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FORMER YUGOSLAV REPUBLIC OF MACEDONIA

January 2019

2018 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR FORMER YUGOSLAV REPUBLIC OF MACEDONIA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2018 Article IV consultation with the Former Yugoslav Republic of Macedonia, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its January 23, 2019 consideration of the staff report that concluded the Article IV consultation with the Former Yugoslav Republic of Macedonia.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on January 23, 2019, following discussions that ended on November 21, 2018, with the officials of the Former Yugoslav Republic of Macedonia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 14, 2018.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Statement** updating information on recent developments.
- A **Statement by the Executive Director** for the Former Yugoslav Republic of Macedonia.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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January 29, 2019

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IMF Executive Board Concludes 2018 Article IV Consultation with FYR Macedonia

On January 23, 2019, the Executive Board of the International Monetary Fund (IMF) concluded the 2018 Article IV Consultation with FYR Macedonia.[1]

After nearly stalling in 2017, real GDP growth experienced a modest rebound in the first three quarters of 2018 and is estimated to have reached 2 percent for the year. Private consumption—buoyed by employment and household credit growth—and robust exports growth—boosted by solid foreign demand and revived metal sector— supported economic activity. However, investment continued to contract due to the postponement of large infrastructure projects, falling construction and lingering uncertainties. The resulting subdued investment-related imports, together with strong exports, is estimated to have reduced the current account deficit to little over ½ percent of GDP in 2018. After a brief spike, mostly reflecting higher international oil prices, headline inflation has eased in recent months.

The overall fiscal deficit is expected to have marginally improved to 2.6 percent of GDP in 2018 mostly due to under-execution of capital spending. Revenues on aggregate underperformed, although collections of corporate income tax and social security contributions exceeded expectations. Public debt is estimated to have reached 50.7 percent of GDP at end-2018.

The banking sector is well-capitalized, liquid, and profitable. Banks comfortably meet Pillar I capital adequacy requirements and maintain sound aggregate liquidity buffers. Credit risks are contained due to high provisioning. Against the background of favorable foreign exchange market developments, strong deposit growth, moderate inflation, and a negative output gap, the NBRM cut its policy rate twice to 275 bps. The monetary policy easing, along with higher demand from households, supported private sector credit growth.

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

Executive Board Assessment[2]

Executive Directors welcomed the revival of reforms following the restoration of political stability, which has resulted in renewed confidence and a pickup in economic activity. With the prospect of opening accession negotiations with the European Union, Directors underscored the importance of pursuing an ambitious structural reform agenda to lift productivity growth and accelerate income convergence, while also rebuilding fiscal policy space and external buffers.

Directors noted that fiscal developments in the past decade have reduced policy space. They agreed that a gradual and steady fiscal consolidation toward a zero primary balance in the medium term is needed to put public debt on a firm downward trajectory. They welcomed recent measures aimed at reducing the pension deficit and improving the targeting of social assistance benefits. They emphasized the need for steadfast implementation of the CPI-only pension indexation and recommended additional measures to improve tax efficiency and compliance, rationalize agricultural subsidies, and reduce the scope for early retirement. Directors also encouraged further efforts to strengthen public financial management and increase fiscal transparency.

Directors agreed that monetary policy has been appropriately accommodative against a background of moderate economic activity, low inflation, and favorable foreign exchange markets. Directors welcomed the authorities' readiness to tighten the monetary stance if reserves accumulation falls below baseline projections or global financial conditions tighten.

Directors noted that the banking system remains well-capitalized, liquid, and profitable but that there are risks that should be closely monitored. They underscored that further efforts to gradually increase deposit denarization, coupled with carefully calibrated macroprudential measures to reduce foreign currency lending to households, would help strengthen financial system resilience.

Directors commended the authorities for the considerable improvement in financial sector regulation and supervision over the past decade. However, they agreed on the need to further strengthen the financial stability framework along the lines identified in the recent Financial Sector Assessment Program. Directors noted that the macroprudential policy framework would benefit from additional capacity building for systemic risk monitoring and enhanced inter-agency coordination. They also stressed the importance of addressing residual gaps in supervision and promptly finalizing the modernization of the crisis management and bank resolution regime.

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summing up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

Directors called for a multi-pronged strategy to address labor market weaknesses that hinder growth. To reduce skill shortages and mismatches, Directors recommended enhancing the quality of secondary and vocational education and realigning tertiary education toward delivering the skills demanded by the economy. They noted that active labor market policies should continue to target youth and the long-term unemployed but with a greater emphasis on building skills and facilitating education-to-work transition. Directors also welcomed ongoing efforts to raise female labor force participation.

Directors urged the authorities to maintain an unwavering commitment to implementing key institutional reforms that strengthen governance, reduce corruption, and ensure an effective rule of law. These will prove instrumental to improving the investment climate and reducing widespread informality, as well as unlocking EU accession negotiations.

FYR Macedonia: Selected Economic Indicators

	2013	2014	2015	2016	2017	2018 (p)	2019 (p)
	Year-on-year change, unless otherwise specified						
Real GDP	2.9	3.6	3.9	2.8	0.2	2.0	2.8
Real domestic demand	1.3	4.4	5.4	5.0	0.3	0.0	2.6
Consumption	1.6	2.4	4.3	2.1	0.1	2.5	2.0
Gross investment	0.5	10.7	8.3	12.5	0.8	-6.1	4.1
Net exports	7.0	-8.0	-14.1	-16.7	-2.1	9.0	-1.3
CPI inflation (annual average)	2.8	-0.3	-0.3	-0.2	1.4	1.5	1.8
Unemployment rate (annual average)	29.0	28.0	26.1	23.8	22.4	21.0	20.3
Private Sector Credit 1/	6.4	9.8	9.5	0.0	5.3	8.0	7.0
	In percent of GDP						
Current account balance	-1.6	-0.5	-2.0	-2.9	-1.0	-0.6	-1.4
Goods and services balance	-18.3	-17.2	-16.2	-15.2	-14.1	-13.1	-13.4
Exports of goods and services	43.3	47.7	48.8	50.9	55.1	60.0	62.2
Imports of goods and services	61.6	64.9	65.0	66.2	69.1	73.1	75.6
Private transfers	18.1	17.3	16.8	15.4	15.9	15.8	15.5
External debt	64.0	70.0	69.3	74.7	73.9	76.1	78.5
Gross investment	28.8	30.3	30.4	32.5	33.0	31.7	32.8
Domestic saving	27.2	29.8	28.5	29.7	32.0	31.1	31.4
Public	-0.5	-0.9	-0.1	0.2	0.5	-0.2	0.5
Private	27.7	30.6	28.6	29.5	31.5	31.2	30.9
Foreign saving	1.6	0.5	2.0	2.9	1.0	0.6	1.4
General government gross debt	34.0	38.0	38.1	39.8	39.4	41.4	42.5
Public sector gross debt 1/	37.9	43.3	44.0	46.7	48.0	50.7	53.0
Central government balance	-3.8	-4.2	-3.5	-2.7	-2.7	-2.6	-3.0
Memorandum items:							
Nominal GDP (billions of denars)	501.9	527.6	559.0	594.8	616.6	639.3	670.4
Nominal GDP (billions of euros)	8.1	8.6	9.1	9.7	10.0	10.4	10.9
GDP per capita (euros)	3930	4126	4380	4657	4825	...	...

Sources: NBRM; SSO; MOF; IMF staff estimates.

1/ Includes general government and SOE debt.

FORMER YUGOSLAV REPUBLIC OF MACEDONIA

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION

December 14, 2018

KEY ISSUES

Context: More than twelve years after achieving candidate status, FYR Macedonia's prospects for opening accession negotiations with the European Union are looking hopeful for the first time. The end of the political crisis has revived structural reforms, but investment is yet to gain a strong footing amid lingering uncertainties. Structural policies should focus on addressing longstanding weaknesses in the labor market, judiciary, and public administration to boost productivity and achieve faster income convergence. Macroeconomic policies should support this goal by rebuilding buffers and maintaining financial stability.

Key Policy Recommendations

Structural Policy. To lift productivity and optimize use of the labor force, policies should address skill shortages and mismatches, governance vulnerabilities and corruption, high informality, and limited availability of affordable childcare. A steadfast commitment to tangible implementation of institutional reforms that safeguard judicial autonomy and instill a more effective rule of law is critical to raise confidence and public trust, attract high-quality investments, and retain skilled workers.

Fiscal Policy. A gradual and sustained fiscal consolidation is needed to put public debt firmly on a downward path. This should be underpinned by steady implementation of recent measures to reduce the pension deficit and improve targeting of social assistance spending, as well as additional measures to improve tax efficiency and compliance, and rationalize untargeted subsidies. Efforts to strengthen public financial management and increase fiscal transparency should continue.

Monetary and Financial Policies. Monetary policy has been appropriately accommodative and may need to be tightened if the external environment worsens. The current risks in the financial sector are muted but high structural vulnerabilities warrant close monitoring. The FSAP recommended to further enhance banking and non-banking supervision, strengthen systemic risk identification capacity and institutional arrangements for macroprudential oversight, and modernize the bank resolution regime.

Approved By
Jörg Decressin (EUR) and Nathan Porter (SPR)

Discussions were held in Skopje during November 8–21, 2018. The mission met with Prime Minister Zaev, Deputy Prime Minister Angjushev, Finance Minister Tevdovski, Governor Angelovska Bezhoska, other senior officials, parliamentarians, labor unions and representative of the private sector and diplomatic envoys.

The staff team comprised Ms. Rahman (head), Messrs. Poulain, El Ashram (both EUR), and Hukka (FIN), Mr. Sosa (Resident Representative), and Mr. Nacevski (IMF Local Economist). Mr. Verkoren (FSAP Mission Chief) and Mr. Tolici (OED) attended some meetings. Ms. Jirasavetakul contributed to the background analysis. Ms. Mahadewa and Ms. Meng assisted in the preparation of the report from Headquarters.

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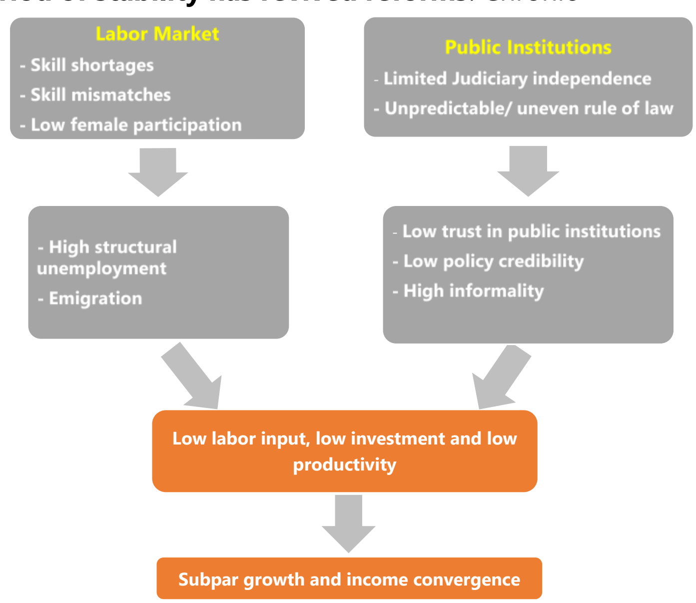
CONTEXT

1. **More than twelve years after gaining candidate status, FYR Macedonia's prospects for opening EU accession negotiations are looking hopeful**. In the past year, significant efforts have gone into reenergizing the country's EU and NATO accession bids, particularly with regards to resolving the long-standing name dispute with Greece. In a historic referendum that took place in September 2018, voters overwhelmingly supported changing the country's name to the Republic of North Macedonia as a step to facilitate the opening of accession negotiations, yet the turnout fell short of the 50 percent needed for the referendum to be deemed valid. Subsequently, the Parliament produced just enough votes to approve the start of the process that entails constitutional changes associated with the name change. The full process of changing the name will require a final round of voting in the Parliament and subsequent passage in the Greek Parliament. If completed, FYR Macedonia could start accession negotiations with the EU in 2019, provided there is adequate progress in priority reforms.

2. **After a protracted political crisis, a period of stability has revived reforms**. Chronic structural weaknesses —concentrated in the labor market and public institutions—have held back growth and income convergence in FYR Macedonia, like in other Western Balkans neighbors. The government's reform agenda is appropriately focused on strengthening institutions, supporting employment, and reducing inequality and informality. The challenge is to implement this ambitious agenda without undermining competitiveness, while also creating fiscal policy space to counter adverse shocks. Most importantly, the country is widely viewed as in urgent need of improving rule of law to secure a brighter future.

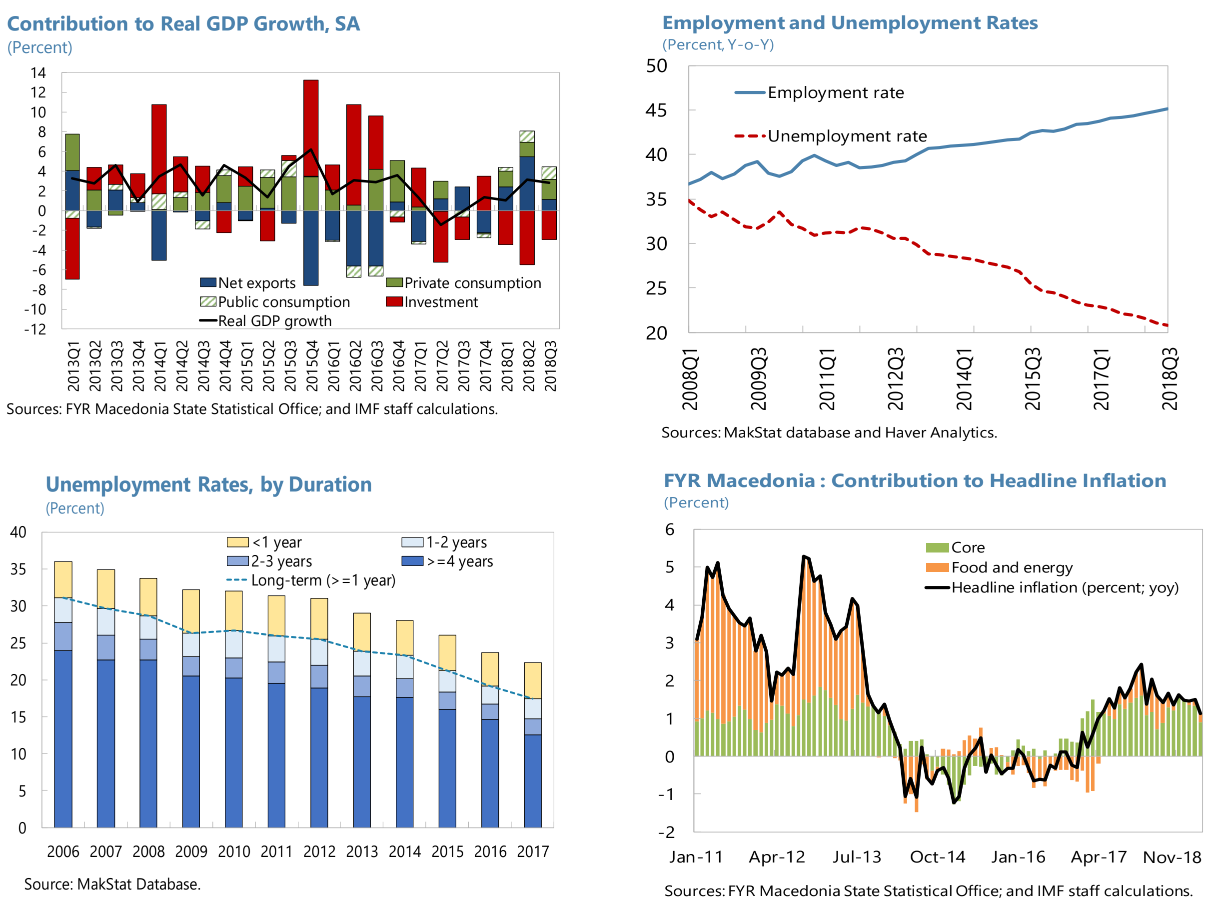


3. Against this background, the 2018 Article IV consultation focuses on macroeconomic and structural policies that would improve FYR Macedonia's growth prospects and rebuild policy buffers to navigate uncertain times.

RECENT DEVELOPMENTS

4. **Real GDP growth is rebounding after nearly stalling in 2017**. In 2017, political uncertainties constrained investment and private consumption, while exports performed well (Table 1, Figure 1). In the first three quarters of 2018, positive developments in the labor market and robust household credit growth supported private consumption, while investment continued to contract due to postponement of large infrastructure projects and falling construction. Economic activity was also supported by buoyant exports, partly due to the resumption of metal exports, and weak import growth (Tables 3a and 3b). Real GDP growth is expected to reach 2 percent in 2018. Unemployment, including long-term unemployment, has seen a sustained decline in the last decade supported by job growth in the export sector and active labor market policies. After a brief spike, mostly reflecting rising international oil prices, headline inflation is easing, averaging to around 1.5 percent during January-November 2018 (Figure 1).

Figure 1. FYR Macedonia—Real Sector Developments



5. The overall fiscal deficit is expected to decline to 2.6 percent of GDP in 2018, mostly due to spending under-execution (Tables 2a and 2b). High political uncertainty in the pre-referendum period and the decision to scrutinize existing portfolio of construction projects contributed to exceptionally weak public spending execution (Figure 2). In mid-2018, the government introduced financial incentives to support investment and employment, subject to extensive qualification criteria which have had a low uptake compared to the budgeted amount (text table). Revenues on aggregate underperformed, although collections of CIT and social security contributions exceeded expectations as exemptions, previously granted to companies in the Technological and Industrial Development Zones (TIDZ), started to expire.

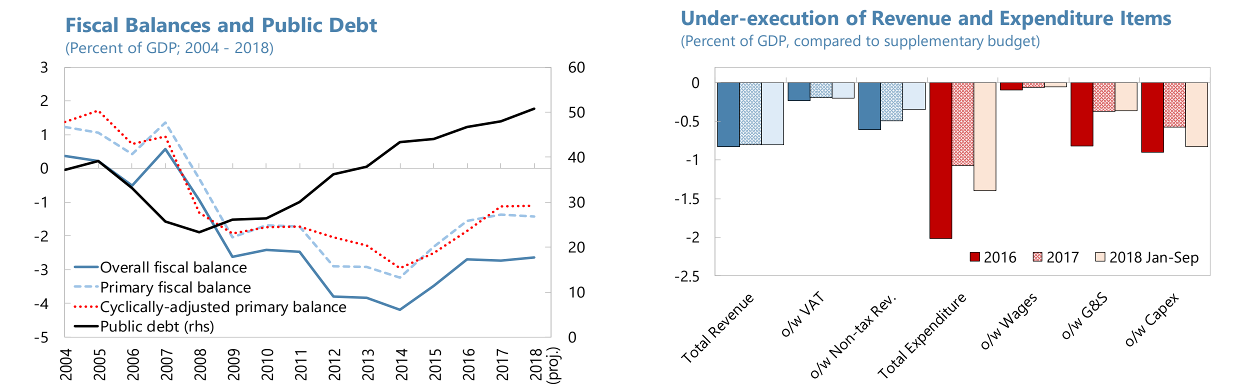
Key Components of the Financial Incentives for Investment and Employment

1	Wage subsidies for new employment with monthly wage at least 50 percent higher than the minimum wage.
2	Financial support to foreign firms with substantial cooperation with domestic suppliers.
3	Financial support for investment in technological development and research.
4	Financial support, tax discounts, and wage subsidies for large investment projects.
5	Financial support for investment in new machinery and equipment.
6	Financail support for purchasing assets from business entities that are subject to bankruptcy/liquidation.
7	Financial support for investments to increase the market competitiveness.
8	Financial support to listed activities defined as assisting the access to new markets and growth.

Sources: Law on Financial Incentives for Investment, approved in May 2018.

Note: In addition to specific criteria for each of the 8 categories, all beneficiaries must meet the following overall criteria (i) having increases in realized income and the number of employees; (ii) not performing activity of public interests and regulated activities; (iii) not receiving agricultural subsidies, performing construction activity related to residential building, nor performing activity in the field of information and communication (except for R&D related activities).

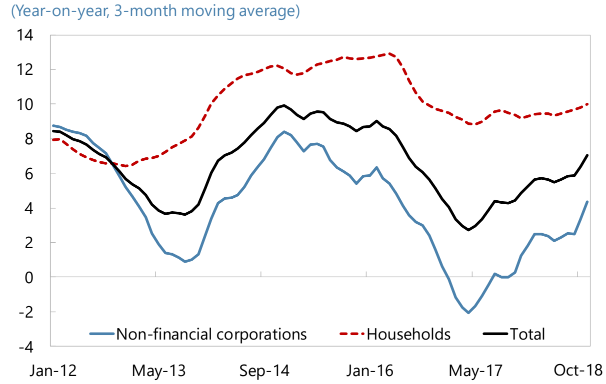
Figure 2. FYR Macedonia—Recent Fiscal Developments



Sources: FYR Macedonia Ministry of Finance; and IMF staff calculations.

Sources: FYR Macedonian Authorities; and IMF staff calculations.

6. Monetary and financial conditions have been favorable. The successful issuance of a 7-year €500 million Eurobond in January 2018 at a record-low yield of 2.75 percent, followed by regular foreign exchange (FX) purchases, has bolstered reserves. Against the background of favorable FX market developments, strong deposit growth, moderate inflation, and a negative output gap, the NBRM cut its policy rate twice by 25 basis points in March and August 2018, respectively.

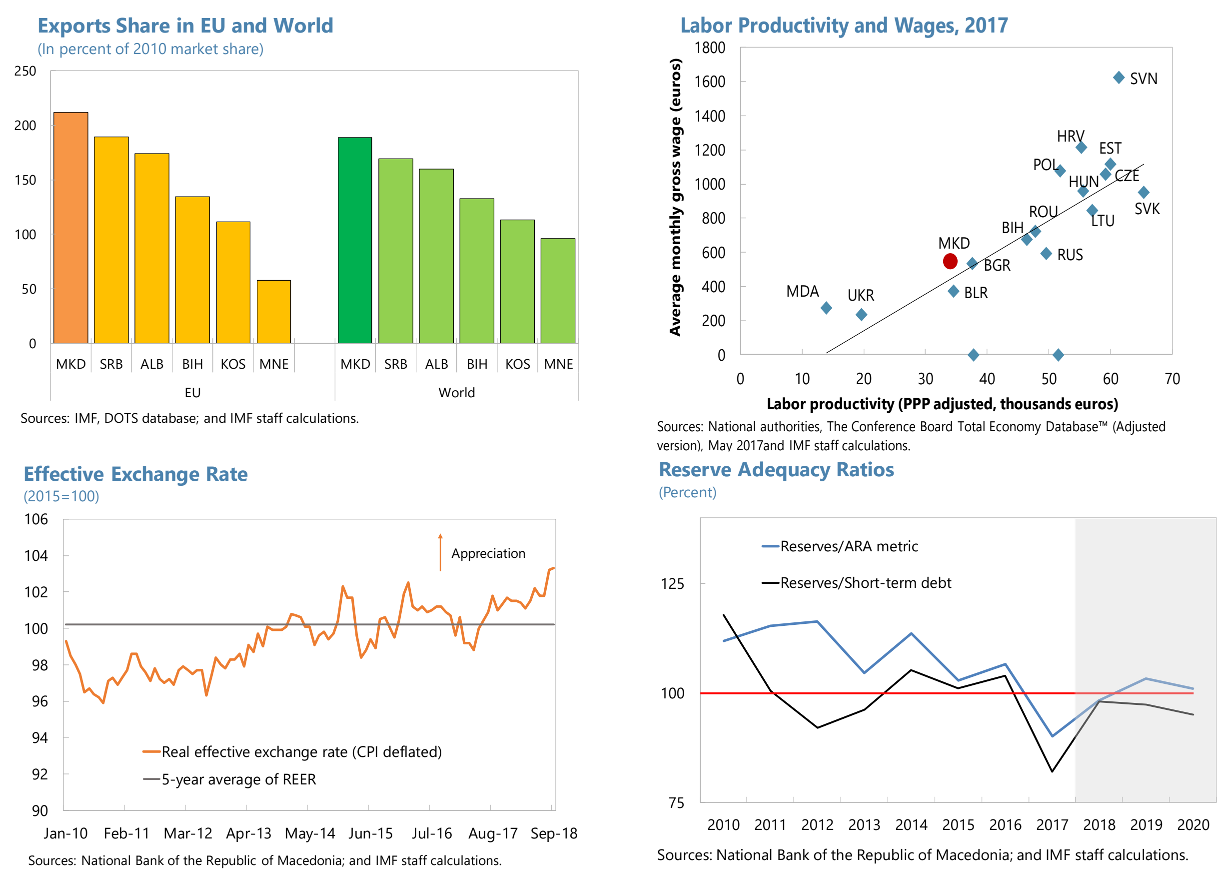


Sources: National Bank of the Republic of Macedonia; and IMF staff calculations.

The monetary policy easing, along with higher demand from households on the back of an improving labor market, is supporting private sector credit growth (Tables 4 and 5).

7. FYR Macedonia's external position is assessed to be broadly in line with its medium-term fundamentals and desirable policies (Table 6). All three EBA-lite approaches suggest that the real effective exchange rate is close to its equilibrium value. The gap between the cyclically-adjusted current account balance and its norm is estimated to be about 0.9 percent of GDP, largely explained by the temporary, strong slowdown in investment. The expected rebound in investment (see paragraph 8) would bring the current account balance closer to its norm without a need for the real exchange rate to adjust. A competitive external position is also demonstrated by rising export shares in key markets and wages that are in line with productivity. Reserve coverage improved following the Eurobond issuance and is expected to reach 98 percent of both short-term debt and the IMF ARA metric in 2018 (Figure 3). Steady foreign direct investment and portfolio flows are projected to provide a broadly adequate reserve coverage in the medium term.

Figure 3. FYR Macedonia—External Sector Developments



Sources: IMF, DOTS database; and IMF staff calculations.

Sources: National authorities, The Conference Board Total Economy Database™ (Adjusted version), May 2017and IMF staff calculations.

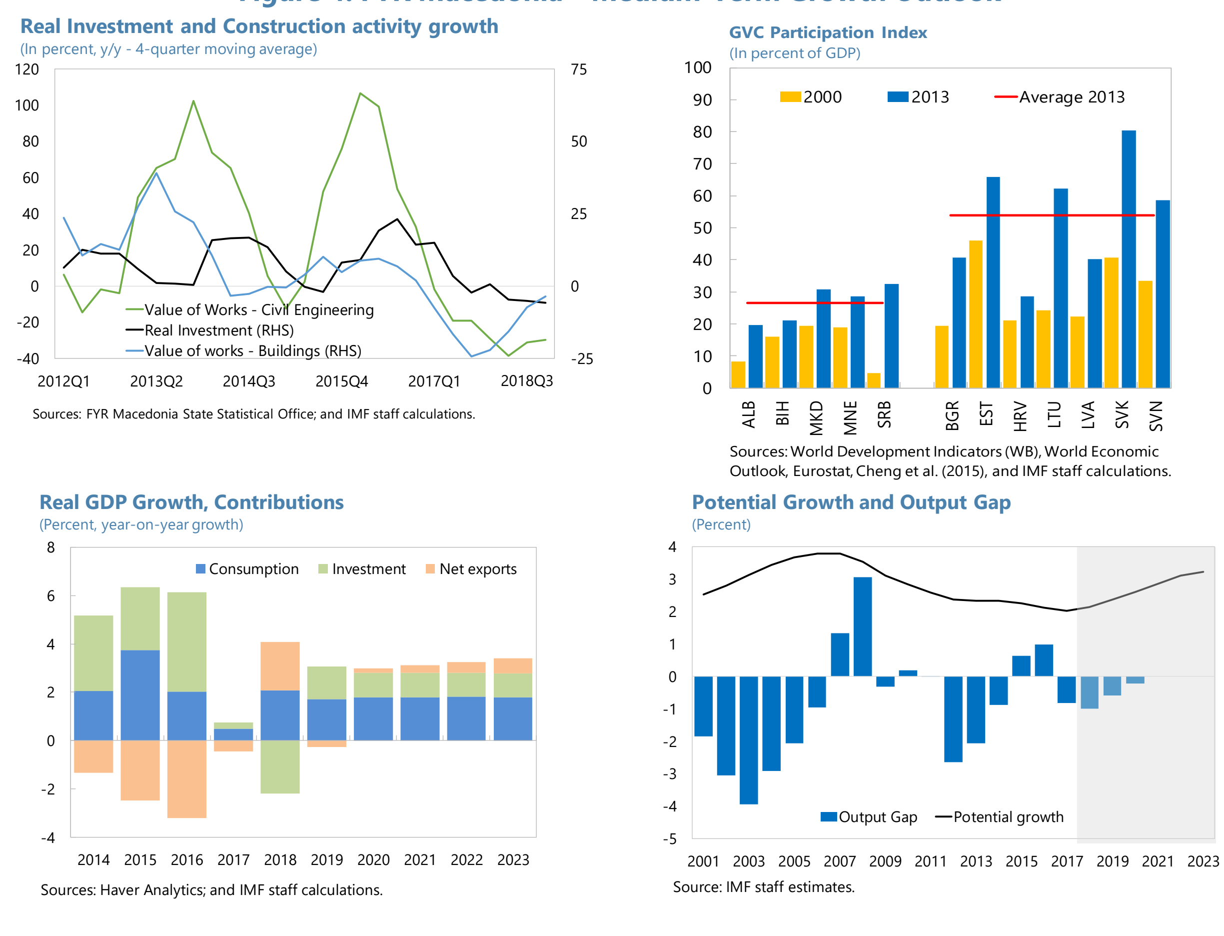
Sources: National Bank of the Republic of Macedonia; and IMF staff calculations.

Sources: National Bank of the Republic of Macedonia; and IMF staff calculations.

OUTLOOK AND RISKS

8. Real GDP growth is projected to recover in 2019 and pick up further in the medium term. With the resumption of infrastructure investment, the lifting of moratoriums on permit issuance in large municipalities, and signs of bottoming out in construction, investment is projected to rebound in 2019, lifting growth to 2.8 percent (Figure 4). FYR Macedonia has attracted considerable foreign direct investments in the past decade as a result of its competitive wages and generous financial incentives, which have increased links with Global Value Chain (GVCs) mostly in manufacturing products. In the medium term, higher exports, together with planned infrastructure investment, are expected to raise growth to 3½ percent (Figure 4). Headline inflation is projected to increase towards 2.2 percent in the medium term as the output gap closes. The current account deficit is expected to widen to around 2½ percent of GDP in the medium term as investment-related imports pick up (Tables 3A and 3B).

Figure 4. FYR Macedonia—Medium-Term Growth Outlook



Note: GVC participation index is defined as the sum of backward and forward trade linkages with partners.

9. Risks to the growth outlook are mostly on the downside (Table 7). Key domestic downside risks include further delays in investment recovery due to technical reasons or a setback to the name change agreement. External downside risks include lower foreign demand amidst rising protectionism and weaker-than-expected global growth which can affect exports negatively, and a tightening of global financial conditions that can have negative impacts on fiscal developments through higher debt servicing costs and refinancing risks. While banks have progressively increased their reliance on local funding sources, the system could still be adversely affected by a materialization of banking sector stress in the Euro area given the dominance of EU-headquartered parent banks. Domestic political risks have declined in recent months with progress on the name resolution. There are upside risks from a successful adoption of the name change, which, together with satisfactory implementation of the EU priority reforms, could start accession negotiations ushering a fresh round of optimism and confidence from investors.

Authorities' Views

10. The authorities broadly shared staff's views on the outlook. They anticipate a stronger rebound of economic activity in the near term, driven by higher investment with the construction of the Kichevo-Ohrid highway and other public projects expected to intensify in 2019. Private consumption is projected to remain an important driver of growth in the medium term, supported by wage and credit growth. The authorities noted that some companies in the TIDZ, which is estimated to produce currently about 40 percent of merchandise exports, are nearing their full capacity. Notwithstanding, exports are projected to remain robust reflecting strong interest from current and prospective foreign investors and rising transport services exports. The authorities broadly agreed with staff's external sector assessment, while noting that excluding inter-company lending and trade credits from the short-term debt statistics would significantly improve reserve coverage indicators.

11. The authorities also viewed risks to be tilted to the downside. They noted that tighter global financial conditions and protectionism, along with further delays in public investment, remain important downside risks. The authorities also underscored upside risks from possible NATO membership and the opening of EU accession negotiations that would strengthen long-term security, with positive spillovers on confidence and growth.

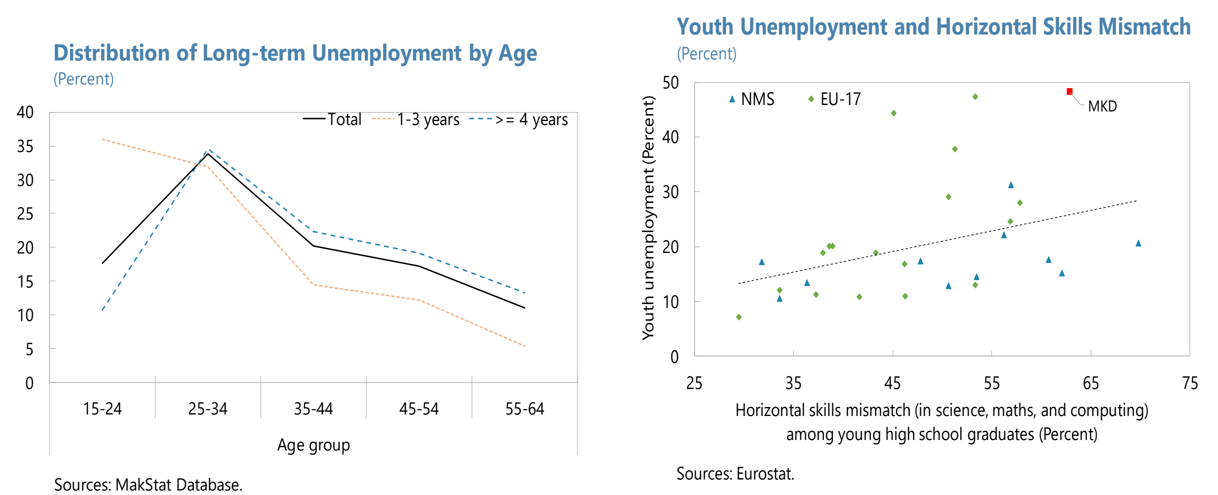
POLICY DISCUSSION

A tighter fiscal policy and an accommodative monetary stance, coupled with growth-enhancing structural policies, are an appropriate mix. Fiscal and structural policies are complementary. The additional fiscal policy space generated by consolidation is expected to provide financing for structural reforms to raise skills, reduce informality and create sustainable jobs, which in turn would bolster fiscal revenues through higher growth. Accommodative monetary policy will help cushion any adverse impact on growth from fiscal consolidation, while remaining vigilant of financial stability.

A. Creating Jobs and Strengthening Institutions

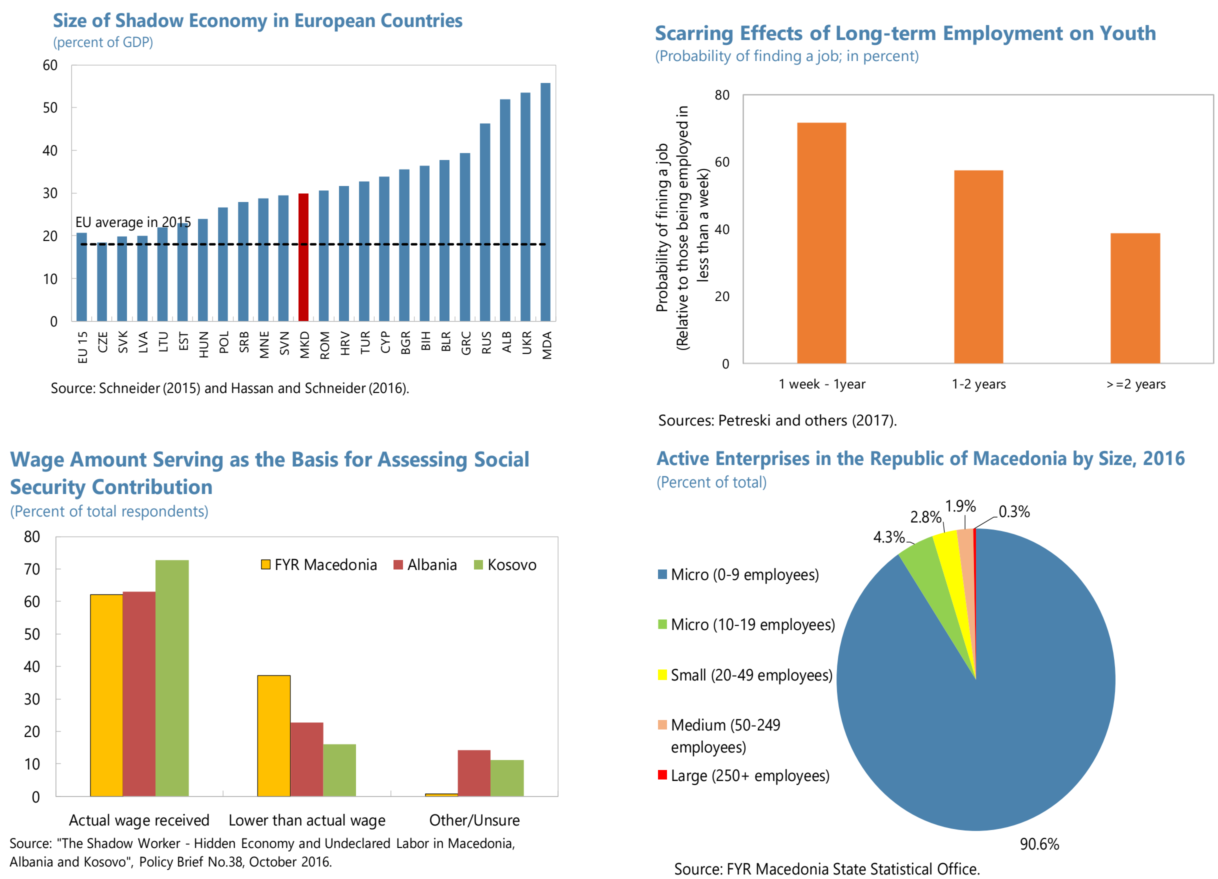
12. An underutilized labor force, characterized by high structural unemployment and low participation rates, is weighing on economic performance. Long-term and youth unemployment rates are particularly elevated reflecting skills shortages and mismatch (Figure 5). Poor quality and low completion rates of secondary education and underdeveloped vocational education are producing sub-optimal skills at a basic level, while university graduates generally lack technical and professional skills demanded in the job market. Large outward migration of skilled workers further exacerbates existing skill deficits and contributes to structural unemployment through higher reservation wages. In addition, about 35 percent of the working age population (15 to 64 years) is inactive, two thirds of which are women, further depressing labor inputs.

Figure 5. FYR Macedonia—Long-Term Unemployment



13. A large shadow economy is picking up the slack in the labor market but at a significant cost to businesses, workers, and the state. The share of the shadow economy is estimated to be around 30 percent of GDP absorbing roughly 18 percent of labor force, the bulk of which are employed in agriculture, construction, transport, catering, and trade sectors. Studies show that informality is a significant obstacle to doing business in FYR Macedonia perpetuated by tax evasion, low tax morale, uneven enforcement of business regulations, and the dominance of micro enterprises (Figure 6).[1] Although the tax burden is not deemed high by businesses or in comparison with regional peers, ambiguous tax legislation, selective application, and weak administration drive firms to informality. In the labor market, irregularities in labor inspection, which allow for undeclared work and higher "envelope payments" vis-à-vis formal wages, low skills, and a lack of adequate job creation in the formal sector contribute to high informality. Surveys show that close to 40 percent of all employees underreport wages for social security contributions (Figure 6).[2]

Figure 6. FYR Macedonia—Informality and Drivers



14. Institutional weaknesses and a high incidence of corruption pose further drags on the economy. A range of governance indicators and comprehensive assessments by the EU show that FYR Macedonia performs significantly worse than peers with respect to judicial independence, property rights protection, and strength of public institutions (Annex 1, Figure 7). These weaknesses contribute to low public trust and negatively impact labor force participation and productivity, as

[1] See "*Strategy for Formalization of the Informal Economy in the Republic of Macedonia, 2018–22*", February 2018; Kirabaeva and others, and "*Cross-Country Report on the Determinants of the Shadow Economy in CESEE and Policy Implications*", International Monetary Fund, forthcoming.

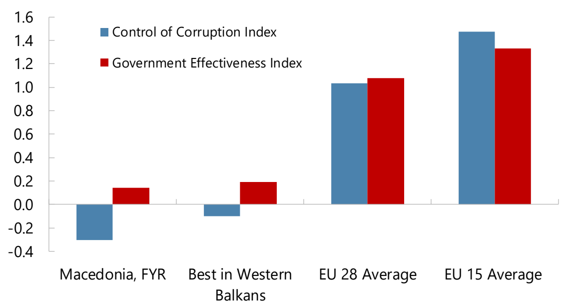
[2] See "*The Shadow Worker—Hidden Economy and Undeclared Labor in Macedonia, Albania and Kosovo*", Center for Research and Policy Making, December 2016.

well as the country's ability to attract high-quality investment and retain talent, dampening potential and inclusive growth. Recent empirical studies have indeed found a strong effect of weak institutions and governance on emigration, particularly of skilled workers (Figure 7).[3]

Figure 7. FYR Macedonia—Institutional Weaknesses and Impact

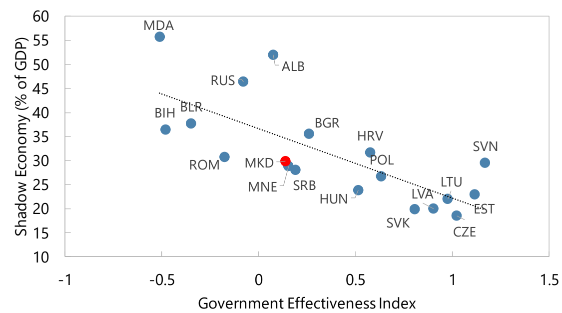
Control of Corruption and Government Effectiveness Indices[1]

(Lower values indicate higher corruption, lower effectiveness)



1/Standard deviations of point estimates for individual countries range from 0.13 to 0.18 for control of corruption and 0.20 and 0.22 for government effectiveness.
Sources: Worldwide Governance Indicators (2017) and IMF staff calculations.

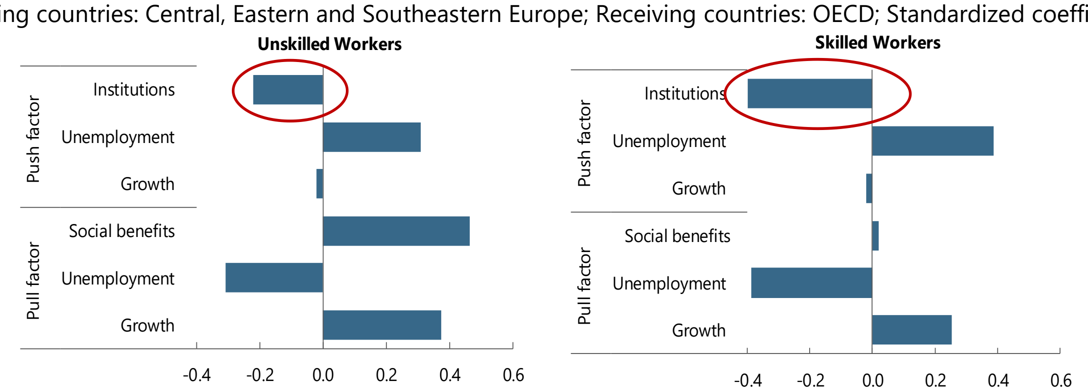
Shadow Economy and Government Effectiveness[1/]



1/Standard deviations of point estimates for individual countries range from 0.20 and 0.22 for government effectiveness.
Sources: Hassan and Schneider (2016); and Worldwide Governance Indicators.

Determinants of Bilateral Emigration

(Sending countries: Central, Eastern and Southeastern Europe; Receiving countries: OECD; Standardized coefficients)



Source: IMF Staff Discussion Note, SDN/16/07 "Emigration and Economic Impact on Eastern Europe."
Note: The standardized coefficients are interpreted as follows: a 1 standard deviation change in factor X results in a # standard deviation increase in migration flows. Estimates are based on panel data gravity models of low and high cumulative outward emigration growth over non-overlapping subperiods of 5 years from 1990 to 2010. Additional control variables for sending and receiving countries are: real GDP per capita, population, countries, and year fixed effects.

15. A multi-pronged approach is needed to address labor market weaknesses. This will require action in the areas of education, labor market, and wage policies. The preliminary fiscal costs of a set of most impactful measures are estimated to be around 0.6 percent of GDP. Improved statistics are also critical to assess labor market trends accurately.

[3] See Ariu and Squicciarini (2013), "The Balance of Brains: Corruption and High-Skilled Migration", IRES Discussion paper 10, and Cooray and Schneider (2016), "Does Corruption Promote Emigration? An Empirical Examination." *Journal of Population Economics*, vol. 29, issue 1, 293–310, and Atoyan and others (2016), "Emigration and Its Economic Impact on Eastern Europe," IMF Staff Discussion Note 16/07.

Cost Estimates of Recommended Structural Reform Measures

Measures	Percent of GDP 1/
Total	**0.57**
Expand affordable pre-school childcare centers 2/	0.12
Reform the basic educational system 3/	0.03
Improve coordination between employers and educational institutions	Neutral
Modernize vocational schools 4/	0.27
Provide additional on-the-job training 5/	0.08
Enhance job matching and intermediation 6/	0.06

Source: Comprehensive Education Action Plan (2018), World Bank, Country authorities, and IMF staff calculations.

1/ Reflects cumulative cost expressed in percent of the 5-year GDP average over 2019-23.

2/ Covers cost of buildings and staffing for 40 pre-schools over 2018-25.

3/ Includes cost of revising curricula, issuing revised text books, and upgrading school activities and conditions.

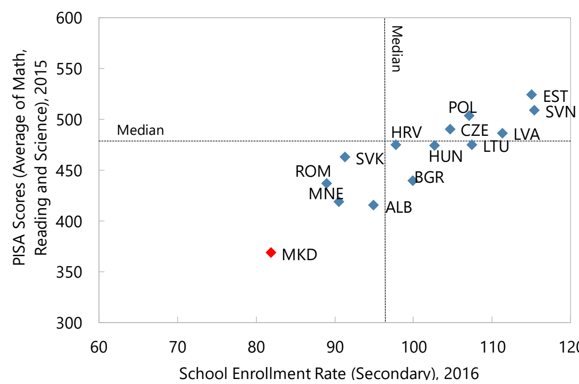
4/ Based on costing for vocational education and training in the authorities' Comprehensive Education Reform Plan.

5/ Reflects cost of doubling current spending on internship and training programs for five years.

6/ Reflects cost of upgrading registration of job seekers; broadening outreach to employers; and developing an online job portal.

- ***Education policies.*** Priorities include boosting basic skills through increasing completion rates for secondary education— which constitutes the highest qualification for the majority of workers—and improving quality, with PISA scores being considerably lower than regional peers. As public spending on education is close to EU-28 average and the teacher-to-student ratio is high compared to peers, there is a need to boost efficiency to ensure increased teachers' training and higher quality of instruction. Further, upgrading and modernizing the vocational educational system is central to addressing significant skill shortages in manufacturing and industrial fields. Meanwhile, tertiary education should be better aligned with the skills required by employers to deliver more graduates in technical fields. These measures should be accompanied by strategic and long-term planning at the national level to ensure proper coordination between relevant ministries, education institutions, and employers.

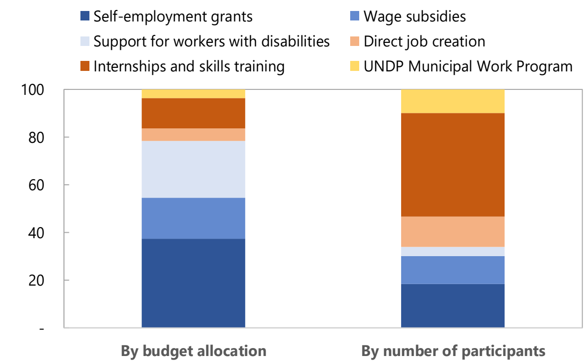
School Enrollment Rate and PISA Scores



Sources: OECD; UNESCO and IMF staff calculations.

- ***Labor market policies***. Active labor market policies (ALMPs) should continue to target youth and the long-term unemployed, but with a greater focus on internships and apprenticeships, programs that have delivered high employment retention. These programs, together with enhanced job-matching and intermediation, are expected to reduce unemployment durably through providing skills and easing education-to-work transition of fresh graduates. Other employment incentives, like self-employment grants and wage subsidies, which currently absorb more than 50 percent of the ALMP budget, require more rigorous monitoring and should be re-evaluated in the context of cost-effectiveness and impact durability. The authorities should continue their efforts to expand affordable preschool services and childcare centers to bring more women into the labor force, whose participation remains below 50 percent mostly due to family responsibilities.[4]

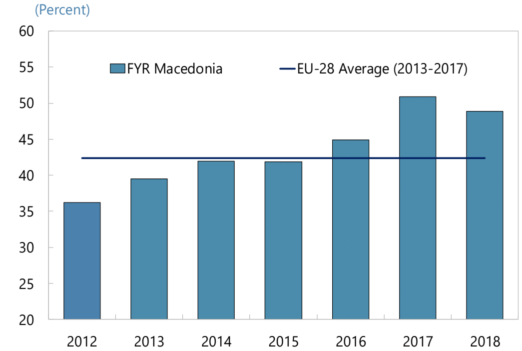
Active Labor Market Policies Spending, 2018
(In percent of total)



Source: FYR Macedonia Authorities and IMF staff Calculations.

- ***Minimum wage policies.*** Formalizing the minimum wage setting process is a step forward and is expected to hedge against pressures for future ad-hoc hikes. While the full impact of recent sizable increases in the minimum wage is yet to be assessed, the current minimum-to-average wage ratio (49 percent) is at a threshold beyond which further increases should be mindful of productivity growth in order not to jeopardize competitiveness (Annex II).

Minimum-to-Average Wage Ratio
(Percent)



Sources: FYR Macedonia Authorities, EuroStat, World Economic Outlook (WEO) and IMF staff calculations.

- ***Statistics.*** To better assess actual rates of unemployment and labor force participation, and facilitate policy making, labor market statistics need to be strengthened, including through a new population census (last census was in 2002) and better surveying of informal workers in the economy.

16. A comprehensive approach to reducing informality is needed. Improved tax administration and labor inspection are key deterrents to informal activity, along with tangible efforts to combat corruption that could raise levels of public trust and help support the tax morale. The regulatory burden on microenterprises should be reduced, including through an even and predictable implementation of business regulations. And finally, raising labor skills and improving

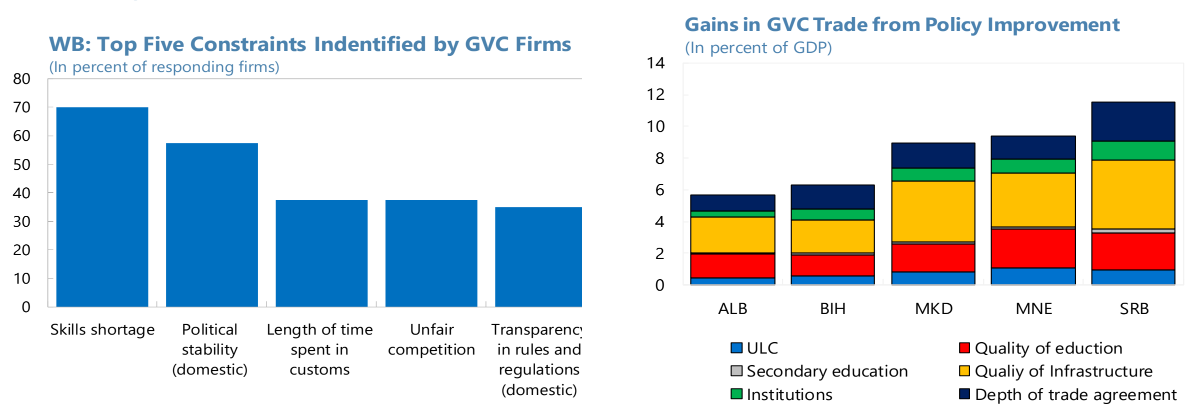
[4] See Atoyan and Rahman, 2017, *Western Balkans: Increasing Women's Role in the Economy*, IMF Working Paper 17/194, September, Washington DC

formal job opportunities, including through ALMPs and a coherent wage policy, would encourage more workers to exit the informal economy.

17. Staff stressed macroeconomic benefits of an autonomous judiciary and more effective rule of law. Earlier staff analysis suggests that incomplete reforms of judicial systems and weak institutions may explain a significant part of the productivity gaps in emerging market economies in central and eastern Europe compared to EU-15.[5] The European Commission and the Council of Europe have made concrete recommendations, including recent and planned legislative amendments to the Law on the Judicial Council, which staff welcomed (Annex I, Table 1). Sustained efforts are needed to ensure tangible implementation of the legislative reforms and demonstrate steadfast commitment to tackling corruption. Empowering the State Commission for Prevention of Corruption (SCPC) to fulfill its mandate in pursuing corruption cases will be a critical step in that regard.

18. A more skilled labor force, along with better institutions, will set FYR Macedonia on a higher growth path. According to recent enterprise surveys, low skills and poor institutional quality are considered key obstacles to investment, together with weak trade logistics and political uncertainties (Figure 8). Improvements on these fronts will create a more predictable environment for investors and raise growth, including through higher links with GVCs. Efforts should aim to increase the transparency of business regulations, improve customs processes, and speed up court proceedings for contract enforcement and debt collection.

Figure 8. FYR Macedonia—Investment Constraints and Gains from Removal



Note: The LHS chart reflects survey responses from 66 largest export-oriented companies operating across a wide variety of sectors in five countries (Albania, Bosnia and Herzegovina, FYR Macedonia, Montenegro and Serbia). They represent both stand-alone and GVC-linked export firms and represent a large share of the exporters in these countries. The responses reflect the number of firms identifying the stated factor as a key constraint in percent of total firms surveyed. The gains shown in the RHS are computed based on results from empirical esimtation of a gravity model usinga sample of of 1088 country-pair observations over 2000-13.
Source: *Lifting Exports in Western Balkan Countries: The Role of Global Value Chians and Services Exports,* Departmental Cross-Country Paper, International Monetary Fund, forthcoming.

[5] See IMF 2016 *Regional Economic Issues: Central, Eastern, and Southern Europe.* May, Washington, DC.

Authorities' Views

19. The authorities agreed on the need to address deep labor market challenges. Growing skill shortages are becoming a sizable constraint on productivity and growth. The authorities are focusing on strengthening vocational training with planned technical assistance from Germany. To slow the emigration of skilled labor, they intend to diversify away from labor-intensive industries and attract foreign investments in higher value-added industries that could generate jobs for the tertiary educated and facilitate technology transfer. To increase female labor force participation, a dozen new childcare centers were opened across different municipalities, with the number expected to double by year-end. The proposed law on social assistance, which tie activation and employment plans to the receipt of means-tested minimum guaranteed income, is expected to reduce incentives to stay out of the workforce. The authorities remain committed to enhancing social inclusion and equity but indicated that they would refrain from further ad-hoc increases in the minimum wage until the full effects of previous hikes can be assessed.

20. The authorities consider combatting informality a priority. They have introduced new regulations in June 2018 that progressively limit the size of cash transactions to target large cash-based entities in the informal economy and reduce scope for "envelope payments" to informal workers. In addition, they are strengthening the customs border control to combat "suitcase trade" by informal businesses. They concurred that stronger labor inspection is needed to reduce informal employment and hidden wages at registered businesses.

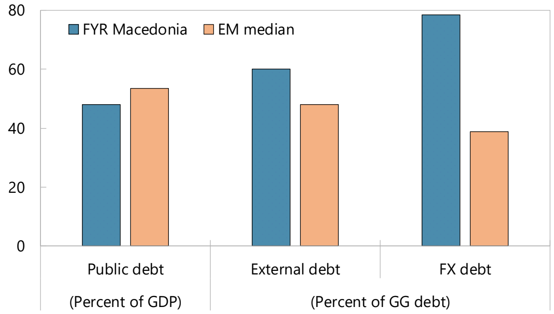
21. The authorities expressed their firm commitment to strengthen judicial independence and anti-corruption efforts. They intend to address outstanding recommendations made by the Council of Europe and the Venice Commission in their latest review through additional legislative amendments to the Law on the Judicial Council and the Law on Courts, to be ratified by the Parliament in early 2019. New draft legislation on corruption prevention aims to grant the State Commission for Prevention of Corruption access to the financial and banking information of public officials as well as a range of government databases to strengthen oversight and facilitate asset verifications. Proposed amendments to the Law on the Public Prosecutor's Office will enshrine the Special Prosecutor's Office in legislation indefinitely and expand its jurisdiction to other high-level corruption cases and election irregularities.

B. Rebuilding Fiscal Policy Space

22. Fiscal developments in the past decade have increased risks and reduced policy space. Public debt, at 48 percent of GDP at end-2017, has doubled in the last decade. This partly reflects investment in road infrastructure and public construction projects, but mostly recurring primary deficits driven by declining tax revenues and rising current spending. As a result, notable risks to fiscal sustainability have built up over time in terms of high gross financing needs and composition of public debt, with limited policy space to counter shocks and address long-term needs (Figure 9, Annex III).

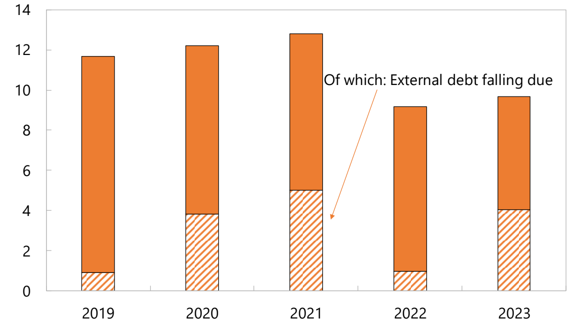
Figure 9. FYR Macedonia: Fiscal Risks

Public Debt Structure, 2017
(Percent)



Sources: Public Debt Management Reports, IMF *World Economic Outlook* (WEO), and IMF staff calculations.

Central Government Gross Financing Needs
(Percent of GDP)



Sources: FYR Macedonian Authorities and IMF staff projections.

Implementation of Past Policy Advice

Traction of IMF policy advice has improved in recent months, in particular regarding fiscal policy were the authorities are implementing several long-standing recommendations.

- ***Fiscal policy.*** The authorities are taking steps to implement a number of staff's previous fiscal recommendations, with the 2019 budget proposing measures to reduce the pension deficit and improve targeting of social assistance spending. Significant technical assistance has been provided to help implement other long-standing recommendations to increase VAT tax base and compliance, but progress has been limited in these areas.

- ***Structural policies.*** Active labor market policies have been scaled up, although the focus has been more on providing subsidies rather than training and skills improvement. Plans to expand childcare facilities to boost female labor force participation are ongoing. The authorities are also taking steps to improve governance and public administration.

- ***Monetary and financial policies.*** Implementation has generally been in line with IMF recommendations. The 2018 FSAP noted that recommendations from the 2008 FSAP have been substantially implemented.

23. In line with staff's previous recommendations, the government's draft 2019 budget proposes measures to reduce the pension deficit and improve targeting of social assistance spending (text box). The pension reforms include higher contribution rates and CPI-only indexation of benefits along with partial harmonization of accrual rates and measures to address legacy weaknesses (Box 1). On social assistance, the proposed reforms intend to improve targeting and increase current limited coverage by consolidating the partially overlapping child and social protection benefits with two means-tested programs, a guaranteed minimum income that is conditional on participation in activation programs, and an elderly social pension. In addition, the budget introduces a second PIT rate at 18 percent that applies to the top 1 percent of earners together with an increase in the threshold for tax-free allowance and in the flat tax rate on capital income from 10 to 15 percent. These measures have a net positive impact on the fiscal balance by 0.2 percent of GDP in 2019 (text table).

Estimated Net Budget Effect of Reforms, 2019

(Percent of projected GDP)

Net impact of reforms, of whic	**0.2**
PIT reform	0.2
Social Assistance Reform 1/	(0.3)
Pension and Healthcare 2/	0.3

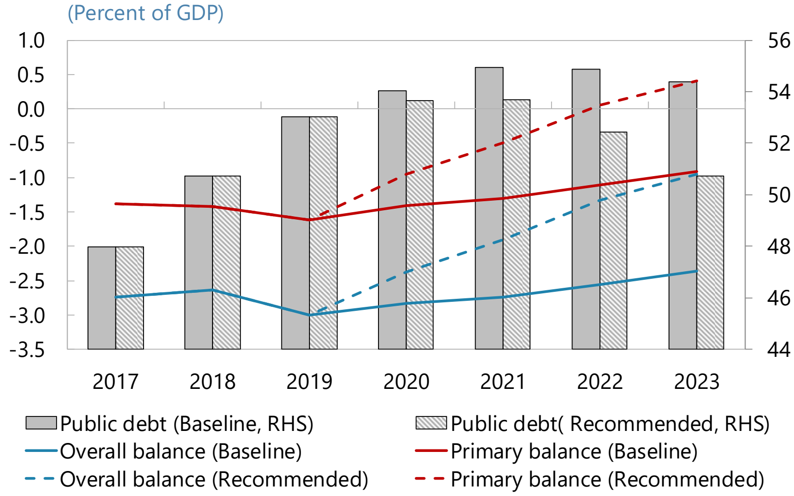
Sources: Authorities, IMF staff calculations.

1/ The reform is expected to be budget-neutral in the long-term as assistance for third-child parental allowance runs down.
2/ Includes both pension and healthcare social contribution increases, indexation of benefits to CPI only and net effect of transfers of accrued contributions between pay-as-you-go and fully-funded pillars.

24. **Under the baseline, staff projects the overall deficit to increase to 3 percent of GDP in 2019 before gradually declining to 2.4 percent of GDP by 2023.** The projected fiscal deficit for 2019 incorporates the estimated net impact of the measures discussed above, with the divergence in staff's and the authorities' 2019 deficit projections reflecting differences in underlying GDP and wage growth projections, and, to a lesser degree, the assessment of the expansionary elements in the 2019 budget (e.g., support for investment and employment). In the medium term, staff projects the overall deficit to decline to 2.4 percent of GDP, largely due to restrained pension expenditure growth. Staff's medium-term baseline projections assume a higher growth in pension benefits relative to the CPI-only indexation rule reflecting historical divergence from the pension indexation rule. The baseline projections are subject to macroeconomic risks discussed in paragraph 9. In addition, there are specific risks on the downside from higher wage pressures and, on the upside, from continued under-execution of capital spending, and higher tax revenues upon expiry of prior tax incentives granted to companies in the TIDZ.

Fiscal Balances: Baseline and Recommendations

(Percent of GDP)



Sources: Macedonia Ministry of Finance; and IMF staff calculations.

25. **Staff recommended a more ambitious fiscal consolidation to limit growing vulnerabilities and create adequate policy space.** Specifically, staff recommended reaching a zero-primary balance by 2023, implying additional consolidation of about one percent of GDP relative to the baseline. Almost two-thirds of this can be achieved by refraining from any deviations

of the newly proposed CPI-only pension benefit indexation rule and avoiding ad-hoc increases which have been frequent in the past. This should be complemented by durable revenue and expenditure measures discussed below. Additional fiscal space created through these measures can pay for structural reforms and build buffers to counter negative shocks. In addition, to ensure long-term pension sustainability, tightening conditions for early retirement and gradually raising and equalizing statutory retirement ages to that of the EU average will be important (Box 1).

Recommended Fiscal Reforms and Estimated Fiscal Gains/Savings

Measures (and expected time for budget impacts 1/)	Percent of GDP
Possible permanent gains from revenue and savings measures	**1.2-1.9**
Steadfast implementation of the CPI only indexation of pension benefits	0.5-0.6
Improving revenue administration and compliance risk management and/or expanding the VAT base by curtailing untargeted preferential treatment of certain goods and services (M) 2/	0.3-0.8
Rationalization of agricultural subsidies (S-M)	0.4-0.5
Reform of property taxation (M-L) 3/	0.3-0.5 (local govt.)

Sources: Estimates by World Bank (VAT, subsidies) and IMF staff (revenue administration).

1/ The letters in brackets stand for gains in the short (S), medium (M), and long (L) terms.

2/ Curtailing estimate based on removing reduced rates for publications, pharmaceuticals, hotel accommodation and computers and software.

3/ Assumes gradual increase in the range of permissible recurrent tax rates from current 0.1-0.2 percent to 0.3-0.6 percent by 2022. The gain does not directly contribute to central government balances, but limits contingent risks and creates room for further savings from central government transfers to

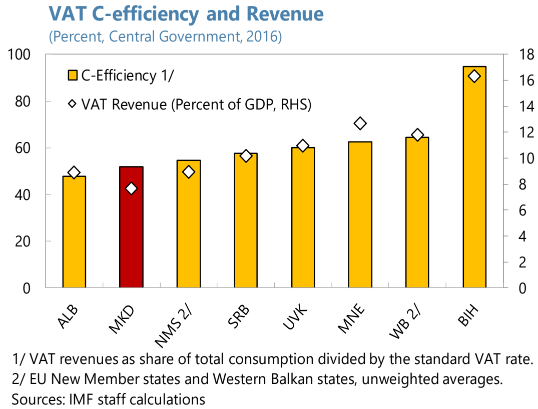
3/ Assumes gradual increase in the range of permissible recurrent tax rates from current 0.1-0.2 percent to 0.3-0.6 percent by 2022. The gain does not directly contribute to central government balances, but creates room for further savings from central government transfers to local governments.

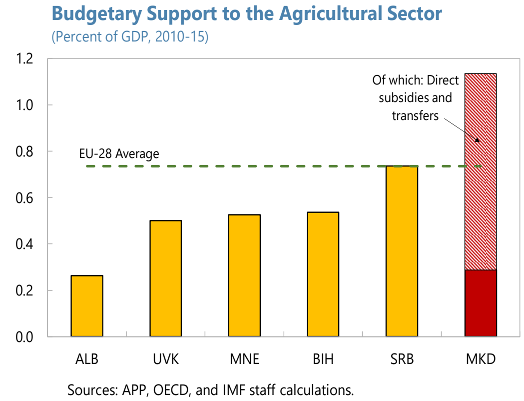
- *Raise tax base and compliance, particularly in VAT.* Staff recommended reducing the current policy gaps in VAT by eliminating the preferential VAT treatment of certain goods and services that are not well targeted by international standards. This should be accompanied by efforts to limit non-compliance—the main obstacle to improve current low VAT efficiency (Figure 10)—and continued efforts to address administrative inefficiencies (Box 2). While estimates of revenue gains from such measures are subject to notable uncertainty, they can be sizable given the prevalence of informality. Parallel efforts should also be continued to improve compliance in other tax categories, including by reviewing the effectiveness of the wide-ranging incentives awarded to investors in the TIDZ.

- *Rationalize subsidies.* Prioritizing farm subsidies to high-value production and reducing their size towards the EU average could both provide fiscal savings and improve the agricultural sector's competitiveness (Figure 10).

- *Introduce a broad-based property tax reform.* A gradual increase in the minimum permissible recurrent property tax rate, alongside limiting generous exemptions and deductions, would significantly enhance local governments' fiscal autonomy, limit central government's contingent liabilities (the supplementary 2018 budget increased transfers to local government to partially clear previously accumulated arrears) and provide room for future savings from transfers. Ensuring municipalities have sufficient scope for stable self-financing would also complement the authorities' recent initiative to strengthen local government expenditure discipline.

Figure 10. FYR Macedonia—Fiscal Recommendations

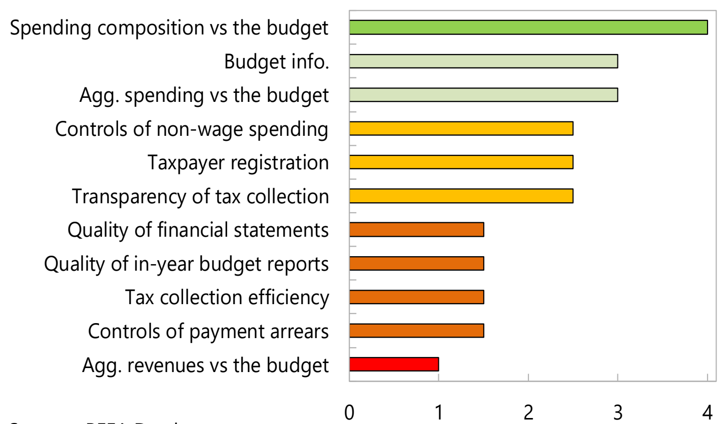




26. Staff welcomed the authorities' efforts to improve fiscal transparency but highlighted the importance of a more comprehensive fiscal coverage and revenue efficiency. The recent evaluation of fiscal transparency shows that FYR Macedonia meets the standard of good or advanced level of practice in more than one third of the areas assessed. Publication of timely budget execution reports, budgetary documentation of medium-term macroeconomic and fiscal projections, and timely submission of the budget drafts to the Parliament are key strengths. Efforts should focus on improving coverage by including entities currently outside the general government (mostly SOEs), developing capacity to monitor fiscal costs of tax expenditures, ensuring more realistic macroeconomic projections as well as improving tax collection efficiency (Box 2). Staff urged the authorities to speed up the process of developing an accrual-based fiscal reporting to exercise a better control over expenditure commitments to prevent further accumulation of arrears and strengthen capacity to address chronic under-execution of capital spending.

Selected PEFA Sub-indicators on Budget Credibility, Predictability, and Reporting

(Scale of 1=below basic level to 4=highest performance)

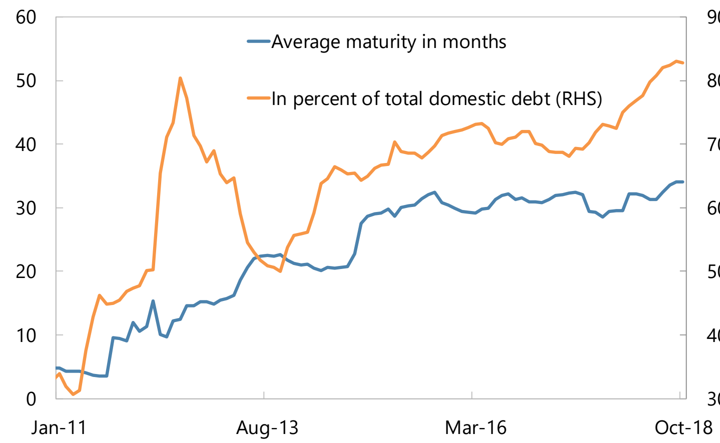


Sources: PEFA Database.

Authorities Views

27. The authorities agreed with staff's recommended medium-term fiscal consolidation and expressed strong commitment to stabilize public debt. The authorities are confident that the measures incorporated in the proposed budget will reduce the fiscal deficit to 2½ percent of GDP in 2019. While the medium-term fiscal strategy is still in the process of being updated, the authorities continue to target a near primary balance over the medium-term. They shared staff's views on the importance of stabilizing the pension system deficit. They also highlighted revenue potential from the ongoing tax efficiency and compliance initiatives, including the new IT system to enhance tax audit candidate selection, progressive steps to cap cash payments, as well as steps aiming to limit VAT circumvention, close loopholes related to transfer pricing and introduce pre-filled PIT tax reforms. They also expressed openness to consider further reforms to ensure fiscal and pension system sustainability as needed and pointed to the existing scope to rationalize public administration. The authorities highlighted continued development of the domestic debt market, with higher subscription rates and longer maturities of local currency debt issuance, as well as lower costs of borrowing.

Local Currency Debt, Average Maturity and Share



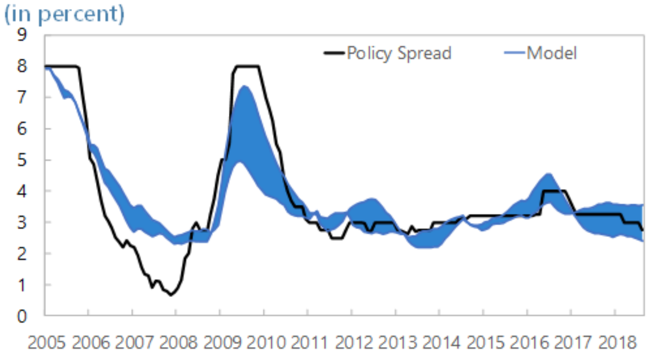
Sources: FYR Macedonia Ministry of Finance, and IMF staff calculations.

28. The authorities agreed with the need for continued improvement in public financial management. They stressed the importance of ongoing work and their intention to improve fiscal reporting in line with GFS 2014. They appreciated Fund technical assistance and noted the need for continued support and proceeding with the required legal changes and development of necessary IT systems as a package. On broadening the general government coverage of public sector entities, the authorities expressed their preference for a gradual approach. They noted that central government arrears have been reduced to around 0.2 percent of GDP and the 2018 supplementary budget provided for clearance of half of the municipal arrears (about ½ percent of GDP). Remaining outstanding arrears are expected to be cleared from each public entity's own funds. The authorities also highlighted recent initiatives to better monitor arrears and deter new accumulation. All public entities now have a legal responsibility to correctly report their overdue obligations on a monthly basis which are to be published quarterly. The recent initiative to cap municipal-level budgeted spending to realized average revenues of the last three years plus a 10 percent margin, is also expected to instill local government budget discipline.

C. Ensuring Monetary and Financial Stability

29. Monetary policy has been appropriately accommodative. FYR Macedonia has a de-facto stabilized exchange rate arrangement, but limited integration with the global financial system provides the NBRM with a degree of short-term autonomy. The real interest rate is considerably below its long-term average and the policy rate spread with the ECB is in the low range of staff's model-based policy reaction function. Staff considers the current accommodative monetary stance as appropriate given the negative output gap, benign inflation outlook, and stable foreign exchange market. If reserves accumulation falls below the baseline projections or global financial conditions tighten, the NBRM should stand ready to tighten.

Policy Interest rate spread - Actual vs. Modeled 1/
(in percent)



Sources: NBRM, SSO, Haver, and IMF Staff calculations
1/ Policy rate spread with the ECB modeled as a function of its own lagged value and the reserve gap, credit growth, domestic and euro area inflation, deposit euroization and EMBI.

30. Risks to the financial sector are muted but high structural vulnerabilities warrant close monitoring. The banking sector is well-capitalized and liquid, with banks comfortably meeting Pillar I capital adequacy requirements and maintaining sound aggregate liquidity buffers (Table 8, Figure 11). While credit risks are contained due to high provisioning, the recently conducted Financial Sector Assessment Program (FSAP) finds high structural vulnerabilities—including indirect credits risks due to large FX exposures to potentially unhedged borrowers and high dependence on adjustable- and variable-rate loans, as well as high corporate portfolio concentrations. FSAP stress tests estimate that bank recapitalization costs under extreme macro-financial solvency shocks would be limited, but these may expand in case of second-round effects from sizable bank losses. In addition, with subsidiaries of the euro area banks accounting for a large share of assets, there are risks of negative spillovers (including from deleveraging) in the case of bank distress in the euro area.

31. As recommended by the recent FSAP mission, staff highlighted the need for following measures to bolster the financial stability framework (text table).

- **Macroprudential policy framework.** The NBRM has been successfully using macroprudential policies to curb vulnerabilities, but the policy framework should be further strengthened. The NBRM should be granted a legal macroprudential mandate, including clear objectives that can guide the exercise of macroprudential powers, and further develop its framework for early identification of systemic risks.

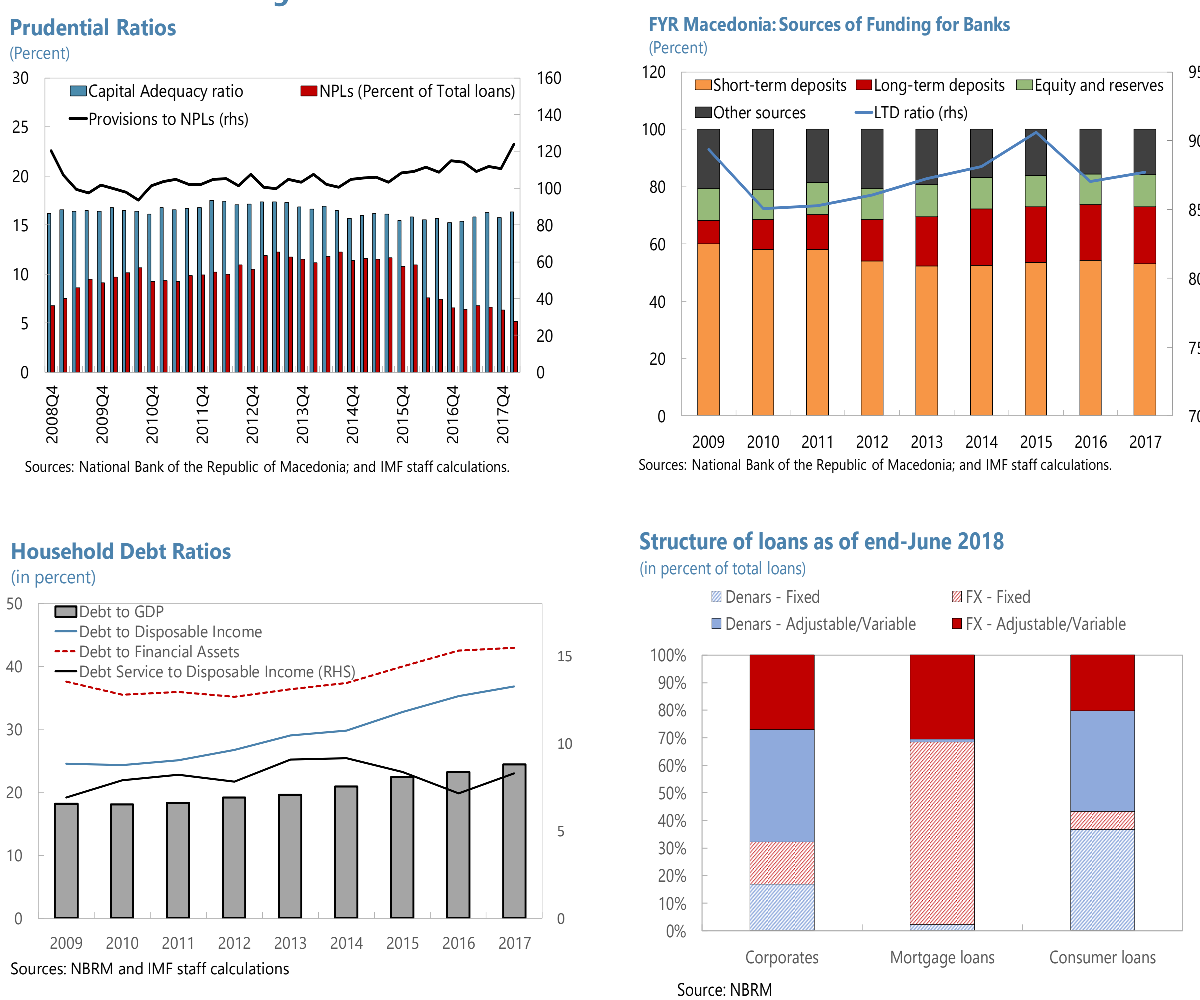
- **Supervision and regulation.** Further steps are needed to safeguard the operational independence of the NBRM, intensify full-scope inspections for domestic systemically important banks, and formalize the framework for corrective action and early intervention. Weaknesses in non-bank supervision require urgent attention and would benefit from institutional reforms in the medium term.

- **Crisis management and resolution.** A modern bank resolution framework should be introduced, providing for adequately specified triggers, additional resolution powers, and resolution funding mechanisms. With significant presence of foreign banks and substantial funding in euro, staff highlighted the importance of developing contingency plans for euro liquidity.

- **Financial Market Infrastructure (FMI) oversight.** The oversight perimeter should be extended to ensure that all systemically important FMI are covered. Coordination between the NBRM and Securities Exchange Commission should be improved.

- **AML/CFT.** Addressing previously identified deficiencies hinges on the timely implementation of the new AML/CFT Law and National Strategy.

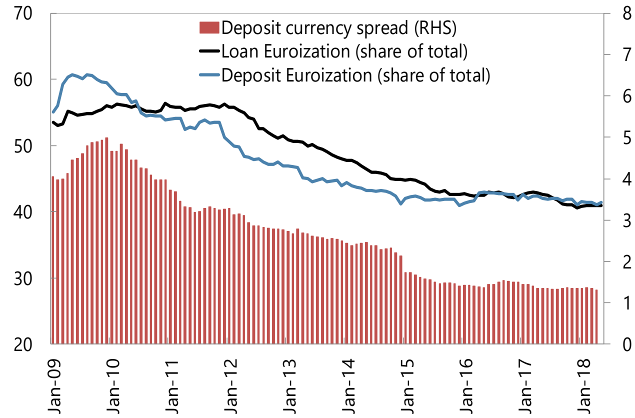
Figure 11. FYR Macedonia: Financial Sector Indicators



32. The NBRM should continue with its policies to ensure gradual de-euroization. Policies to affect banks' relative costs of intermediation in FX have been effective in reducing deposit euroization, but the steady decline has tapered off in recent years. Additional actions could be taken to help revive progress, e.g. by further increasing FX reserve requirements or raising the premium for deposit insurance on FX deposits. Macroprudential measures could also be introduced, e.g. higher risk weights on FX lending to help reduce indirect FX risk on a system-wide level. However, measures should be carefully calibrated and paced given their possible impact on financial system liquidity, financial intermediation, and costs of sterilization.

FYR Macedonia: Loan and Deposit Euroization

(Percent)



Sources: National Bank of the Republic of Macedonia; and IMF staff calculations.

33. Deepening financial inclusion will require actions on multiple fronts. Micro, small and medium enterprises face barriers due to high collateral requirements and weak financial accounts and management. Improvements in the framework for insolvency and creditor rights, combined with support for business planning, would help alleviate these constraints. More broadly, International Financial Reporting Standards for corporates should be upgraded to enable better credit risk reviews and market transparency. Meanwhile, households' distrust in financial institutions is a key impediment to financial inclusion. The establishment of a comprehensive legal and regulatory framework for financial consumer protection would help address unfair business practices and boost confidence in using financial services.

Authorities' Views

34. The authorities agreed with the staff's assessment of the current monetary policy stance. They stand ready to tighten policy stance in case of large external shocks. However, they noted that further reduction in the policy rate should not be ruled out if the current favorable conditions in the foreign exchange market continue and growth fails to gain steam.

35. The authorities generally agreed with the main FSAP findings and are taking steps to implement some key recommendations. They broadly shared staff's views on the strengths and vulnerabilities of the financial system while noting that it remained resilient during recent episodes of turbulence. They also agreed that risks stemming from euroization need to be closely monitored and pointed to the stability of the exchange rate peg as a key mitigating factor. The authorities appreciated the detailed assessment against international standards for banking and insurance supervision and are preparing action plans in response to the assessors' conclusions. They acknowledged the need for further capacity building and inter-agency coordination to better monitor systemic risks across the entire financial sector, which they view as a precondition for broadening the NBRM's formal mandate for macroprudential policy. FSAP recommendations on bank resolution and crisis management will be considered as part of the ongoing design of a modern bank resolution framework. Finally, the authorities noted a number of hurdles for consolidating non-bank supervisory entities in the central bank.

Text Table: FYR Macedonia: FSAP Key Recommendations

Recommendations	Time[1]
Financial stability assessment	
Create a centralized macrofinancial database; collect granular household data.	MT
Improve liquidity reporting to better estimate stable and less stable deposit outflows and prepare for implementation of the liquidity coverage ratio (LCR).	ST
Monitor and gradually strengthen banks' FX liquidity buffers.	MT
Financial stability oversight	
Systemic risk oversight and macroprudential policies	
– Grant the NBRM a legal macroprudential mandate via primary legislation.	ST
– Reconstitute the Financial Stability Committee (FSC) as principal domestic coordination body for macroprudential policy and crisis management.	MT
– Develop further the systemic risk monitoring framework.	ST
Banking supervision	
– Enhance the NBRM's independence by excluding it from the scope of the Law on Administrative Officers; and strengthen governance arrangements.	ST
– Increase supervisory intensity for D-SIBs, supported by adequate rise in staffing.	MT
Financial markets infrastructure oversight	
– Amend the legal framework to enhance transparency and consistency in FMI identification, regulation, and oversight. Extend NBRM oversight to all FMIs.	ST
Financial integrity	
– Ensure effective implementation of the new Law and National Strategy on Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) and strengthen staffing at the Financial Intelligence Office (FIO).	MT
Crisis management and resolution	
Finalize draft legislation for a new resolution regime, aligned with international best practices; and strengthen the DIS.	ST
Establish the NBRM's new resolution unit, develop resolution toolkit, and initiate resolvability assessments and resolution planning for at least all D-SIBs.	MT
Financial efficiency and inclusion	
Enhance the out-of-court restructuring framework, including by introducing standstill agreements and appropriate guidelines.	ST
Strengthen auditors' quality and corporate accounting standards and practices.	MT
Develop a legal and institutional framework for financial consumer protection.	MT

[1] *ST = short term (1–3 years); MT = medium term (3–5 years).*

STAFF APPRAISAL

36. Economic activity is projected to pick up in 2019. Supported by a rebound in investment, real GDP growth is expected to increase to 2.8 percent in 2019 and further accelerate to 3.4 percent in the medium-term on the back of higher net exports. The external position is assessed to be in line with medium-term fundamentals and desirable policies. Rising global protectionism and tightening of international financial conditions are key downside risks to the outlook. On the upside, a decisive push for structural reforms and opening of EU and NATO accession negotiations could boost capital inflows and confidence. To lift productivity and speed up convergence, structural policies should address key labor market and institutional weaknesses, while macroeconomic policies should focus on rebuilding fiscal and external buffers. Continued efforts to boost reserves remain important to underpin stability of the exchange rate peg as a key mitigating factor for euroization-related risks.

37. A multi-pronged policy is needed to address key labor market weaknesses. Enhancing the quality of secondary and vocational education is central to tackling skills shortages that constrain growth and investment. This should be accompanied by strategic planning and coordination at the national level to realign tertiary education toward delivering skills demanded by the economy. Active labor market policies have succeeded in reducing unemployment and should focus more on skill building and facilitating education-to-work transition through internships and apprenticeships. Further increases in the minimum wage should be mindful of labor productivity growth to avoid exacerbating youth unemployment and informality. Expansion of affordable preschool and childcare services is welcome and should continue as planned to improve female labor force participation. An updated census is vital to assessing labor market conditions.

38. Reforms to strengthen governance, reduce corruption, and ensure effective rule of law are instrumental to improving the investment climate and reducing informality. Recent and planned legislative reforms regarding the judiciary are encouraging. Sustained efforts are needed to ensure their tangible implementation to improve public perception. To help improve the business environment and retain skilled workers, a more effective rule of law and stronger anti-corruption efforts are needed. Success in these areas will raise growth potential as well as unlock EU accession negotiations. Better public administration, including through tackling tax evasion, strengthening labor inspection, and ensuring predictable implementation of business regulations, would prove critical to combatting widespread informality.

39. The 2019 budget rightly aims to reduce the pension deficit and better target social assistance benefits. The proposed pension reforms, which include higher contribution rates and benefit re-indexation to CPI-only, in line with long-standing staff recommendations, are expected reduce the pension deficit and improve the overall fiscal balance in the medium term. The reform of social assistance programs, which intends to consolidate and replace currently overlapping social assistance schemes with a means-tested guaranteed minimum income and social pensions for the elderly, is expected to improve targeting while increasing coverage. Staff estimates that envisaged measures will temporarily increase the fiscal deficit to 3 percent of GDP in 2019 before narrowing to 2.4 percent over the medium-term, with public debt peaking around 54.9 percent of GDP in 2021.

40. A more ambitious consolidation is needed to reduce vulnerabilities and build adequate policy space. Staff recommends achieving a zero-primary balance over the medium term to put public debt on a firm downward trajectory. To achieve this, steadfast implementation of the CPI-only re-indexation of pensions is key, while further measures to improve tax compliance, particularly of VAT, and rationalize agricultural subsidies are needed. In addition, to ensure long-term pension sustainability, tightening conditions for early retirement and raising statutory retirement age should be considered. Recent reforms to strengthen public financial management and increase fiscal transparency are welcome and should be complemented by developing an accrual-based fiscal reporting, a more comprehensive coverage, and further disclosure of budget information.

41. Monetary policy has been appropriately accommodative. Against a background of moderate economic activity, low inflation, and favorable foreign exchange markets, the NBRM lowered its policy rate twice in 2018. If reserves accumulation falls below the baseline projections or global financial conditions tighten, the NBRM should stand ready to tighten monetary policy.

42. The banking system is healthy, but risks need to be closely monitored. Banks are well capitalized, liquid, and profitable. The share of non-performing loans has decreased, and credit risks are well provisioned. The authorities have maintained financial stability through episodes of turbulence, but vigilance remains necessary in view of structural risks. Further efforts to gradually increase deposit denarization, coupled with carefully calibrated macro-prudential measures to reduce foreign currency lending to households, would help strengthen financial system resilience.

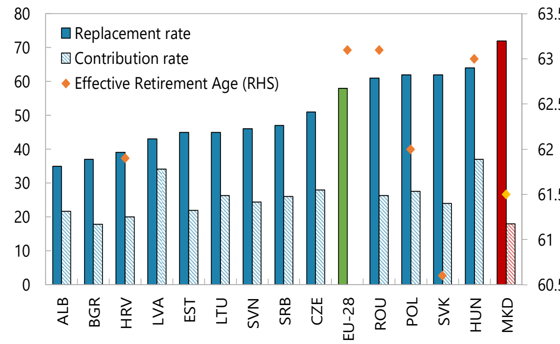
43. Further strengthening the financial stability framework is important. Financial sector supervision and regulations have been enhanced considerably over the past decade. Still, residual gaps in supervision, as identified by the FSAP, should be addressed to ensure continued effectiveness. The macroprudential policy framework would benefit from further capacity building for systemic risk monitoring and enhanced inter-agency coordination, while ongoing efforts to modernize the crisis management and bank resolution regime should be promptly completed.

44. It is recommended that the next Article IV consultation cycle take place on the standard 12-month consultation cycle.

Box 1. Proposed Pension Reforms

FYR Macedonia's pension system faces considerable sustainability and social equity risks. The system's deficit is projected to increase from 4½ percent of GDP at end-2017 to a peak above 6 percent of GDP by early 2030s. Generous first pillar (pay-as-you-go) pensions, and a series of ad hoc benefit increases have increased pension expenditures far above what is expected for FYR Macedonia's current comparatively young demographics. At the same time, technical registration errors originating from the time the fully-funded second-pillar was established in 2006 resulted in unpaid obligations to the second pillar, while the lower accrual rates awarded to participants in the dual-pillar system have proven insufficient to ensure equitable pensions for those now entering or nearing retirement. More generally, the wide disparity in accrual rates between participants in the first pillar only (older generations not mandated to move to the dual-pillar system) and those in the dual-pillar system gives rise to inter-generational imbalances in pension benefits expected to last well through the next decade.[1] Without decisive reform actions, the pension system would impose an increasing and protracted burden on FYR Macedonia's fiscal position over the next decade, with limited space to ensure equitable treatment of all system participants.

Pension Indicators
(Percent and years old, Latest)



Sources: World Bank, Eurostat, and PIOM of FYR Macedonia.
Note: Replacement rate is a ratio of pension income to average income from work.

The pension reforms included in the 2019 budget aim to address these challenges. The reforms allow dual-pillar participants near the retirement age to switch back to the first pillar to obtain equitable benefits, with the transfer of their accrued second-pillar contributions more than offsetting the near-term cost of clearing unpaid obligations to the second pillar. The first-pillar-only and dual-pillar accrual rates are partially harmonized to alleviate the inter-pillar imbalances in pension benefits. To improve long-term sustainability of the system, pension contribution rates would be increased by 0.4 percentage points both in 2019 and 2020 and benefits would be re-indexed to CPI only, isolating them from economic swings (current "Swiss formula" indexation is linked both to prices and real wages).

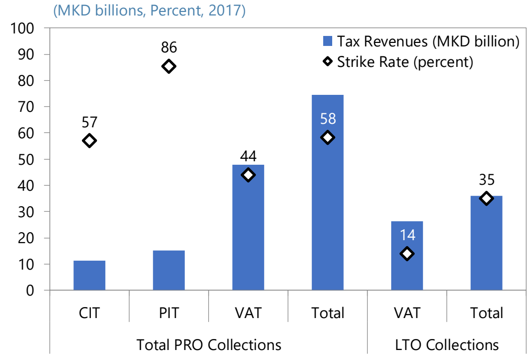
Rising spending pressures beyond the medium-term warrant consideration of further measures. To contain the rise in the pension system deficit in the medium-term, steadfast implementation of agreed contribution rate increases and pension benefit re-indexation are key. Nonetheless, rising demographic pressures are expected to start increasing the deficit already in early-2020s, partially compounded by the longer-term costs of near-retirement participants moving back to the more generous first pillar. Further sustainability measures should therefore be considered soon, including tightening of conditions for early retirement and gradually harmonizing and raising the currently gender-specific statutory retirement ages[2], while also keeping further adjustment to contribution rates and harmonization of accrual rates under review.

1/ Net accrual rates in the dual-pillar system (0.75 and 0.86 percent for men and women respectively) are lower than in the first pillar only (1.6-2.6 pillar depending on time of service period and gender) and well below their share of pay-as-you-go contributions (two-thirds of contributions paid). The proposed reforms reduce the first pillar accrual rate for the current service period to 1.47 percent and increases dual-pillar accrual rates to 1 and 1.14 percent form men and women respectively.
2/ Retirement ages are 64 and 62 for men and women respectively with 15 years of contributions. Participants working in hazardous occupations can qualify for early retirement at the age of 49.

Box 2. Improving VAT Collections

Weak compliance and inefficient administration represent persistent drags on VAT revenues. FYR Macedonia's tax revenues rely heavily on the VAT (nearly half of the total), yet revenue performance is significantly behind regional peers, both in terms of their level and efficiency. C-efficiency, controlling for both differences in statutory rates as well as the level of consumption, is about 52 percent relative to the WB average of over 60 percent.[1] The comparatively low efficiency may, in part, reflect more sizable policy gaps (reduced rates and exemptions on specific goods), but also weak compliance (the informal sector is estimated at around 30 percent of GDP) and inefficiencies and capacity constraints in tax administration (reflected in large cumulative tax arrears). Data limitations prohibit a precise compliance gap estimate for FYR Macedonia, but a crude approximation drawing on available policy gap estimates for new EU member states would place it in the range of 15-25 percent of potential VAT revenues, corresponding to about 1–2 percent of GDP.[1]

Tax Revenues and Audit Strike Rates by Tax Type
(MKD billions, Percent, 2017)



Sources: PRO, IMF staff calculations.

Strengthening VAT efficiency requires intensified efforts to address weaknesses in revenue administration processes and capacity.[2] First, identification and treatment of compliance risks at the Public Revenue Office (PRO) should be enhanced to support better targeted tax audits and limit activities that go unreported. VAT audit strike rates (share of identified irregularities in conducted audits) are low, notably for the large tax payer office (LTO), indicating inefficiencies in audit candidate selection leading to excessive focus on low risk, low yield activities (a new IT-system for candidate selection to be introduced early 2019 is expected to lead to some improvement). Second, the PRO suffers from persistent underfunding and capacity constraints, including outdated and fragmented IT systems and understaffing (particularly in the LTO). Resource bottlenecks are exacerbated by PRO's many non-tax responsibilities, notwithstanding recent termination of some, as well as inefficiencies in workforce allocation. Third, there is a need to improve processes for timely collection of new tax debts to prevent accumulation of uncollectable arrears, and for dispute resolution, which currently relies on Administrative Court reviews in the absence of a dedicated PRO function. Beyond administrative efficiency gains, these steps can limit the scope for corruption and foster voluntary compliance by building public trust in the quality and fairness of the tax system. Finally, successful implementation of the modernization initiatives calls for urgent strengthening of the PRO's governance mechanisms, including their more systematic integration in the PRO's management and planning processes and establishing a single coordination unit for the reforms. Proposed legal amendments seeking to address deficiencies in registering cash payments can also help improve VAT collection.

1/ C-efficiency, a measure of the overall VAT gap to hypothetical VAT revenues assuming all consumption were taxed at the statutory VAT rate, may be decomposed as: C-efficiency = (1 – policy gap) x (1- compliance gap). The approximated compliance gap for FYR Macedonia corresponds to the 25th-75th percentile range of estimated policy gaps in new EU members states (CASE, *Study and Reports on the VAT Gap in the EU-28 Member States Final Report,* September 2017).
2/ The PRO has adopted a Modernization Program 2017–21, building on recommendations of prior IMF 2014 technical assistance mission and 2016 Tax Administration Diagnostic Assessment Tool (TADAT) assessment, but systematic implementation of the program has stalled.

Table 1. FYR Macedonia: Summary of Economic Indicators, 2015–2023
(Percent, unless otherwise indicated)

	2015	2016	2017	2018	2019	2020	2021	2022	2023
				Projections					
Real GDP	3.9	2.8	0.2	2.0	2.8	3.0	3.1	3.3	3.4
Real domestic demand	5.4	5.0	0.3	0.0	2.6	2.3	2.4	2.4	2.4
Consumption	4.3	2.1	0.1	2.5	2.0	2.1	2.1	2.1	2.1
Private consumption	4.4	3.9	0.7	2.4	2.4	2.5	2.5	2.5	2.5
Gross investment	8.3	12.5	0.8	-6.1	4.1	3.0	3.0	3.0	3.0
Exports (volume)	8.5	9.1	8.1	11.7	8.7	9.0	9.0	9.0	9.0
Imports (volume)	9.9	11.1	6.4	6.1	7.0	6.8	6.8	6.8	6.8
Contributions to growth 1/									
Domestic demand	6.3	6.0	0.7	0.0	3.1	2.8	2.8	2.8	2.8
Net exports	-2.5	-3.2	-0.5	2.0	-0.3	0.2	0.3	0.4	0.6
Output gap (percent of potential GDP)	0.6	1.0	-0.8	-1.0	-0.6	-0.2	0.0	0.0	0.0
Central government operations (percent of GDP)									
Revenues	28.7	28.4	29.1	29.7	30.9	30.9	30.8	30.8	30.8
Expenditures	32.2	31.1	31.8	32.3	33.9	33.7	33.6	33.4	33.2
Of which: capital	3.3	2.9	3.2	2.5	3.5	3.5	3.5	3.5	3.5
Balance	-3.5	-2.7	-2.7	-2.6	-3.0	-2.8	-2.7	-2.6	-2.4
Savings and investment (percent of GDP)									
National saving	28.5	29.7	32.0	31.1	31.4	31.9	32.4	33.0	33.7
Public	-0.1	0.2	0.5	-0.2	0.5	0.7	0.8	1.0	1.2
Private	28.6	29.5	31.5	31.2	30.9	31.2	31.6	32.1	32.5
Foreign saving	2.0	2.9	1.0	0.6	1.4	1.8	2.1	2.3	2.4
Gross investment	30.4	32.5	33.0	31.7	32.8	33.7	34.5	35.3	36.1
Consumer prices									
Period average	-0.3	-0.2	1.4	1.5	1.8	2.0	2.2	2.2	2.2
End-period	-0.3	-0.2	2.4	1.4	2.0	2.0	2.2	2.2	2.2
Private sector credit growth	9.5	0.0	5.3	8.0	7.0	7.0	7.0	7.0	7.0
Memorandum items:									
Current account balance (percent of GDP)	-2.0	-2.9	-1.0	-0.6	-1.4	-1.8	-2.1	-2.3	-2.4
Gross official reserves (millions of euros)	2,262	2,613	2,336	2,779	3,155	3,340	3,476	3,685	3,775
in percent of ST debt	101.2	104.0	82.0	98.1	97.4	95.0	112.0	101.0	100.8
in months of prospective imports	4.2	4.5	3.7	4.1	4.2	4.1	4.0	3.9	3.7
Gross general government debt (percent of GDP)	38.1	39.8	39.4	41.4	42.5	43.2	43.8	44.1	44.1
Public and publicly guaranteed debt (percent of GDP) 2/	44.0	46.7	48.0	50.7	53.0	54.0	54.9	54.9	54.4
Foreign direct investment (percent of GDP)	2.2	3.3	1.8	3.3	3.2	3.2	3.2	3.2	3.2
External debt (percent of GDP)	69.3	74.7	73.9	76.1	78.5	78.4	77.4	76.9	75.5
Nominal GDP (billions of denars)	559	595	617	639	670	705	742	784	828
Nominal GDP (millions of euros)	9,073	9,656	10,014	10,383	10,887	11,442	12,055	12,727	13,455

Sources: NBRM; SSO; MOF; World Bank; and IMF staff estimates and projections. National Accounts are revised by SSO, using ESA 2010
1/ The inconsistency between Real GDP growth and contributions to growth results from discrepancies in the official data on GDP and its
2/ Includes general government and SOEs debt.

Table 2a. FYR Macedonia: Central Government Operations, 2015–23

(Billions of MKD denars, unless otherwise specified)

	2015	2016	2017	2018		2019		2020	2021	2022	2023
				Budget	Proj.	Budget	Proj.	Proj.	Proj.	Proj.	Proj.
Total Revenues	160.7	169.0	179.4	192.4	189.7	210.7	207.0	217.8	228.8	241.6	255.4
Tax Revenues and Contributions	140.8	150.4	157.5	170.8	169.8	184.2	182.0	191.8	201.4	212.7	224.8
PIT	12.9	14.2	15.3	16.7	16.4	19.1	18.7	19.6	20.5	21.6	22.9
CIT	12.0	10.8	11.4	14.5	14.5	15.3	15.2	16.0	16.8	17.8	18.8
VAT (net)	41.7	45.9	47.9	49.4	49.2	52.1	51.6	54.2	57.1	60.3	63.7
Excises	19.8	22.2	23.1	25.9	25.6	27.3	26.7	28.0	29.3	31.0	32.8
Custom Duties	4.3	4.8	5.2	5.6	5.6	5.8	5.9	6.2	6.5	6.9	7.3
Other Taxes	2.2	2.2	1.9	2.5	2.4	2.3	2.3	2.4	2.5	2.7	2.8
Social Contributions	47.9	50.3	52.9	56.2	56.2	62.3	61.7	65.5	68.7	72.5	76.6
Pensions	32.2	33.8	35.6	37.8	37.8	42.5	42.1	44.7	46.7	49.3	52.2
Unemployment	2.0	2.2	2.3	2.4	2.4	2.5	2.5	2.7	2.8	2.9	3.1
Health	13.6	14.3	15.0	16.0	16.0	17.3	17.1	18.2	19.1	20.2	21.4
Non-Tax Revenues	12.9	13.0	13.3	14.9	13.7	18.5	17.2	18.1	19.0	20.1	21.2
Capital Revenues	2.3	2.0	1.5	1.9	1.9	2.0	2.0	2.1	2.2	2.3	2.4
Grants	4.7	3.6	7.2	4.8	4.3	6.0	5.9	5.9	6.2	6.5	6.9
Expenditures	180.1	185.0	196.3	210.4	206.6	228.4	227.1	237.8	249.2	261.7	275.0
Current Expenditures	162.0	168.4	176.7	192.0	190.7	202.9	203.6	213.0	223.2	234.2	245.9
Wages and salaries	24.7	26.0	26.2	26.8	26.8	28.3	28.3	29.8	31.4	33.1	35.0
Goods and services	18.1	16.8	15.3	17.6	16.3	19.3	19.3	20.3	21.4	22.6	23.9
Transfers	112.7	118.9	126.8	139.8	139.8	146.1	146.7	152.9	159.7	167.0	174.9
Pension fund expenditures	50.3	54.6	58.1	61.1	61.1	64.6	64.6	67.0	69.7	72.5	75.5
Health	23.6	25.6	27.0	29.0	29.0	30.1	30.1	31.6	33.3	35.2	37.2
Other	38.8	38.7	41.6	49.7	49.7	51.3	52.0	54.3	56.7	59.3	62.2
Interest	6.5	6.8	8.4	7.8	7.8	9.2	9.2	10.0	10.7	11.4	12.1
Capital Expenditures	18.7	17.0	19.9	18.5	15.9	25.6	23.6	24.8	26.2	27.6	29.2
Lending minus repayment 1/	-0.5	-0.4	-0.3	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Overall fiscal balance	-19.4	-16.1	-16.9	-18.0	-16.9	-17.7	-20.1	-20.0	-20.4	-20.1	-19.6
Primary fiscal balance	-13.0	-9.2	-8.5	-10.2	-9.1	-8.5	-10.9	-9.9	-9.7	-8.7	-7.5
Financing	19.4	16.1	16.9		16.9		20.1	20.0	20.4	20.1	19.6
Domestic	21.7	-3.4	21.3		0.1		0.8	12.3	19.9	-3.8	18.3
Central Bank deposits	10.3	-5.3	10.5		-4.8		-0.1	0.2	-0.6	-0.3	0.3
Other domestic financing	11.4	1.9	10.8		4.9		0.9	12.0	20.5	-3.6	18.0
Privatization receipts	0.0	0.2	0.4		0.0		0.0	0.0	0.0	0.0	0.0
Foreign	-2.3	19.3	-4.8		16.8		19.3	7.7	0.5	23.9	1.3
Memo items:											
Gross general government debt (in percent of GDP) 2/	38.1	39.8	39.4		41.4		42.5	43.2	43.8	44.1	44.1
Nominal GDP (billions of denars)	559	595	617		639		670	705	742	784	828
Stock of government deposits at the NBRM (billions of denars eop)	26	33	22		27		27	27	27	27	27
Public and publicly guaranteed debt (in percent of GDP) 2/ 3/	44.0	46.7	48.0		50.7		53.0	54.0	54.9	54.9	54.4

Sources: MoF and IMF staff estimates.

1/ Results from excluding: (i) revenues from lending; and (ii) lending guarantees from current expenditures.

2/ The historical debt ratios differ slightly from the numbers reported by MoF due to using end-year debt in local currency divided by local currency GDP.

3/ Includes general government and SOEs debt.

Table 2b. FYR Macedonia: Central Government Operations, 2015–23
(Percent of GDP)

	2015	2016	2017	2018		2019		2020	2021	2022	2023
				Budget	Proj.	Budget	Proj.	Proj.	Proj.	Proj.	Proj.
Total Revenues	28.7	28.4	29.1	30.1	29.7	31.4	30.9	30.9	30.8	30.8	30.8
Tax Revenues and Contributions	25.2	25.3	25.5	26.7	26.6	27.5	27.1	27.2	27.1	27.1	27.1
PIT	2.3	2.4	2.5	2.6	2.6	2.8	2.8	2.8	2.8	2.8	2.8
CIT	2.2	1.8	1.8	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3
VAT (net)	7.5	7.7	7.8	7.7	7.7	7.8	7.7	7.7	7.7	7.7	7.7
Excises	3.5	3.7	3.7	4.1	4.0	4.1	4.0	4.0	4.0	4.0	4.0
Custom Duties	0.8	0.8	0.8	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Other Taxes	0.4	0.4	0.3	0.4	0.4	0.3	0.3	0.3	0.3	0.3	0.3
Social Contributions	8.6	8.5	8.6	8.8	8.8	9.3	9.2	9.3	9.3	9.3	9.3
Non-Tax Revenues	2.3	2.2	2.2	2.3	2.1	2.8	2.6	2.6	2.6	2.6	2.6
Capital Revenues	0.4	0.3	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Grants	0.8	0.6	1.2	0.7	0.7	0.9	0.9	0.8	0.8	0.8	0.8
Expenditures	32.2	31.1	31.8	32.9	32.3	34.1	33.9	33.7	33.6	33.4	33.2
Current Expenditures	29.0	28.3	28.7	30.0	29.8	30.3	30.4	30.2	30.1	29.9	29.7
Wages and salaries	4.4	4.4	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2
Goods and services	3.2	2.8	2.5	2.8	2.6	2.9	2.9	2.9	2.9	2.9	2.9
Transfers	20.2	20.0	20.6	21.9	21.9	21.8	21.9	21.7	21.5	21.3	21.1
Pension fund expenditures	9.0	9.2	9.4	9.5	9.5	9.6	9.6	9.5	9.4	9.3	9.1
Health	4.2	4.3	4.4	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5
Other	6.9	6.5	6.8	7.8	7.8	7.7	7.8	7.7	7.6	7.6	7.5
Interest	1.2	1.1	1.4	1.2	1.2	1.4	1.4	1.4	1.4	1.5	1.5
Capital Expenditures	3.3	2.9	3.2	2.9	2.5	3.8	3.5	3.5	3.5	3.5	3.5
Lending minus repayment 1/	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall fiscal balance	-3.5	-2.7	-2.7	-2.8	-2.6	-2.6	-3.0	-2.8	-2.7	-2.6	-2.4
Primary fiscal balance	-2.3	-1.6	-1.4	-1.6	-1.4	-1.3	-1.6	-1.4	-1.3	-1.1	-0.9
Financing	3.5	2.7	2.7		2.6		3.0	2.8	2.7	2.6	2.4
Domestic	3.9	-0.6	3.5		0.0		0.1	1.7	2.7	-0.5	2.2
Central Bank deposits	1.8	-0.9	1.7		-0.8		0.0	0.0	-0.1	0.0	0.0
Other domestic financing	2.0	0.3	1.7		0.8		0.1	1.7	2.8	-0.5	2.2
Foreign	-0.4	3.2	-0.8		2.6		2.9	1.1	0.1	3.1	0.2
Memo items:											
Gross general government debt (in percent of GDP) 3/	38.1	39.8	39.4		41.4		42.5	43.2	43.8	44.1	44.1
Nominal GDP (billions of denars)	559	595	617		639		670	705	742	784	828
Stock of government deposits at the NBRM (billions of denars eop)	26	33	22		27		27	27	27	27	27
Public and publicly guaranteed debt (in percent of GDP) 2/ 3/	44.0	46.7	48.0		50.7		53.0	54.0	54.9	54.9	54.4

Sources: MoF and IMF staff estimates.

1/ Results from excluding: (i) revenues from lending; and (ii) lending guarantees from current expenditures.

2/ The historical debt ratios differ slightly from the numbers reported by MoF due to using end-year debt in local currency divided by local currency GDP.

3/ Includes general government and SOEs debt.

Table 3a. FYR Macedonia: Balance of Payments, 2015–23

(Millions of euros, unless otherwise indicated)

	2015	2016	2017	2018	2019	2020	2021	2022	2023
				Projections					
Current account	-177	-275	-103	-66	-153	-206	-257	-291	-323
Trade balance	-1823	-1813	-1788	-1796	-1916	-2025	-2146	-2253	-2354
Exports	3047	3529	4074	4686	5142	5656	6224	6851	7539
Imports	4870	5342	5861	6482	7058	7681	8370	9104	9893
Services (net)	349	341	377	438	462	489	519	552	587
Primary Income (net)	-286	-384	-398	-427	-468	-512	-539	-569	-602
Secondary Income (transfers, net)	1583	1581	1706	1720	1768	1842	1909	1979	2046
Of which									
Official	54	91	113	77	84	91	89	93	95
Private	1529	1490	1593	1643	1684	1750	1821	1886	1950
Capital account (net)	7	11	18	10	10	11	12	12	11
Net lending (+) / Net borrowing (-)	-170	-265	-85	-56	-144	-195	-245	-279	-312
Financial account	12	-610	52	-498	-520	-381	-381	-489	-402
Direct investment (net)	-203	-317	-180	-342	-348	-366	-385	-407	-430
Portfolio investment (net)	-66	-429	19	-362	-262	-264	-50	-255	-24
Other investment	280	136	213	207	90	249	54	173	52
Trade credits (net)	-61	-37	-72	-75	-78	-82	-87	-92	-97
MLT loans (net)	58	-94	51	44	-189	49	-100	20	-109
ST loans (net)	-4	-12	-14	6	4	5	4	6	7
Currency and deposits (net)	287	279	248	232	353	278	237	239	251
Other (net)	0	0	0	0	0	0	0	0	0
Errors and omissions	-2	-8	-10	0	0	0	0	0	0
Overall Balance	-183	337	-146	442	376	185	136	209	90
Memorandum Items:									
ST debt at residual maturity (year-end)	2236	2513	2849	2832	3238	3516	3103	3649	3745
Gross foreign exchange reserves	2262	2613	2336	2779	3155	3340	3476	3685	3775
Months of prospective imports of G&S	4.2	4.5	3.7	4.1	4.2	4.1	4.0	3.9	3.7
Percent of short-term debt (residual maturity)	101.2	104.0	82.0	98.1	97.4	95.0	112.0	101.0	100.8
External debt (percent of GDP)	69.3	74.7	73.9	76.1	78.5	78.4	77.4	76.9	75.5
External debt service	1948	1740	1929	2265	2257	2668	2950	2543	3094
Percent of exports of G&S	44.0	35.4	35.0	36.4	33.3	36.1	36.6	28.9	32.1
Percent of exports of G&S and transfers	32.7	27.2	27.1	28.8	26.7	29.2	29.8	23.8	26.7

Sources: NBRM; and IMF staff estimates.

Table 3b. FYR Macedonia: Balance of Payments, 2003–23
(Percent of GDP, unless otherwise indicated)

	Avg 2003-12	2015	2016	2017	2018	2019	2020	2021	2022	2023
					Projections					
Current account	-4.9	-2.0	-2.9	-1.0	-0.6	-1.4	-1.8	-2.1	-2.3	-2.4
Trade balance	-23.4	-20.1	-18.8	-17.9	-17.3	-17.6	-17.7	-17.8	-17.7	-17.5
Exports	25.3	33.6	36.5	40.7	45.1	47.2	49.4	51.6	53.8	56.0
Imports	48.6	53.7	55.3	58.5	62.4	64.8	67.1	69.4	71.5	73.5
Services (net)	3.0	3.8	3.5	3.8	4.2	4.2	4.3	4.3	4.3	4.4
Primary Income (net)	-1.6	-3.2	-4.0	-4.0	-4.1	-4.3	-4.5	-4.5	-4.5	-4.5
Secondary Income (transfers, net)	17.1	17.4	16.4	17.0	16.6	16.2	16.1	15.8	15.5	15.2
Of which										
Official	0.9	0.6	0.9	1.1	0.7	0.8	0.8	0.7	0.7	0.7
Private	16.1	16.8	15.4	15.9	15.8	15.5	15.3	15.1	14.8	14.5
Capital account (net)	0.0	0.1	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Net lending (+) / Net borrowing (-)	-4.9	-1.9	-2.7	-0.8	-0.5	-1.3	-1.7	-2.0	-2.2	-2.3
Financial account	-7.2	0.1	-6.3	0.5	-4.8	-4.8	-3.3	-3.2	-3.8	-3.0
Direct investment (net)	-4.1	-2.2	-3.3	-1.8	-3.3	-3.2	-3.2	-3.2	-3.2	-3.2
Portfolio investment (net)	-0.7	-0.7	-4.4	0.2	-3.5	-2.4	-2.3	-0.4	-2.0	-0.2
Other investment	-2.4	3.1	1.4	2.1	2.0	0.8	2.2	0.5	1.4	0.4
Trade credits (net)	-0.9	-0.7	-0.4	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7
MLT loans (net)	-1.6	0.6	-1.0	0.5	0.4	-1.7	0.4	-0.8	0.2	-0.8
ST loans (net)	-0.1	0.0	-0.1	-0.1	0.1	0.0	0.0	0.0	0.0	0.1
Currency and deposits (net)	0.6	3.2	2.9	2.5	2.2	3.2	2.4	2.0	1.9	1.9
Of which: Commercial banks	-0.1	-0.2	-0.2	-0.1	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1
Other (net)	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	0.0	0.0	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Overall Balance	2.3	-2.0	3.5	-1.5	4.3	3.5	1.6	1.1	1.6	0.7
				(Percentage change, year-on-year)						
Exports of G&S (Value)	10.8	8.2	11.2	12.1	13.0	8.8	9.0	9.2	9.3	9.3
Volume	8.5	8.5	9.1	8.1	11.7	8.7	9.0	9.0	9.0	9.0
Price	1.6	-0.2	1.9	3.6	1.2	0.0	0.0	0.1	0.2	0.2
Imports of G&S (Value)	9.4	6.1	8.4	8.3	9.6	8.4	8.4	8.6	8.5	8.4
Volume	6.9	9.9	11.1	6.4	6.1	7.0	6.8	6.8	6.8	6.8
Price	2.0	-3.5	-2.5	1.8	3.3	1.3	1.5	1.7	1.5	1.5

Sources: NBRM; and IMF staff estimates.

Table 4. FYR Macedonia: Monetary Survey, 2015–23
(Billions of denars, unless specified otherwise)

	2015	2016	2017	2018	2019	2020	2021	2022	2023
				Projections					
NFA	137.5	158.5	144.0	171.2	194.3	205.6	213.9	226.7	232.2
Central Bank	134.2	155.6	138.9	166.1	189.1	200.5	208.8	221.6	227.1
Commercial Banks	3.3	2.9	5.1	5.1	5.1	5.1	5.1	5.1	5.1
NDA	196.6	196.2	228.9	237.9	234.3	246.8	263.8	277.7	300.5
Credit to Government (net)	13.3	2.5	14.8	9.5	10.2	11.8	11.2	10.9	11.3
From Banks (net)	36.5	32.6	34.0	33.0	33.7	35.1	35.1	35.1	35.1
of which: Credit (Tbills)	38.0	34.0	35.3	34.9	35.6	37.0	37.0	37.0	37.0
From Central Bank (net)	-23.2	-30.1	-19.1	-23.5	-23.5	-23.3	-23.9	-24.2	-23.8
of which: Deposits	-26.2	-32.6	-21.9	-26.7	-26.7	-26.5	-27.1	-27.4	-27.0
Credit to Private Sector (Gross)	285.7	285.8	300.8	324.9	347.6	371.9	397.9	425.8	455.6
From Banks	284.8	284.8	299.9	324.0	346.6	371.0	397.0	424.9	454.7
Denars	157.6	160.0	175.0	180.2	192.8	206.3	220.8	236.3	252.9
FX	127.2	124.8	124.9	143.8	153.9	164.7	176.2	188.6	201.8
From Central Bank	0.9	1.0	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Other Items (net)	-102.4	-92.2	-86.8	-50.6	-77.5	-90.9	-99.5	-113.1	-120.5
Broad Money (M3)	334.1	354.7	372.9	409.0	428.6	452.4	477.7	504.4	532.7
Currency in Circulation	26.3	28.2	30.0	31.1	32.6	34.2	36.1	38.1	40.3
Total Deposits	307.8	326.5	343.0	377.9	396.0	418.2	441.6	466.3	492.5
Denars	183.4	193.0	204.2	225.0	235.8	249.0	262.9	277.6	293.2
FX	124.4	133.5	138.8	152.9	160.3	169.2	178.7	188.7	199.3
				(Percentage change, year-on-year)					
Private Sector Credit	9.5	0.0	5.3	8.0	7.0	7.0	7.0	7.0	7.0
Broad Money	6.9	6.2	5.1	9.7	4.8	5.6	5.6	5.6	5.6
Private Sector Deposits	6.4	6.1	5.0	10.2	4.8	5.6	5.6	5.6	5.6
				(Contribution to annual growth in broad money)					
NFA	-2.9	6.3	-4.1	7.3	5.6	2.6	1.8	2.7	1.1
NDA	9.8	-0.1	9.2	2.4	-0.9	2.9	3.7	2.9	4.5
				(Percent of GDP)					
Private Sector Credit	51.1	48.0	48.8	50.8	51.8	52.8	53.6	54.3	55.0
Broad Money	59.8	59.6	60.5	64.0	63.9	64.2	64.4	64.4	64.3
Private Sector Deposits	55.1	54.9	55.6	59.1	59.1	59.4	59.5	59.5	59.4
Memorandum Items:									
Money Multiplier	5.5	5.4	5.4	5.4	5.3	5.3	5.2	5.3	5.3
Reserve Requirement Ratio (% of deposits)									
Denars	8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0
FX Indexed	20.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0
FX	15.0	15.0	18.0	18.0	18.0	18.0	18.0	18.0	18.0
Velocity	1.7	1.7	1.7	1.6	1.6	1.6	1.6	1.6	1.6

Sources: NBRM; and IMF staff estimates.

Table 5. FYR Macedonia: Central Bank Survey, 2015–23

(Billions of denars, unless specified otherwise)

	2015	2016	2017	2018	2019	2020	2021	2022	2023
				Projections					
NFA	134.2	155.6	138.9	166.1	189.1	200.5	208.8	221.6	227.1
Assets	139.4	160.7	143.7	170.9	194.1	205.5	213.8	226.7	232.2
Liabilities	-5.1	-5.1	-4.8	-4.9	-4.9	-5.0	-5.0	-5.1	-5.1
NDA	-73.0	-90.1	-67.3	-89.9	-108.7	-114.9	-117.7	-125.6	-125.9
Banks (net)	-33.9	-41.1	-35.9	-53.7	-72.4	-78.8	-81.0	-88.6	-89.3
of which:									
NBRM Bills and short-term facilities	-34.0	-36.5	-35.9	-45.9	-45.9	-45.9	-45.9	-45.9	-45.9
Central Government (net)	-20.1	-26.6	-16.1	-20.9	-21.0	-20.7	-21.3	-21.6	-21.3
of which:									
Deposits at Central Bank	-26.2	-32.6	-21.9	-26.7	-26.7	-26.5	-27.1	-27.4	-27.0
Denar	-8.8	-11.0	-13.9	-16.1	-16.1	-16.0	-16.2	-16.4	-16.2
FX	-17.4	-21.7	-8.0	-10.6	-10.7	-10.5	-10.9	-11.0	-10.8
State and Local Governments (net)	-3.1	-3.5	-3.0	-3.0	-3.0	-3.0	-3.0	-3.0	-3.0
Other items (net)	-15.9	-18.9	-12.3	-12.3	-12.3	-12.3	-12.3	-12.3	-12.3
Reserve Money	61.2	65.5	69.7	76.1	80.4	85.6	91.1	96.0	101.3
Currency in Circulation	26.3	28.2	30.0	31.1	32.6	34.2	36.1	38.1	40.3
Other	34.9	37.4	39.7	45.1	47.8	51.3	55.1	58.0	61.0
Cash in Vaults	5.7	6.2	6.2	6.4	6.6	6.8	7.0	7.2	7.4
Total Reserves	29.3	31.1	33.5	38.6	41.2	44.5	48.0	50.7	53.5
on Denar Deposits	16.0	17.0	19.4	22.3	24.0	26.4	28.9	30.5	32.2
on FX Deposits	13.3	14.1	14.1	16.4	17.1	18.1	19.1	20.2	21.3
				(Contribution to annual growth in reserve money)					
NFA	-17.8	34.9	-25.5	39.0	30.3	14.1	9.7	14.1	5.7
NDA	18.4	-27.9	34.7	-32.4	-24.7	-7.7	-3.2	-8.7	-0.3
				(Percentage change, year-on-year)					
Reserve Money	0.6	7.1	6.3	9.3	5.6	6.4	6.5	5.4	5.4
Memorandum Items:				(Percent of GDP)					
NBRM Bills	4.5	3.9	4.1	5.7	5.5	5.2	5.0	4.7	4.5
Government Deposits at Central Bank	4.7	5.5	3.5	4.2	4.0	3.8	3.6	3.5	3.3

Sources: NBRM; and IMF staff estimates.

Table 6. FYR Macedonia: External Sector Assessment		
Foreign Asset and Liability Position and Trajectory	**Background.** The net international investment position (NIIP) stood at – 57.8 percent of GDP at end-2017, slightly deteriorating from -57.3 percent in 2016. The change was mostly driven by a reduction in foreign exchange reserves caused by a delay in Eurobond issuance. Net liabilities of the banking sector only represent 5.5 percent of GDP, down from 5.9 percent of GDP in 2010. Gross foreign asset and liability positions were 51.2 percent of GDP and 109.1 percent of GDP, respectively in 2017. **Assessment.** The sizable negative NIIP poses some risks to external sustainability but is mitigated by the large share of FDI (representing 80 percent of NIIP). The NIIP is expected to improve to -55 percent of GDP by 2023 reflecting slower private sector borrowing.	**Overall Assessment:** The external position of the Former Yugoslav Republic of Macedonia is assessed to be broadly in line with medium-term fundamentals and desirable policies. The expected rebound in investment in the medium-term would bring the current account closer to its estimated norm without a need for the exchange rate to adjust.
Current Account	**Background.** The current account (CA) deficit shrank to 1.0 percent of GDP in 2017, driven by (i) a much slower growth of imports amidst a sharp slowdown in investment and (ii) accelerating export growth. Over the medium-term, the current account deficit is expected to gradually increase as investment-related imports expand again. **Assessment.** The EBA light CA model suggests a cyclically-adjusted norm of -2.7 percent of GDP for 2017, which is lower than the observed cyclically-adjusted CA balance of -1.8 percent of GDP. This suggests a CA gap of 0.9 percent of GDP, implying a small REER undervaluation of 2.1 percent. The model estimates a -1.2 percent policy gap mostly resulting from limited integration of the country to international financial markets.	
Real Exchange Rate	**Background.** The CPI-based real effective exchange rate (REER) appreciated slightly in 2017 (0.4 percent). **Assessment.** The REER EBA-lite approach points to a small undervaluation of 5.4 percent. In addition, the External Sustainability EBA-Lite approach suggests that stabilizing the net IIP at its 2017 level suggest undervaluation is marginal (-0.4 percent). Overall, all three approaches assess the real exchange rate to be close to its equilibrium value.	
Capital and Financial Accounts: Flows and Policy Measures	**Background.** FYR Macedonia experienced net capital inflows in 2017 even though portfolio flows dried out in the second half of the year as the new government delayed the issuance of Eurobond. Portfolio inflows have resumed in 2018 as well as FDI inflows – which held up well during the political crisis. **Assessment.** Capital and Financial flows are dominated by FDI flows and portfolio flows due to sovereign issuance. Other private flows have been small in recent years amidst stable external corporate borrowing and banks reduction of external funding.	
FX Intervention and Reserves Level	**Background.** FYR Macedonia has a de facto stabilized exchange rate arrangement. The peg to the euro is implemented by the NBRM with standing offers to buy and sell FX with the main banks at a small window around the target. **Assessment.** Reserves covered 90 percent of the ARA metric and 82 percent of short term in 2017. Coverage is projected to improve and reach broadly adequate levels, at 98 of both metrics in 2018 thanks to the Eurobond issuance and improving current account balance.	

Table 7. FYR Macedonia: Risk Assessment Matrix[1]
(Scale—high, medium, or low)

Source of Risks	Relative Likelihood	Impact If Realized	Recommended Policy Response
Country-specific			
Return of heightened political instability	**Low**	**Medium** • Deterioration of investor confidence, possible deposit outflows and financial instability; pressure on foreign exchange reserves • Higher sovereign borrowing costs	• Tighten monetary policy and adopt targeted macro-prudential measures to counter financial sector stress • Durable fiscal consolidation within a credible medium-term budget framework
Further delays in large investment projects	**Medium**	**Medium** • Slower near-term growth	• Accelerate procedures and technical work holding back large infrastructure projects • Take measures to improve business environment
Opening of EU accession negotiations in 2019	**Medium**	**High** • A stronger push for structural reforms • Higher FDI which could lift both near- and medium-term growth	• Steady implementation of the EU's Urgent Reform Priorities to benefit most from a possible opening of accession negotiations
Global			
Rising protectionism and retreat from multilateralism	**High**	**Medium** • Potential setback to global trade could lower exports and FDI	• Adopt a slower pace of fiscal consolidation, depending on the size of the shock • Accelerate structural reforms to enhance productivity and diversification and attract FDI. • Invest in skills and human capital
Weaker-than-expected global growth, particularly in the euro area	**Medium**	**Medium** • Weaker exports, remittances, and FDI, given significant direct trade and FDI linkages with the Euro area	
Sharp tightening of global financial conditions	**High**	**High** • Higher debt service costs and refinancing risks • Higher euroization which could put pressure on the peg	• Adopt a more ambitious fiscal consolidation plan to reduce financing needs • Tighten monetary policy to restore confidence

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability of 30 percent or more). The RAM reflects staff views on the source of risks at the time of discussions with the authorities.

Table 8. FYR Macedonia: Financial Soundness Indicators of the Banking System, 2012–2018

(in percent unless otherwise mentioned)

	2012	2013	2014	2015	2016	2017	2018Q2
Capital adequacy							
Regulatory capital/risk weighted assets	17.1	16.8	15.7	15.5	15.2	15.7	16.5
Tier I capital/risk weighted assets	14.5	14.4	13.7	13.9	13.9	14.2	15.1
Equity and reserves to Assets	11.2	11.3	10.8	10.8	10.6	10.8	15.0
Asset composition							
Structure of loans							
Enterprises (loans to enterprises/total loans)	56.9	55.4	55.2	53.9	51.3	50.2	48.8
Households (loans to households/total loans)	36.4	37.7	38.7	40.0	42.9	44.8	46.7
Lending with foreign currency component to private sector	55.4	52.7	49.4	46.5	44.9	42.5	42.7
Foreign currency lending/total credit to private sector	25.5	23.8	22.4	20.5	18.0	16.5	15.8
Foreign currency indexed lending/total credit to private sector	29.8	28.9	27.0	25.9	27.0	26.1	26.9
NPLs 1/							
NPLs/gross loans	10.1	10.9	10.8	10.3	6.3	6.1	4.9
NPLs net of provision/own funds	-3.7	-1.8	-3.0	-5.3	-5.5	-3.7	-6.4
Provisions to Non-Performing Loans	107.1	103.1	104.6	108.4	114.8	110.6	124.1
Large exposures/own funds	205.1	188.5	233.1	212.4	185.4	176.3	148.9
Connected lending							
Banking system exposure to subsidiaries and shareholders/own funds	3.5	4.2	4.3	3.4	8.4	3.8	4.1
Banking system equity investments/own funds	1.8	1.7	2.6	2.6	2.0	1.9	1.3
Earning and profitability							
ROAA 2/	0.4	0.6	0.8	1.1	1.5	1.4	2.4
ROAE 2/	3.8	5.7	7.4	10.4	13.6	13.5	21.3
Interest margin/gross income 3/	60.7	62.2	63.5	62.8	62.7	60.6	57.5
Noninterest expenses/gross income 4/	65.3	62.8	58.1	54.7	53.2	52.5	48.6
Personnel expenses/noninterest expenses	33.1	35.0	35.5	35.8	35.2	34.8	37.7
Interest Rates							
Local currency spreads	3.5	3.6	4.0	4.2	3.9	0.0	4.2
Foreign currency spreads	4.6	4.8	4.9	4.6	4.2	0.0	4.2
Interbank market interest rate	2.1	2.2	1.5	1.2	1.0	0.0	1.1
Liquidity							
Highly liquid assets/total assets 5/	29.4	27.3	25.5	24.3	25.7	23.2	22.5
Highly liquid assets/total short-term liabilities 6/	48.2	47.6	45.5	42.4	44.5	40.1	39.2
Liquid assets/total assets	32.4	31.2	29.8	28.2	28.9	27.1	27.1
Liquid assets/total short-term liabilities	53.0	54.5	53.2	49.2	50.1	46.9	47.4
Customer deposits/total (noninterbank) loans	113.5	112.7	113.4	110.3	114.9	114.0	114.5
Foreign currency deposits/total deposits	47.3	44.9	42.3	42.1	43.0	42.7	43.6
Including foreign exchange-indexed 7/	48.3	45.5	42.8	42.4	43.1	43.1	43.9
Sensitivity to market risk							
Net open foreign exchange position/own funds	11.4	15.6	17.5	11.1	14.5	6.2	6.4

Source: NBRM's Financial Stability Unit.

1/ Includes loans to financial and nonfinancial sector.

2/ Adjusted for unallocated provisions for potential loan losses.

3/ Interest margin represents interest income less interest expense. Gross income includes net interest income, fees and

4/ Noninterest expenses include fees and commissions expenses, operating expenses and other expenses excluding

5/ Highly liquid assets are defined as cash and balance with the NBRM, treasury bills, NBRM bills, and correspondent accounts with foreign banks. Assets in domestic banks are excluded from total assets.

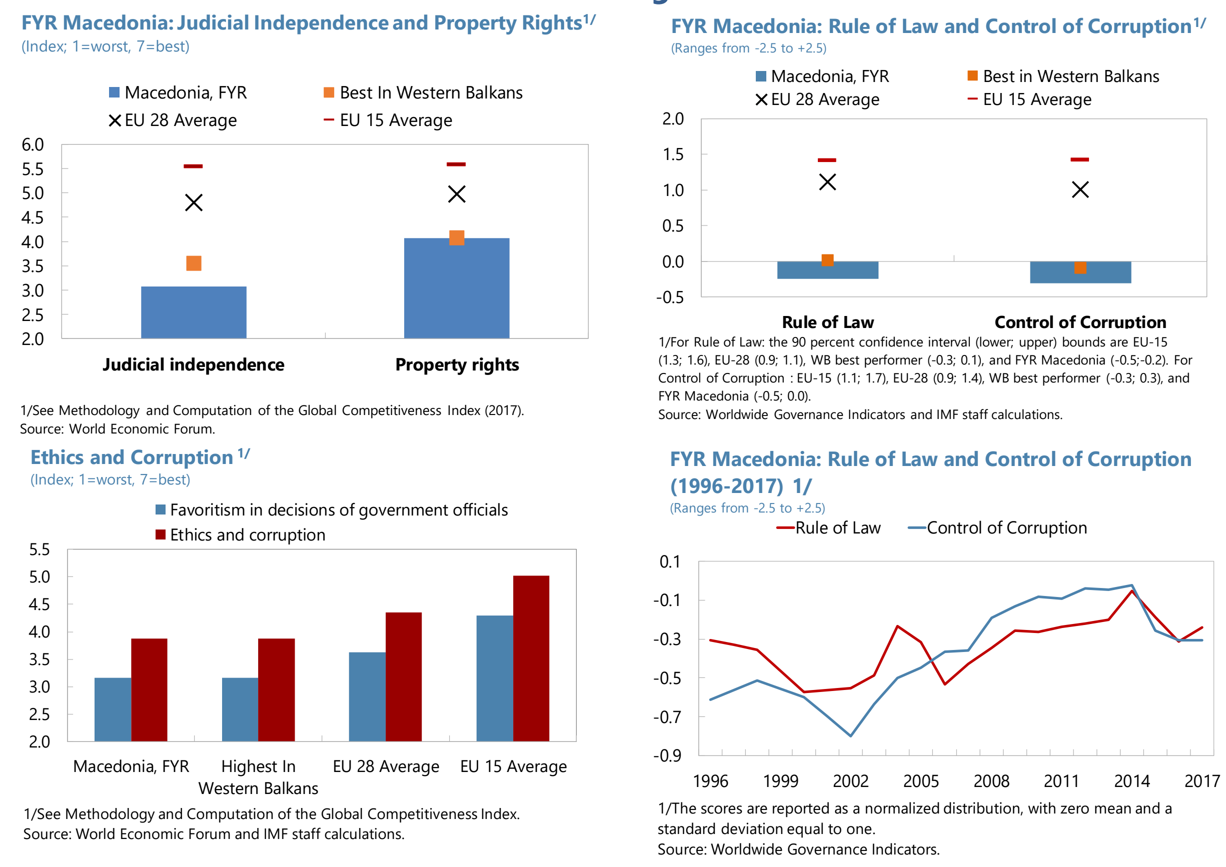
6/ Short-term liabilities are defined as deposits and other liabilities with a maturity of one year or less (without deposits and borrowings from domestic banks).

7/ FX indexed deposits include deposits and other FX indexed liabilities.

Annex I. Judicial Reform and Anti-Corruption Efforts in FYR Macedonia: Recent Progress and Next Steps

1. **Judicial reforms and the fight against corruption are key structural reform priorities for FYR Macedonia**. Material progress in these areas are paramount to starting accession negotiations with the EU, a long-standing goal of the country. Meanwhile, improving the quality and transparency of public institutions is expected to help boost potential growth, increase social inclusion, and provide a better environment for investment—all are prerequisites to accelerating income convergence with advanced Europe. A range of third-party indicators on governance highlight significant institutional gaps in FYR Macedonia (Annex I Figure 1).

Annex I. Figure 1



FYR Macedonia: Judicial Independence and Property Rights[1/]
(Index; 1=worst, 7=best)
1/See Methodology and Computation of the Global Competitiveness Index (2017).
Source: World Economic Forum.

FYR Macedonia: Rule of Law and Control of Corruption[1/]
(Ranges from -2.5 to +2.5)
1/For Rule of Law: the 90 percent confidence interval (lower; upper) bounds are EU-15 (1.3; 1.6), EU-28 (0.9; 1.1), WB best performer (-0.3; 0.1), and FYR Macedonia (-0.5;-0.2). For Control of Corruption : EU-15 (1.1; 1.7), EU-28 (0.9; 1.4), WB best performer (-0.3; 0.3), and FYR Macedonia (-0.5; 0.0).
Source: Worldwide Governance Indicators and IMF staff calculations.

Ethics and Corruption[1/]
(Index; 1=worst, 7=best)
1/See Methodology and Computation of the Global Competitiveness Index.
Source: World Economic Forum and IMF staff calculations.

FYR Macedonia: Rule of Law and Control of Corruption (1996-2017) 1/
(Ranges from -2.5 to +2.5)
1/The scores are reported as a normalized distribution, with zero mean and a standard deviation equal to one.
Source: Worldwide Governance Indicators.

2. **Decisive steps have been taken to start restoring judicial efficiency and effectiveness in FYR Macedonia**. A new reform strategy and action plan have been adopted in 2017 to address weaknesses highlighted in the Urgent Reform Priorities of the European Commission (EC) and the recommendations of the Venice Commission. Important progress has been made recently through a series of amendments to the Law on the Judicial Council in December 2017 and May 2018, and the Law on Courts in May 2018, regarding the appointment, appraisal, and promotion systems as well as disciplinary and dismissal procedures for judges. These legislative changes are expected to help provide buffers against undue interference in the

judicial system and enhance its functioning. Amendments to the Law on the protection of whistle-blowers are also an important step in corruption repression.

3. Sustained efforts are needed to address remaining institutional gaps and step up the fight against corruption. The EC's 2018 report on FYR Macedonia's EU candidacy acknowledges "some level of preparation" in these key areas but highlights persistent risks to judicial autonomy. This can negatively impact legal certainty, which underpins the efficiency of a market economy. The report calls for further efforts on part of the Judicial Council to safeguard against external and internal pressure, notes the prevalence of corruption in many sectors, and highlights shortcomings in the state's capacity to tackle it. Meanwhile, the Group of States against Corruption (GRECO) 2018 report on corruption prevention recommends further action to secure the autonomy and accountability of judges in settling disputes and strengthen the code of conduct of judges (see Annex I, Table 1). To date, final court rulings on high level corruption cases have been limited.[1] In this context, the EC report calls for a stronger track record on investigations, indictments, and final convictions in corruption cases, while empowering supervisory bodies with adequate budget, staff, and autonomy to fulfill their mandate. As of November 2018, additional legislative amendments have been prepared to address most of the outstanding recommendations and are expected to be discussed in Parliament in February 2019. Notwithstanding, tangible implementation of these legislative reforms remains key.

4. Stronger, more efficient institutions are expected to improve economic outcomes. Institutional reforms have a significant potential to raise income and productivity across Central, Eastern, and Southeastern Europe (IMF2016). In FYR Macedonia, strengthening the effective rule should help fend off the pernicious effects of widespread corruption on growth and provide a level playing field for those who supply capital, ideas, and labor to incentivize investment and innovation (Johnson and others 2002). While judicial reforms are particularly instrumental in that regard, strengthening the broader governance framework for public institutions is also critical to improving the distribution of resources. Enhancing fiscal and financial transparency, strengthening accountability, and discouraging rent-seeking behavior would help boost public investment efficiency and the quality of public services, including in education and healthcare, in line with staff recommendations. This would contribute to creating a favorable environment that can potentially slowdown the persistent drain of skilled workers and reduce related shortfalls in productivity and competitiveness (Cooray and Schneider 2014). In addition to EU membership aspirations providing a significant external anchor for the reform process and the effective modernization of the AML/CFT framework enhancing anti-corruption efforts, the IMF can continue to play a catalytic role through technical assistance to boost state capacity, particularly on public financial management, fiscal transparency.

[1] Out of 26 investigations launched by the Special Prosecutor's Office into high-level corruption, 17 indictments were confirmed. However, only a single defendant in one case was convicted.

Annex I. Table 1. GRECO's Recommendations and Assessment of its Second Compliance Report on Corruption Prevention in Respect of Judges in FYR Macedonia

Recommendation	GRECO Assessment	Recent Action by Authorities	Recommended Action
Abolish the ex officio membership of the Minister of Justice in the Judicial Council (JC).	**Not Implemented**	Constitutional amendments were prepared but later abandoned. Instead, the Law on the Judicial Council was amended in 2017 to deprive the Minister of Justice from voting rights in appointing judges.	Preclude the participation of the Minister of Justice in the JC through legislative or constitutional amendments.
Introduce specific guidelines and training to strengthen independence, and integrity of lay judges.	**Partly Implemented**	A training program, including on ethics and independent judiciary, is now delivered to lay-judges at the judicial academy.	Further strengthen the conditions required to become a lay judge to enhance integrity.
Increase the transparency of the decisions of the Judicial Council on the promotion of judges.	**Fully Implemented**	The Law on the Judicial Council was amended in 2017 obliging JC members to publicly explain their decision on the election of a judge, while informing each candidate in writing on the decision of election.	--
Review the appraisal system for judges to introduce more qualitative criteria and limit automatic grade lowering for some actions.	**Fully Implemented**	Amendments to the Law on Judicial Council overhauls the appraisal system for judges using quantitative as well as qualitative criteria, with 60 percent weight for the latter.	--
Develop rules and guidance for judges on the acceptance of gifts, hospitality, and other advantages.	**Partly Implemented**	A guide on principles of ethical behavior for judges was prepared in March 2016, with references to gifts and other ethical conduct. The new advisory body for Judicial Ethics is expected to ensure compliance.	Further enhance guidance using additional explanations, and concrete examples on unacceptable gifts and other advantages.
Clearly define disciplinary infringements applicable to judges and extend the range of sanctions. Reserve the dismissal of a judge for the most serious cases of misconduct and abolish automatic sanctions.	**Partly Implemented**	A new Law on Courts defines a series of serious and less serious violations, with an extended range of disciplinary measures; abolishes automatic sanctions. Dismissal is considered for 9 serious offences only, following a disciplinary procedure.	Reduce excessive vagueness of some offenses described in Article 75 of the law, like "unprofessional, untimely, or inattentive exercise of the judicial office".
Review disciplinary proceedings to judges to: (i) allow for one disciplinary procedure; (ii) separate the authority initiating proceedings from one deciding sanctions.	**Fully Implemented**	Amendments to the Law on the Judicial Council in May 2018 allow for a single disciplinary procedure. Earlier amendments in December 2017 prevent JC members participating in an investigation from voting on the disciplinary action for a judge.	--

Sources: GRECO Report on FYR Macedonia; Fourth Evaluation Round, Second Compliance Report, August 2018.

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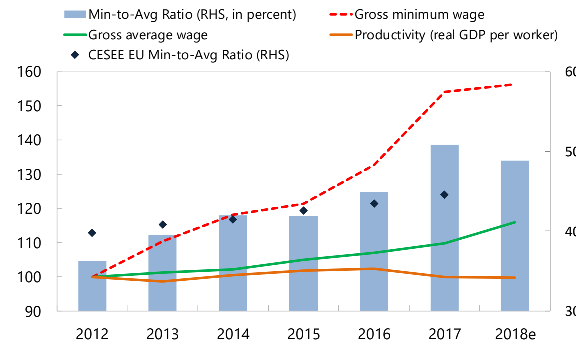
Annex II. Minimum Wage Policies in FYR Macedonia: Risks and Impact[1]

1. **Minimum wages have risen sharply relative to average wages and productivity over 2012–2018.** While labor productivity remained flat, minimum wages have risen by over 50 percent to about half the average wage, up from about a third in 2012, placing the ratio above the CESEE average in 2017.

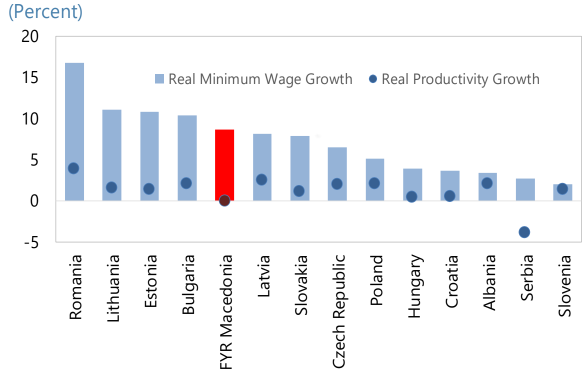
Wages and Productivity Growth, 2012-2018
(Index 100 in 2012)



Sources: State Statistical Office; Eurostat and IMF staff calculations.

2. **The trend is not unique to FYR Macedonia**. Real minimum wages have risen faster than productivity across CESEE, with as much as a 13-percentage point annual gap in countries like Romania. This reflects, in part, the increasing use of minimum wage policy as a tool to improve income distribution and economic conditions for low-wage earners with no direct fiscal costs. The effectiveness of such policy is subject to debate (see IMF 2016 for a literature review).

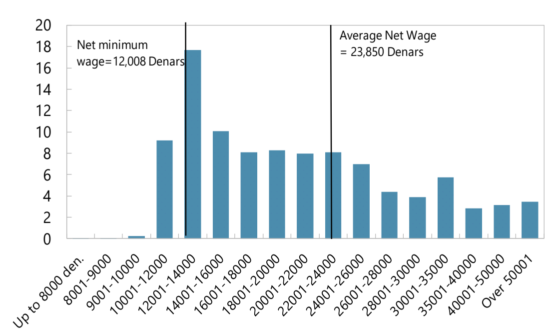
Average Annual Real Minimum Wage and Productivity Growth, 2012-2017
(Percent)



Source: Eurostat; WEO Database; and IMF staff calculations.

3. **FYR Macedonia's large shadow economy is central to the minimum wage policy debate.** Minimum wage is not binding for informal workers or businesses and can be circumvented without adequate compliance efforts. A higher minimum wage may push more businesses and employment into the informal sector if businesses cannot absorb the higher labor costs or pass it on to consumers. It can also trigger reshuffling of official and unofficial payments without affecting actual remuneration, particularly if there are incentives to avoid taxes and higher social security contributions.

Net Wage Distribution in all sectors, 2017
(Percent of total employed)



Sources: State Statistical Office; and IMF staff calculations.

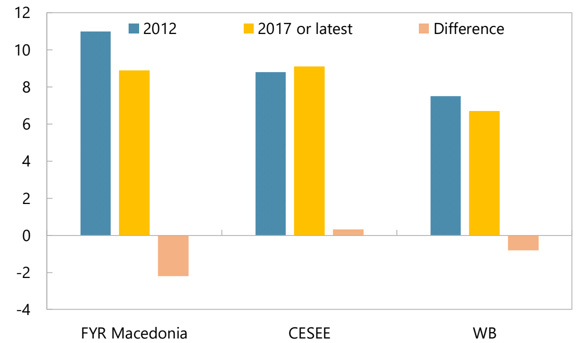
4. **Because of lower income levels, minimum wage policy affects more workers and businesses in the Western Balkans compared to EU peers**. Low-wage earners, defined as those earning less than two-thirds below the median wage, hover around 25 percent of employed persons in the WB, compared

[1] The annex is an updated analysis of "An Assessment of the Minimum Wage Policy," Omoev, Murad, 2017, *Selected Issues Paper on Former Yugoslav Republic of Macedonia,* IMF Country Report No. 17/276.

to an EU-average of 17 percent. In FYR Macedonia, almost 30 percent of all workers are currently at or close to the minimum wage floor, compared to 9 percent in Poland, 15 percent in Latvia and 22 percent in Romania (IMF 2016). This has been aggravated by the rapid increase in the minimum wage floor which compressed the lower-end of the wage distribution.

5. Raising the minimum wage may have supported low-wage earners in FYR Macedonia. Raising the minimum wage effectively increased the take-home pay for formal workers and may have reduced incentives to circumvent the tax wedge by working informally. Measures of income inequality like the Gini coefficient and in-work at risk poverty rate also improved since the introduction of the minimum wage.

In-Work at-Risk-of-Poverty Rate from 18 to 64 Years
(Percent)



Sources: Eurostat; and IMF staff calculations.

6. However, the authorities need to be aware of the trade-offs associated with minimum wage hikes. To the extent they are binding, large minimum wage hikes could raise unit labor costs, with adverse effects on competitiveness of low-skill labor intensive sectors, especially given stagnant productivity growth. In FYR Macedonia, around half of the workers in the manufacturing and trade sectors currently earn minimum wage suggesting a direct and measurable impact on firms' cost of labor. Minimum wage increases can also affect the general wage level in the economy if wage differentials were to be reasonably maintained. Depending on country circumstances and the tightness in the labor market, the pass-through could range from 10 to 45 percent (IMF 2016). As discussed above, without efforts to increase tax compliance, higher minimum wage may increase informality.

7. The full economic effects of recent increases are yet to be assessed. Government subsidies were offered for the labor-intensive textile and leather industries in order to comply with the minimum wage policy. The impact on the profitability and competitiveness of these and other labor-intensive export industries will become clearer after these subsidies expire in 2018.

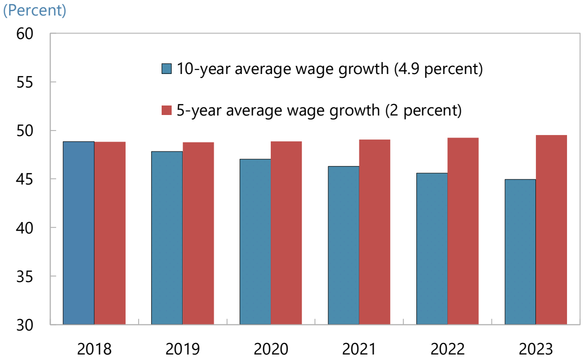
8. The authorities should exercise caution with further ad-hoc increases in the minimum wage. Despite the recent favorable impact on minimum wage earners, the minimum-to-average wage ratio in FYR Macedonia (49 percent) is at a critical threshold beyond which further increases have been associated with adverse effects on employment of youth and unskilled workers. An IMF cross-country study on select CESEE countries found that, at a ratio of 45 percent, a further increase in the minimum wage of 10 percent is associated with a reduction of youth employment by 2 percent—a costly outcome for a country struggling with a 48 percent youth unemployment. This is consistent with existing literature (see Neumark and Wascher 2013, and Neumark 2015) and is supported by another EC cross-country study showing a 1.5 to 2 percent decrease in employment rate of young adults and the unskilled for a 10 percent increase in minimum wages across a sample of 19 EU countries (EC 2018). There is also suggestive evidence that that distributional benefits diminish once the ratio reaches a high level.

9. The introduction of a minimum wage indexation formula is expected to hedge against ad-hoc increases, but reform efforts are needed to preserve competitiveness. Starting from March 2019–2020, minimum wage increases would be tied to the average of CPI changes, real GDP growth, and average wage growth. This is expected to hold the current minimum-to-average wage ratio stable under moderate wage growth assumptions. Notwithstanding, a ratio below 40 percent is considered more favorable for emerging countries, with even a lower threshold if unemployment is high and concentrated among the young and the low-skilled (Rutkowski 2003).

10. The absolute level of labor cost vis-à-vis peers needs to be monitored to ensure regional competitiveness is not passively eroded. As of 2017/2018, estimated hourly labor cost for FYR Macedonia of around 3 euros remains below that of Bulgaria (about 5 euros), the lowest in the EU. However, significant productivity shortfalls vis-à-vis other EU peers render FYR Macedonia less competitive, even on a PPP-adjusted basis. This requires efforts to raise value-added per worker, including through boosting labor skills, adopting new technologies, and moving up the value chain.

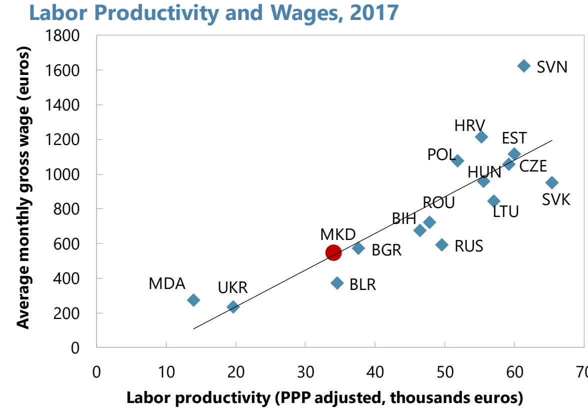
Minimum-to-Average Wage Ratio

(Percent)



Sources: FYR Macedonia Authorities, and IMF staff calculations.

Labor Productivity and Wages, 2017



Sources: National authorities, The Conference Board Total Economy Database™ (Adjusted version), May 2017and IMF staff calculations.

11. Tackling inequality more effectively requires policy efforts that go much beyond the minimum wage. Minimum wages can improve the wage distribution to some extent if they start from a low base and if they are adequately enforceable. At the current minimum wage level, authorities should focus on complementary measures like better targeting of social spending, a more progressive tax system, and more comprehensive taxation of capital and wealth.

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Annex III. Debt Sustainability Analysis

General government and public debt is projected to increase, driven by primary deficits before stabilizing toward the end of the medium-term projection period. Public debt is assessed sustainable under the staff's baseline projection, but high gross financing needs and potential shocks to growth continue to constitute major risks. Durable fiscal consolidation is therefore needed to put debt firmly on a downward path and rebuild fiscal space. Improvement in public debt management is visible and should be continued.

A. Background

1. FYR Macedonia's public debt, which includes general government and SOE-guaranteed debt, has nearly doubled since 2008, reaching 48 percent of GDP in 2017. Over this period, the general government debt has increased by 18¾ percentage points of GDP to about 39½ percent of GDP at end-2017. Despite revenue shortfalls and increases in pensions and subsidies, the fiscal deficit has narrowed in recent years due to a halt in goods and services, and capital investment spending during the political crisis. Publicly guaranteed debt of SoEs rose from 2½ percent of GDP in 2008 to 8½ percent of GDP at end-2017 due to implementations of public transport infrastructure projects by the Public Enterprise for State Roads (PESR). Meanwhile, medium-term gross financing requirements of the general government and the public sector are high due to high roll-over needs, peaking at about 13 and 15 percent of GDP, respectively, in the next three years.

2. There have been improvements in the public debt structure, particularly in domestic public debt. The average maturity of outstanding government securities has increased significantly from less than 12 months in 2011 to around 4½ years by 2017, reflecting increasing reliance on long-term borrowing. In the meantime, the share of FX-denominated domestic government securities has declined from 90 percent in 2009 to around 46½ percent in 2017. Interest rates on all types of securities have decreased noticeably. However, most of the public debt is external, resulting in around three-quarters of public debt being FX-denominated.

3. External debt has increased by 25 percent of GDP since 2008, reaching 73.9 percent of GDP in 2017. The main drivers of the increases in external debt have been public sector borrowing and FDI-related intercompany borrowing. External gross financing needs have continued their declining trend to reach 19 percent of GDP in 2017, thanks to a broadly stable debt service in nominal terms and moderately improving trade balances.

B. Public DSA Results

Baseline

4. The baseline scenario assumes a temporary increase in the fiscal deficit in 2019, followed by a gradual consolidation over the medium term. It's underpinned by the following assumptions.

- *Real GDP growth* is projected to be around 2 percent of GDP in 2018, a slight rebound after stalling in 2017, driven by private consumption and net exports. Medium-term growth is projected to pick up to around 3½ percent of GDP, supported by investment, expanded export capacities, and continued improvements in the labor markets. This is broadly consistent with the medium-term growth potential.

- *Headline inflation* is projected to gradually reach 2 percent by end-2019 reflecting a narrowing output gap and wage pressures.

- *The general government primary balance* is projected to decline slightly to around 2.6 percent of GDP in 2018. Following slight increase to about 3 percent in 2019, the deficit is expected to narrow gradually to 2.4 percent of GDP in the medium term, reflecting, in particular, the pension reform measures introduced in conjunction with the 2019 budget.

5. Forecast error analysis suggests no systemic bias in historical estimations of real GDP growth and primary balance, but some negative bias on inflation. Forecasts of the primary balance were optimistic between 2012 and 2014. However, this bias disappeared in recent years and became more conservative. Growth projections have remained within the interquartile range in the past five years, except for in 2017 when growth stagnated because of the political crisis and a halt in investment.

6. Under the baseline scenario, the public debt is expected to rise to around 55 percent in the medium term, driven by increases in both general government and guaranteed debt, with gross financing needs reaching about 15 percent of GDP in 2021. Due to the limited projected fiscal consolidation, the general government debt would continue its upward trajectory to about 44 percent at end-2023. Publicly guaranteed debt is expected to grow by around 2½ percentage points of GDP between 2017 and 2021, reflecting continued borrowing to finance public infrastructure investments, before gradually declining at the end of the projection period. Baseline public gross financing requirements are projected to remain high and peak in 2021 around the 15-percent benchmark, mainly due to the general government's amortization of Eurobonds and syndicated loans.

C. Macro-Fiscal and Additional Stress Tests

7. Macroeconomic and fiscal shocks can significantly increase public debt and public gross financing needs relative to the baseline. Among all stress test scenarios, FYR Macedonia has the highest vulnerability to a combined macro-fiscal shock and the real GDP growth shock of one standard deviation in 2019-20.[1] Under these stress test scenarios, public debt would rise to 60–63 percent of GDP in the medium term with gross financing needs being at and above 15 percent of GDP through 2021. Closing the real exchange rate gap implies a small exchange rate appreciation which will result in a very slight decline in external public debt and external gross financing needs.[2] Nonetheless, the still substantial share of FX-denominated public debt poses general vulnerability to exchange rate risks.

8. In addition, fan charts illustrate the possible evolution of public debt over the medium term. They present a spectrum of possible outcomes for the public debt level based on a probabilistic view of uncertainty around the baseline. Under a symmetric distribution, the public debt stock at end-2023 would remain below 60 percent of GDP in 80 percent of the simulated outcomes. However, under a restricted distribution, which precludes positive shocks to the primary balance, public debt rises above 60 percent in more than 30 percent of simulations.

D. External Debt Sustainability

9. The external debt is expected to peak in 2019 before gradually declining thereafter. The debt level is expected to peak at 78.5 percent of GDP in 2019 and gradually decline thereafter as growth improves. Trade deficits are projected to decrease moderately from 17.8 percent of GDP in 2021 to 17.4 percent in 2023. The projected expansion in private sector borrowing in medium and long-term loans is expected to be remain modest while public debt service is gradually reduced starting in 2020–2021.

10. The external debt path is particularly sensitive to real exchange rate depreciation and non-interest current account shocks. Under a 30 percent exchange rate depreciation shock, foreign debt level would increase to 112 percent of GDP in 2019 and stay broadly stable around that level afterwards. The shock to the current account of half a standard deviation (around 2 percent of GDP) would cause a more gradual deterioration in external debt. However, debt would not stabilize over the forecast horizon to reach 84 percent of GDP in 2023, A fiscal path worse than assumed under the baseline could also have a significant impact on external debt dynamics by leading to larger and more expensive external borrowing as well as higher trade deficits (Figure 9).

E. Conclusion

11. Stronger fiscal consolidation is needed to ensure fiscal sustainability and create fiscal space. While the level of public debt is not alarmingly high, the speed of debt accumulation since the financial crisis calls for caution. Baseline gross financing needs are already around the 15 percent benchmark, and adverse shocks, particularly in GDP growth. could send

[1] Stress tests include individual shocks to macro variables (real interest rate, real GDP growth, real exchange rate) and primary balance. The combined macro-fiscal shock incorporates the largest effect of individual shocks on all variables.

[2] The real exchange rate gap is estimated to be around -2.7 percent (Table 6).

general government and public debt to around 48½ and 60 percent of GDP respectively by 2023. Space for fiscal policy, the main countercyclical stabilization policy tool in FYR Macedonia, is limited. The general government's primary deficit is expected to be around 1 percent of GDP by 2023, broadly around the debt-stabilizing primary balance, implying need for stronger fiscal consolidation to put public debt firmly on a downward path. In addition, public debt sustainability depends on sound macroeconomic management and continuing progress on institutional and structural issues which would help unlock the economy's growth potential and reduce its vulnerability to shocks.

12. The improvement in public debt management is welcome and should be continued. Notwithstanding positive progress to date, efforts to further lengthen the average maturity of domestic debt and deepen the secondary market would help reduce the domestic debt roll-over and interest rate risks. With a large share of public debt being external, the medium-term fiscal strategy should be accompanied by a debt management strategy that strikes a balance between achieving an efficient mix of external and domestic financing to maintain overall macroeconomic stability.

Figure 1. FYR Macedonia: General Government Debt Sustainability Analysis (DSA) Borderline Scenario

(In percent of GDP unless otherwise indicated)

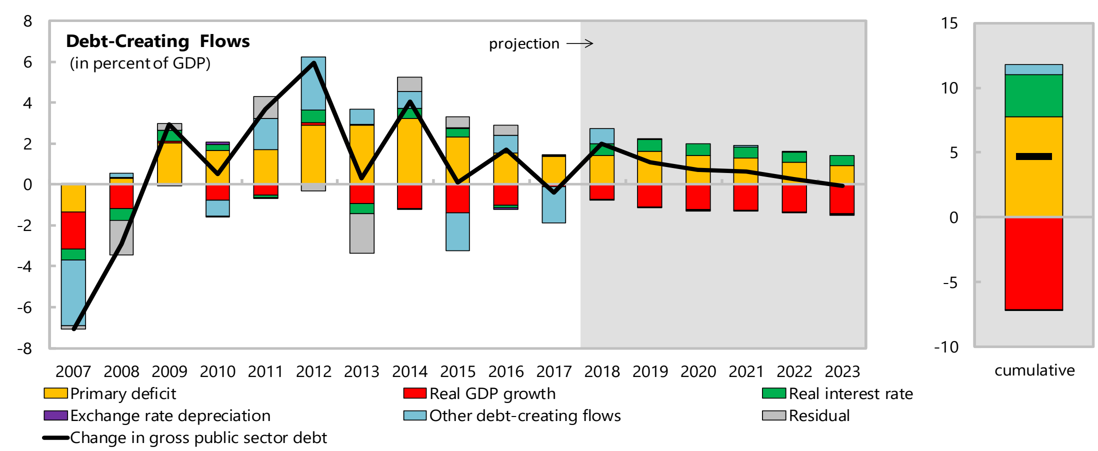
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2007-2015 [2/]	2016	2017	2018	2019	2020	2021	2022	2023
Nominal gross public debt	29.3	39.8	39.4	41.4	42.5	43.2	43.8	44.1	44.1
Public gross financing needs	14.7	14.9	12.4	13.7	11.7	12.2	12.8	9.2	9.6
Real GDP growth (in percent)	3.0	2.8	0.2	2.0	2.8	3.0	3.1	3.3	3.4
Inflation (GDP deflator, in percent)	2.8	3.5	3.4	1.7	2.0	2.0	2.2	2.2	2.2
Nominal GDP growth (in percent)	5.9	6.4	3.7	3.7	4.9	5.1	5.4	5.6	5.7
Effective interest rate (in percent) [4/]	3.1	3.2	3.6	3.2	3.5	3.5	3.5	3.5	3.5

As of October 10, 2018		
Sovereign Spreads		
EMBIG (bp) 3/	293	
5Y CDS (bp)	n.a.	
Ratings	Foreign	Local
Moody's	n.a.	n.a.
S&Ps	BB-	BB-
Fitch	BB	BB

Contribution to Changes in Public Debt

	Actual			Projections							
	2007-2015	2016	2017	2018	2019	2020	2021	2022	2023	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	0.8	1.7	-0.4	2.0	1.1	0.7	0.6	0.3	-0.1	4.6	
Identified debt-creating flows	1.0	1.2	-0.4	2.0	1.1	0.7	0.6	0.3	-0.1	4.7	
Primary deficit	1.7	1.6	1.4	1.4	1.6	1.4	1.3	1.1	0.9	7.8	-1.0
Primary (noninterest) revenue and gra	29.9	28.4	29.1	29.7	30.9	30.9	30.8	30.8	30.8	183.9	
Primary (noninterest) expenditure	31.6	30.0	30.5	31.1	32.5	32.3	32.1	31.9	31.7	191.7	
Automatic debt dynamics [5/]	-0.8	-1.2	0.0	-0.2	-0.5	-0.6	-0.8	-0.9	-0.9	-3.9	
Interest rate/growth differential [6/]	-0.8	-1.2	0.0	-0.2	-0.5	-0.6	-0.8	-0.9	-0.9	-3.9	
Of which: real interest rate	0.1	-0.1	0.0	0.6	0.6	0.6	0.5	0.5	0.5	3.2	
Of which: real GDP growth	-0.8	-1.0	-0.1	-0.7	-1.1	-1.2	-1.3	-1.4	-1.4	-7.1	
Exchange rate depreciation [7/]	0.0	-0.1	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.0	0.9	-1.8	0.8	0.0	0.0	0.1	0.0	0.0	0.8	
Privatization receipts (negative)	-0.2	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Changes in cash, deposits, and securi	0.2	0.9	-1.7	0.8	0.0	0.0	0.1	0.0	0.0	0.8	
Residual, including asset changes [8/]	-0.2	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi(1+g)$ and the real growth contribution as $-g$.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

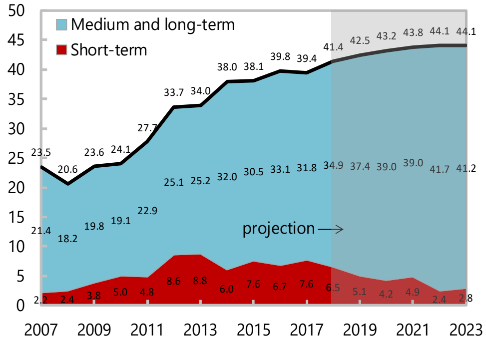
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

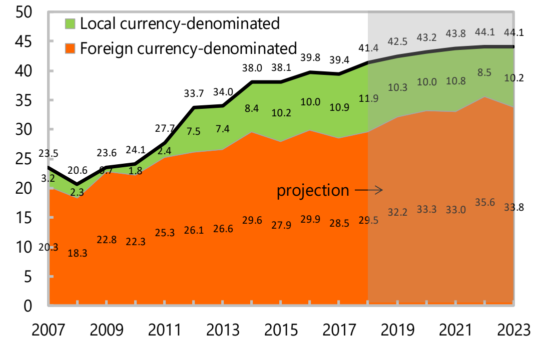
Figure 2. FYR Macedonia: General Government DSA – Composition of General Government Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



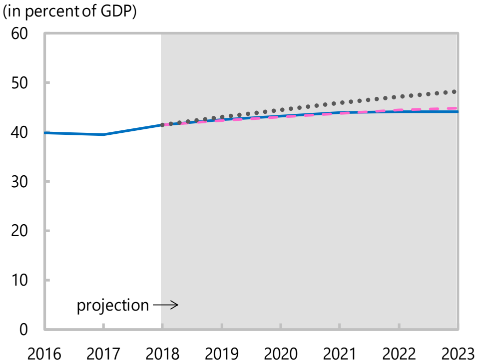
By Currency
(in percent of GDP)



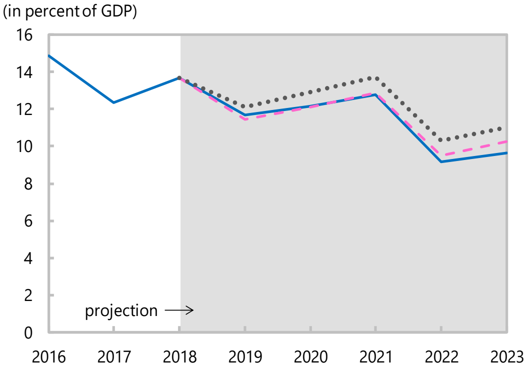
Alternative Scenarios

Baseline · Historical · Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



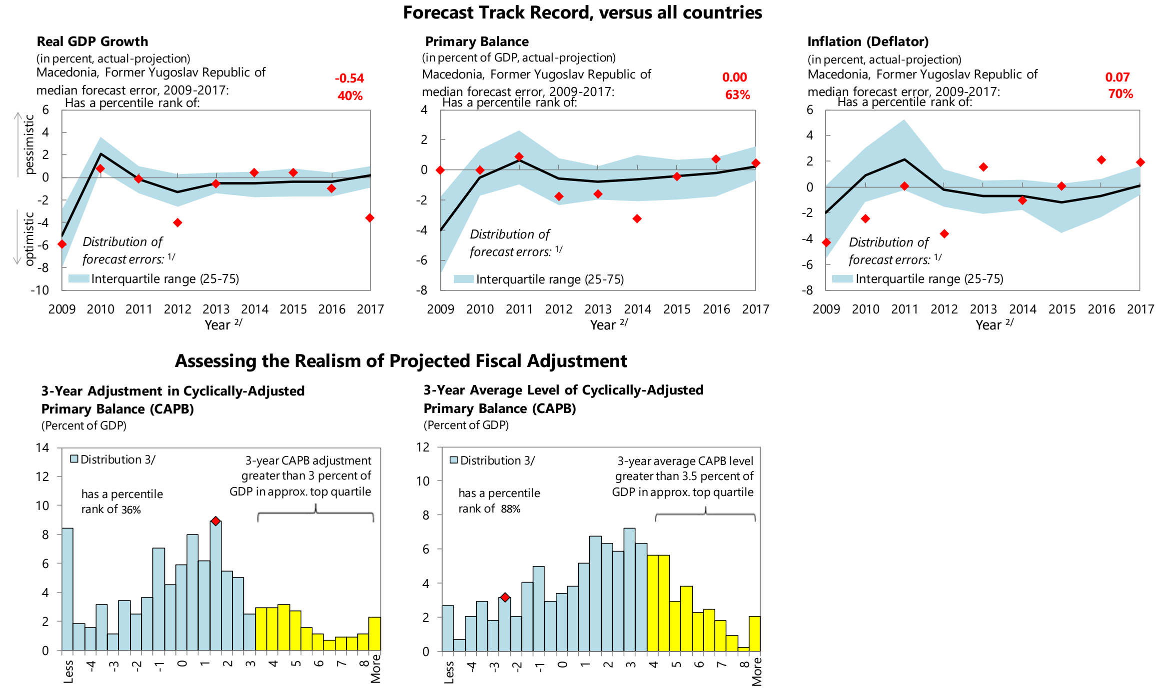
Underlying Assumptions
(in percent)

Baseline Scenario	2018	2019	2020	2021	2022	2023
Real GDP growth	2.0	2.8	3.0	3.1	3.3	3.4
Inflation	1.7	2.0	2.0	2.2	2.2	2.2
Primary Balance	-1.4	-1.6	-1.4	-1.3	-1.1	-0.9
Effective interest rate	3.2	3.5	3.5	3.5	3.5	3.5
Constant Primary Balance Scenario						
Real GDP growth	2.0	2.8	3.0	3.1	3.3	3.4
Inflation	1.7	2.0	2.0	2.2	2.2	2.2
Primary Balance	-1.4	-1.4	-1.4	-1.4	-1.4	-1.4
Effective interest rate	3.2	3.5	3.5	3.5	3.5	3.5

Historical Scenario	2018	2019	2020	2021	2022	2023
Real GDP growth	2.0	2.4	2.4	2.4	2.4	2.4
Inflation	1.7	2.0	2.0	2.2	2.2	2.2
Primary Balance	-1.4	-2.0	-2.0	-2.0	-2.0	-2.0
Effective interest rate	3.2	3.5	3.2	3.1	2.9	2.7

Source: IMF staff.

Figure 3. FYR Macedonia: General Government DSA – Realism of Baseline Assumptions



Source : IMF Staff.

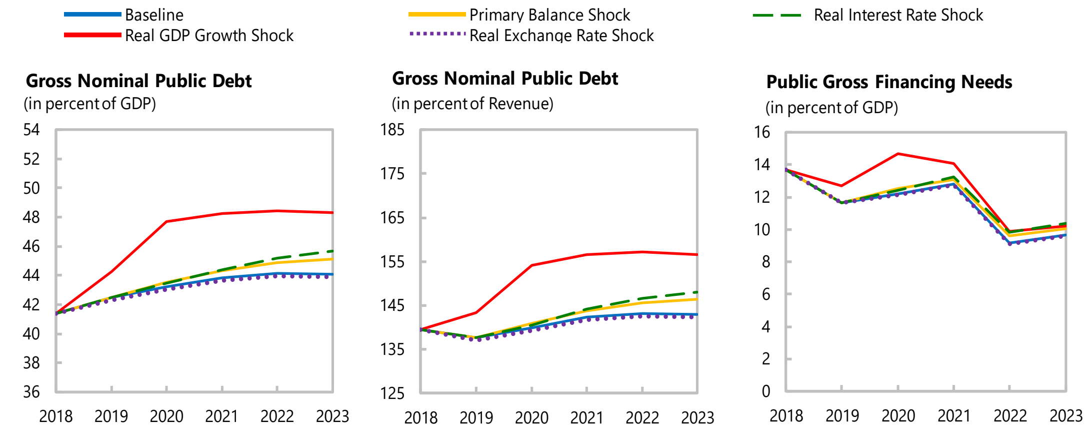
1/ Plotted distribution includes all countries, percentile rank refers to all countries.

2/ Projections made in the spring WEO vintage of the preceding year.

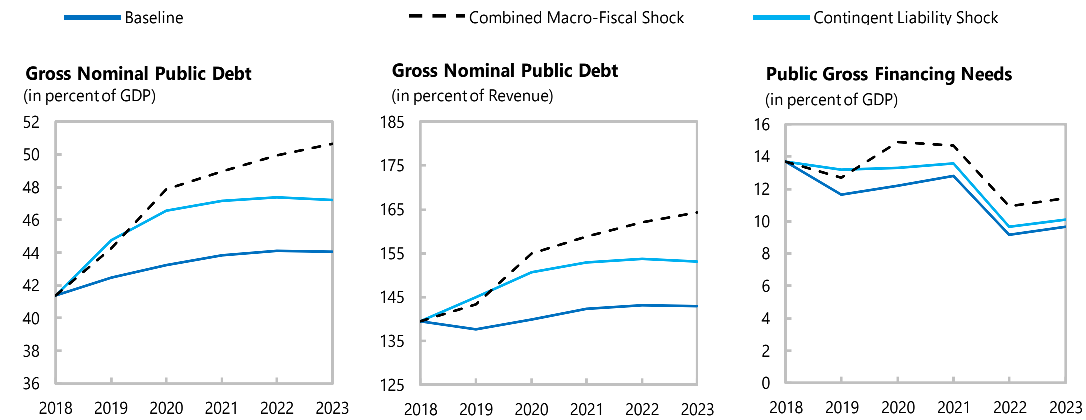
3/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Figure 4. FYR Macedonia: General Government DSA – Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

	2018	2019	2020	2021	2022	2023
Primary Balance Shock						
Real GDP growth	2.0	2.8	3.0	3.1	3.3	3.4
Inflation	1.7	2.0	2.0	2.2	2.2	2.2
Primary balance	-1.4	-1.6	-1.7	-1.5	-1.4	-1.2
Effective interest rate	3.2	3.5	3.5	3.5	3.5	3.5
Real Interest Rate Shock						
Real GDP growth	2.0	2.8	3.0	3.1	3.3	3.4
Inflation	1.7	2.0	2.0	2.2	2.2	2.2
Primary balance	-1.4	-1.6	-1.4	-1.3	-1.1	-0.9
Effective interest rate	3.2	3.5	4.1	4.4	4.7	4.8
Combined Shock						
Real GDP growth	2.0	0.8	1.0	3.1	3.3	3.4
Inflation	1.7	1.5	1.5	2.2	2.2	2.2
Primary balance	-1.4	-2.4	-3.0	-1.5	-1.4	-1.2
Effective interest rate	3.2	3.5	4.1	4.3	4.6	4.7

	2018	2019	2020	2021	2022	2023
Real GDP Growth Shock						
Real GDP growth	2.0	0.8	1.0	3.1	3.3	3.4
Inflation	1.7	1.5	1.5	2.2	2.2	2.2
Primary balance	-1.4	-2.4	-3.0	-1.3	-1.1	-0.9
Effective interest rate	3.2	3.5	3.6	3.6	3.5	3.5
Real Exchange Rate Shock						
Real GDP growth	2.0	2.8	3.0	3.1	3.3	3.4
Inflation	1.7	1.7	2.0	2.2	2.2	2.2
Primary balance	-1.4	-1.6	-1.4	-1.3	-1.1	-0.9
Effective interest rate	3.2	3.5	3.5	3.5	3.5	3.5
Contingent Liability Shock						
Real GDP growth	2.0	0.8	1.0	3.1	3.3	3.4
Inflation	1.7	1.5	1.5	2.2	2.2	2.2
Primary balance	-1.4	-2.9	-1.4	-1.3	-1.1	-0.9
Effective interest rate	3.2	3.6	3.6	3.5	3.5	3.5

Source: IMF staff.

Figure 5. FYR Macedonia: General Government DSA Risk Assessment

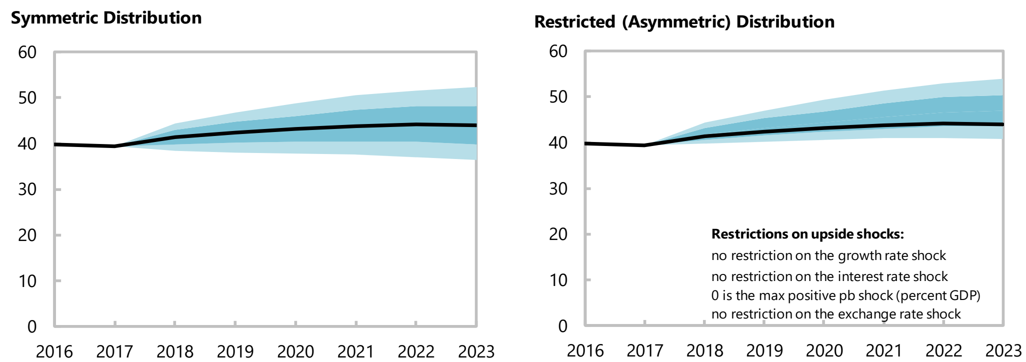
Heat Map

Debt level 1/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs 2/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile 3/	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)

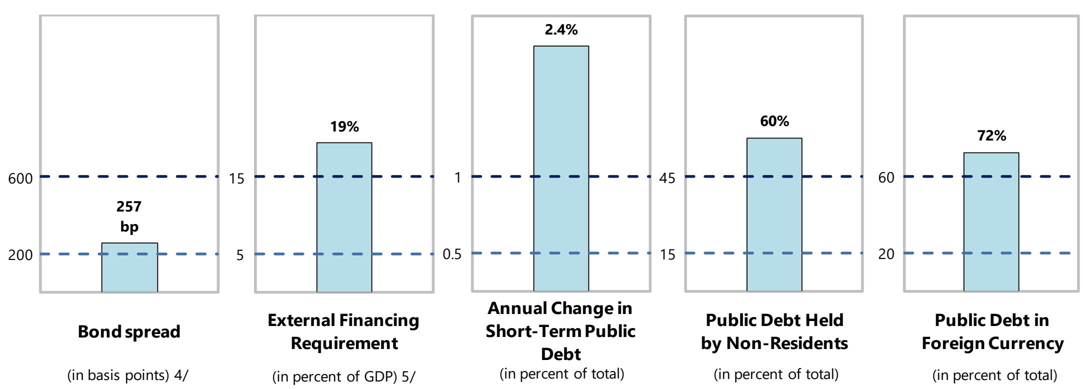
Baseline Percentiles: 10th-25th 25th-75th 75th-90th



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2017)

Macedonia, Former Yugosla Lower early warning Upper early warning



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ Long-term bond spread over German bonds, an average over the last 3 months, 12-Jul-18 through 10-Oct-18.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Figure 6. FYR Macedonia: Public Sector General Government Debt Sustainability (DSA) – Baseline Scenario

(In percent of GDP unless otherwise indicated)

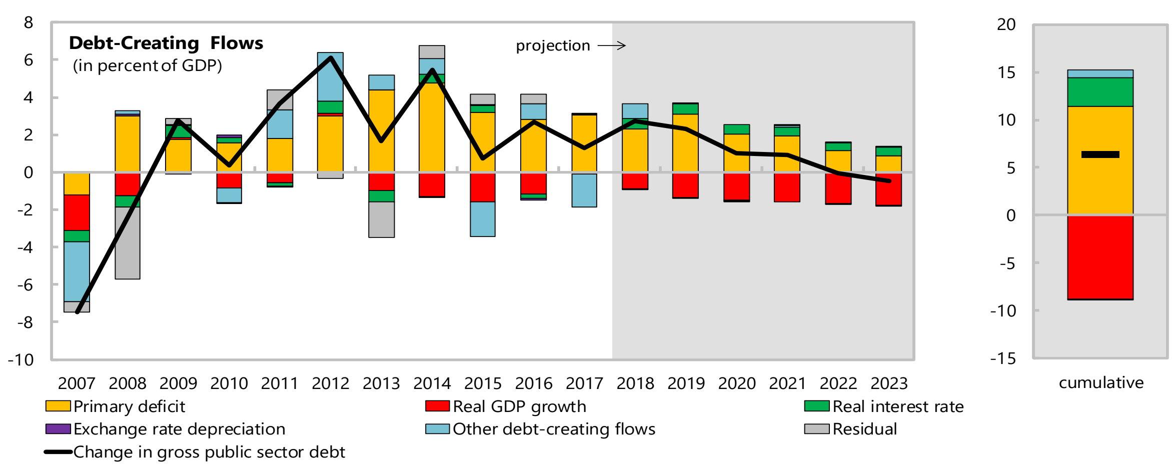
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2007-2015 [2/]	2016	2017	2018	2019	2020	2021	2022	2023
Nominal gross public debt	32.5	46.7	48.0	50.7	53.0	54.0	54.9	54.9	54.4
Public gross financing needs	16.4	16.6	14.9	15.4	14.4	14.2	14.9	10.7	11.1
Real GDP growth (in percent)	3.0	2.8	0.2	2.0	2.8	3.0	3.1	3.3	3.4
Inflation (GDP deflator, in percent)	2.8	3.5	3.4	1.7	2.0	2.0	2.2	2.2	2.2
Nominal GDP growth (in percent)	5.9	6.4	3.7	3.7	4.9	5.1	5.4	5.6	5.7
Effective interest rate (in percent) [4/]	3.1	3.0	3.5	3.0	3.2	3.2	3.2	3.1	3.1

As of October 10, 2018		
Sovereign Spreads		
EMBIG (bp) 3/		293
5Y CDS (bp)		n.a.
Ratings	Foreign	Local
Moody's	n.a.	n.a.
S&Ps	BB-	BB-
Fitch	BB	BB

Contribution to Changes in Public Debt

	Actual			Projections							
	2007-2015	2016	2017	2018	2019	2020	2021	2022	2023	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	1.2	2.7	1.3	2.7	2.3	1.0	0.9	-0.1	-0.5	6.4	
Identified debt-creating flows	1.7	2.2	1.2	2.7	2.3	1.0	0.9	-0.1	-0.5	6.4	
Primary deficit	2.5	2.8	3.1	2.3	3.1	2.0	1.9	1.2	0.9	11.4	-1.4
Primary (noninterest) revenue and gra	29.9	28.4	29.1	29.7	30.9	30.9	30.8	30.8	30.8	183.9	
Primary (noninterest) expenditure	32.4	31.2	32.2	32.0	34.0	32.9	32.8	32.0	31.7	195.3	
Automatic debt dynamics [5/]	-0.8	-1.5	-0.1	-0.3	-0.8	-1.0	-1.1	-1.3	-1.3	-5.8	
Interest rate/growth differential [6/]	-0.9	-1.4	-0.1	-0.3	-0.8	-1.0	-1.1	-1.3	-1.3	-5.8	
Of which: real interest rate	0.1	-0.2	0.0	0.6	0.6	0.5	0.5	0.4	0.4	3.0	
Of which: real GDP growth	-0.9	-1.2	-0.1	-0.9	-1.4	-1.5	-1.6	-1.7	-1.8	-8.8	
Exchange rate depreciation [7/]	0.0	-0.1	0.0	...	...	...	...	...	...	...	
Other identified debt-creating flows	0.0	0.9	-1.8	0.8	0.0	0.0	0.1	0.0	0.0	0.8	
Privatization receipts (negative)	-0.2	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Changes in cash, deposits, and secur	0.2	0.9	-1.7	0.8	0.0	0.0	0.1	0.0	0.0	0.8	
Residual, including asset changes [8/]	-0.4	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	



Source: IMF staff.

1/ Includes general government and SOEs debt.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

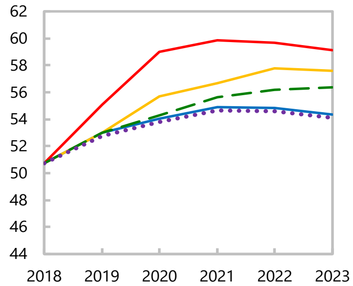
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure 7. FYR Macedonia: Public Sector DSA – Stress Tests

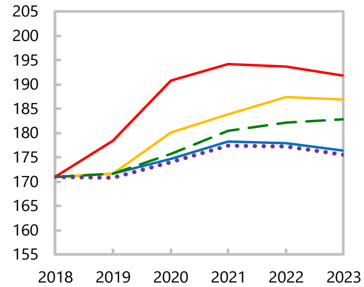
Macro-Fiscal Stress Tests

Baseline
Real GDP Growth Shock
Primary Balance Shock
Real Exchange Rate Shock
Real Interest Rate Shock

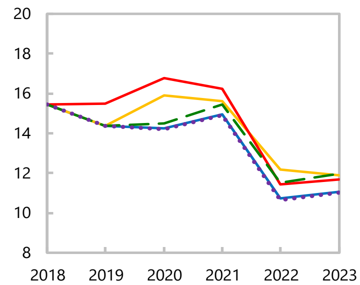
Gross Nominal Public Debt
(in percent of GDP)



Gross Nominal Public Debt
(in percent of Revenue)



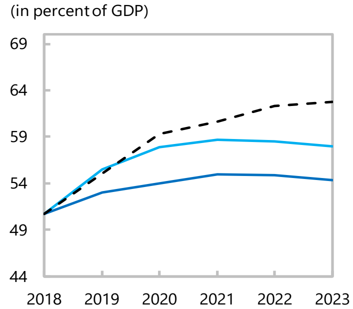
Public Gross Financing Needs
(in percent of GDP)



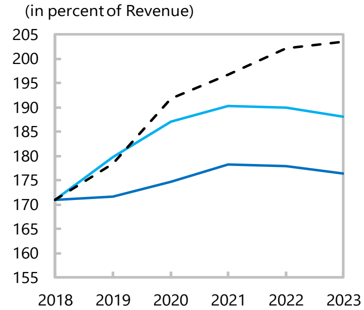
Additional Stress Tests

Baseline
Combined Macro-Fiscal Shock
Contingent Liability Shock

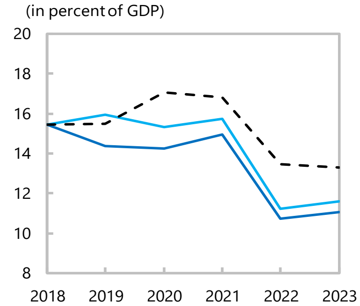
Gross Nominal Public Debt
(in percent of GDP)



Gross Nominal Public Debt
(in percent of Revenue)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

Primary Balance Shock	2018	2019	2020	2021	2022	2023
Real GDP growth	2.0	2.8	3.0	3.1	3.3	3.4
Inflation	1.7	2.0	2.0	2.2	2.2	2.2
Primary balance	-2.3	-3.1	-3.7	-2.0	-2.3	-1.3
Effective interest rate	3.0	3.2	3.2	3.3	3.2	3.2
Real Interest Rate Shock						
Real GDP growth	2.0	2.8	3.0	3.1	3.3	3.4
Inflation	1.7	2.0	2.0	2.2	2.2	2.2
Primary balance	-2.3	-3.1	-2.0	-1.9	-1.2	-0.9
Effective interest rate	3.0	3.2	3.7	4.0	4.3	4.5
Combined Shock						
Real GDP growth	2.0	0.8	1.0	3.1	3.3	3.4
Inflation	1.7	1.5	1.5	2.2	2.2	2.2
Primary balance	-2.3	-3.9	-3.7	-2.0	-2.3	-1.3
Effective interest rate	3.0	3.2	3.7	4.0	4.3	4.4

Real GDP Growth Shock	2018	2019	2020	2021	2022	2023
Real GDP growth	2.0	0.8	1.0	3.1	3.3	3.4
Inflation	1.7	1.5	1.5	2.2	2.2	2.2
Primary balance	-2.3	-3.9	-3.6	-1.9	-1.2	-0.9
Effective interest rate	3.0	3.2	3.2	3.3	3.2	3.2
Real Exchange Rate Shock						
Real GDP growth	2.0	2.8	3.0	3.1	3.3	3.4
Inflation	1.7	1.7	2.0	2.2	2.2	2.2
Primary balance	-2.3	-3.1	-2.0	-1.9	-1.2	-0.9
Effective interest rate	3.0	3.2	3.2	3.2	3.1	3.1
Contingent Liability Shock						
Real GDP growth	2.0	0.8	1.0	3.1	3.3	3.4
Inflation	1.7	1.5	1.5	2.2	2.2	2.2
Primary balance	-2.3	-4.3	-2.0	-1.9	-1.2	-0.9
Effective interest rate	3.0	3.3	3.2	3.2	3.2	3.2

Source: IMF staff.

Figure 8. FYR Macedonia: Public Sector DSA Risk Assessment

Heat Map

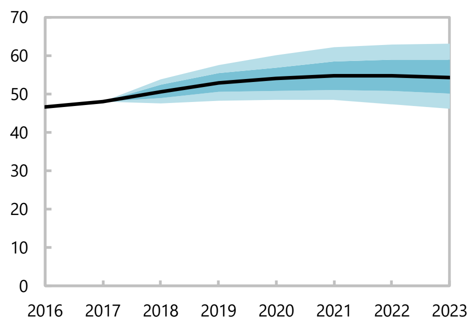
Debt level 1/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs 2/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile 3/	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

Evolution of Predictive Densities of Gross Nominal Public Debt

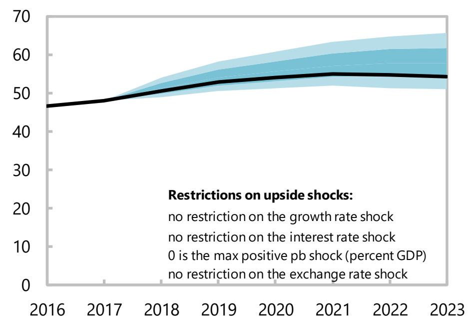
(in percent of GDP)

Baseline Percentiles: 10th-25th 25th-75th 75th-90th

Symmetric Distribution



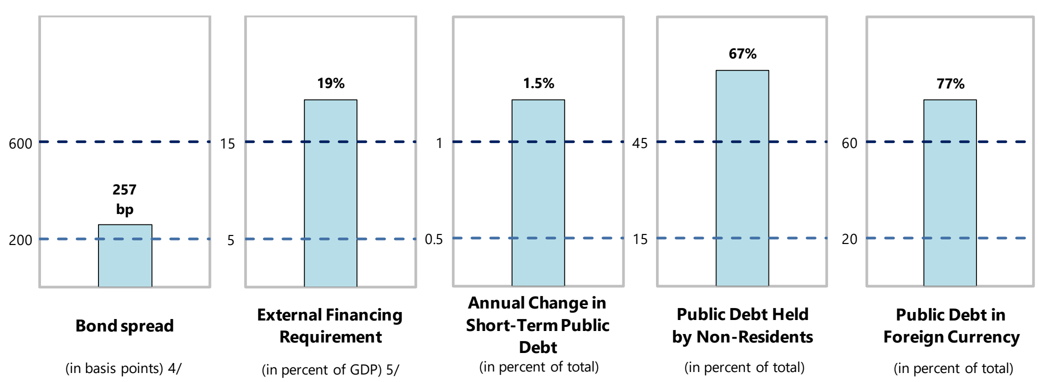
Restricted (Asymmetric) Distribution



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2017)

Macedonia, Former Yugoslav Lower early warning Upper early warning



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ Long-term bond spread over German bonds, an average over the last 3 months, 12-Jul-18 through 10-Oct-18.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Table 1. FYR Macedonia: Non-Financial Public Sector Debt Stress Test Scenarios

Name	Description	Impact on debt 1/
Primary Balance Shock	Minimum shock equivalent to 50% of planned adjustment (50% implemented), or baseline minus half of the 10-year historical standard deviation, whichever is larger. There is an increase in interest rates of 25bp for every 1% of GDP worsening in the primary balance.	3.2
Real GDP Growth Shock	Real GDP growth is reduced by 1 standard deviation for 2 consecutive years; revenue-to-GDP ratio remains the same as in the baseline; level of non-interest expenditures is the same as in the baseline; deterioration in primary balance lead to higher interest rate (see above); decline in growth leads to lower inflation (0.25 percentage points per 1 percentage point decrease in GDP growth).	4.7
Interest Rate Shock	Interest rate increases by difference between average real interest rate level over projection and maximum real historical level, or by 200bp, whichever is larger.	2.0
Real Exchange Rate Shock	Estimate of overvaluation or maximum historical movement of the exchange rate, whichever is higher; pass-through to inflation with default elasticity of 0.25 for EMs and 0.03 for AEs.	-0.2
Combined Macro-Fiscal Shock	Shock size and duration based on the underlying shocks.	8.4

Source: IMF staff estimates.

1/ Percentage points in excess of the baseline at the end of the projection period.

Table 2. FYR Macedonia: External Debt Sustainability Framework, 2007–2023

(In percent of GDP, unless otherwise indicated)

	Actual													Projections						
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017			2018	2019	2020	2021	2022	2023	Debt-stabilizing non-interest current account 6/
1 **Baseline: External debt**	46.7	49.1	56.0	57.9	64.2	68.2	64.0	70.0	69.3	74.7	73.9			**76.1**	**78.5**	**78.4**	**77.4**	**76.9**	**75.5**	**-6.0**
2 Change in external debt		2.4	7.0	1.9	6.4	3.9	-4.1	5.9	-0.7	5.4	-0.8			2.2	2.4	-0.2	-1.0	-0.5	-1.4	
3 Identified external debt-creating flows (4+8+9)		0.1	5.9	0.1	-8.2	8.0	-6.7	-6.9	10.7	-2.6	-4.5			-3.3	-3.3	-3.0	-2.8	-2.7	-2.6	
4 Current account deficit, excluding interest payments		12.7	6.7	1.3	1.8	2.5	1.1	0.0	1.3	2.1	0.1			-0.3	0.4	0.8	1.1	1.3	1.4	
5 Deficit in balance of goods and services		-42.7	-31.7	-38.4	-45.5	-44.4	-43.2	-47.7	-48.7	-50.9	-55.0			-59.9	-62.2	-64.5	-66.8	-69.1	-71.5	
6 Exports	43.3	42.7	31.8	38.5	45.6	44.5	43.3	47.7	48.8	50.9	55.1			60.0	62.2	64.6	66.9	69.2	71.6	
7 Imports		0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1			0.1	0.1	0.1	0.1	0.1	0.1	
8 Net non-debt creating capital inflows (negative)		-5.3	-3.6	-1.8	-3.9	-1.1	-1.6	-4.2	-0.4	-1.4	-1.4			-2.6	-2.6	-2.6	-2.6	-2.6	-2.6	
9 Automatic debt dynamics 1/		-7.3	2.8	0.6	-6.1	6.6	-6.2	-2.6	9.7	-3.3	-3.2			-0.4	-1.1	-1.2	-1.3	-1.4	-1.5	
10 Contribution from nominal interest rate		0.1	0.1	0.7	0.7	0.6	0.5	0.5	0.6	0.7	0.9			0.9	1.0	1.0	1.0	1.0	1.0	
11 Contribution from real GDP growth		-2.1	0.2	-1.9	-1.2	0.3	-1.8	-2.2	-3.0	-1.9	-0.2			-1.3	-2.1	-2.2	-2.3	-2.4	-2.5	
12 Contribution from price and exchange rate changes 2/		-5.3	2.5	1.8	-5.6	5.7	-5.0	-0.9	12.2	-2.2	-3.9			...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/		2.3	1.1	1.7	14.6	-4.1	2.5	12.8	-11.3	8.0	3.7			5.5	5.6	2.8	1.8	2.2	1.2	
External debt-to-exports ratio (in percent)	107.9	114.8	176.4	150.5	140.8	153.3	147.9	146.6	142.2	146.7	134.3			126.9	126.2	121.4	115.7	111.1	105.5	
Gross external financing need (in billions of US dollars) 4/		3.1	2.5	2.3	2.2	2.7	2.8	2.1	2.4	2.1	2.1			2.6	2.6	3.2	3.6	3.2	3.9	
in percent of GDP		31.6	26.2	24.6	20.8	28.1	26.0	18.8	24.3	19.7	18.5	10-Year	10-Year	21.4	21.1	24.1	25.6	21.3	24.4	
Scenario with key variables at their historical averages 5/														**76.1**	**79.4**	**83.4**	**85.9**	**88.9**	**90.8**	**-4.7**
Key Macroeconomic Assumptions Underlying Baseline												Historical Average	Standard Deviation							
Real GDP growth (in percent)		5.5	-0.4	3.4	2.3	-0.5	2.9	3.6	3.9	2.8	0.2	2.4	2.0	2.0	2.8	3.0	3.1	3.3	3.4	
GDP deflator in US dollars (change in percent)		12.7	-4.8	-3.1	10.6	-8.1	7.8	1.4	-14.8	3.2	5.6	1.1	8.7	6.4	-1.1	3.4	2.8	3.0	2.8	
Nominal external interest rate (in percent)		0.3	0.2	1.2	1.3	0.9	0.9	0.8	0.8	1.1	1.3	0.9	0.4	1.3	1.3	1.4	1.3	1.4	1.4	
Growth of exports (US dollar terms, in percent)		17.5	-29.5	21.3	34.3	-10.8	8.1	15.9	-9.6	10.9	14.4	7.2	18.7	18.2	5.4	10.5	9.8	10.0	9.8	
Growth of imports (US dollar terms, in percent)		31.5	-24.7	6.9	28.6	-7.5	2.2	10.9	-11.4	8.1	10.5	5.5	17.2	14.7	5.1	9.9	9.3	9.2	9.0	
Current account balance, excluding interest payments		-12.7	-6.7	-1.3	-1.8	-2.5	-1.1	0.0	-1.3	-2.1	-0.1	-3.0	3.9	0.3	-0.4	-0.8	-1.1	-1.3	-1.4	
Net non-debt creating capital inflows		5.3	3.6	1.8	3.9	1.1	1.6	4.2	0.4	1.4	1.4	2.5	1.6	2.6	2.6	2.6	2.6	2.6	2.6	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

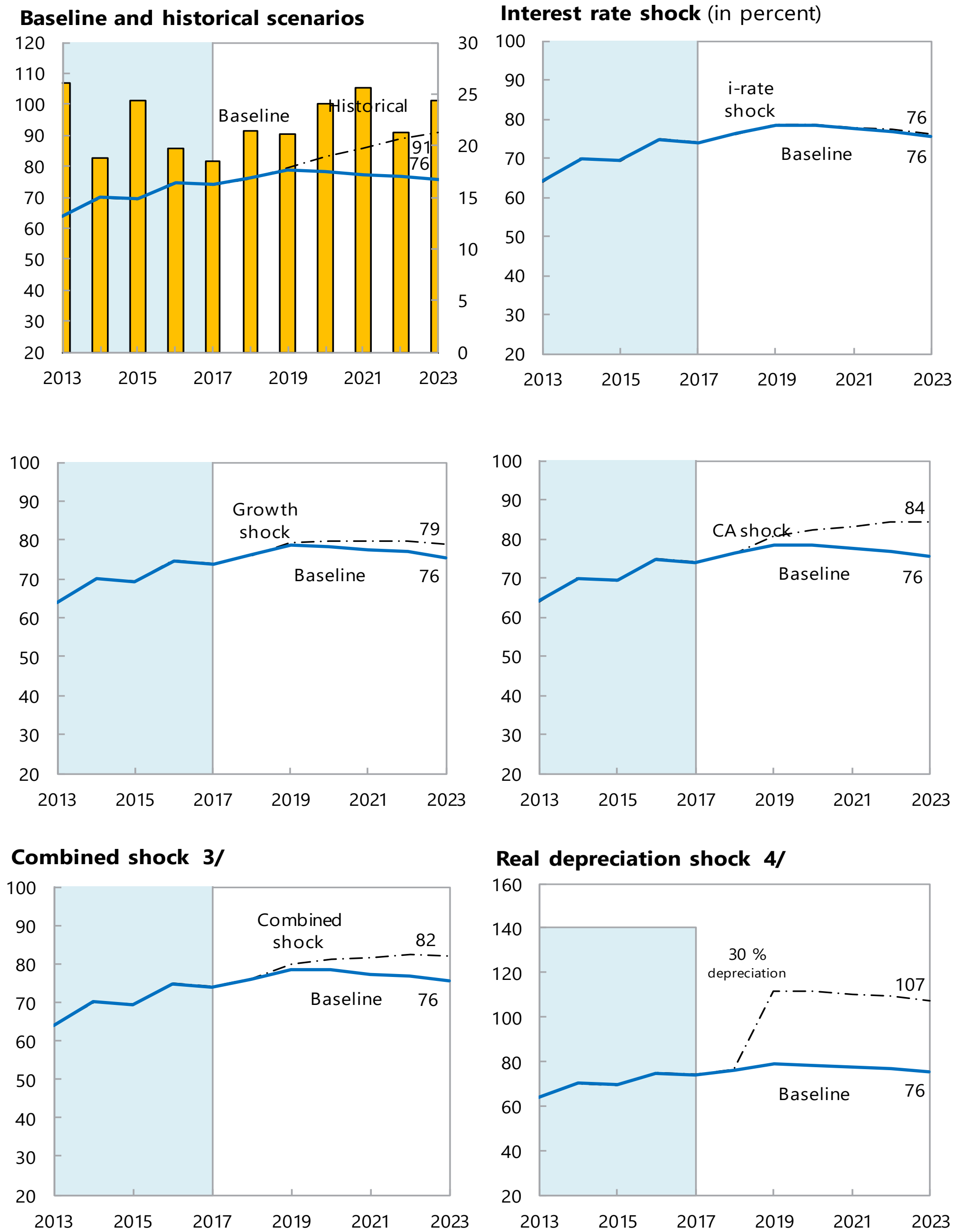
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Figure 9. Country: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2018.

INTERNATIONAL MONETARY FUND

FORMER YUGOSLAV REPUBLIC OF MACEDONIA

December 14, 2018

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By European Department

CONTENTS

FUND RELATIONS

(As of November 26, 2018)

Missions. Article IV, Skopje, November 8-16, 2018. Concluding statement is available at: https://www.imf.org/en/News/Articles/2018/11/19/The-Former-Yugoslav-Republic-of-Macedonia-Staff-Concluding-Statement-2018-Article-IV-Mission

Staff team. Jesmin Rahman (head), Jean-Guillaume Poulain and Ahmed El Ashram (both EUR), Janne Hukka (FIN), Sebastian Sosa (Resident Representative), and Gjorgji Nacevski (local economist).

Discussions. The staff team met Prime Minister Zaev, Deputy Prime Minister Angjushev, Minister of Finance Tevdovski, National Bank Governor Angelovska Bezhoska, other senior officials, and representatives of the banking, business, political and international communities.

Publication. The Macedonian authorities have indicated that they agree with publication of this staff report.

Membership Status:	Joined 12/14/92; Article VIII	
General Resources Account:	SDR Million	Percent of Quota
Quota	140.30	100.00
Fund holdings of currency	140.30	100.00
Reserve position	0.00	0.00
SDR Department:	SDR Million	Percent of Allocation
Net cumulative allocation	65.62	100.00
Holdings	3.07	4.68
Outstanding Purchases and Loans:	None	

Latest Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
PLL [1/]	01/19/2011	01/18/2013	413.40	197.00
Stand-By	08/31/2005	08/30/2008	51.68	10.50
Stand-By	04/30/2003	08/15/2004	20.00	20.00

[1/] Formerly PCL.

Projected Payments to the Fund (Expectation Basis)[1]

(SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2018	2019	2020	2021	2022
Principal					
Charges/Interest	0.15	0.65	0.65	0.65	0.65
Total	0.15	0.65	0.65	0.65	0.65

Exchange Arrangement:

FYR Macedonia has accepted the obligations of Article VIII, Sections 2, 3 and 4 and currently maintains an exchange system free of restrictions on payments and transfers for current international transactions.

Article IV Consultations:

The first consultation with the FYR of Macedonia was concluded in August 1993. The last consultation was concluded on November 13, 2017 (IMF Country Report 17/354). The FYR Macedonia is on the standard 12-month Article IV consultation cycle.

[1] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

Table 1. Technical Assistance Since 2006

Purpose	**Department**		**Date**
Banking Law	LEG/MCM		June 2006
Central Bank Law	LEG/MCM		July 2007
FX Reserves Modeling	RES/MCM		February 2012 February 2013
Macroeconomic Modeling at NBRM	MCM		May 2007 November 2009 September 2010 November 2010 May 2011 November 2011 February 2012 November 2012 March 2013 November 2013 March 2014
Liquidity, Cash and Debt Management	MCM		April 2007
Contingency Planning and Crisis Preparedness	MCM		February 2009
Stress Testing	MCM		February 2011
Domestic Debt Market Development	MCM		October 2011
Provisioning Regulation	MCM		November 2012
Public Debt Management	MCM/WB		January 2017
Expenditure Rationalization	FAD		November 2007
Public Financial Management	FAD		September 2009 November 2012
Cash management in the context of Broader PFM Reforms	FAD		October 2017
Medium-Term Budgeting	FAD		May 2011
Organic Budget Law developing	FAD		December 2017
Budgeting Framework/Payment Arrears	FAD		March 2012
Developing the fiscal rule and introducing a fiscal council	FAD		February 2018
Fiscal Transparency Evaluation	FAD		March 2018 April 2018
Tax Policy	FAD		September 2006 July 2007 January 2017 September 2017

Table 1. Technical Assistance Since 2006 (continued)			
Tax Administration	FAD		April 2007 July 2009 April 2010 June 2011 September 2013 December 2014 April 2016 May 2016 July 2016 May 2017 September 2017 March 2018
Tax IT System Improvement	FAD		May 2017 September 2017
Taxpayer Registration	FAD		November 2018
Tax Audit Function	FAD		February 2016 November 2016 March 2017 February 2018
Tax Arrears Management	FAD		March 2013 October 2014 September 2018
Large Taxpayers Office	FAD		March 2016
Property Tax System	FAD		September 2017 April 2018
Transfer Pricing and Related International Issues	FAD		September 2017
Tax Compliance Management	FAD		November 2013 March 2014 October 2014 February 2015 October 2015 October 2016 November 2016 October 2018
National Accounts Statistics	STA		April 2007 June 2007 January 2008 May 2008 September 2008 December 2008 June 2009 August 2011 September 2012 March 2013 October 2013
Export and Import Deflators	STA		December 2007

Table 1. Technical Assistance Since 2006 (concluded)

Government Finance Statistics	STA		June 2006 December 2007 October 2008 January 2015 June 2016 November 2016 February 2017 July 2017 November 2017 March 2018 June 2018
Balance of Payments Statistics	STA		October 2006 October 2008
External Sector Statistics	STA		April 2017
SDDS Subscription	STA		December 2010
STA TA Evaluation	STA		September 2012
Monetary and Financial Statistics (MFS)	STA		January 2015
Safeguards Assessment	FIN		February 2011
Sectoral Financial Accounts and Balance Sheet Statistics	STA		October 2018
Regional Advisors			
Revenue Administration	FAD		2015-
Public Financial Management	FAD		2015-
National Accounts	STA		2012-2014
Resident Experts			
Tax Administration	FAD		October 2006–August 2011
Banking Supervision	MCM		May 2006–May 2008
FSAP Participation and ROSCs (since 2003)			
FSAP	MCM/WB		May-June 2003
FSAP update	MCM/WB		March 2008 April 2018 July 2018 September 2018
Data ROSC	STA		February 2004
Fiscal ROSC	FAD		February 2005

IMF–WORLD BANK COLLABORATION

Background

The Bank and the Fund country teams on the Former Yugoslav Republic of Macedonia maintained close collaboration, seeking synergies and harmonizing policy recommendations. Close coordination has resulted in largely shared views of the economic situation in the country.

Key Areas of World Bank Involvement

- The World Bank Country Partnership Framework (CPF) in FYR Macedonia focuses on two interrelated themes: i) Growth and Competitiveness; and ii) Skills and Inclusion. For Growth and Competitiveness, successful poverty reduction would need sustained private sector led growth, making FYR Macedonia more attractive as a destination for investments and as a country whose private companies can compete at the regional and global level. For Skills and Inclusion, the fruits of growth can be shared broadly if more Macedonians have access to better jobs and if public services are of good quality and delivered efficiently. Since FYR Macedonia's future is clearly linked to the European integration, the Bank's Country Partnership Strategy (CPS) actively promotes the EU accession agenda and this represents a cross-cutting theme of the strategy. As the current CPF expires at the end of 2018, the Bank is currently in the preparation of a new CPF with a Board date scheduled for 26th of March 2019.

- The Bank continues to be engaged in the transport sector through two projects. The National and Regional Roads Rehabilitation Project (US$ 71 million) is helping enhance the connectivity of selected national and regional roads, primarily to Corridors X and VIII, and to improve the Public Enterprise for State Roads' capacity for road safety and climate resilience. The new Road Upgrading and Development Project's objective (US$90.95 million) is to improve transport connectivity for road users along Corridor VIII between Kriva Palanka and Rankovce, and to improve the asset management and planning functions of the Public Enterprise for State Roads. There are two investments in the area of local government development. The first is the Municipal Services Improvement Project (MSIP) (US$75 million), which is helping to improve transparency, financial sustainability and delivery of targeted municipal services in selected municipalities. In addition to this, the EU has provided additional financing of US$17.72 million, to complement MSIP activities in rural municipalities. The high demand from the municipalities has led to a second Municipal Services Improvement Project (US$28.04 million), approved in January 2016, and effective as of July 2016. The World Bank is also active in the human development sector through the Social Services improvement project (US$33.4 millions) and the Skills Development and Innovation Support Project (US$24 million).

- The Local and Regional Competitiveness Project is financed by an EU Trust Fund of US$19.36 million, with the objective of enhancing the contribution of tourism to local economic development and improving the capacity of the government and public entities to foster tourism growth.

Macedonia–Bank and Fund Planned Activities in Macro Critical Structural Reform Areas June 2017–May 2018			
Title	**Products**	**Provisional Timing of Missions**	**Expected Delivery Date**
1. Fund work program	Article IV Report	September 2017	November 2017
	Technical assistance on Revenue Administration Reforms (Tax Compliance and Risk Management, Arrears Management, Large Taxpayers Office)	Short-term expert visits FY18	TA report after the mission
	Technical assistance on Revenue Administration Reforms	Regular short-term visits of region-based long-term expert FY2018	
	Technical assistance on Government Finance Statistics	Short-term expert visits FY2018	TA report after the mission
	Financial Sector Assessment Program (FSAP)	FY2018-19	FY2019
2. Bank work program	Southeastern Europe Regular Economic Update	Continuous and periodic missions	November 2019 and April 2019
	Skills Development and Innovation Support Project	Continuous	Project closing May 2019
	Social Services improvement project	Continuous	Project closing June 2024
	Municipal Services Improvement Project	Continuous	Project closing March 2019
	Municipal Services Improvement Project 2	Continuous	Project closing March 2021
	Local and Regional Competitiveness Project	Continuous	Project closing December 2019
	National and Regional Road Rehabilitation Project	Continuous	Project closing September 2019
	Road Upgrading and Development Project	Continuous	Project closing December 2020

STATISTICAL ISSUES

(As of November 26, 2018)

I. Assessment of Data Adequacy for Surveillance
General: Data provision has some shortcomings but is broadly adequate for surveillance. Areas that would benefit most from further improvement are national accounts and government finance statistics.
National accounts: Quality of national account measurement need to be improved. In 2013, by Decision of the Government of the Republic of Macedonia, amendments were made to the National Classification of Activities—NKD Rev.2 and entailed significant changes in the decomposition of historical data. The primary objective of the Classification of Activities is to provide a basis for comparing statistical data of the Republic of Macedonia on European and world level, i.e. in its content and structure is completely harmonized with the European Classification of Activities NACE Rev.2. Financial accounts and balance sheets statistics are now being compiled. The NBRM has an objective to publish annual balance sheet data in 2020. **Price statistics:** Improvements to the CPI have been introduced in accordance with international standards and EU regulations to align the Classification of Individual Consumption According to Purpose (COICOP).
Government finance statistics: Macedonia's GFS data has been improving over recent years, assisted by ongoing GFS Technical Assistance. The authorities disseminate both monthly central government operations, and quarterly general government operations, as well as quarterly debt data on their own website and on their SDDS National Summary Data Page. While this data is disseminated in a national presentation, on a cash basis, and does not cover the whole of general government as defined in GFSM 2001/14, the data is of generally good quality. The authorities report detailed data on revenues and expenditures of general government and its subsectors for inclusion in the Annual GFS database (formerly the *Government Finance Statistics Yearbook*) and are taking steps toward publishing quarterly GG data in the GFSM 2014 presentation for inclusion in *International Finance Statistics*, expected to be in place in early 2019. The authorities report central government debt data to the *IMF / World Bank Quarterly Public Sector Debt Database* and are expected to expand reporting to general government debt in 2019.
Monetary and financial statistics: Macedonia regularly reports to the IMF's Statistics Department monetary data for the central bank, other depository corporations, and other financial corporations using the standardized report forms. **Financial sector surveillance:** Macedonia reports to the IMF's Statistics Department, on a quarterly frequency and with one quarter timeliness, all core FSIs for deposit takers as well as sixteen encouraged FSIs for deposit takers and other sectors.

External sector: External sector statistics meet international standards. In additional to quarterly balance of payments data, the authorities compile and disseminate international investment position (IIP) data, reserve assets and foreign currency liquidity data, and external debt statistics.	
II. Data Standards and Quality	
FYR Macedonia has subscribed to the Special Data Dissemination Standard (SDDS) since November 2011 and is currently in a process to adhere to SDDS plus.	Data ROSC published on September 29, 2004.

Former Yugoslav Republic of Macedonia: Table of Common Indicators Required Surveillance

(As of November 26, 2018)

	Date of Latest Observation	Date Received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]
Exchange Rates	11/23/18	11/23/18	D	W	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Oct,18	11/14/18	D	M	M
Reserve/Base Money	Oct. 18	11/22/18	D	W	M
Broad Money	Oct. 18	11/21/18	M	M	M
Central Bank Balance Sheet	Oct. 18	11/21/18	M	M	M
Consolidated Balance Sheet of the Banking System	Oct. 18	11/21/18	M	M	M
Interest Rates[2]	Sep. 18	10/31/18	M	M	M
Consumer Price Index	Oct. 18	11/07/18	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Sep. 18	11/15/18	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	Oct. 18	11/26/18	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Sep. 18	10/31/18	Q	Q	Q
External Current Account Balance	Sep. 18	11/30/18	M	Q	Q
Exports and Imports of Goods and Services	Sep. 18	11/30/18	M	Q	Q
GDP/GNP	Jun. 18	09/06/18	Q	Q	Q
Gross External Debt	Jun. 18	Sep. 18	Q	Q	Q
International Investment Position[6]	Jun, 18	Sep. 18	Q	Q	Q

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

[2] Weighted interest rates on loans and deposits in domestic banks. Separately, data is submitted on the rates on central bank bills (policy rate) and treasury bills, notes, and bonds.

[3] Foreign, domestic bank and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments. Data including local governments is normally published quarterly but is also received on an ad-hoc basis during missions.

[5] Currency and maturity composition is reported only on request.

[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

[7] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); Not Available (NA).

Statement by the Staff Representative on Former Yugoslav Republic of Macedonia
January 23, 2019

This statement provides information that has become available since the issuance of the staff report. The information does not alter the thrust of the staff appraisal.

Approval of the name change by the Macedonian parliament. On January 11, 2019, the authorities secured the required two-third-majority in the Macedonian Parliament to support the third and final approval of the constitutional changes related to the bilateral Prespa agreement with Greece. The bilateral agreement will also have to be approved by the Greek Parliament to become valid, after which the country's official name would become "Republic of North Macedonia". Resolution of the decades long dispute would bring the country closer to NATO membership and opening of EU accession negotiations.

Preliminary 2018 fiscal outcome. Preliminary numbers received from the authorities indicate that the overall fiscal deficit for 2018 is estimated to have reached -1.8 percent of GDP, significantly lower than what was envisaged in the supplementary budget approved late last year (-2.8 percent) or in staff's projections (-2.6 percent). This is mostly attributable to the overall large under execution of capital expenditures (1 percent of GDP) and goods and services spending (0.5 percent of GDP), although these have partially been offset by weaker-than-budgeted non-tax revenues and grants. Meanwhile, tax revenues came out as budgeted with strong personal income tax and social security contributions collection at the end of the year. Staff continues to review this information. These developments do not materially affect staff's baseline projections as a catch-up in capital spending is not expected in 2019, but pose risks of higher under-execution of capital spending due to weaknesses in project documentation and delays in tendering.

Statement by Mr. Richard Doornbosch, Alternate Executive Director for Former Yugoslav Republic of Macedonia and Mr. Dragos Tolici, Senior Advisor to Executive Director
January 23, 2019

On behalf of the Macedonian authorities, we would like to thank staff, led by Ms. Rahman, for their candid and constructive exchange of views during the Article IV mission and express our appreciation for the constructive policy findings and recommendations reflected in their report. The authorities broadly agree with staff's appraisal.

More than 13 years after achieving candidate status, Macedonia has removed a key hurdle to joining NATO and the European Union. In June 2018, an agreement on the formal name of Republic of North Macedonia started the process of settling down a decades long name dispute between Macedonia and Greece. The Macedonian Parliament approved on January 11, 2019 the constitutional amendments on the change of the name of Republic of Macedonia to Republic of North Macedonia. The ratification of the agreement in the Greek Parliament will remove the last hurdle for the accession to NATO, which should be formally completed by Summer 2020. Subject to Greek Parliament ratification of the bilateral agreement, and adequate progress with priority reforms, EU accession negotiations will be opened in 2019.

In 2018, the Macedonian economy has rebounded from stagnation, supported by a robust growth in export and private consumption. In the third quarter, the solid growth (3 percent yoy) was the result of favorable performance of exports and solid private consumption. Real GDP growth for 2018 is projected to reach between 2.3 percent (NBRM) and 2.8 percent (MoF), higher than the 2 percent set forward in the staff report, as high frequency indicators, in particular from industry, trade and tax collection, but construction as well, point to further economic growth during the last quarter of the year. Against the backdrop of a sustained economic recovery, the unemployment rate recorded the lowest level over the last twenty-five years although remaining relatively high at 20.8 percent.

Real GDP growth is projected to pick up further in 2019 to reach between 3.2 percent (MoF) and 3.5 percent (NBRM), versus a staff projection of 2.8 percent, mainly due to the expected rebound in infrastructure investment, robust exports and strong private consumption fueled by wage and credit growth.

On the basis of favorable economic prospects, Fitch has affirmed its BB rating with Positive Outlook in July and S&P Global Ratings affirmed its BB-/B ratings, with Stable Outlook in September 2018.

The authorities agree on the need to reform the economy and on the priorities highlighted by staff to increase productivity and inclusive growth. In 2018, the government started a wide range of reforms aimed at addressing labor market weaknesses, combating informality, strengthening institutions and anti-corruption efforts. To reduce the high youth and long-term unemployment, active labor market policies (ALMP) focusing on modernizing vocational training and developing internships and apprenticeships programs have been introduced. These programs have proven to deliver high employment retention. To attract FDI in high-value-added sectors, the authorities envisage secondary and tertiary education policies focused on reducing the technical and professional skills mismatch of young graduates. The authorities acknowledged the need for a better ALMP budget monitoring and agree with staff that employment incentives should be reevaluated in the context of cost effectiveness and impact durability.

The authorities made **significant progress on judicial reform** through the revision of the procedures on the appointment, appraisal, promotion and dismissal for judges, which provides buffers against undue interference in the judicial system. Additional legislative amendments needed to address the remaining gaps and reinforce the fight against corruption are expected to be discussed in the Parliament in February 2019.

In the latest World Bank 2019 Doing Business Report, Macedonia has moved up by one place, to10th best country in the world for doing business. This puts Macedonia in by far the highest position in the Southeastern European region, and ahead of 26 EU members. It reflects a continuing effort to facilitate businesses and support private investment and inflow of FDIs.

The authorities are strongly committed to sound fiscal policies and agree with staff's medium-term fiscal recommendations. They highly appreciate the Fund's ongoing technical assistance programs on tax administration and public financial management.

The authorities estimate a much better fiscal performance in 2018 than anticipated in the budget. The fiscal deficit is expected to be 1.8 percent of GDP instead of 2.7 percent of GDP because of good revenue performance and under-execution of capital expenditure on large infrastructure projects. In line with the medium term Fiscal Strategy, the 2019 budget targets a deficit of 2.5 percent of GDP, lower than staff's projection of 3 percent of GDP. The gap resulting mainly from differences in underlying GDP and revenue projections.

The government is achieving gradual fiscal consolidation by reducing the pension system deficit and improving targeting of social assistance spending. To improve the long-term sustainability, pension contribution rates will gradually increase from 18 to 18.8 percent in 2020. Benefit indexation will be changed to CPI only (from currently ½ average CPI and ½ average wage growth). Further measures may be considered in the future to address increasing demographic pressures.

The introduction of a more progressive personal taxation that replaced the current 10 percent flat tax reflects the authorities' **focus on greater social justice and inequality reduction**. A marginal PIT rate of 18 percent will be applied for top 1 percent earners, to the portion of income exceeding MKD 90,000 (about EUR 1,450 equivalent, or almost 4 times the average net wage).

The authorities have improved public financial management by better monitoring government arrears. These arrears have been reduced by about 0.6 percent of GDP. The new legal provisions introduced in 2018 require quarterly publication for all public entities of their overdue obligations. To achieve local government budget discipline, spending has been capped.

In the 2018-2021 Public Financial Management Reform Program, the government attaches high priority on improving the quality and transparency of public institutions. The 2018 IMF Fiscal Transparency Evaluation Report shows that Macedonia has made significant progress, but also provides a useful list of the main areas of focus for the future. Spending reports have significantly improved in quality and timeliness.

Monetary policy has been appropriate, supporting the economic recovery while keeping inflation expectations stable. The accommodative monetary stance during the entire year of 2018 has been maintained on the backdrop of the favorable foreign exchange market, a rather small output gap, and low and stable inflation. The three consecutive cuts in the key policy rate reflected the continuous favorable movements in the exchange rate market which indicate a solid external position and stable economic agents' expectations.

The accommodative policy stance supported credit recovery in both households and corporate sector (by 10.1 percent yoy and 5.8 percent yoy in the first eleven months of 2018). The strong growth of total deposits by 11.1 percent yoy during the same period was another sign of stable expectations and confidence. Considering the stable inflation outlook, the authorities suggest that there is room for further monetary policy easing, although they stand ready to tighten the monetary stance in case of large external shocks.

Financial System Stability Assessment

The authorities highly appreciate the financial system stability assessment by the Fund and the World Bank and broadly agree with the conclusions of the mission. They share staff's view on the strength and vulnerabilities of the financial system while noting its improved resilience.

The authorities are Committed to Implement the Key Recommendations:

- Enhancing supervisory effectiveness by ensuring the independence of the central bank in its supervisory duties;
- Increasing staffing levels;
- Intensifying on-site and off-site supervision of systemically important banks through full-scope examinations;
- Adopting a new law on banking resolution, implementing the latest international standards and best practices;
- Broaden the recovery planning requirements to all banks (currently applied only to systemically important banks);
- Perform more frequent crisis simulation exercises.
- Improving the macro-prudential and crisis management framework.

It should be noted that since the previous FSAP in 2008, banking supervision and regulation have already been considerably strengthened by the adoption of international regulatory and supervisory standards, enrichment of supervisory tools and implementation of the FSAP recommendations (20 out of 23 recommendations were fully or partially implemented). As staff acknowledged, the legislative basis is strong and comprehensive, and supervision is largely compliant with the Basel Core Principles.

The banking system is well capitalized and liquid, owing to improved economic fundamentals as well as sound prudential policies. The total capital ratio slightly increased to 16.5 percent by end-June 2018. The overall NPL ratio continued the downward trend and dropped from 10 percent in 2015 to 5 percent in 2018.

The authorities will continue developing the supervision framework following the latest European and International standards. The Memorandum of Understanding concluded between NBRM and the European Central Bank in December 2018 will enhance the exchange of supervisory information and represent an essential step forward for further improvement in the integrity, stabilization and efficiency in the bank operations.

Adherence to International Data Standards

The authorities are continuing their efforts to reach full alignment with the international requirements in terms of data transparency and data quality. A notable achievement in this respect is the fulfillment of the requirements of the IMF SDDS Plus. As a result, the official adherence is expected at end January 2019.

Concluding Remarks

The long-awaited opening of the accession to NATO as well as the EU accession negotiations will strengthen the positive momentum, of which the authorities will take advantage to continue implementing their broad-based reform program, as well as to intensify attracting FDI. They are fully aware that a successful integration in the European Union can only be achieved if structural weaknesses in the labor market and public institutions are firmly addressed.