of the reserves in the last two crisis episodes
- Thus, the strategy presupposes having **adequate reserve buffers** for crisis prevention (signaling effect) and for crisis mitigation (intervention on FX market)

Level of gross foreign reserves and Net interventions on the forex market during crisis periods (in EUR million)

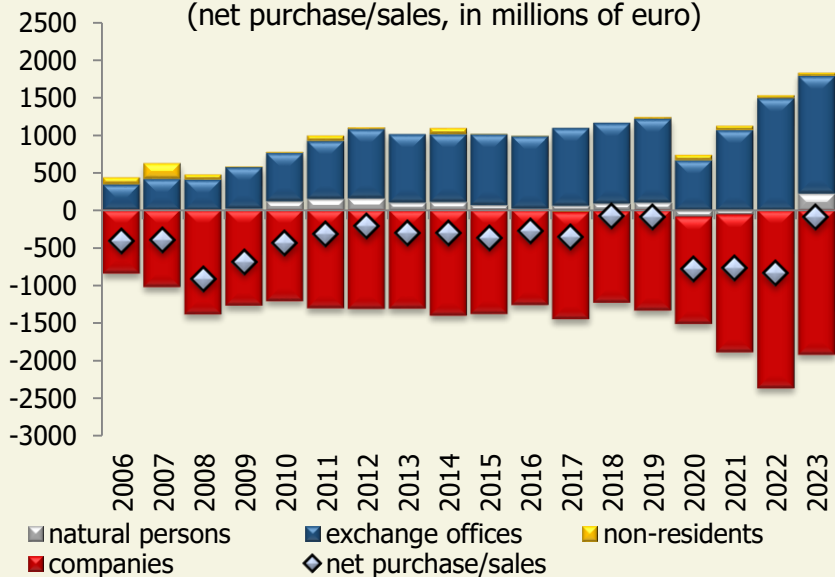




The last couple of years, in particular challenging

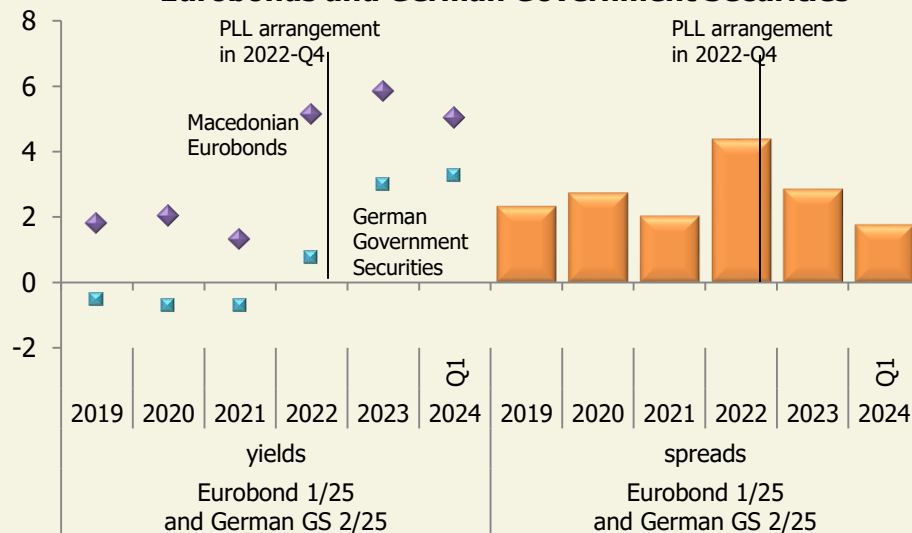
- **From the beginning of pandemic up till mid-2022 significant pressures on the FX market** requiring sizable interventions by the central bank
- **The main sources of FX pressures:** reduced remittances and FDIs in 2020, followed by energy trade deficit and increase in household deposit euroisation (spurred by speculations)
- Given the significant tightening of the financial markets, especially for emerging economies, as visible through the increase of the spread to German bonds, **IFIs played** a key role
- **IMF PLL** arrangement helped replenish our reserves, but also had a catalytic role in access to other concessional and market borrowing - spread declined significantly
- **ECB repo line** had also an important signaling effect

Structure of foreign exchange market,
(net purchase/sales, in millions of euro)



Source: NBRNM.

Yields and spreads between Macedonian Eurobonds and German Government Securities



Source: Bloomberg.



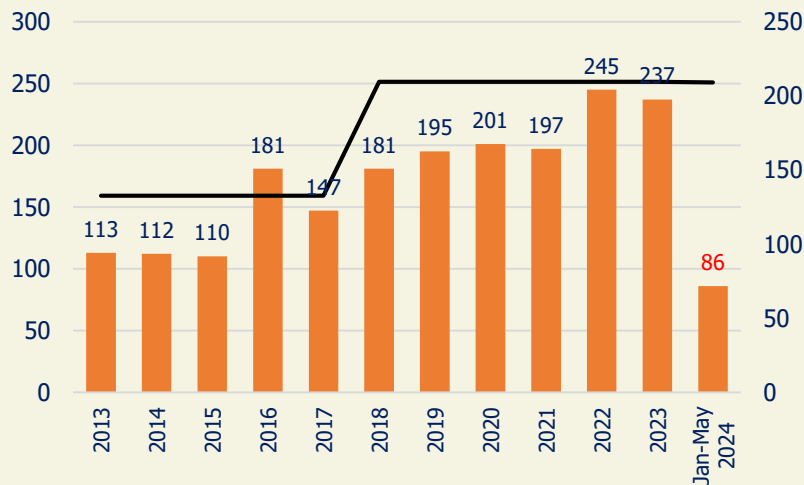
...thus the peg was successfully preserved owing to

- Active **forex interventions**, which were possible given the accumulated reserve buffers before the crisis, as well as IFIs support during the crisis
 - **Accumulated reserve buffers** reflect *past prudent macroeconomic policies* and gradual and well-sequenced *capital account liberalization* (inflows before outflows, non-debt before debt creating, and long-term before short-term)
- Prudent **monetary policy** - timely and aggressively hiking the main policy rate and actively using RR
- A set of **macro-prudential measures** primarily aimed at increasing the resilience of the banking system, but reinforced the MP: countercyclical capital buffers and borrower-based measures (DSTI and LTV)
- Improved communication and increased **transparency**

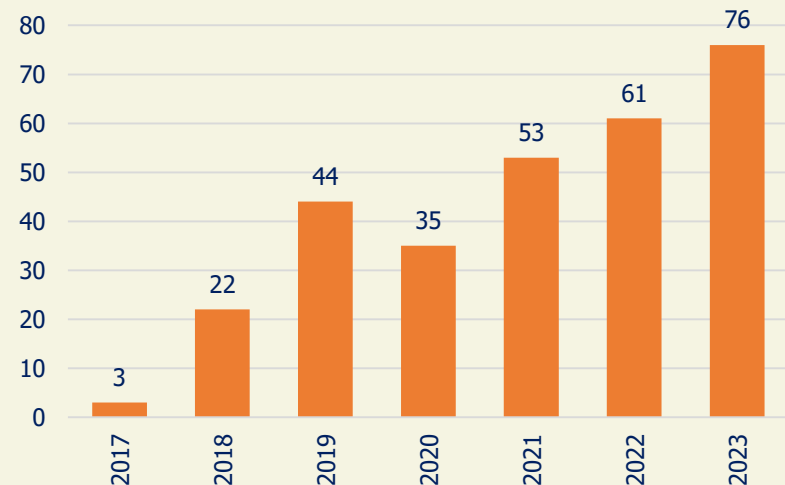
Transparency was significantly improved

- Press releases increased by 25%, and public appearances of high officials by 40%
- Introduced better-tailored messages for different stakeholders, simplified our language
- Visualization and social media
- Financial education (journalist)
- We enlarged statistical data sets fully complying with the SDDS plus standard

Number of press releases



Number of public appearances



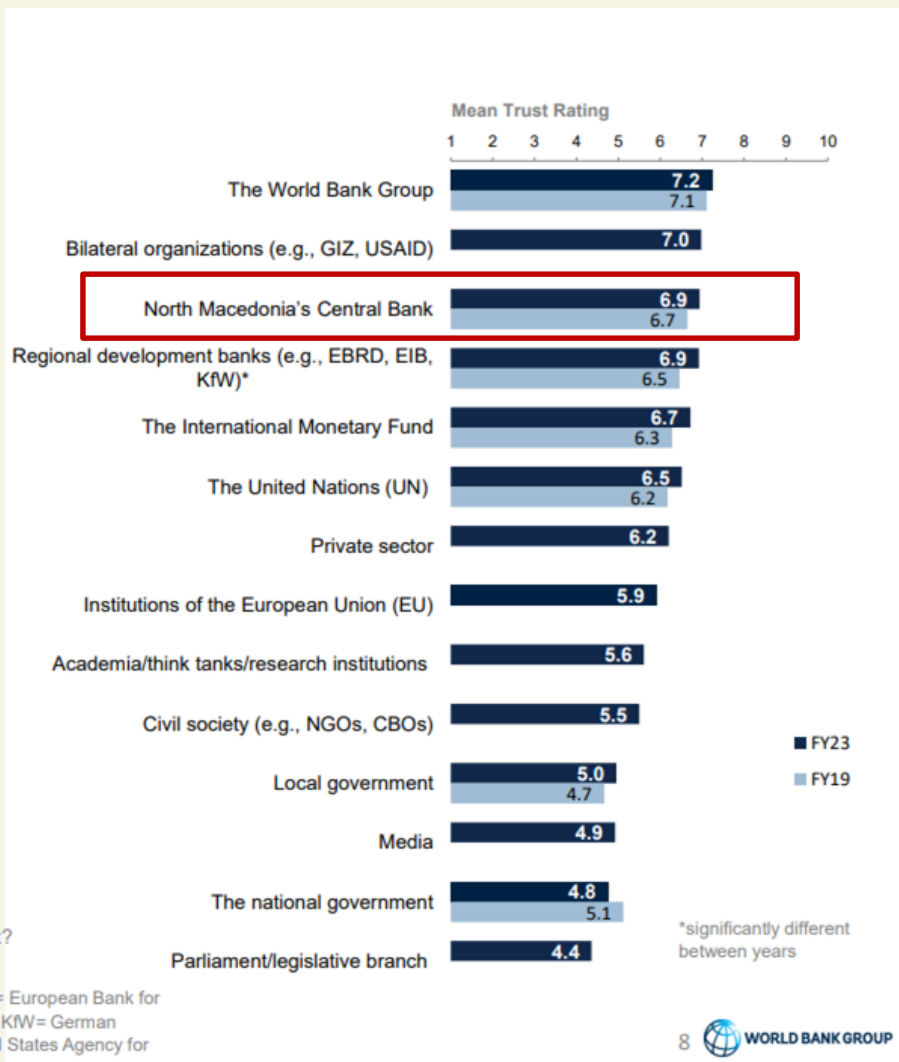


Transparency enhancement has helped maintain CB trust

Trust in Institutions

The WBG, along with regional development banks, bilateral organizations, and North Macedonia's Central Bank, continue to be the most trusted institutions in North Macedonia from among those studied.

At the same time, the Parliament, the national government, and the media are the least trusted institutions, according to the respondents.



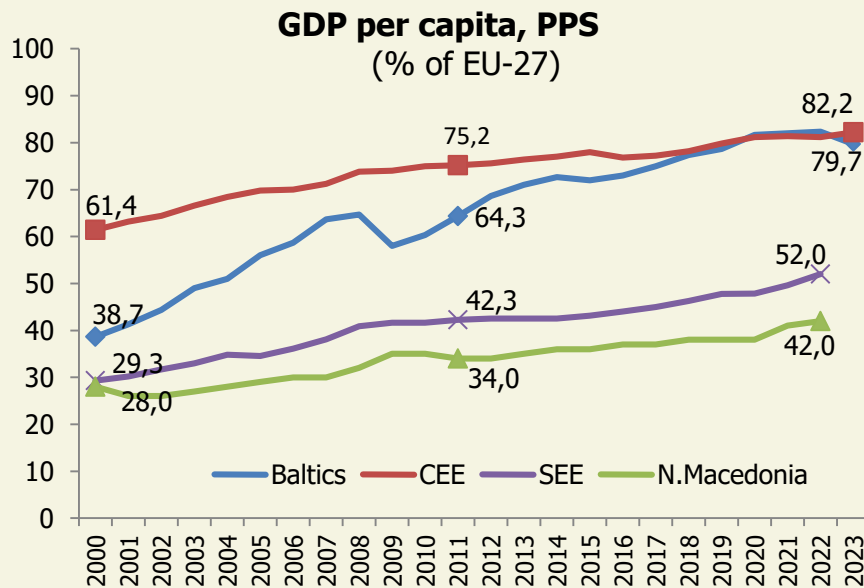
To what extent do you trust each of the following groups to do what is right?
Scale: 1-10 (1: To no degree at all – 10: To a very significant degree)

Note: CBO= Community-based Organization; EIB= European Investment Bank; EBRD= European Bank for Reconstruction and Development; GIZ= German Society for International Cooperation; KfW= German Reconstruction Credit Institute; NGO= Non-governmental Organization; USAID= United States Agency for International Development

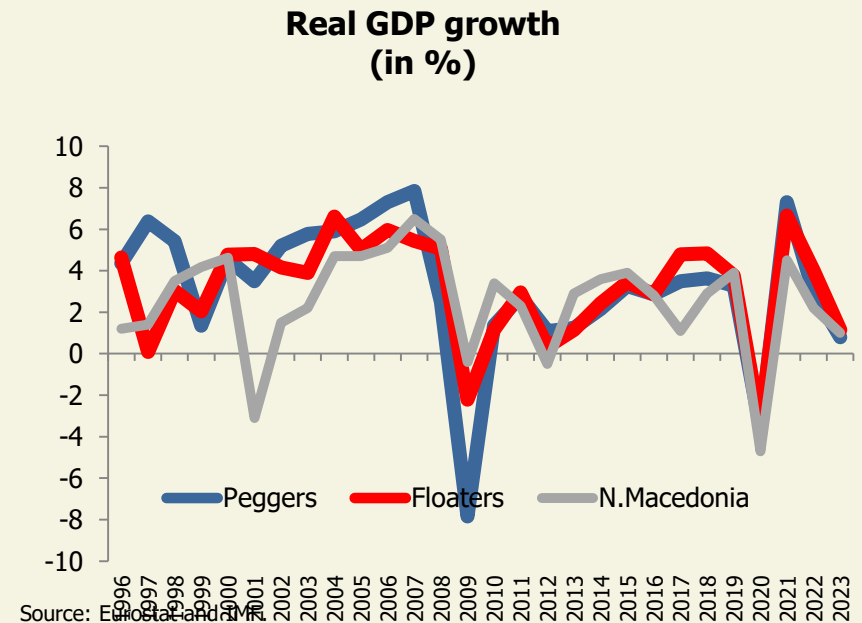


From a longer-term perspective how has growth fared?

- Although exchange rate stability have been growth conducive, the catching up process is sluggish (income 42% of EU-27)
- Still, it reflects structural hurdles: insufficient quantity and quality of labor, low capital stock (around 25% of EU-27) and low productivity (about half of EU)
- In fact, data does not point to a significant difference in performance between peggers and floaters



Source: EUROSTAT.



Source: Eurostat and IMF



Looking forward

- **Economic problems and crises are occurring under any type of exchange rate regimes**, in particular in times of high financial globalization (strong and volatile capital flows)
- **Neither peg nor free float are panacea**, but rather sound macroeconomic and structural policies
- **So far, Macedonian trilemma has worked**: stable exchange rate, relatively open capital account and some monetary autonomy (capital flows have not been of a size and nature to seriously inhibit the monetary autonomy-sound policies and low supply of financial instruments)
- Given our strategic objective of joining the EU, **ultimately there is no other way but join the EA and adopt the Euro as a legal tender**
- In the meantime, while being in the “waiting room”, **priority is sound macroeconomic policies** (countercyclical fiscal and macroprudential) to further build buffers and **sound structural policies** to increase potential of economy, its synchronization with EU and convergence



Thank you for your attention!

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