INTERNATIONAL MONETARY FUND

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FORMER YUGOSLAV REPUBLIC OF MACEDONIA

June 2013

2013 ARTICLE IV CONSULTATION AND FIRST POST-PROGRAM MONITORING DISCUSSIONS

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 2013 Article IV consultation with Macedonia and Post-Program Monitoring discussions, the following documents have been released and are included in this package:

- **Staff Report** for the 2013 Article IV consultation and Post-Program Monitoring Discussions, prepared by a staff team of the IMF, following discussions that ended on April 16, 2013, with the officials of Macedonia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 30, 2013. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- **Informational Annex** prepared by the IMF.
- **Public Information Notice** (PIN) summarizing the views of the Executive Board as expressed during its June 14, 2013 discussion of the staff report that concluded the Article IV consultation.
- **Statement by the Executive Director** for Macedonia.

The document listed below has been or will be separately released.

Selected Issues Paper

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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FORMER YUGOSLAV REPUBLIC OF MACEDONIA

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION AND FIRST POST-PROGRAM MONITORING DISCUSSIONS

May 30, 2013

KEY ISSUES

Context: The authorities have used available margins to lend policy support, mitigating the effects of the euro area crisis on activity and financial conditions. External and financial stability were maintained despite a difficult environment.

Fiscal Policy: In the near term, policies should remain supportive, and the start of the consolidation process should take downside risks to growth into account. However, the relatively rapid rise in public sector debt since the onset of the crisis underscores the need for a well-articulated medium-term fiscal strategy with a deficit path that delivers a gradual reduction in debt. The strategy should aim to safeguard fiscal sustainability, enhance the credibility of the budgetary process, accommodate planned public investment levels, rebuild fiscal buffers, and increase policy transparency.

Financial Sector: The banking sector remains well-capitalized and highly liquid, with a stable domestic financing base, but vulnerable to low probability confidence shocks.

Structural Reform: Despite a long track record of macroeconomic stability, income convergence has been slow. The authorities' strategy to fill infrastructure gaps through public investment and a proactive policy to attract FDI to speed up structural transformation should be complemented by policies that ensure links between new investment and the domestic economy, particularly by absorbing the large pool of unemployed and inactive labor. A number of possible structural impediments to credit supply could be addressed, although their effect is likely to be modest.

Approved By
Ajai Chopra and Dhaneshwar Ghura

Discussions were held in Skopje, April 3–16, 2013. A team comprised of Ms. Vladkova Hollar (head), Messrs. Gerard and Meyer Cirkel (all EUR), and Mr. Tieman (Resident Representative) met with Finance Minister and Deputy Prime Minister Stavreski, NBRM Governor Bogov, other officials; the private sector; media representatives; and others. Mr. Hadzi-Vaskov (OED) joined some of the discussions. At the conclusion of the visit a joint press conference was held with the finance minister. The mission also gave three media interviews. Ms. Mahadewa and Mr. Peterson assisted in the preparation of the staff report.

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CONTEXT

1. **A track record of conservative policies, together with external official assistance, provided Macedonia with buffers to confront spillovers from the global crisis and deal with domestic shocks.** As a result, with only a mild recession in 2009 and then again in 2012, Macedonia averted large real and financial dislocations.

- Balance of payments pressures in the first half of 2009 were managed successfully through higher policy rates and tighter bank liquidity requirements.

- In early 2011, in light of euro area risks, the authorities requested a high-access precautionary Fund arrangement (Precautionary and Liquidity Line). In March 2011, the authorities drew on the PLL, citing impaired access to external markets risks and reduced, market access largely due to the uncertain outcome of impending elections (http://www.imf.org/external/pubs/cat/longres.aspx?sk=25234.0). The drawing reinforced gross reserves.

- A number of financing operations with the World Bank, notably in late 2011 and early 2013, relieved public sector financing constraints and allowed for a widening of the deficit to support weak domestic demand and start clearing budgetary arrears.

2. **Looking forward, the authorities continue to face a difficult external environment but with reduced policy space, particularly in the context of the de facto peg[1].** Persistent uncertainty about financial and demand conditions in Europe will weigh on growth, while the margins for policy stimulus have narrowed.

3. **The start of EU accession negotiations remains uncertain**. The former Yugoslav Republic of Macedonia was granted candidate status in December 2005. However, the name dispute with Greece continues to block the initiation of EU accession negotiations and NATO membership. In its latest progress report from April 2013[2], the European Commission urged the authorities to implement the commitments made in March to end the political stalemate in Parliament, and noted that progress has been made in promoting good neighborly relations as well as on formal talks on the name issue.

4. **Some key recommendations of earlier Article IV consultations have been implemented, others remain outstanding**. The authorities have made important progress in

[1] The report refers to the exchange rate regime as a peg. Formally, the official (de jure) exchange rate classification is "floating" and the de facto exchange rate regime for Macedonia is a "stabilized" arrangement. The NBRM buys or sells foreign exchange to keep the denar trading in a very narrow band around the rate of 61.5 denars per euro.

[2] See European Commission, " The Former Yugoslav Republic of Macedonia: Implementation of Reforms Within the Framework of the High Level Accession Dialogue and Promotion of Good Neighborly Relations," April 16, 2013. http://ec.europa.eu/enlargement/pdf/key_documents/2013/mk_spring_report_2013_en.pdf

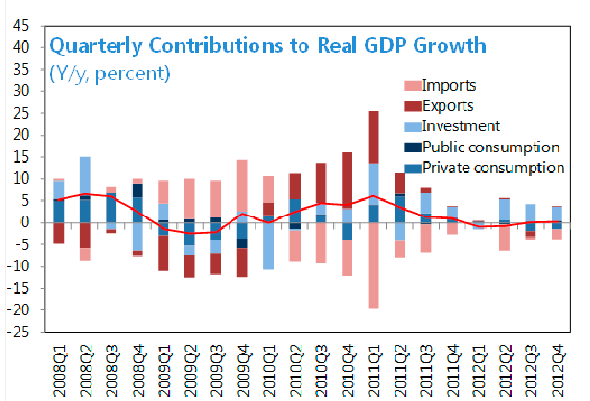
lengthening domestic debt maturities as well as deepening domestic debt markets. They have closed all but one of the identified gaps in the crisis management framework. Progress with public financial management reforms is mixed. The public recognition of government payment arrears— which were reported at MKD 5.6 billion (1.2 percent of GDP) as of September 2012—and the commitment to clear them was a welcome policy decision. The authorities have recently initiated changes to the commitment, recording, and control systems. Continued transparency on the stock of arrears would boost confidence in the durability of the solution.

RECENT ECONOMIC DEVELOPMENTS

Following a shallow recession in 2012, a modest recovery is forecast for 2013, predicated on an acceleration in public investment and FDI projects coming on stream. The weak external environment and difficult liquidity conditions for the domestic private sector present important downside risks. Both fiscal and monetary policies—the latter constrained by the commitment to maintain exchange rate stability—are providing support. The impact of weaker trade on the current account in 2012 has been mitigated by high private transfers, and public sector net external borrowing has helped build up reserves despite modest FDI. The financial sector remains stable—liquid and well-capitalized—albeit with still rising NPLs.

A. Growth and Inflation

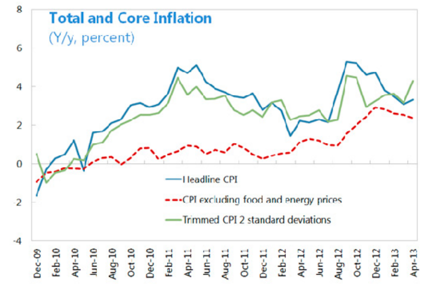
5. Weak domestic and external demand halted growth in 2012. Following a sharp decline in the first half of the year, growth picked up in the second half, mainly supported by construction and public consumption. Overall, activity declined 0.3 percent in 2012, with a negative contribution from net exports and private consumption, against the backdrop of a steady deceleration of private sector credit. In spite of a 0.6 percent increase in employment, gross wages remained flat throughout the year, implying declining real incomes. Trade weighted effective import demand for Macedonian products declined by 1.9 percent.



Sources: SSO; and IMF staff calculations.

6. In 2013, economic activity is expected to pick up to about 2 percent, with risks tilted to the downside. So far, notwithstanding an uptick of the industrial production index in February and March, low turnover in the retail trade sector and persistently weak credit do not point to a solid recovery in domestic demand. Nonetheless, baseline growth is predicated on an acceleration in the second half of the year, driven by public infrastructure works and foreign investment projects, as well as a slight rebound in private consumption. Despite stagnant effective external demand, projected export growth is driven by a rebound of metal exports from last year's lows and FDI-generated specialized exports facing robust demand.

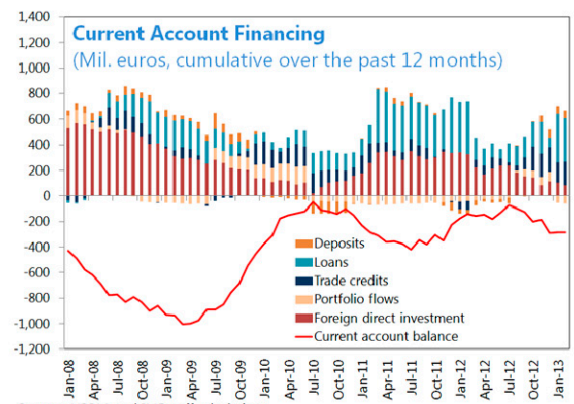
7. Inflation is expected to moderate to 2.5 percent in 2013. After peaking at 5.3 percent year-on-year in September 2012, driven by rising food prices and (regulated) price hikes in the electricity and heating sectors, headline inflation decelerated to reach an average of 3.3 percent for the year as a whole. For 2013, second-round effects of energy price hikes are assumed to wear off, while food prices are expected to decline. After accelerating to 2.9 percent year-on-year in December 2012, core inflation has been on a downward trend, falling to 2.4 percent in April, and is expected to settle at 2.2 percent on average this year. Cost side pressures are weak—unit labor costs are expected to remain broadly flat, and the output gap is not expected to close before end-2015.



Sources: SSO; and IMF staff calculations.

B. External Sector

8. External stabilty was maintaned in 2012, despite weakness in trade and private capital flows. In 2012, the current account deficit widened to 3.9 percent of GDP, with a worsening of the trade balance to 23.7 percent of GDP partly offset by record private transfers (notably remittances), reaching 21 percent of GDP. Yet in spite of weak FDI inflows and some capital outflows in the form of intra-company cross-border loans and corporate deposits, the stability of the peg was supported by official external inflows, sizeable trade credits and inward bank deposits, resulting in a strengthening of official reserves.



Sources: NBRM; and IMF staff calculations.

9. The current account deficit is expected to deteriorate in 2013 on account of increased FDI-related imports. In 2013, import volume growth related to the implementation of FDI projects in the manufacturing sector is expected to accelerate while exports would come on-stream more gradually, resulting in a further deterioration of the trade balance to 25 percent of GDP. This would widen the current account deficit to about 4.9 percent of GDP, assuming no further acceleration of private transfers. The current account is expected to be financed by net FDI inflows of about 3 percent of GDP, as well as net public sector medium-term external borrowing—inflows already reflect a disbursement of a syndicated loan linked to a World Bank Policy-Based Guarantee which more than covered the eurobond maturity in January 2013.

10. On current projections, the level of gross international reserves provides a sufficient buffer against external shocks. Reserve levels are in line with standard 'rule-of-thumb' measures, covering about 120 percent of short-term debt, 4.7 months of prospective imports, and about 53 percent of broad money, as well as with combined metrics such as the Greenspan-Guidotti rule, covering 99.6 percent of the sum of the short-term debt and current account deficit, on average over the years 2012-2016. To better assess reserves against the type and size of pressures observed in past crisis episodes, a new Fund metric[3] benchmarks the level of reserves against a weighted index comprising export earnings, short-term debt, other portfolio liabilities and broad money (M2), the parameterization of which also depends on the exchange rate regime. This metric places reserve levels in Macedonia almost exactly in the midpoint of the suggested adequacy range of 100 to 150 percent. Finally, reserves also provide appropriate cover against country-specific shocks (see text box).

Reserve Adequacy – Further Considerations

In view of the idiosyncratic characteristics of the Macedonian external sector, with a structural trade deficit covered almost 85 percent by private transfers (assumed to primarily reflect remittances), the standard metrics may usefully be adjusted to incorporate scenarios relating to a 'sudden stop' in these current account flows.

In this regard, the level of reserves covers about 90 percent of the needs corresponding to the new Fund metric augmented by a shortfall of expected private transfers by 50 percent, and about 75 percent of the similarly adjusted Greenspan-Guidotti metric, over the 2012–2016 period. A less severe scenario which assumes that the shortfall in private transfers is accompanied by some compression in imports, brings the reserve cover to about 80 percent of the identified financing needs under the Greenspan-Guidotti metric.

Moreover, a recent technical assistance mission, relying on country-specific calibrations of the Jeanne and Ranciere (2008) welfare-based model, where risk-averse policy makers are assumed to hold reserves as a self-insurance instrument against sudden stops in capital flows, also concluded that reserve holdings were adequate, including when incorporating the endogenous probability of a currency or banking crisis.

C. Fiscal Policy

11. The accommodation of weaker revenues and the start of the arrears clearance process widened the 2012 cash deficit to 3.8 percent of GDP. Total realized revenues— 8 percent below the level forecast in the supplementary budget—were weaker across the board, reflecting weaker than expected economic activity. Substantially lower VAT revenues

Budget Execution
(Billion of denars)

	Revised Budget 2012	Outturn 2012	% change	Budget 2013	% over 2012 outturn	Q1 2013
Total Revenues	**145.3**	**133.9**	**-8**	**143.2**	**7**	**28.7**
Taxes and Contributions	120.2	113.8	-5	121.4	7	25.3
o/w VAT	44.2	38.5	-13	45.2	17	7.4
Non-Tax Revenues	14.7	12.4	-16	13.4	8	2.5
Expenditures	**157.5**	**151.6**	**-4**	**160.9**	**6**	**40.1**
Current	136.6	133.5	-2	142.7	7	36.1
Capital	21.4	18.8	-12	18.7	0	4.0
Deficit	**12.1**	**17.8**	**47**	**17.7**		**11.4**
Deficit (in percent of GDP) 1/	2.6	3.8	46	3.5		2.4

Notes: Total revenues and expenditures are net of transition costs for pension system and revenue from repayment of loans. Nominal GDP growth assumed for 2013 equal to 4.6 percent.
1/ Deficit in 2013 excludes any deficit projections for the former Road Fund.

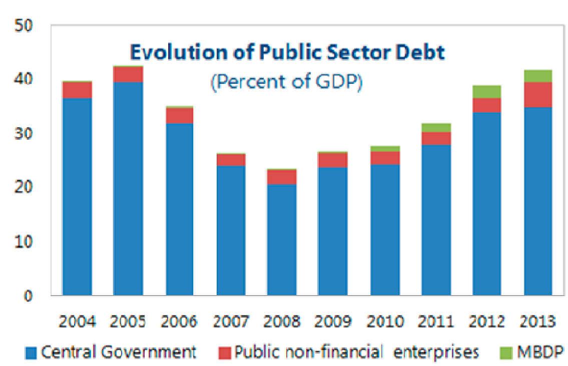
[3] IMF (2011), Assessing Reserve Adequacy, Board Paper, Washington DC, February 2011.

also reflected a policy choice to start clearing refund arrears—a total of MKD 1.8 billion (0.38 percent of GDP) VAT refund arrears were cleared in 2012. Keeping the cash deficit contained at 3.8 percent of GDP required expenditure compression beyond the ceilings established in the supplementary budget. With only about 20–25 percent of discretionary room in the budget, the adjustment fell mainly on capital expenditure.

12. **The deficit for the first quarter of 2013, at 2.4 percent of projected annual GDP, already represents two thirds of the annual target**. Revenue developments were dominated by large VAT refunds through February, with all other revenues at about a quarter of the annual target, and an overperformance of profit taxes. On the expenditure side, subsidies and other transfers rose by 250 percent relative to Q1: 2012, mainly related to advance payments of agricultural subsidies. While this appears to be an intra-annual reallocation of expenditure, further expenditure compression will likely be needed to meet the deficit target of 3.5 percent of GDP. The authorities were not considering a supplementary budget at the time of the discussions, noting that on current revenue trends the required spending adjustment could be accommodated within normal capital spending buffers by postponing envisaged but not-yet started projects as has been the case in the past.

13. **Some capital expenditure has shifted off-budget starting in 2013**. As of January 2013, most of the public sector road infrastructure projects will be taken up through the newly created Public Enterprise for State Roads (PESR). Previously part of the budgetary central government, this entity can borrow on its own behalf, although most of its debt carries an explicit sovereign guarantee. Given the envisaged increase in capital expenditure for developing road infrastructure in the near to medium term, it would be important to track the evolution of the public sector aggregate that includes the deficit and debt of this new state-owned enterprise, for assessing both debt sustainability and the aggregate demand impact of fiscal policy.[4]

14. **Overall public sector debt has risen faster than central government debt, as the public sector has sought to accommodate the protracted economic downturn**. Since the crisis, the authorities have sought to support domestic demand through both higher budget deficits as well as through financing support for SMEs through the Macedonian Bank for Development Promotion (MBDP). Debt of the MBDP has risen from 0.4 percent of GDP in 2009 to 2.2 percent in 2012, and largely reflects the use of credit lines provided by the European Investment Bank (some €250 mn in 2009–2012, and additional €100 mn announced in 2013). In 2013, the projected marked



Sources: FYR Macedonia Authorities; and IMF staff calculations.

[4] Since the PESR is a non-market non-profit institution (NPI), which performs government functions, it would be advisable to consolidate it within the central government for deficit and debt accounting puposes. See IMF (2011) "Public Sector Debt Statistics—Guide for Compilers and Users", Washington, DC: Chapter 2.

increase of SOE debt, from 2.7 to 4.5 percent of GDP, is mainly a result of the creation of the PESR, and the external credit lines supporting its expanding activity.

15. Substantial net domestic issuance in 2012 as well as in the first quarter of 2013 has provided financing for the higher deficits. Net domestic issuance of €451 million and net external borrowing of about €79 million in 2012 financed the budget deficit as well as built up government deposits at the NBRM to €319 million (4¼ percent of GDP) at year end. Net domestic issuance through April 2013 stands at €120 million, higher than the €100 million envisaged in the budget, which the authorities intend to use as a financing buffer for 2014. In addition, in line with previous Fund advice, since Q3 2011 the Treasury has continuously sought to lengthen debt maturities. Some maturing 3-month T-bills have been rolled over into 6- and 12-month securities, and the authorities have increased the issuance of 3- and 5-year bonds. These longer dated securities currently make up 25 percent of the total debt stock, up from 5 percent at the end of 2011.

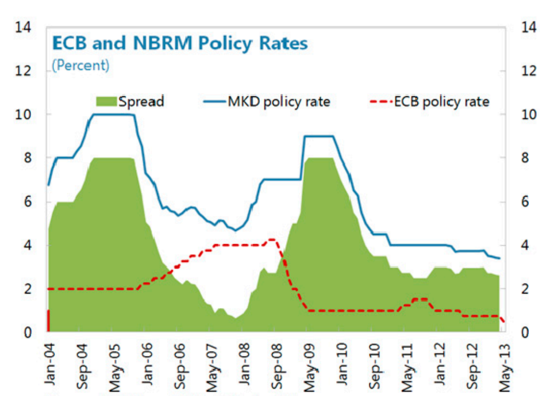
FYR Macedonia. Central Government Financing Table

	2011		2012		2013		2014	
	mil. Euros	Percent of GDP	mil. Euros	Percent of GDP	mil. Euros	Percent of GDP	mil. Euros	Percent of GDP
Total Financing Requirement	**628**	**8.4**	**746**	**9.9**	**1240**	**15.8**	**1204**	**14.5**
Fiscal deficit	187	2.5	289	3.8	275	3.5	249	3.0
Gross Amortizations	442	5.9	457	6.1	965	12.3	954	11.5
Maturing Treasury bills and bonds 1/	310	4.1	371	4.9	704	8.9	776	9.3
Domestic structural bonds	81	1.1	30	0.4	30	0.4	28	0.3
External	50	0.7	57	0.8	231	2.9 4/	150	1.8 /7
Total Financing Sources	**628**	**8.4**	**746**	**9.9**	**1240**	**15.8**	**1204**	**14.5**
Use of government deposits	-119	-1.6	-195	-2.6	96	1.2	96	1.2
Issuance of Government securities	354	4.7	822	10.9	804	10.2	871	10.5
Net Treasury bonds issuance	44	0.6	451	6.0	100	1.3	95	1.1
Treasury bills and bonds rollover 2/	310	4.1	371	4.9	704	8.9	776	9.3
External financing	398	5.3	135	1.8	341	4.3	237	2.8
o/w private	130	1.7 2/	75	1.0	250	3.2 5/	127	1.5
o/w official	268	3.6	60	0.8 3/	91	1.2 6/	110	1.3
o/w IMF PLL	221	2.9	0	0	0	0	0	0
Memo:								
Nominal GDP (mn EUR)	7,506		7,523		7,870		8,316	
Stock of government deposits at the NBRM	125		320		225		129	

Source: MoF; and IMF staff estimates
1/ The rollover requirements here are defined as the short term debt stock (smaller or equal to 12 month maturity) at the end of the previous year.
2/ Includes the EUR 130 million syndicated loan backed by a World Bank Policy Based Guarantee.
3/ Official financing includes a World Bank Competitiveness Development Policy Loan for EUR 35.5 M (USD 50 M), disbursed in November 2012.
4/ Includes the amortization of the EUR 175 million Eurobond falling due in January 2013.
5/ Includes syndicated loan (EUR 250 million) covered by a second World Bank Policy Based Guarantee, disbursed in January 2013.
6/ Includes the second World Bank Competitiveness Development Policy Loan for EUR 35.5 M (USD 50 M) assumed to be disbursed in the second half of 2013.
7/ This line includes the IMF PLL repayments of EUR 83 million in 2014, EUR 111 million in 2015 and EUR 28 million in 2016.

D. Monetary and Financial Developments and Policies

16. The absence of external pressures in a low growth environment allowed the NBRM to lower the policy rate by 25 basis points to 3.5 percent in January 2013, and to gradually reduce its stock of outstanding Central Bank bills. In addition, in order to stimulate private credit growth while also strengthening the balance of payments, the NBRM lowered reserve requirements by the amount of new loans to domestic net exporters and electricity



Sources: NBRM; and IMF staff calculations.

producers, effective January 1, 2013, with limited take-up to date. Since April 2012, the amount of outstanding 1-month CB bills (its main sterilization instrument) has gradually been reduced by about MKD 10 billion to MKD 24 billion (Figure 3). Over the last few months, this has resulted in a higher subscription of 7-day NBRM deposits, which carry a 1¾ percent interest rate.

17. Banking sector indicators suggest that the system is in overall sound shape, but non-performing loans are increasing. As of December 2012, the capital adequacy ratio stood at 17.1 percent (with tier 1 capital at 14.5 percent), and over 29 percent of total assets were highly liquid. Deposits provide the main funding source. The NPL ratio rose to 11.7 percent in February 2013, but provisions exceed NPLs. Profitability remains low but positive. Euroization of deposits, while high, continues to decrease gradually to below pre-crisis levels.

18. After steadily decelerating in 2012, credit growth is expected to remain subdued in 2013. Loan growth declined from 5.2 percent (year-on-year) in December 2012 to 4.4 percent in February 2013, even as deposit growth accelerated from 4.9 percent to 5.6 percent. On the supply side, banks are likely to remain conservative in light of modest growth prospects and low profitability. In addition, group-wide policies prescribed by foreign parents seeking to strengthen their capital ratios at the consolidated level are likely to limit asset growth in the largest banks in the system. Meanwhile, credit demand continues to be affected by the economic outlook.

19. The NBRM made several changes to banks' provisioning rules. In mid-2012, it introduced minimum provisions for unsold collateral-in-possession on banks' balance sheets. In March 2013, it announced further changes, effective December 1, 2013, providing the banks with somewhat more leeway in taking into account collateral value when provisioning loans. The NBRM expects the latter amendments to result in a modest release of provisions, which the banks will be obliged to allocate to reserves.

20. Adoption of amendments to the banking law early this year closed all but one of the long-standing gaps in the crisis management framework. The amendments ensure that the NBRM has the ability to impose fit and proper requirements on bank management and owners, and pave the way for the central bank to widen the class of collateral that banks may use to access liquidity support. The last outstanding issue in this area requires clarification of the NBRM's power to intervene an insolvent bank without being subject to court challenge.

POLICY DISCUSSIONS

Despite a long track record of macroeconomic stability, income convergence has been slow. The discussions focused on policies that would reduce risks to the outlook in the near to medium term, preserve the sustainability of fiscal and external positions, and address structural constraints that have held back sustained strong growth.

A. Outlook and Risks

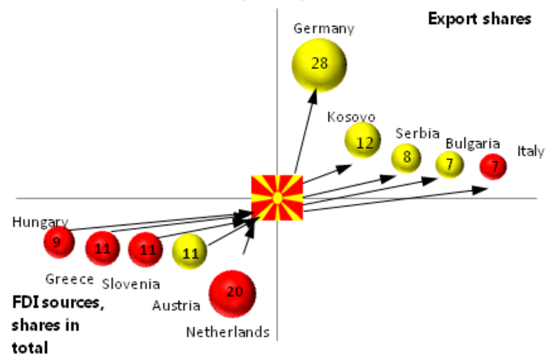
21. Macedonia's near-term growth outlook remains difficult, but the economy is well-positioned to restart the convergence process. In the short run, the main risk to growth is a slower than anticipated pick up in private consumption in a context of weak export growth—a repeat of the factors that stalled growth in 2012. Over the medium term, staff's baseline scenario envisages growth to settle around 4 percent by 2016, implying a modest acceleration relative to average growth in the pre-crisis decade but also only a moderate speed of convergence toward living standards in EU countries. Over this horizon, the main risks relate to weaker-than-expected investment and a continued drag of net exports on growth, should there be setbacks in the implementation of FDI plans or difficulties in developing backward linkages to the domestic economy.

22. Despite strong real and financial linkages to the euro area (text chart and Box 1), a number of factors mitigate risks in the near term:

- New tradable sector FDI has reduced reliance on traditional exports and reoriented exports geographically.

Macedonia: Trade and and FDI linkages

(Percent)



Note:
Risk map based on WEO growth projections for 2013 (red < 0%, yellow >0%)
FDI stock data, end 2011. Exports shares data, end 2012.

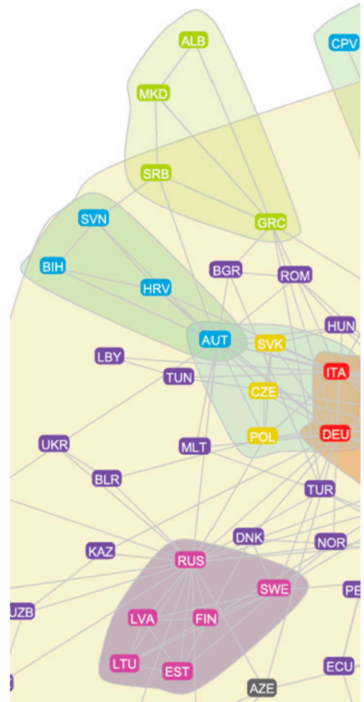
- Local subsidiaries of euro area banks (Greece and Slovenia) are well-capitalized and liquid and have limited exposure to parents—with no short-term wholesale funding dependency—as well as limited credit exposure to those economies.

- With banks funded mainly by resident deposits, and with public sector external financing requirements for 2013 already met, the channels for transmission of any renewed stress in Europe appear limited to relatively low probability but high impact confidence shocks. The short-lived spike in deposit withdrawals from the Macedonian subsidiary of Slovenia's NLB in late March bears testimony to such risks.

23. A sudden loss of confidence could be transmitted through remittances, which are sensitive to domestic conditions. While generally a stable source of current account financing, a sudden stop of remittances—a large share of the 20 percent of GDP in private transfers—has the potential to quickly create large balance of payments pressures, as was the case in 2009. Renewed political uncertainty could affect the volume of these flows.

24. The toolkit for crisis management has been strengthened further. Creating the scope for widening ELA collateral eligibility provides a substantial enhancement of the crisis management toolkit. The standing Financial Stability Committee (FSC) can serve as a useful platform for a regular discussion of risks, and some thought could be given to expanding the membership to include other financial sector regulators such as the Insurance Supervision Agency. In light of the heightened risk of confidence shocks in the current environment, staff suggested that the authorities may want to review the scope of the deposit insurance system, which currently applies only to natural persons.

Box 1. Know Your Cluster-Macedonia[1]

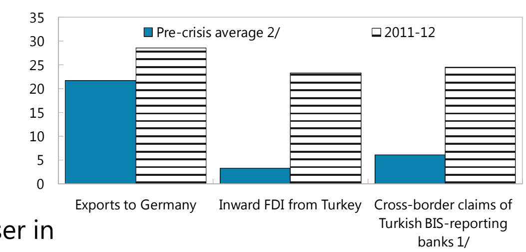


A network analysis of global interconnectedness suggests that Macedonia and its neighboring countries form a tight cluster of economies that are mutually interdependent—more connected to one another than those outside the cluster[2]—with Greece and Serbia acting as likely gateways, connecting the cluster to others. Membership in the cluster reflects the strength of trade, banking, and migrant and remittance links.

Data limitations are unavoidable in any large cross country comparison: in this context, issues of nationality in classifying origin and destination of migrants and remittances, as well as accounting for transshipping of exports through neighbors to Germany may obscure stronger direct linkages to the core.

Nonetheless, this framework is useful in highlighting the following: 1) with two gateways in the cluster, there is greater potential for negative feedback effects within and between clusters; 2) a shock to one member of the cluster may be transmitted more widely to other members through the variety of links that define the cluster. Finally, this broad and systematic approach does not uncover any new sources of spillovers that may have remained hidden by a more narrow focus on bilateral linkages in specific areas.
Looking forward, recent changes in export destinations and FDI and bank flows may have moved Macedonia closer in within the global network, as bilateral links to Germany and Turkey have strengthened.

Trade and Financial Ties since 2010
(Percent of total; unless otherwise indicated)



Sources: Central bank; BIS.
1/ 2011-12 figure is for end-June 2012. Defined in per hundred basis points.
2/ Pre-crisis average 2000-10 for exports, 2007-10 for inward FDI, 2005-07 for cross-border claims.

[1] Franziska Ohnsorge (SPRAM).
[2] The network of bilateral ties as of 2010 in Figure 1 is based on trade, bank exposures, portfolio assets, FDI stocks, migrants, and remittances. A link between a country pair is defined as its share in the average of the two countries' total. To produce the network graph, the links that are "sufficiently large" are aggregated by either taking an unweighted average or choosing the maximum (if the difference between the maximum and minimum link is sufficiently large). See I. Derényi, G. Palla, T. Vicsek, "Clique percolation in random networks" Phys. Rev. Lett. 94, 160–202 (2005). Details of the approach can be found in the IMF Board Paper FO/DIS/12/38.

25. **The authorities noted that they are prepared for tail risk events, and the past stress in Europe has not translated into a loss of confidence in the banking sector.** The authorities monitor deposits on a daily basis, and have tested bank IT systems' ability to generate reliable insured deposit data on short notice. In case of deposit outflows, they expect to be able to supply the system with ample liquidity on a short notice, which should serve to stabilize the situation quickly. Overall, the NBRM believes that its bank resolution framework is adequate. Deposit insurance coverage and scope are seen as appropriate.

B. Fiscal Policy—Restoring a Medium-Term Perspective

26. As the crisis subsides, fiscal policy should regain its medium-term perspective. The authorities are appropriately looking to increase growth potential with some upfront fiscal costs. However, as debt levels have shifted up from low to moderate, the authorities have revised up their near term deficit targets while at the same time shifting some capital expenditure off-budget. Until there are palpable payoffs from the authorities' growth enhancing strategy, the debt-carrying capacity of the economy will remain low, which calls for a careful reconciliation of competing fiscal policy objectives.

27. In order to preserve debt sustainability, there is a critical need to anchor fiscal policy in a medium-term fiscal strategy which would reconcile competing priorities. The authorities' commitment to a business friendly, low tax environment is paired with increasing pressures on current and capital expenditures:

- Ad-hoc pension increases in excess of the standing indexation formula add about MKD 2 billion (0.4 percent of GDP) to 2013 primary expenditure; agricultural subsidies continue to increase, and public sector wages—which were temporarily frozen as a crisis-adjustment measure—are expected to rise by 5 percent in 2014.

- Scaling up public investment projects, namely road and railway infrastructure, is a key stated medium-term objective. The authorities also appropriately envisage higher spending on labor market activation policies, training, skills and education to maximize the benefits of FDI inflows.

- In addition, in the medium term, rising interest cost—due to a higher debt stock and a projected rise in global interest rates—will compete for space with productive expenditure in the overall spending envelope. This is currently mitigated by the still large share of long-dated official external public sector debt at concessional rates (around 40 percent of total public sector debt in 2012), which will reprice rather slowly.

28. A greater focus on multi-annual budgeting would provide a better framework for assessing available fiscal space and help avoid arrears. Optimistic revenue assumptions and weaknesses in the commitment recording and control framework—particularly as it pertains to multiyear projects—were key factors behind the emergence of public sector payment and VAT refund arrears. Strengthening the forecasting framework, as well as the system of commitment controls will improve fiscal management. The authorities have been taking corrective measures, but weaknesses in the Treasury system (text box) will complicate monitoring and control functions in the near term. Meanwhile, it remains crucial that commitments are entered promptly into the existing system.

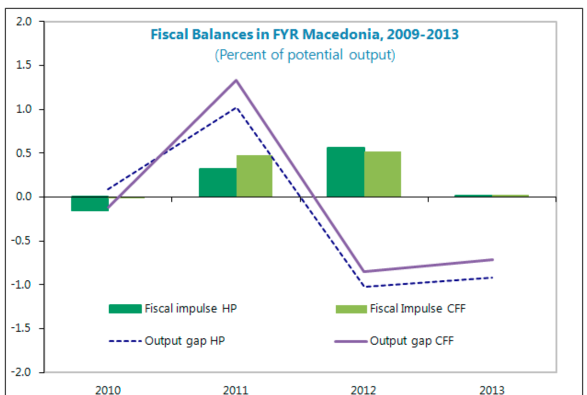
Treasury Operations: Status of Corrective Measures

Reporting. The Manual of Treasury operations has been amended to define the procedures for reporting multi-annual liabilities of budget users to the Treasury, improving the procedures for reporting liabilities in line with signed contracts, and defining the procedures for validation of liabilities by internal auditors.

IT upgrade. In line with findings of shortcomings in the Treasury System by successive annual audits by the State Audit Office, a working group has been set up to define the technical specifications and needed documentation for upgrading the Treasury software, so as to give it the required capacity for proper detailed electronic filing of payment orders as well as sending out electronic reports to budget users. However, this new Treasury module would not be rolled out before 2014.

29. A return to medium-term fiscal strategy documents would help revitalize fiscal transparency. The last such document, covering 2011–2013, was published in December 2010. Resuming the preparation and publication of such strategy documents would foster a better-informed public debate, strengthen government accountability and credibility, as well as improve risk awareness. The published fiscal reports should cover a wider scope of public institutions than the budgetary central government, capture a broad range of direct and contingent liabilities, be published in a timely manner, and take a rigorous approach to risk analysis. As such, these documents would prove to be valuable tools to the public, investors, and policymakers alike.

30. In that light, while an economic case can be made for creating the PESR, fiscal risks should be carefully monitored. A proliferation of entities set up as public non-financial corporations can be associated with the dilution of accountability and control and problems in reporting and consolidating fiscal data, complicating overall fiscal management. First and foremost, the central authorities should be able to exercise tight control of the entity's budget preparation and execution. In addition, they should ensure that financial reporting is timely, transparent and subject to oversight, and allows for the consolidation of PESR activities with central government fiscal tables for the purposes of macro-fiscal analysis.



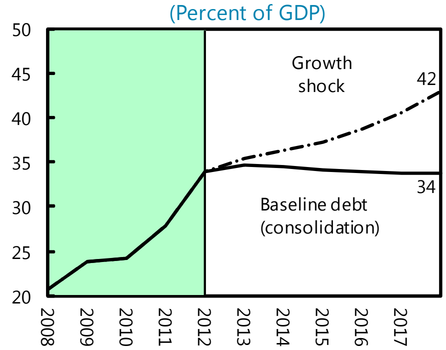
Source: IMF Staff estimates.
Note: HP stands for Hedrick-Prescott Filter, and CFF for Christiano-Fitzgerald Filter. The fiscal impulse (primary balance here) is the difference in the cyclically-adjusted balance between the previous and the current year (a negative fiscal impulse means a cyclically-adjusted contraction). Cyclical adjustment of fiscal balances is done with respect to output gap. The fiscal deficit is adjusted for a structural break to include central government and the off-budget PESR deficit in 2013.

31. To ensure debt sustainability, the central government primary deficit should be gradually reduced to first stabilize debt and then rebuild fiscal buffers.

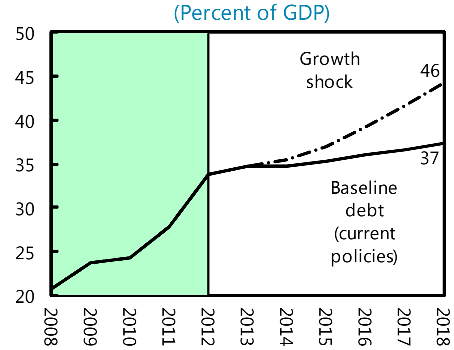
- **In the near term, fiscal policy should remain supportive**. On current fiscal targets, fiscal policy is expected to provide a very small positive impulse in 2013, appropriately aiming to sustain the still fragile recovery in output as private sector activity starts to strengthen.

- **Once the recovery sets in, central government deficits should decline**. Country-specific factors such as a low and volatile revenue ratio, low average growth, rigidity of expenditure, and the constraints imposed by the exchange rate regime suggest that safe debt levels for Macedonia would be generally on the lower end of standard intervals[5]. While rebuilding fiscal buffers used during the crisis will be important in the longer term, the more immediate policy goal is to stabilize debt. Under benign assumptions about the growth-interest rate spread, this would require a reduction of central government primary fiscal deficit by about 1.6 percent of GDP relative to forecast for 2013 outturns (text table and chart). Given largely downside risks to growth, the start of the consolidation process could be effectively managed by identifying consolidation measures that the authorities could commit to in 2014, but which would have a full year effect in 2015.

Debt path under consolidation scenario and growth shocks
(Percent of GDP)



Debt path under current policies scenario and growth shocks
(Percent of GDP)



FYR Macedonia: Underlying Assumptions for Debt Paths
(Percent of GDP, unless otherwise indicated)

	2012	2013	2014-15	2016-18
Consolidation scenario overall deficit	3.8	3.5	2.5	2.2
Consolidation scenario primary deficit	2.9	2.6	1.5	0.5
Current policies overall deficit	3.8	3.5	3.0	3.0
Nominal interest rate (Percent, domestic)	3.3	2.7	3.0	5.0
Nominal interest rate (Percent, foreign)	2.9	2.8	3.2	5.1
Growth, shock scenario (Percent)	-0.3	0.9	2.1	2.9

Sources: IMF staff estimates.

- **The recommended fiscal path for central government deficits appropriately balances risks to debt from plausible shocks against the growth benefits of higher public infrastructure spending.** Recent research, addressing the criticism that the lack of an explicit link between public investment and the resulting acceleration of growth creates a bias

[5] Model-based approaches fail to provide a clear anchor as they produce a fairly wide range of appropriate debt levels for emerging markets. See World Economic Outlook (September 2003): "Public Debt in Emerging Markets", Chapter 3, pp. 113–152; IMF Selected Issues Paper (2009): "A Medium-Term Fiscal Framework for FYR Macedonia", Section III, pp. 20–26; IMF Board Paper (2011): "Modernizing the Framework for Fiscal Policy and Public Debt Sustainability Analysis".

toward conservative borrowing limits,[6] suggests that even if scaling up public investment can be favorable in the long run, the transition period is challenging and exposes the country to increased risk of carrying a permanently higher debt level. Offsetting some of the planned scaling up of public investment in Macedonia by some adjustment to current expenditures would stem a rapid build-up in debt, particularly under an uncertain outlook for growth (see Annex I on debt sustainability).

Authorities' views

32. The authorities noted that boosting growth is indeed the centerpiece of economic policies. In the near term, addressing arrears has played a crucial role in supporting demand. Increasing capital expenditure is a key pillar of their growth strategy, as well as attracting and accommodating FDI in a manner that ensures positive spillovers and linkages to the domestic economy.

33. The authorities concurred with the need to reduce the deficit as the cycle turns, but noted that the pace of consolidation would depend on a number of factors. They saw the need for a cautious pace of deficit reduction. The authorities noted that capital expenditure plans include big projects that would require budgetary space—Corridor X highway construction, railways, a gas pipeline. They argued that a solid social safety net is an important stabilizer, and saw higher subsidies in agriculture and increases in pensions and social assistance as a needed cushion that counterbalances less popular structural reforms.

34. The authorities noted that a medium-term fiscal and debt management strategy is currently under preparation. They saw the suspension of medium-term fiscal strategy documents as a reflection of the extreme uncertainty under which policymakers have been operating through the global downturn. They noted that a medium term fiscal and debt management strategy would be provided to Parliament before the 2014 budget. They concurred that the strategy should indeed provide detailed information and analysis on expenditure and debt of various levels of government.

35. The authorities were mindful of the need to maintain sight of and control over broader public debt. They noted that fiscal risks from the broader perimeter of government are contained by strict controls at the central government level, and reiterated that the Ministry has full control over the indebtedness process of public enterprises, including the newly created Public Enterprise for State Roads.

36. The authorities emphasized their commitment to a durable solution for public sector arrears. They have publicly announced that all arrears have been cleared and noted that they have taken measures to prevent reoccurrence, including by strengthening reporting

[6] A few recent papers focus on the public investment and growth link and the implications for assessing debt sustainability exclusively in the context of low-income countries where infrastructure gaps are notably large. Buffie et al (2012) develop an overall framework for making this link explicit.

requirements for multi-annual contracts, and are confident in their ability to properly monitor the emergence of payment delays. Execution of the budget through March has been in line with the authorities' expectations, providing assurances that there is enough budget space and liquidity to remain current on all due obligations.

C. Monetary Policy and International Reserves

37. The exchange rate peg to the euro continues to serve Macedonia well, delivering low average inflation and a stable real exchange rate. Staff continues to view the peg as appropriate for Macedonia, provided supportive macroeconomic policies remain in place. CGER estimates do not indicate significant misalignments of the real exchange rate, and the current account deficit remains lower that the estimated norm. Yet the persistence of a large trade deficit, mainly attributable to structural constraints, needs to be addressed by policies aimed at boosting non-price competitiveness, securing foreign direct investment and unlocking potential growth by establishing backward linkages from newly established firms to domestic suppliers (Box 2).

FYR Macedonia: Estimated REER Misalignment

Approach	Magnitude of Misalignment
Macroeconomic Balance	-0.1
Equilibrium REER	4.2
External Stability	0.8
Overall Assessment	No Significant Misalignment

Source: IMF staff estimates.
1/ A negative value indicates undervaluation.

38. The primacy of the exchange rate peg limits the latitude for further easing. The policy rate spread over euro rates has narrowed. Reserves remain adequate, balance of payments pressures are limited, core inflation is coming back down, and the ratio of euro-denominated to denar deposits continues to decline, but credit growth is weak—conditions that, at the margin, may allow for some further limited stimulus. Nonetheless, this needs to be carefully weighed against external risks, particularly as further rate declines may be less effective in light of banks' demonstrated risk aversion and already high liquidity. With regards to the efficiency of monetary transmission, staff sees the recent (since January 2013) persistent shift of volume from Central Bank bills to 7-day deposits as a risk to the effectiveness of CB bills as the main instrument of monetary policy. This risk is emphasized by recent issuances of 6-month government paper below the policy rate.

Authorities' views

39. The authorities see monetary policy as appropriately accommodative, and reaffirmed their readiness to raise interest rates to respond to potential exchange rate pressures. They noted that while conditions late last year were conducive to some further relaxation, they had been concerned about the uptick in core inflation. Nonetheless, last year's inflationary peak is seen as a transitory consequence of fuel and food price developments, and a gradual decline in headline and core inflation is expected to continue, with monthly core inflation in February and March at zero percent. This may provide some further room, if necessary, to support activity. The authorities explained that the decision to keep the central bank bill level stable in the face of excess demand was intended to give banks an incentive and opportunity to extend credit to the private sector. They noted that even 7-day deposits enjoy a comfortable interest rate differential in favor of holding denars. Finally, they saw the recent increase in the take up of 7-day deposits as temporary, and see no obvious factors—higher capital flows or higher economic activity—that would lead to continued increases in these balances. Nevertheless, they reiterated that it was not their long-term policy intention to use this instrument as their main instrument for liquidity management. The authorities continue to see the monetary policy framework as consistent with the exchange rate peg, and reaffirmed their readiness to raise interest rates if necessary to respond to any potential exchange rate pressures.

Box 2. External Sector Assessment

Macedonia's external position appears sustainable. In particular, while net external liabilities are on a declining path, various frameworks for computing the real effective equilibrium exchange rate do not point to overvaluation. Nonetheless, the persistence of a high trade deficit is an important vulnerability, and suggests that there are important non-price factors that weigh on competitiveness. To a large extent, the authorities' policies center on addressing these structural bottlenecks to growth.

Economic policies in Macedonia are geared toward attracting foreign direct investment by maintaining cost competitiveness and improving the business environment. These policies have been largely successful. Since the mid-2000s, brownfield and greenfield foreign direct investments have gathered speed in the tradable sector, particularly in the automotive component, but also in the food processing and tobacco sectors, leading to increased export diversification and trade integration with the EU. Key features of the Macedonian economy that have been behind the recent inflows are the proximity to core EU markets, a stable macroeconomic environment, contained unit labor costs attributable to a policy of wage moderation, and a large pool of available labor, and a low-tax environment.

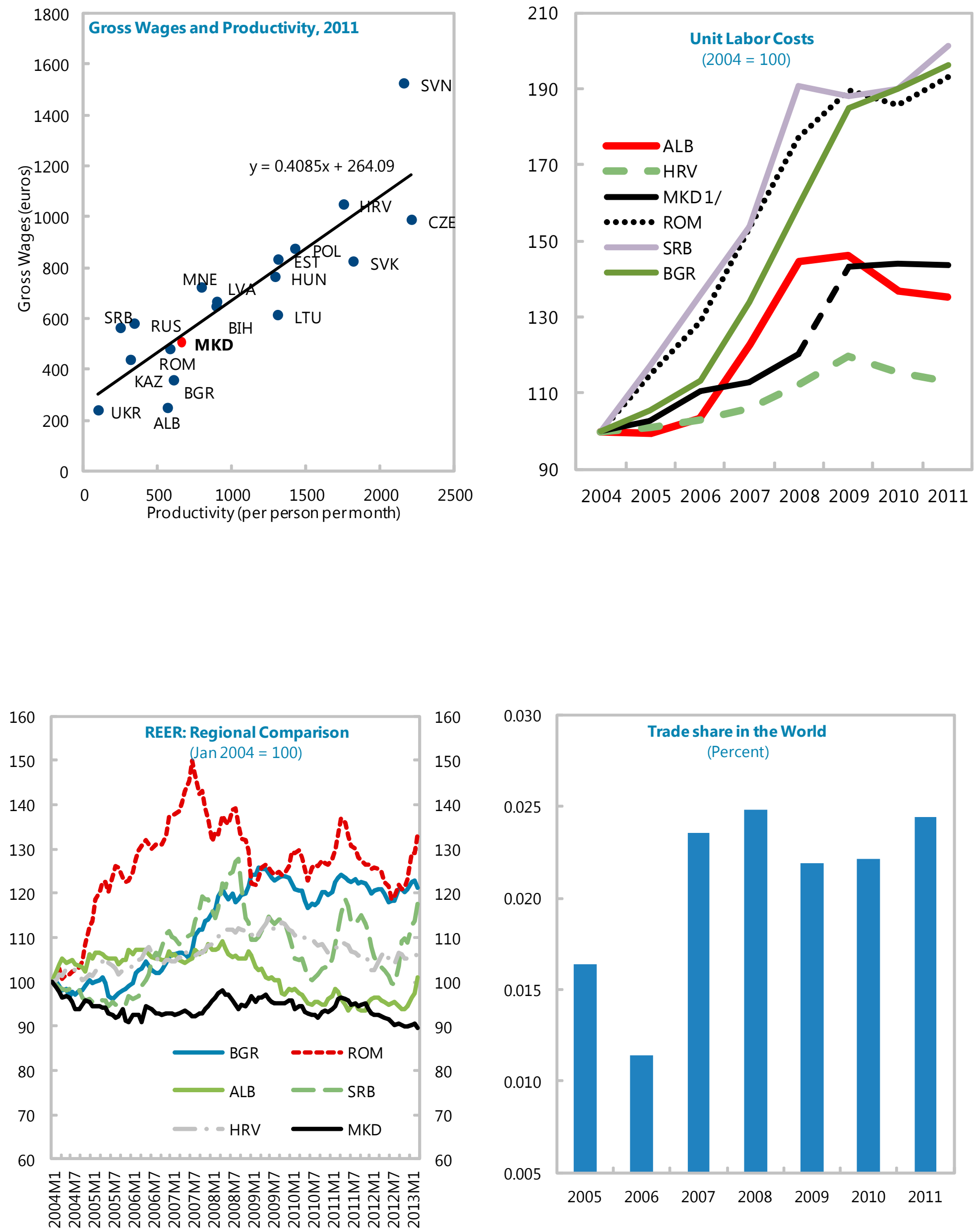
External debt is projected to have peaked at 68 ½ percent of GDP in 2012. Staff's baseline forecast is for a decline in the external debt to GDP ratio of about 8 percentage points over the forecast horizon. The baseline forecast is predicated on about 4 percent of GDP in non-debt creating inflows annually, i.e., slightly below the average inflows recorded over the pre-crisis years 2003–2008, fully financing the non-interest current account deficit. The assumed recovery of FDI to pre-crisis levels seems plausible, given supportive policies put in place in recent years and in view of increasing export market shares.

Continued effort to address non-price competitiveness constraints is needed to boost growth and reduce the large trade deficit over the medium term. Labor participation rates remain notably low and the grey economy widespread. Infrastructure gaps—particularly in roads and railways, but also in energy—are being addressed through public expenditure programs, mostly financed by concessional long term loans. The mechanisms for providing feedback from the needs of new industries to the education and training on offer should help absorb the large pool of unemployed labor. Skill upgrades, together with continued improvements in the business environment should help strengthen linkages of FDI to the domestic economy.

[1] The latter factor is expected to largely limit the scope of second-round effects that may arise from the recently announced indexation of the minimum wage in the private sector.

Box 2. External Sector Assessment (concluded)

Figure. Macedonia: Competitiveness Indicators



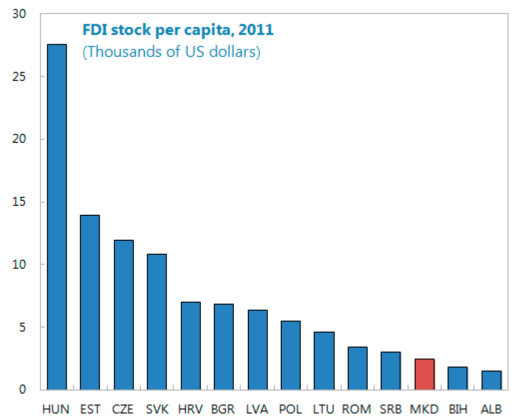
Source: Haver; WEO; INS; Country Authorities; and IMF staff calculations.
1/ MKD statistics with break due to change from net to gross wage accounting.

D. Structural Reform—Boosting Growth

Unemployment and Jobs

40. The high unemployment rate in Macedonia cannot be easily explained by standard labor market frictions. While measured unemployment –at 30½ percent—is disquietingly high, there are no obvious large policy-induced distortions on the demand or supply sides of the labor market that could explain such an outcome. A comprehensive analysis of traditional labor market constraints suggests that employment protection legislation is slightly more flexible, on average, than in peers, the size and duration of social assistance does not provide notable disincentives to seek work, nor are labor tax wedges particularly high (see Chapter 1 of the Selected Issues Papers). This, combined with the observed degree of unresponsiveness of employment to output changes, suggests that more structural factors are at play.

41. Large emigration flows, considerable loss of skilled labor, and small FDI inflows slowed the necessary structural transformation to boost employment. While civil conflicts were much less disruptive in Macedonia than in some other former Yugoslav republics, brain drain estimates place Macedonia among the most affected countries (Beine et al. 2006). Late structural transformations, and a weak flow of foreign investments, partly due to armed conflicts in the region in the 1990s, also hindered the natural development of new sectors with large productivity increases. The composition of output in Macedonia still shows a relatively large dependence on low-productivity sectors such as small scale farming and heavy industry.



Source: IIP Database; and IMF staff calculations.

42. The effort to attract FDI is bearing fruit, and should have a positive impact on the speed of structural transformation and, critically, on activity rates and employment. The authorities have developed a strategy that goes beyond a low tax environment—focusing on building needed infrastructure and allowing feedback from the needs of new industries to the education and training on offer. This, together with a greater focus on primary education, should help absorb the large pool of unemployed labor. However, with labor costs being an important input into location decisions of labor-intensive industries, the authorities should carefully monitor the impact on labor costs of the decision to link the minimum wage to the average wage. Durably boosting growth would also depend on FDI projects developing closer linkages with the domestic economy—this will be a gradual process, but continued improvements in the business environment would help.

Authorities' views

43. The authorities broadly concurred with this overall assessment. They highlighted the magnitude of the structural challenge, particularly in light of the limited public expenditure space. In that respect, the authorities noted that further work could usefully investigate which of the constraints to job creation are most binding. In addition, as job creation accelerates, it would be useful to understand the potential role of other constraints, such as the real scope for mobility of the labor force to accommodate higher labor demand created by new FDI.

Financing Convergence

44. Boosting sustainable credit growth would help finance economic convergence to European income levels. While cyclical considerations and conservative policies at the parent group level currently play a role in limiting credit extension, Macedonia has historically stood out for its low level financial deepening, as proxied by the credit-to-GDP ratio compared to peer countries. Empirical analysis (see Chapter 2 of the Selected Issues Papers) provides some evidence of unsatisfied demand for credit in the economy, likely due to constraints on credit supply.

45. A number of possible structural impediments to credit supply could be alleviated. The authorities have already initiated the process of reviewing the bankruptcy legislation, with a view to streamline inefficient and lengthy procedures. Further improvements to corporate accounting practices at SMEs would allow banks to lend against business plans rather than only against collateral. More realistic valuations of collateral would lower perceived risks by banks; these would require improved data collection and dissemination, particularly on real estate sales transactions. Finally, the interest rate cap, set at 8 and 10 percent above the policy rate for household and corporate loans, respectively, has led to a bunching of rates close to the ceiling and has likely negatively affected access to credit for riskier projects. In addition, the cap, which is reset every 6 months, could inhibit monetary policy transmission in an environment of rising rates.

Authorities' views

46. The authorities largely concurred with staff's analysis. They noted that in addition to the effects mentioned above, the interest rate cap may have raised lending rates across the board, as banks cannot properly differentiate risk by adjusting the price of credit. Recording and publishing real estate transaction data could technically be done by the cadastre, but would likely require a formal change to its mandate. The authorities noted, and staff agree, that while all of these measures could boost credit growth at the margin, the overall effects may not be large.

E. Capacity to Pay

47. Macedonia's capacity to repay the Fund is adequate. Fund repayments (some €230 million in total) are concentrated in 2014–15 (Table 7); a €150 million Eurobond matures in 2015, and further bulky repayments are due on syndicated lending operations in 2016. The authorities noted that current domestic issuance plans will cover financing requirements for this year and part of next year. They saw external capital markets as open, with potential for bond issuance in the second half of 2014. Staff projects a modest accumulation of reserves in 2014 even in the absence of a sovereign bond issue, contingent on the realization of current public sector external borrowing plans and benign market conditions that would allow the rollover of short term external debt.

FYR Macedonia: External Financing Requirements

(Millions of euros, unless specified otherwise)

	2012	2013	2014	2015	2016
			Projections		
Gross financing requirements	2223	2409	2536	2759	2554
Current account deficit	291	387	498	523	524
ST debt amortization (original maturity)	1588	1741	1777	1819	1868
MLT debt amortization 1/	344	106	261	268	162
Sovereign Eurobond amortization	0	175	0	150	0
Financing sources	2223	2409	2536	2759	2554
FDI (net)	111	354	416	442	473
ST debt disbursements	1741	1777	1819	1868	1925
MLT debt disbursements	407	482	449	591	462
of which: Syndicated loan disbursment	75	0	0	0	0
Sovereign Eurobond disbursment	0	0	0	150	0
Other 2/	85	-33	-36	-44	-61
Net change in reserves (-: increase)	-120	-171	-112	-248	-245
Gross international reserves (GIR)	2193	2365	2476	2725	2970
GIR as % of ST debt	108.5	116.0	110.7	134.2	132.9
GIR as % of Fund New Metric	127.2	128.2	124.0	128.4	128.7

Sources: NBRM; and IMF staff estimates.

1/ Excluding the amortization of MLT intercompany loans, which is included in FDI (net).
2/ Including the capital account balance, net errors and omissions, currency and deposits, portfolio investments, flows and stock data.

STAFF APPRAISAL

48. **Macedonia is well positioned to return to growth, although the external outlook presents a key risk.** Having avoided the build-up of large imbalances in the pre-crisis period, Macedonia does not face the prospects of a growth-dampening repair of private and public sector balance sheets. Consequently, the economy is well positioned to restart growth. The expectation of a near term moderate recovery in growth is supported by a solid pipeline of FDI, improvements in the export base and diversification of markets, and public infrastructure investment. Nonetheless, export diversification cannot compensate for the importance of the European market—real linkages to the euro area remain very strong and could weigh on the fragile recovery.

49. **Policies should remain focused on boosting medium-term growth.** Income convergence in the pre-crisis decade has been slow. One key precondition for growth is to maintain macroeconomic stability, and that requires ensuring the sustainability of fiscal policies—gradually reducing the deficit and debt over time. Investing in future capacity, namely public physical investment in transportation and energy, as well as investment in education, training, and labor

market policies to counter long-term and youth unemployment, should be accommodated within available fiscal space. These policies would allow Macedonia to fully reap the benefits of incoming FDI.

50. External and financial stability have been maintained despite a difficult external environment. A number of important factors—bank funding models and the prefinancing of public sector external borrowing requirements—have limited the direct channels of transmission of renewed financial market stress in Europe. Reserve levels are adequate. Nonetheless, the external environment remains volatile, and the authorities should remain vigilant and ready to react to low probability but high impact confidence shocks. Recent changes to the Banking Law have closed most of the identified remaining gaps in the crisis management framework. Progress on the last outstanding issue in this area—addressing the risk of court challenges to the NBRM's intervention of insolvent banks– would complete this agenda.

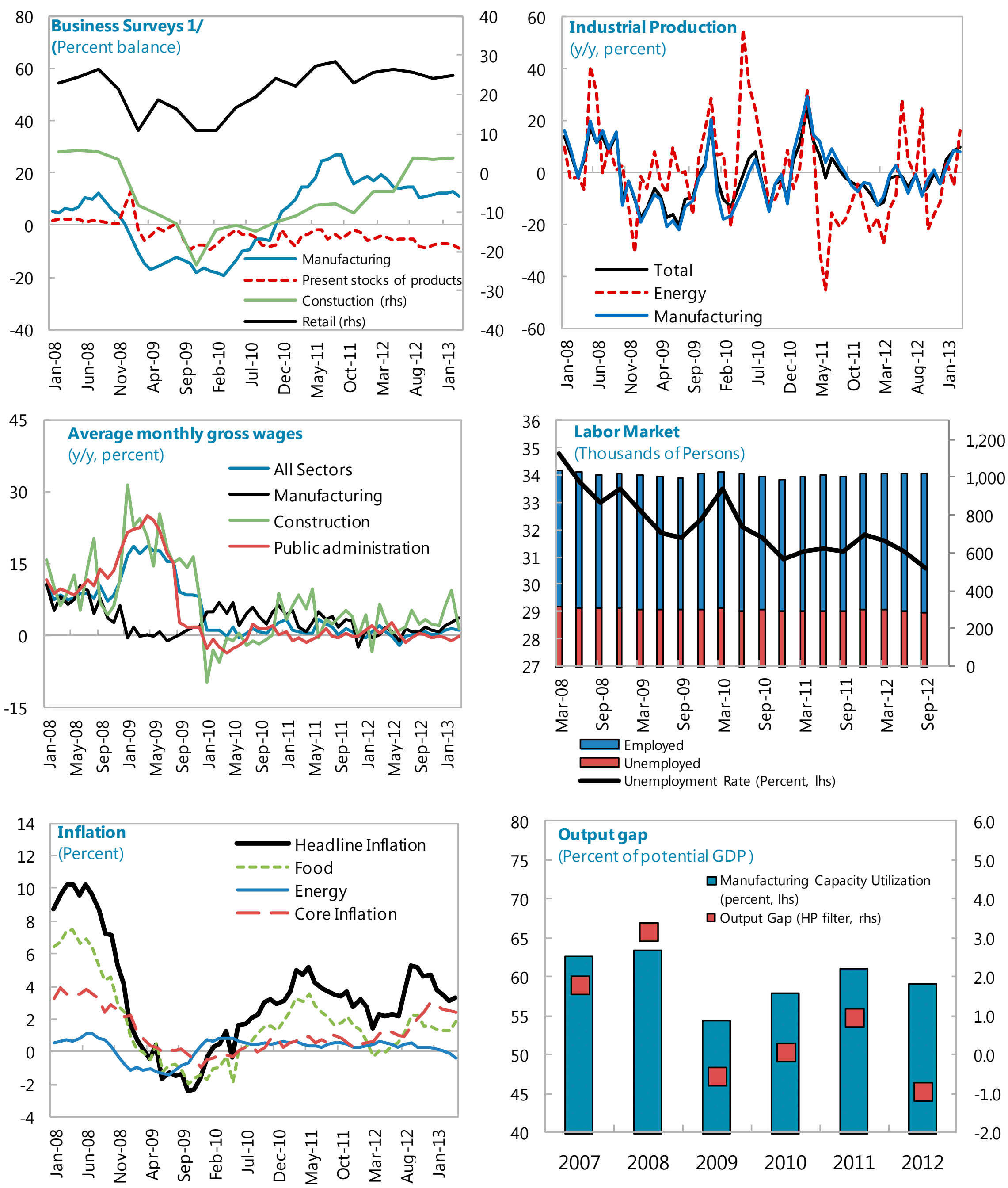
51. The near term policy mix remains appropriate. Given the largely downside risks to growth, policies should remain supportive. Fiscal policy settings for 2013 provide a small positive impulse to growth. While margins for maneuver are limited by the commitment to exchange rate stability, monetary policy settings reflect an appropriate balance between stability and growth.

52. The authorities should anchor fiscal policy in a medium-term fiscal strategy which commits to a long term sustainable debt level. Medium-term fiscal deficits would need to be lowered relative to the authorities' current baseline scenario, in order to first stabilize central government debt and then gradually rebuild some fiscal space for future countercyclical responses. The debt trajectory should take into account the fact that safe debt levels depend on country-specific characteristics such as the level and volatility of revenue ratios and average growth rates. A fleshed out medium-term strategy would increase budget transparency and present a framework for the prioritization of expenditure in the context of consolidation.

53. Strong monitoring and control of public sector entities would ensure that fiscal risks remain contained. With some capital expenditure being moved off-budget, it will be important to (i) take into consideration the evolution of the debt and deficits of the broader public sector aggregate in setting budgetary targets, so as to appropriately balance the risks to debt against the growth benefits of infrastructure building, and (ii) maintain tight central control of budget preparation and the pace and nature of indebtedness of the PESR as well as other state-owned enterprises.

54. It is expected that the next Article IV consultation will be held on the standard 12-month cycle.

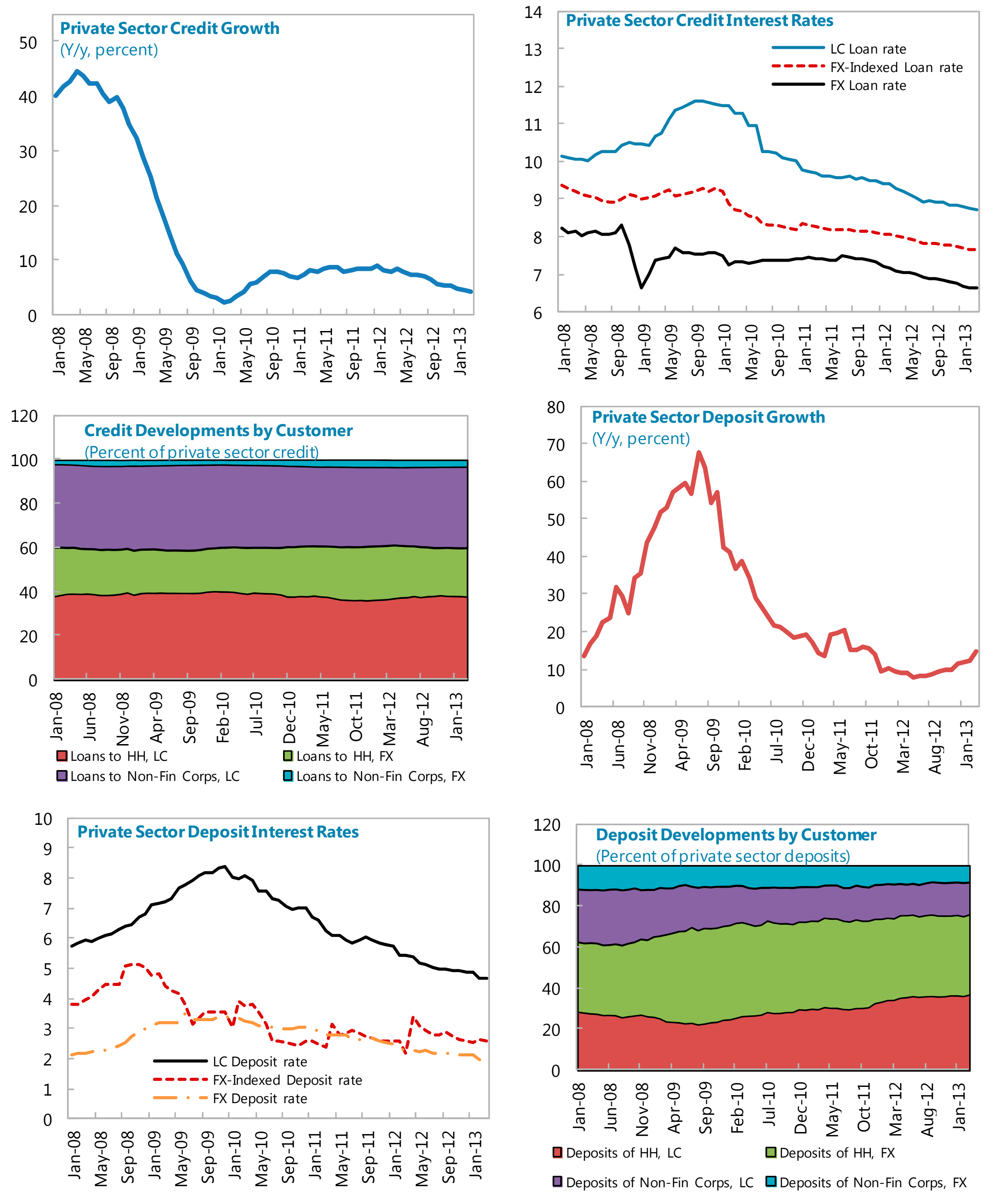
Figure 1. FYR Macedonia: Real Sector Developments, 2008-2013



Sources: Haver; SSO; and IMF staff calculations.
1/ Note: the percent balance is the difference in percentage shares between the 'positive' and 'negative' assessments on the current business situation.

Figure 2. FYR Macedonia: Credit Developments, 2008-2013

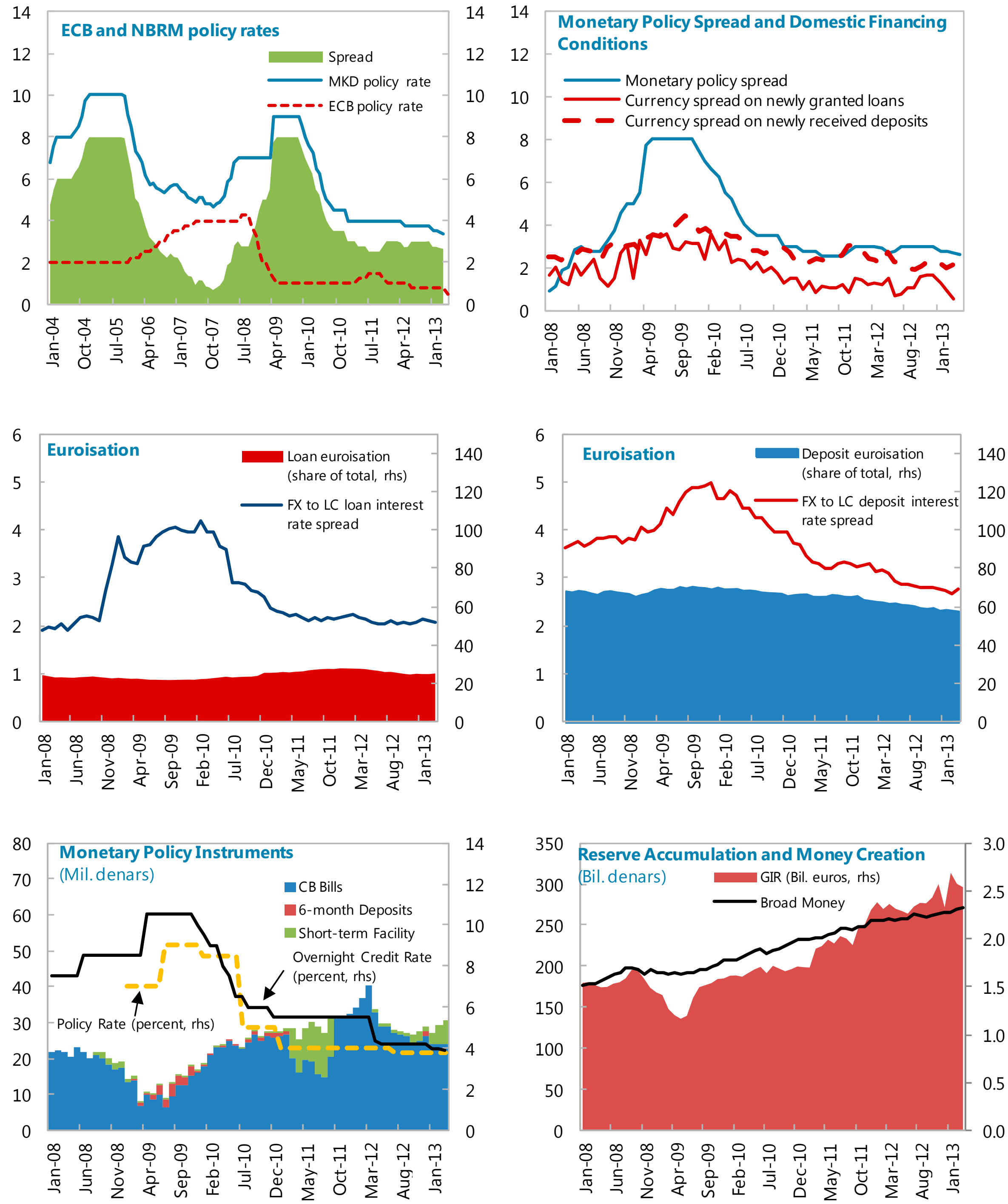
(Percent, unless otherwise indicated)



Sources: NBRM; and IMF staff calculations.

Figure 3. FYR Macedonia: Monetary Policy Developments, 2004-2013

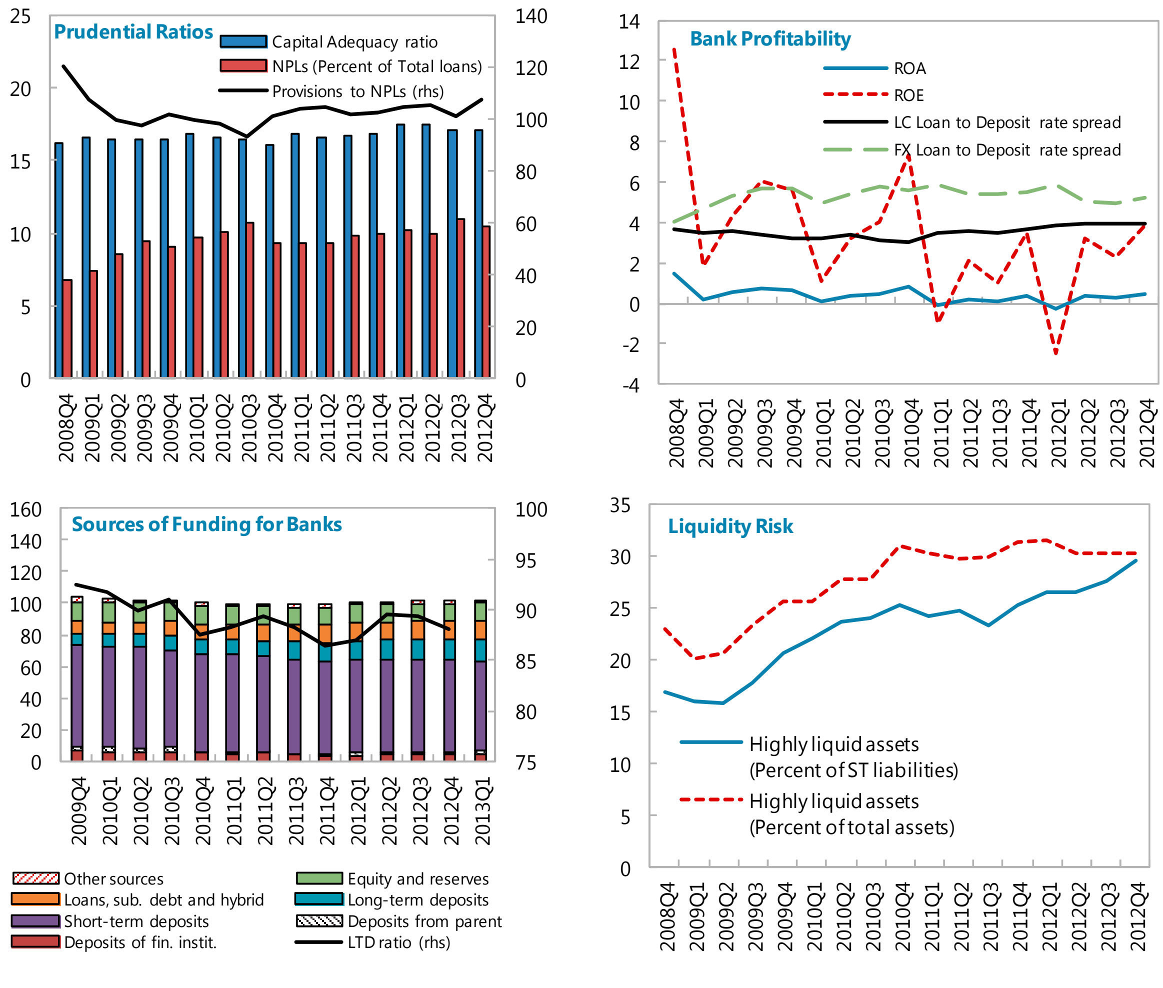
(Percent, unless otherwise indicated)



Sources: NBRM; Haver Analytics; and IMF staff calculations.

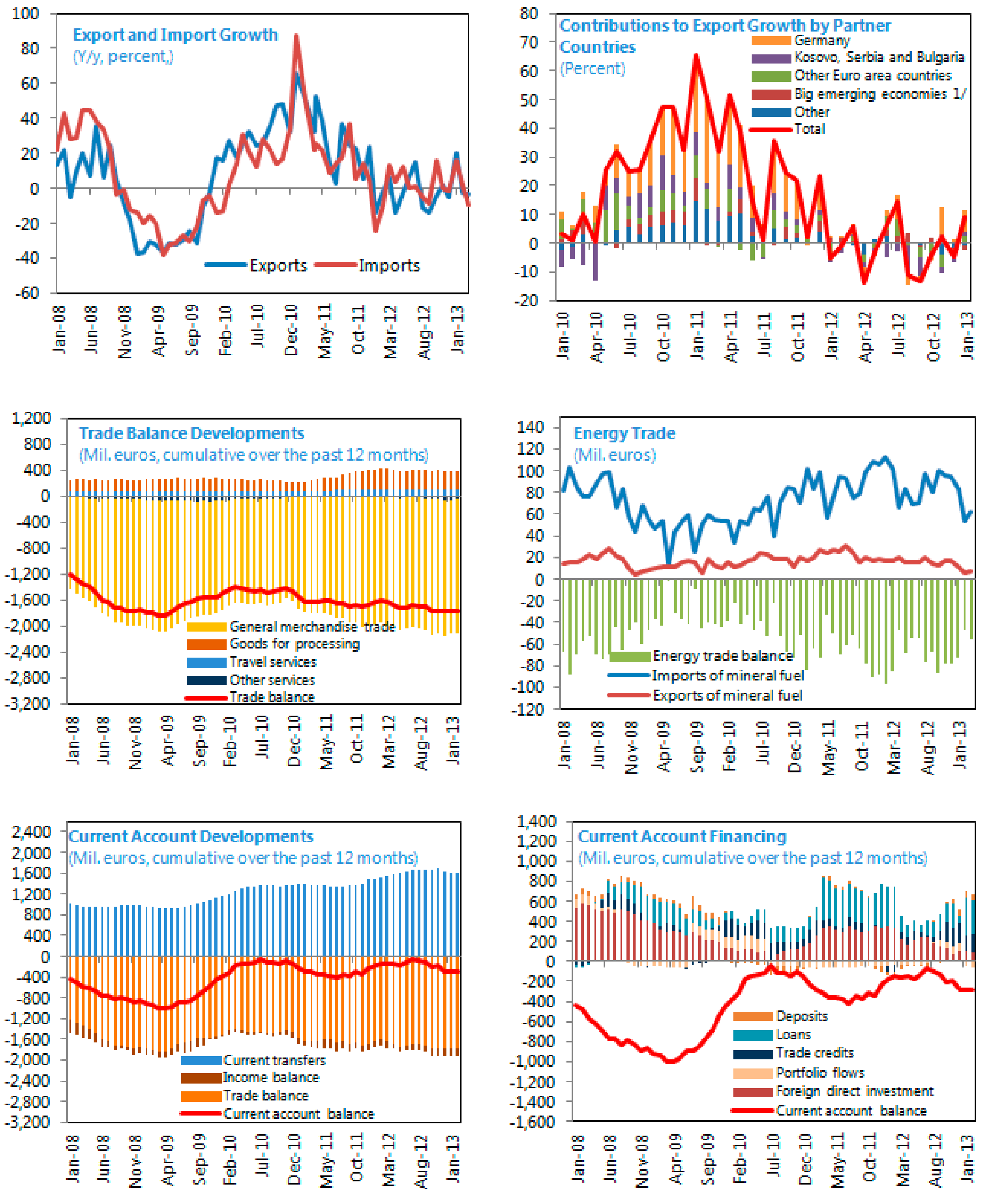
Figure 4. FYR Macedonia: Banking Sector Developments, 2008-2013

(Percent, unless otherwise indicated)



Sources: NBRM; and IMF staff calculations.

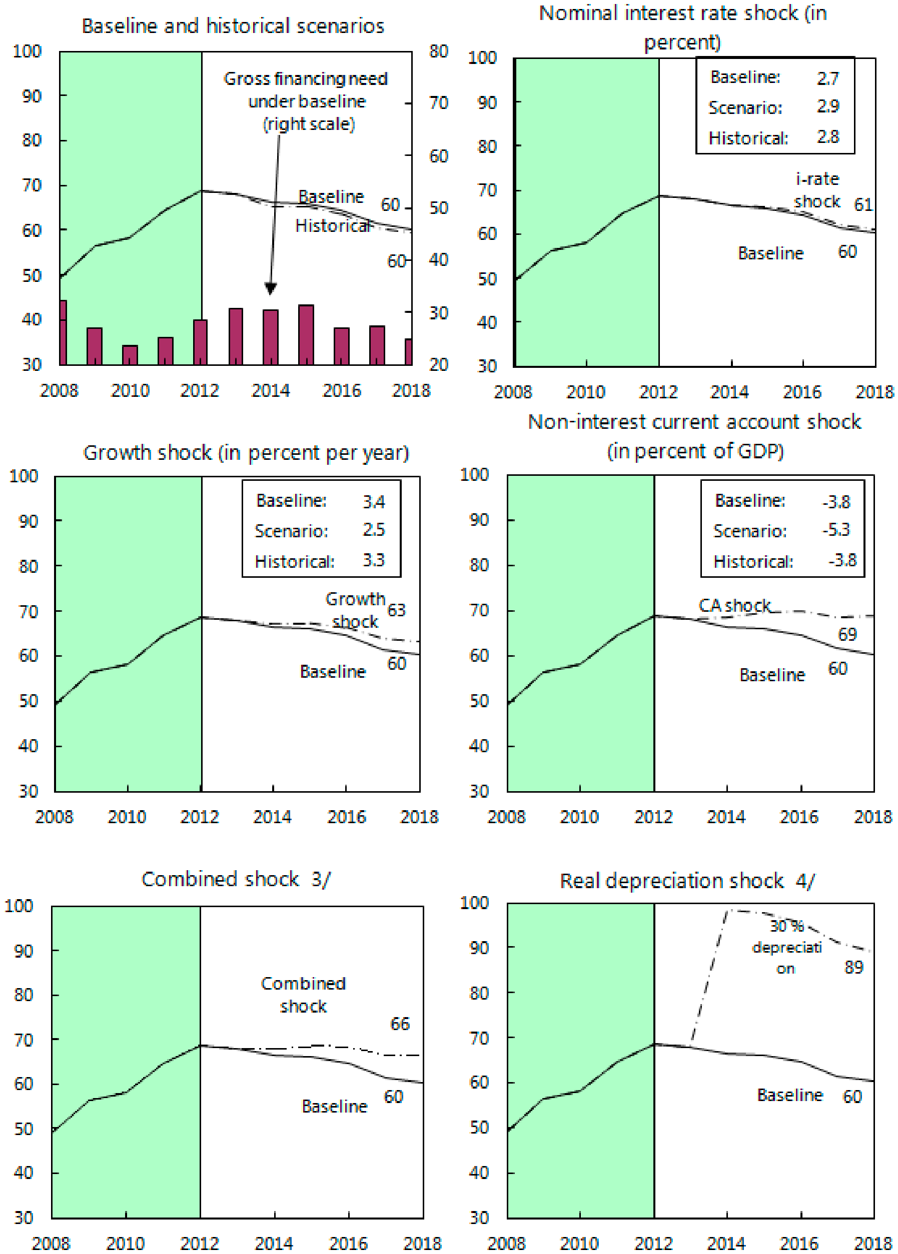
Figure 5. FYR Macedonia: External Sector Developments, 2008-2013



Sources: NBRM; and IMF staff calculations.
1/ Brazil, China, India, Russia and Turkey.

Figure 6. FYR Macedonia: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)



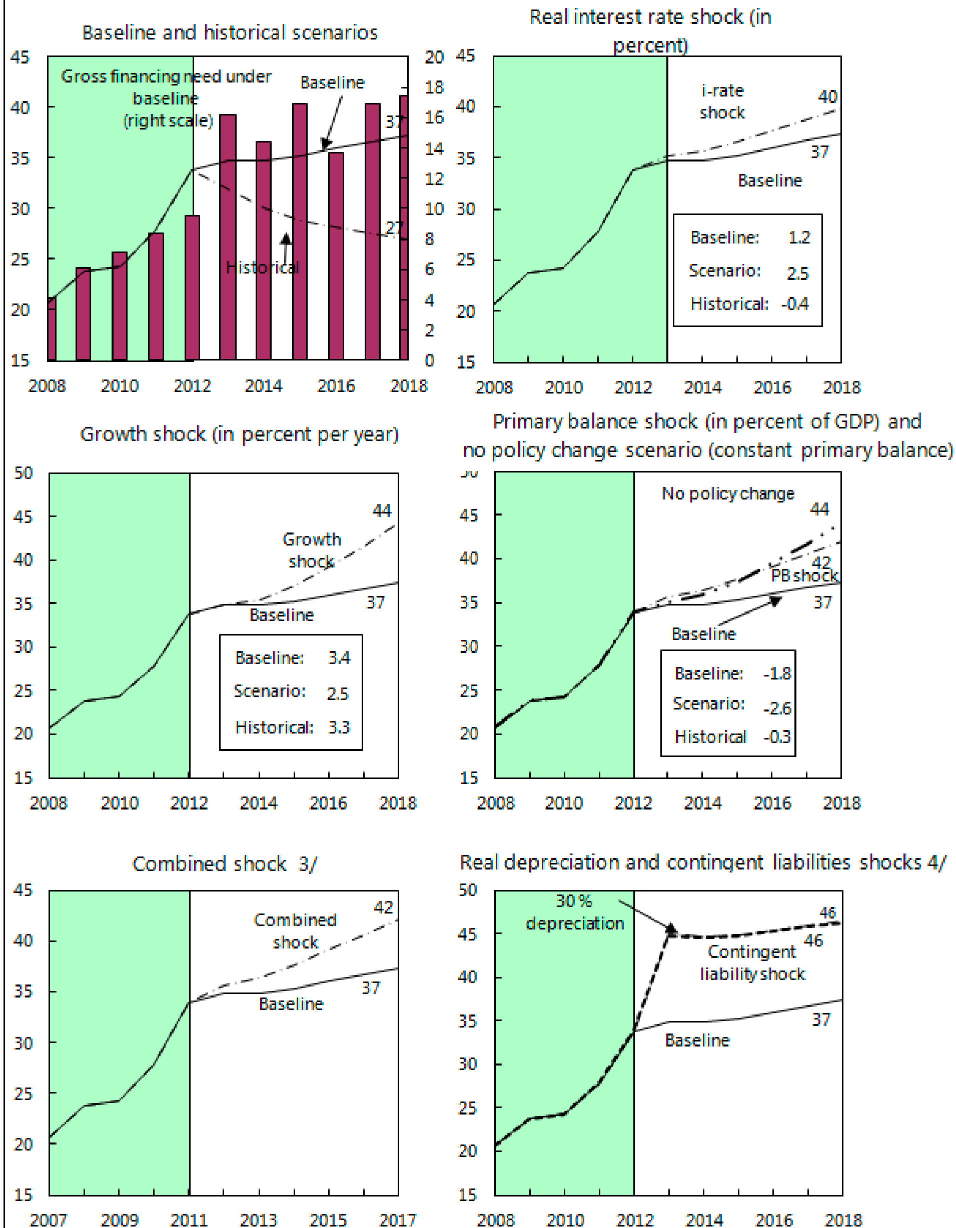
Sources: International Monetary Fund, Country desk data, and staff estimates.

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.

Figure 7. FYR Macedonia: Public Debt Sustainability: Bound Tests 1/ 2/
(Public 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 primary balance.
4/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2010, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Table 1. FYR Macedonia: Macroeconomic Framework, 2009–2018
(Year-on-year percentage change, unless otherwise indicated)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
							Proj.			
Real GDP	-0.9	2.9	2.9	-0.3	2.0	3.0	3.5	4.0	4.0	4.0
Real domestic demand	-2.9	-0.1	5.3	1.8	2.9	4.0	3.7	3.6	3.6	3.6
Consumption	-3.8	0.8	3.4	-0.5	2.0	3.6	3.3	3.3	3.3	3.3
Private	-4.7	1.4	4.0	-0.9	1.9	3.9	3.4	3.4	3.4	3.4
Public	0.5	-2.0	0.6	1.3	2.6	2.3	2.5	2.6	2.6	2.6
Gross investment	1.0	-3.6	13.5	11.0	6.0	5.2	5.0	4.8	4.8	4.8
Exports (volume)	-15.7	24.2	10.4	-0.5	8.4	10.5	10.0	9.0	8.4	8.2
Imports (volume)	-14.3	9.4	13.2	3.6	7.9	9.8	8.1	6.8	6.4	6.4
Contributions to growth										
Domestic demand	-3.6	-0.1	6.2	2.2	3.5	4.9	4.5	4.5	4.5	4.5
Net exports	2.7	3.0	-3.3	-2.4	-1.5	-1.9	-1.0	-0.5	-0.5	-0.5
Central government operations (percent of GDP)										
Revenues	30.5	29.6	28.8	28.9	28.5	28.5	28.5	28.5	28.5	28.5
Expenditures	33.2	32.0	31.3	32.8	32.0	31.5	31.5	31.5	31.5	31.5
Of which: capital	3.3	3.5	3.8	4.1	3.9	4.0	4.0	4.0	4.0	4.0
Of which: Unidentified expenditure adjustment	0.0	0.0	0.0	0.0	-1.0	-1.3	-1.3	-1.3	-1.3	-1.3
Balance	-2.7	-2.4	-2.5	-3.8	-3.5	-3.0	-3.0	-3.0	-3.0	-3.0
Balance incl. PESR 1/	-2.7	-2.4	-2.5	-3.8	-3.8	-3.3	-3.3	-3.3	-3.3	-3.3
Savings and investment (percent of GDP)										
Domestic saving	19.1	23.4	24.2	24.9	24.5	23.6	23.9	24.3	24.5	24.8
Public	0.6	1.1	1.3	0.2	0.3	1.0	1.0	1.0	1.0	1.0
Private	18.5	22.3	22.8	24.7	24.2	22.6	22.9	23.3	23.5	23.8
Foreign saving	6.8	2.1	3.0	3.9	4.9	6.0	5.9	5.5	5.3	5.0
Gross investment	25.9	25.5	27.2	28.8	29.4	29.6	29.8	29.8	29.8	29.8
Consumer prices										
Period average	-0.8	1.5	3.9	3.3	2.5	2.1	2.0	2.0	2.0	2.0
End-period	-1.6	3.0	2.8	4.7	2.2	2.0	2.0	2.0	2.0	2.0
Memorandum items:										
Current account balance (percent of GDP)	-6.8	-2.1	-3.0	-3.9	-4.9	-6.0	-5.9	-5.5	-5.3	-5.0
Gross official reserves (millions of euros)	1,598	1,715	2,069	2,193	2,365	2,476	2,725	2,970	3,088	3,410
in percent of ST debt	105	104	112	108	116	111	134	133	143	165
in months of prospective imports	4.2	3.7	4.4	4.1	4.0	3.9	3.9	4.0	3.9	4.1
Gross Central Government Debt (percent of GDP)	23.8	24.2	27.8	33.8	34.8	34.8	35.3	36.0	36.7	37.3
Gross Central Gov. & PESR Debt (percent of GDP)	23.8	24.2	27.8	33.8	35.9	36.1	36.8	37.7	38.5	39.3
Public Sector Gross Debt (percent of GDP) 2/	26.8	27.8	31.9	38.7	41.8	42.5	43.7	44.3	44.8	45.2
Foreign direct investment (percent of GDP)	2.0	2.2	4.5	1.5	4.5	5.0	5.0	5.0	5.0	5.0
External debt (percent of GDP)	56.4	58.2	64.6	68.6	67.9	66.4	65.9	64.5	61.5	60.2
Nominal GDP (billions of denars)	411	434	462	463	484	512	544	582	622	666
Nominal GDP (millions of euros)	6,703	7,057	7,506	7,523	7,870	8,316	8,845	9,455	10,114	10,819

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

1/ The Road Fund was converted into the Public Enterprise for State Roads (PESR) in January 2013.

2/ Total Public Sector (including MBDP, municipalities, public sector non-financial enterprises; w/o NBRM).

Table 2. FYR Macedonia: Central Government Operations, 2010–2013
(Billions of denars)

	2010	2011	2012		2013	
			Budget	Outturn	Budget	Proj.
Total revenue 1/	128.5	132.9	152.5	133.9	143.2	137.7
Tax revenue	109.3	115.2	125.3	113.8	121.4	116.5
Personal income tax	8.9	9.5	10.7	9.6	10.4	10.0
Corporate income tax	3.7	3.9	3.9	3.7	4.0	3.8
VAT	37.7	42.2	44.7	38.5	45.2	40.5
Excises	14.9	15.5	17.2	16.6	14.7	14.8
Custom duties	4.7	3.8	5.8	4.1	3.9	4.5
Other taxes	3.9	4.0	4.0	4.3	4.6	4.6
Social contributions (total)	35.5	36.3	39.0	37.2	38.6	38.2
Pension contributions	23.0	23.4	24.7	23.9	24.5	24.5
Unemployment contributions	1.7	1.7	1.9	1.7	1.9	1.9
Health contributions	10.9	11.2	12.4	11.5	12.2	11.8
Non tax revenue	12.1	12.7	15.9	12.4	13.4	13.5
Capital revenue	5.6	3.9	7.2	4.6	4.8	4.3
Of which: Telecom dividend	2.5	2.3	2.7	2.5		2.2
Grants	1.5	1.1	4.1	3.0	3.5	3.5
Total expenditure 1/	139.0	144.4	165.0	151.6	160.9	154.8
Current expenditure	124.2	127.5	138.6	133.5	142.7	141.3
Wages and salaries	22.6	23.1	22.7	22.7	23.1	23.1
Goods and services	14.7	13.9	17.4	14.6	17.4	15.9
Transfers	83.7	86.9	94.9	91.9	98.1	98.1
Interest	3.2	3.5	3.6	4.2	4.1	4.2
Capital expenditure	15.3	17.7	27.0	18.8	18.7	18.7
Lending minus repayment	-0.5	-0.8	-0.6	-0.6	-0.6	-0.6
Unidentified adjustment	0.0	0.0	0.0	0.0		-4.6
Overall fiscal balance	-10.5	-11.5	-12.4	-17.8	-17.7	-17.0
Financing	10.5	11.5	12.4	17.8	17.7	17.0
Domestic	5.9	-9.4	-2.0	13.6	13.7	10.1
Central Bank deposits	4.0	-7.3	0.0	-12.0	12.0	5.8
Other domestic financing	1.9	-2.1	-2.0	25.7	1.7	4.3
Privatization receipts	0.0	0.3	0.2	0.1	0.1	0.1
Foreign	4.6	20.6	14.2	5.1	3.9	6.9
Official	4.6	13.1	0.7	4.6		15.5
Private	0.0	7.6	13.5	0.5		-8.6
Memo items:						
Contributions to second pillar pensions	3.2	3.5	3.6	3.6		1.2
Gross debt (as share of GDP)	24.2	27.8	31.3	33.8		34.8
Nominal GDP (billions of denars)	434	462	485	463	495	484

Sources: IMF Staff and MoF estimates.

1/ Adjusted for transitional costs for the pension system and revenue from the repayment of loans, amounting to MKD 4,200 million and MKD 600 million respectively in 2013.

Note: Central government refers to the core government, plus consolidated extra-budgetary funds.

Table 2. FYR Macedonia: Central Government Operations, 2010–2013 (concluded)
(Percent of GDP)

	2010	2011	2012		2013	
			Budget	Outturn	Budget	Proj.
Total revenue 1/	29.6	28.8	31.4	28.9	28.9	28.5
Tax revenue	25.2	25.0	25.8	24.6	24.5	24.1
Personal income tax	2.0	2.1	2.2	2.1	2.1	2.1
Corporate income tax	0.9	0.8	0.8	0.8	0.8	0.8
VAT	8.7	9.1	9.2	8.3	9.1	8.4
Excises	3.4	3.4	3.6	3.6	3.0	3.0
Custom duties	1.1	0.8	1.2	0.9	0.8	0.9
Other taxes	0.9	0.9	0.8	0.9	0.9	0.9
Social contributions (total)	8.2	7.9	8.0	8.0	7.8	7.9
Pension contributions	5.3	5.1	5.1	5.2	5.0	5.1
Unemployment contributions	0.4	0.4	0.4	0.4	0.4	0.4
Health contributions	2.5	2.4	2.6	2.5	2.5	2.4
Non tax revenue	2.8	2.8	3.3	2.7	2.7	2.8
Capital revenue	1.3	0.8	1.5	1.0	1.0	0.9
Grants	0.3	0.2	0.8	0.7	0.7	0.7
Total expenditure	32.0	31.3	34.0	32.8	32.5	32.0
Current expenditure	28.6	27.6	28.6	28.8	28.9	29.2
Wages and salaries	5.2	5.0	4.7	4.9	4.7	4.8
Goods and services	3.4	3.0	3.6	3.2	3.5	3.3
Transfers	19.3	18.8	19.6	19.9	19.8	20.3
Interest	0.7	0.8	0.7	0.9	0.8	0.9
Capital expenditure	3.5	3.8	5.6	4.1	3.8	3.9
Lending minus repayment	-0.1	-0.2	-0.1	-0.1	-0.1	-0.1
Unidentified adjustment	0.0	0.0	0.0	0.0	0.0	-1.0
Overall fiscal balance	-2.4	-2.5	-2.6	-3.8	-3.6	-3.5
Financing	2.4	2.5	2.6	3.9	3.6	3.5
Domestic	1.4	-2.0	-0.4	2.9	2.8	2.1
Central Bank deposits	0.9	-1.6	0.0	-2.6	2.4	1.2
Other domestic financing	0.4	-0.5	-0.4	5.5	0.3	0.9
Privatization receipts	0.0	0.1	0.0	0.0	0.0	0.0
Foreign	1.1	4.5	2.9	1.1	0.8	1.4
Official	1.1	2.8	0.1	1.0		3.2
Private	0.0	1.6	2.8	0.1		-1.8
Memo items:						
Contributions to second pillar pensions	0.7	0.8	0.7	0.8		0.2
Gross debt (as share of GDP)	24.2	27.8	31.3	33.8		34.8
Nominal GDP (billions of denars)	434	462	485	463	495	484

Sources: IMF Staff and MoF estimates.
1/ Adjusted for transitional costs for the pension system and revenue from the repayment of loans.
Note: Central government refers to the core government, plus consolidated extra-budgetary funds.

Table 3. FYR Macedonia: Balance of Payments, 2009–2018

(Millions of euros, unless otherwise indicated)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
					Projections					
Current account	-457	-144	-224	-291	-387	-498	-523	-524	-536	-536
Trade balance	-1560	-1448	-1682	-1784	-1964	-2105	-2163	-2209	-2272	-2336
Exports	1933	2530	3179	3093	3546	3954	4440	4890	5334	5821
Imports	-3492	-3978	-4861	-4877	-5511	-6060	-6604	-7099	-7605	-8157
Services (net)	16	37	98	23	39	54	85	120	157	198
Income (net)	-47	-100	-121	-150	-165	-173	-181	-190	-229	-274
Transfers (net)	1133	1367	1480	1620	1703	1726	1737	1755	1807	1876
Of which										
Official	35	31	76	48	52	59	53	55	56	54
Private	1098	1337	1404	1572	1651	1667	1684	1701	1752	1822
Of which: Cash exchange	928	1155	1224	1389	1443	1512	1584	1658	1732	1811
Capital and financial account	444	203	560	370	558	610	771	769	654	858
Capital account (net)	20	12	21	16	0	0	0	0	0	0
Financial account	424	191	538	355	558	610	771	769	654	858
Direct investment (net)	137	159	337	111	354	416	442	473	506	541
Portfolio investment (net)	104	-57	-42	76	-181	-4	-3	-2	-1	-1
Of which: Eurobonds disbursements	175	0	0	0	0	0	150	0	0	0
Of which: Eurobonds amortizations	0	0	0	0	-175	0	-150	0	0	0
Other investment	183	89	244	168	385	198	331	298	150	318
Trade credits (net)	169	71	-9	192	71	75	80	85	91	98
MLT loans (net)	34	67	463	64	376	188	324	300	149	307
Public sector	7	39	367	62	287	88	194	159	-9	130
Disbursements	47	98	457	161	342	238	378	250	250	250
of which: IMF credit	0	0	221	0	0	0	0	0	0	0
Amortization	-40	-59	-89	-99	-56	-150	-185	-91	-259	-120
of which: Repayment to the IMF	0	0	0	0	0	86	115	29	0	0
Banks (net)	16	94	53	-24	40	46	58	62	71	82
Non-Banks (net)	12	-66	43	26	49	53	72	79	87	96
ST loans (net)	16	62	-27	-5	31	33	35	38	40	43
Currency and deposits (net)	-62	-171	-234	-115	-93	-98	-108	-125	-131	-130
Of which: Commercial banks	-60	-81	-98	113	0	0	0	0	0	0
Other (net)	25	60	50	32	0	0	0	0	0	0
Errors and omissions	27	1	-4	41	0	0	0	0	0	0
Overall Balance	14	61	332	120	171	112	248	245	118	322
				(Percent of GDP)						
Current account	-6.8	-2.0	-3.0	-3.9	-4.9	-6.0	-5.9	-5.5	-5.3	-5.0
Of which										
Trade balance	-23.3	-20.5	-22.4	-23.7	-25.0	-25.3	-24.5	-23.4	-22.5	-21.6
Private transfers	16.4	18.9	18.7	20.9	21.0	20.0	19.0	18.0	17.3	16.8
FDI (net)	2.0	2.2	4.5	1.5	4.5	5.0	5.0	5.0	5.0	5.0
				(Year-on-year percent change)						
Exports of G&S (Value)	-24.7	25.9	25.0	-1.6	14.7	11.5	12.3	10.1	9.1	9.1
Volume	-15.7	24.6	10.4	-0.5	8.4	10.5	10.0	9.0	8.4	8.2
Price	-10.6	1.1	13.2	-1.1	5.8	0.9	2.1	1.0	0.6	0.9
Imports of G&S (Value)	-20.3	12.9	20.9	2.1	13.0	10.0	9.1	7.5	7.1	7.2
Volume	-14.3	10.6	13.2	3.6	7.9	9.8	8.1	6.8	6.4	6.4
Price	-7.1	2.1	6.8	-1.5	4.7	0.2	0.9	0.7	0.7	0.8
Terms of trade (2008=100)	96.2	94.5	99.8	100.2	101.2	101.9	103.1	103.4	103.4	103.5
Memorandum Items:										
Nominal GDP	6703	7057	7506	7523	7870	8316	8845	9455	10114	10819
ST debt at residual maturity (year-end)	1516	1649	1847	2022	2038	2237	2030	2236	2162	2066
Gross foreign exchange reserves	1598	1715	2069	2193	2365	2476	2725	2970	3088	3410
Months of prospective imports of G&S	4.2	3.7	4.4	4.1	4.0	3.9	3.9	4.0	3.9	4.1
Percent of short-term debt (residual maturity)	105.4	104.0	112.0	108.5	116.0	110.7	134.2	132.9	142.8	165.1
External debt (percent of GDP)	56.4	58.2	64.6	68.6	67.9	66.4	65.9	64.5	61.5	60.2
Medium and long-term	37.9	39.6	43.4	45.5	45.3	44.5	44.8	44.1	41.8	41.1
Short-term	18.5	18.6	21.2	23.1	22.6	21.9	21.1	20.4	19.7	19.1
External debt service	1427	1608	1780	1972	2158	2180	2388	2190	2397	2332
Percent of exports of G&S	56.0	50.1	44.7	50.3	48.0	43.5	42.4	35.3	35.4	31.6
Percent of exports of G&S and private transfers	38.7	35.1	32.6	35.6	34.8	32.3	32.4	27.5	28.0	25.2

Sources: NBRM; and IMF staff estimates.

Table 4. FYR: Macedonia - Monetary Survey 2007-2018
(Billions of denars, unless specified otherwise)

	2007	2008	2009	2010	2011				2012			
					1Q-11	2Q-11	3Q-11	4Q-11	1Q-12	2Q-12	3Q-12	4Q-12
NFA	109.1	91.0	94.8	99.9	110.8	104.8	111.0	124.7	121.7	115.4	124.1	126.1
Central Bank	94.4	91.0	93.2	100.6	112.2	108.2	109.1	122.5	122.5	119.6	124.7	128.9
Commercial Banks	14.6	0.0	1.5	-0.7	-1.3	-3.5	1.9	2.2	-0.9	-4.2	-0.6	-2.8
NDA	66.7	104.5	112.5	132.7	123.9	134.7	134.1	130.3	136.0	143.1	136.4	140.2
Credit to Government (net)	-10.5	-8.4	-4.8	9.0	-3.7	2.0	2.2	-1.8	1.9	4.9	-0.8	1.9
From Banks (net)	10.6	5.5	9.0	15.0	14.9	13.7	13.0	14.0	14.6	22.3	22.0	29.1
of which: Credit (Tbills)	13.0	9.4	13.1	18.1	17.8	16.4	15.9	16.7	17.3	25.5	24.6	31.7
From Central Bank (net)	-21.2	-13.9	-13.7	-6.0	-18.7	-11.7	-10.8	-15.8	-12.7	-17.4	-22.8	-27.2
of which: Deposits	-20.8	-12.3	-12.7	-9.0	-20.6	-13.4	-12.7	-19.1	-15.4	-20.3	-25.7	-30.4
Credit to Private Sector (Gross)	130.4	174.8	180.2	193.4	197.6	202.3	205.1	208.2	211.8	217.3	218.2	219.0
From Banks	129.0	173.3	178.7	191.9	196.1	202.2	205.1	208.1	211.7	217.2	218.1	218.9
Denars	97.9	134.5	139.8	143.6	145.9	149.8	149.5	150.6	153.6	159.8	162.7	164.5
FX	31.0	38.8	38.9	48.3	50.3	52.4	55.6	57.6	58.1	57.4	55.4	54.4
From Central Bank	1.4	1.5	1.5	1.5	1.4	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other Items (net)	-53.1	-61.9	-62.9	-69.7	-69.9	-69.6	-73.2	-76.0	-77.7	-79.1	-80.9	-80.7
Broad Money (M3)	175.8	195.5	207.3	232.6	234.7	239.4	245.1	255.0	257.6	258.5	260.5	266.3
Currency in Circulation	17.9	17.6	16.3	17.0	15.9	17.0	17.2	19.3	17.9	18.8	19.2	20.1
Total Deposits	157.9	177.9	191.0	215.6	218.8	222.4	227.9	235.7	239.8	239.6	241.3	246.2
Denars	89.6	94.1	90.5	106.8	107.9	110.2	113.3	122.3	128.0	129.0	131.9	135.1
FX	68.3	83.8	100.5	108.8	110.8	112.2	114.6	113.5	111.8	110.7	109.4	111.1
(Year-on-year percent change)												
Private Sector Credit	39.0	34.1	3.1	7.3	8.0	7.8	7.3	7.7	7.2	7.4	6.4	5.2
Broad Money	29.3	11.2	6.0	12.2	11.4	8.6	10.5	9.7	9.8	8.0	6.3	4.4
Private Sector Deposits	31.9	12.7	7.3	12.9	11.7	8.6	10.7	9.3	9.6	7.8	5.9	4.4
(Contribution to annual growth in broad money)												
NFA	1.1	-10.3	1.9	2.5	8.5	2.2	6.3	10.7	4.6	4.4	5.3	0.5
NDA	28.2	21.5	4.1	9.7	2.9	6.5	4.2	-1.0	5.1	3.5	1.0	3.9
Broad Money	29.3	11.2	6.0	12.2	11.4	8.6	10.5	9.7	9.8	8.0	6.3	4.4
(Percent of GDP)												
Private Sector Credit	35.7	42.5	43.9	44.5	44.5	44.6	44.9	45.1	45.9	47.1	47.6	47.5
Broad Money	48.2	47.5	50.5	53.6	52.8	52.8	53.6	55.2	55.8	56.0	56.8	57.8
Private Sector Deposits	43.3	43.2	46.5	49.7	49.2	49.0	49.9	51.1	51.9	52.0	52.6	53.4
Memorandum Items:												
Money Multiplier	4.6	4.8	4.5	4.7	5.0	4.9	5.3	4.8	5.3	5.0	4.9	4.8
Reserve Requirement Ratio (% of deposits)												
Denars	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0
FX Indexed	10.0	10.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0
FX	10.0	10.0	13.0	13.0	13.0	13.0	13.0	13.0	13.0	13.0	13.0	13.0
Velocity	2.1	2.1	2.0	1.9	1.9	1.9	1.9	1.8	1.8	1.8	1.8	1.7

Sources: NBRM; and IMF staff estimates.

Table 5. FYR: Macedonia - Central Bank Survey 2007-2018
(Billions of denars, unless specified otherwise)

	2007	2008	2009	2010	2011				2012			
					1Q-11	2Q-11	3Q-11	4Q-11	1Q-12	2Q-12	3Q-12	4Q-12
NFA	94.4	91.0	93.2	100.6	112.2	108.2	109.1	122.5	122.5	119.6	124.7	128.9
Assets	95.0	91.9	97.8	105.5	116.9	120.2	119.1	141.6	145.5	139.3	145.9	143.3
Liabilities	-0.6	-1.0	-4.6	-4.9	-4.8	-12.0	-10.1	-19.1	-22.9	-19.7	-21.2	-14.4
NDA	-56.6	-50.1	-47.3	-51.6	-64.8	-59.8	-62.5	-68.9	-73.7	-67.4	-71.8	-73.0
Banks (net)	-21.0	-19.0	-16.8	-26.9	-28.5	-30.0	-31.6	-32.2	-40.4	-28.1	-25.7	-26.1
of which:												
NBRM Bills and short-term facilities	-21.0	-19.0	-16.0	-25.9	-28.5	-30.0	-31.6	-32.2	-40.4	-29.8	-27.1	-27.1
Central Government (net)	-19.6	-11.0	-11.4	-3.5	-15.2	-8.1	-7.3	-13.4	-9.9	-14.6	-20.1	-24.9
of which:												
Deposits at Central Bank	-20.8	-12.3	-12.7	-9.0	-20.6	-13.4	-12.7	-19.1	-15.4	-20.3	-25.7	-30.4
Denar	-15.3	-9.2	-2.8	-5.9	-2.9	-2.6	-5.0	-7.0	-4.4	-9.9	-13.2	-19.5
FX	-5.5	-3.1	-9.9	-3.1	-17.7	-10.8	-7.7	-12.1	-11.0	-10.4	-12.5	-10.9
State and Local Governments (net)	-1.6	-2.8	-2.4	-2.5	-3.5	-3.6	-3.5	-2.3	-2.7	-2.8	-2.7	-2.3
Other items (net)	-14.4	-17.2	-16.7	-18.7	-17.7	-18.0	-20.2	-20.9	-20.6	-21.9	-23.3	-19.7
Reserve Money	37.9	40.9	46.0	49.0	47.3	48.5	46.5	53.6	48.8	52.2	52.9	55.9
Currency in Circulation	17.9	17.6	16.3	17.0	15.9	17.0	17.2	19.3	17.9	18.8	19.2	20.1
Other	20.0	23.3	29.7	32.0	31.4	31.4	29.3	34.3	30.9	33.4	33.7	35.8
Cash in Vaults	2.0	3.2	3.2	3.2	2.8	3.1	3.2	3.5	3.2	3.3	3.3	3.9
Total Reserves	18.0	20.1	26.5	28.8	28.6	28.3	26.2	30.9	27.7	30.0	30.4	32.0
on Denar Deposits	10.7	10.3	14.2	15.7	15.1	14.4	12.0	16.7	14.7	16.9	17.4	18.9
on FX Deposits	7.3	9.8	12.2	13.2	13.5	13.9	14.2	14.1	13.0	13.1	13.0	13.0
(Contribution to annual growth in reserve money)												
NFA	30.4	-9.2	5.6	16.0	40.8	16.6	21.2	44.7	21.9	23.5	33.6	11.9
NDA	-10.2	17.2	6.8	-9.4	-33.2	-14.5	-19.5	-35.2	-18.9	-15.8	-19.9	-7.7
Reserve Money	20.2	8.0	12.4	6.6	7.6	2.1	1.8	9.5	3.1	7.7	13.7	4.3
Memorandum Items:												
NBRM Bills (percent of GDP)	5.8	4.2	3.9	6.0	4.5	4.2	4.5	7.0	8.8	6.2	5.7	5.7
Govt Deposits at Central Bank (Percent of GDP)	5.7	3.0	3.1	2.1	4.6	2.9	2.8	4.1	3.3	4.4	5.6	6.6

Sources: NBRM; and IMF staff estimates.

Table 6. FYR Macedonia: Financial Soundness Indicators of the Macedonian Banking System, 2007-2012
(Percent)

	2007	2008	2009	2010	2011	2012			
						2012Q1	2012Q2	2012Q3	2012Q4
Capital adequacy									
Regulatory capital/risk weighted assets	17.0	16.2	16.4	16.1	16.8	17.5	17.4	17.1	17.1
Tier I capital/risk weighted assets 1/	15.7	14.0	13.8	13.4	14.1	14.7	14.7	14.4	14.5
Equity and reserves to Assets	11.4	11.5	11.4	10.6	11.0	11.4	11.6	11.5	11.2
Asset composition									
Structure of loans									
Enterprises (loans to enterprises/total loans)	54.9	54.2	58.7	58.9	58.2	58.4	58.2	57.8	56.9
Households (loans to households/total loans)	37.7	38.5	37.9	37.1	36.5	36.0	36.1	36.6	36.4
Lending with foreign currency component to private sector	54.7	57.0	58.5	58.8	59.2	58.3	57.0	55.7	55.4
Foreign currency lending/total credit to private sector	24.6	22.9	22.6	25.8	28.2	28.0	27.1	26.0	25.5
Foreign currency indexed lending/total credit to private sector	30.1	34.1	35.9	33.0	31.0	30.3	29.8	29.7	29.8
NPLs 2/									
NPLs/gross loans	7.5	6.7	8.9	9.0	9.5	9.9	9.7	10.6	10.1
NPLs net of provision/own funds	-5.0	-6.2	-0.6	-0.3	-0.9	-2.0	-2.3	-0.5	-3.7
Provisions to Non-Performing Loans	114.3	118.1	101.4	100.7	101.9	104.2	104.7	100.9	107.1
Large exposures/own funds	181.4	118.0	213.3	200.4	189.6	183.8	188.7	181.3	205.1
Connected lending									
Banking system exposure to subsidiaries and shareholders/own funds	5.6	3.1	4.6	6.3	4.6	4.0	3.9	4.0	3.5
Banking system equity investments/own funds	4.9	3.9	1.5	1.5	1.6	1.7	1.7	1.7	1.8
Earning and profitability									
ROAA 3/	1.8	1.4	0.6	0.8	0.4	-0.3	0.4	0.3	0.4
ROAE 3/	15.0	12.5	5.6	7.3	3.4	-2.5	3.2	2.3	3.8
Interest margin/gross income 4/	57.0	58.9	62.6	61.8	60.0	64.2	64.2	64.3	60.7
Noninterest expenses/gross income 5/	60.3	64.0	64.5	68.2	69.7	67.7	65.2	68.6	65.3
Personnel expenses/noninterest expenses	38.4	36.5	36.9	36.1	34.1	34.6	35.7	33.5	33.1
Interest Rates									
Local currency spreads	4.5	3.2	2.8	2.3	3.2	3.4	3.4	3.4	3.5
Foreign currency spreads	6.5	4.2	4.2	4.4	4.8	4.8	4.8	4.7	4.6
Interbank market interest rate	3.1	5.3	6.2	2.7	2.2	2.1	2.4	2.2	2.1
Liquidity									
Highly liquid assets/total assets 6/	20.9	16.9	20.6	25.3	25.3	26.5	26.5	27.5	29.4
Highly liquid assets/total short-term liabilities 7/	28.2	24.0	30.1	38.5	39.6	42.1	42.6	44.8	48.2
Liquid assets/total assets	34.7	22.9	25.6	30.9	31.2	31.5	30.2	30.2	30.2
Liquid assets/total short-term liabilities	46.8	32.4	37.4	46.9	48.9	50.2	48.6	49.3	49.3
Customer deposits/total (noninterbank) loans	128.4	107.7	108.2	114.3	115.7	114.9	111.8	111.9	113.5
Foreign currency deposits/total deposits	44.5	48.1	56.2	53.5	50.8	49.1	48.6	48.0	47.3
Including foreign exchange-indexed 8/	51.5	54.8	60.9	55.5	52.7	51.1	49.3	48.8	48.3
Central bank credit to banks/bank liabilities	0.1	0.01	0.01	0.01	0.01	0.0	0.5	0.4	0.4
Sensitivity to market risk									
Net open foreign exchange position/own funds	38.2	25.1	13.0	18.9	21.3	12.5	8.7	12.3	11.4

Sources: NBRM's Financial Stability Unit.

1/ Until 2007Q3 Tier I Capital includes common shares, non-cumulative preference shares, general reserves and undistributed profits, net of uncovered loss from previous years, current loss and goodwill. Starting from 2007Q4, Tier I Capital includes nominal value of common and non-cumulative preference shares, premiums from common and noncumulative preference shares, general reserves and distributed profits, positions as a result of consolidation, net of uncovered loss from previous years, current loss and intangible goods, owned common and non-cumulative preference shares and the difference between the amount of necessary and the amount of allocated reserves for potential losses.

2/ Includes loans to financial and nonfinancial sector.

3/ Adjusted for unallocated provisions for potential loan losses. Since 2009Q1 these items have been adjusted for unrecognized impairment.

4/ Interest margin represents interest income less interest expense. Gross income includes net interest income, fees and commissions income (gross, not net) and other gross income excluding extraordinary income.

5/ Noninterest expenses include fees and commissions expenses, operating expenses and other expenses excluding extraordinary expenses.

6/ 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.

7/ 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).

8/ FX indexed deposits include deposits and other FX indexed liabilities. However FX indexed deposits comprise the majority of these items. Since 2009Q1, the figure refers only to FX indexed deposits.

Table 7. FYR Macedonia: Capacity to Repay Indicators

	2013	2014	2015	2016	2017	2018
Exposure and Repayments (Millions of SDR)						
GRA credit to Macedonia 1/	197.0	123.1	24.6	0.0	0.0	0.0
(In percent of quota)	286	179	36	0	0	0
Charges 2/	2.2	2.1	1.2	0.2	0.1	0.1
Repurchase	0.0	73.9	98.5	24.6	0.0	0.0
Debt and Debt Service Ratios						
In percent of GDP						
Total external debt	67.9	66.4	65.9	64.5	61.5	60.2
External debt, public	21.9	21.8	22.7	22.9	21.3	20.3
Total public debt	34.8	34.8	35.3	36.0	36.7	37.3
GRA credit to Macedonia	2.9	1.7	0.3	0.0	0.0	0.0
Total external debt service	27.4	26.2	27.0	23.2	23.7	21.6
Public external debt service	3.5	2.4	4.5	1.9	3.7	3.1
Debt service due on GRA credit	0.0	1.0	1.3	0.3	0.0	0.0
In percent of Central Government Revenues						
Public external debt service	12.3	8.5	15.8	6.8	13.0	10.7
Debt service due on GRA credit	0.0	3.6	4.5	1.1	0.0	0.0
In percent of Gross International Reserves						
Total external debt	226.0	223.0	214.1	205.3	201.3	190.9
External debt, public	73.0	73.3	73.7	73.0	69.9	64.3
GRA credit to Macedonia	9.5	5.7	1.0	0.0	0.0	0.0
Debt service due on GRA credit	0.0	3.4	4.2	1.0	0.0	0.0
In percent of Exports of Goods and Services						
Total external debt service	48.0	43.5	42.4	35.3	35.4	31.6
Public external debt service	6.1	4.0	7.1	3.0	5.5	4.5
Debt service due on GRA credit	0.0	1.7	2.0	0.5	0.0	0.0
In percent of Total External Debt						
GRA credit to Macedonia	4.2	2.6	0.5	0.0	0.0	0.0
In percent of Total External Debt Service						
Debt service due on GRA credit	0.0	3.9	4.8	1.3	0.0	0.0
In percent of Total Public External Debt						
GRA credit to Macedonia	13.0	7.8	1.4	0.0	0.0	0.0
In percent of Total Public External Debt Service						
Debt service due on GRA credit	0.0	42.2	28.5	15.5	0.0	0.0

Sources: Macedonian authorities; Finance Department; World Economic Outlook; and IMF staff estimates.

1/ Repurchases are assumed to be made as scheduled.

2/ Includes GRA basic rate of charge, surcharges and service fees.

Table 8. FYR Macedonia: External Debt Sustainability Framework, 2008-2018
(Percent of GDP, unless otherwise indicated)

	2008	2009	2010	2011	2012			Projections 2013	2014	2015	2016	2017	2018	Debt-stabilizing non-interest current account 6/
1 **Baseline: External debt**	49.2	56.4	58.2	64.6	68.6			**67.9**	**66.4**	**65.9**	**64.5**	**61.5**	**60.2**	**-6.4**
2 Change in external debt	1.5	7.2	1.8	6.4	4.1			-0.7	-1.5	-0.5	-1.4	-3.0	-1.3	
3 Identified external debt-creating flows (4+8+9)	2.4	1.7	-1.7	-3.9	2.1			0.0	0.1	-2.0	-0.9	-1.1	-1.3	
4 Current account deficit, excluding interest payments	11.5	5.7	0.7	1.2	2.2			3.2	4.3	4.2	3.9	3.7	3.4	
5 Deficit in balance of goods and services	26.1	23.0	20.1	21.1	23.4			24.5	24.7	23.5	22.1	20.9	19.8	
6 Exports	50.4	38.0	45.2	53.1	52.1			57.1	60.3	63.7	65.6	66.9	68.2	
7 Imports	76.5	61.1	65.3	74.2	75.5			81.6	85.0	87.2	87.7	87.8	88.0	
8 Net non-debt creating capital inflows (negative)	-5.1	-5.3	-1.0	-3.4	-1.7			-3.6	-4.0	-5.7	-4.0	-4.0	-4.0	
9 Automatic debt dynamics 1/	-4.0	1.2	-1.4	-1.7	1.5			0.4	-0.2	-0.5	-0.8	-0.8	-0.7	
10 Contribution from nominal interest rate	1.4	1.1	1.4	1.7	1.7			1.7	1.7	1.7	1.7	1.6	1.6	
11 Contribution from real GDP growth	-2.1	0.5	-1.6	-1.6	0.2			-1.3	-1.9	-2.2	-2.5	-2.4	-2.3	
12 Contribution from price and exchange rate changes 2/	-3.2	-0.3	-1.3	-1.9	-0.3			...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	-0.8	5.6	3.5	10.3	2.0			-0.7	-1.6	1.5	-0.5	-1.9	0.1	
External debt-to-exports ratio (in percent)	97.6	148.2	128.8	121.6	131.7			118.9	110.2	103.6	98.4	91.9	88.2	
Gross external financing need (in billions of euros) 4/	2.2	1.8	1.7	1.9	2.1			2.4	2.5	2.8	2.6	2.8	2.7	
in percent of GDP	32.2	27.0	23.6	25.0	28.4			30.6	30.5	31.2	27.0	27.4	24.9	
Scenario with key variables at their historical averages 5/						10-Year Historical Average	10-Year Standard Deviation	**67.9**	**65.0**	**65.3**	**63.6**	**60.6**	**59.6**	**-6.5**
Key Macroeconomic Assumptions Underlying Baseline														
Real GDP growth (in percent)	5.0	-0.9	2.9	2.9	-0.3	3.3	2.3	2.0	3.0	3.5	4.0	4.0	4.0	
GDP deflator in euros (change in percent)	7.3	0.7	2.3	3.4	0.5	3.2	2.5	2.5	2.6	2.8	2.8	2.8	2.8	
Nominal external interest rate (in percent)	3.2	2.2	2.6	3.2	2.6	2.8	0.5	2.6	2.6	2.7	2.7	2.6	2.7	
Growth of exports (euro terms, in percent)	10.3	-24.7	25.0	25.0	-1.6	11.7	15.8	14.7	11.5	12.3	10.1	9.1	9.1	
Growth of imports (euro terms, in percent)	21.7	-20.3	12.5	20.9	2.1	10.2	13.5	13.0	10.0	9.1	7.5	7.1	7.2	
Current account balance, excluding interest payments	-11.5	-5.7	-0.7	-1.2	-2.2	-3.8	3.7	-3.2	-4.3	-4.2	-3.9	-3.7	-3.4	
Net non-debt creating capital inflows	5.1	5.3	1.0	3.4	1.7	4.4	2.4	3.6	4.0	5.7	4.0	4.0	4.0	

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 euro 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.

Table 9. FYR Macedonia: Fiscal Debt Sustainability Framework, 2008-2018

(Percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	**Debt-stabilizing primary balance 9/**
1 **Baseline: Public sector debt 1/**	20.7	23.8	24.2	27.8	33.8	**34.8**	**34.8**	**35.3**	**36.0**	**36.7**	**37.3**	**-0.5**
o/w foreign-currency denominated	13.7	16.5	16.7	21.1	21.5	21.9	21.8	22.7	22.9	21.3	20.3	
2 Change in public sector debt	-3.3	3.1	0.5	3.6	6.0	1.0	0.0	0.5	0.8	0.6	0.6	
3 Identified debt-creating flows (4+7+12)	-1.3	3.1	1.2	1.0	3.8	2.0	1.1	0.9	0.7	0.7	0.6	
4 Primary deficit	0.3	2.1	1.7	1.7	2.9	2.6	2.1	1.9	1.5	1.3	1.1	
5 Revenue and grants	32.5	30.5	29.6	28.8	28.9	28.5	28.5	28.5	28.5	28.5	28.5	
6 Primary (noninterest) expenditure	32.8	32.6	31.3	30.5	31.9	31.1	30.6	30.3	30.0	29.7	29.6	
7 Automatic debt dynamics 2/	-2.0	0.6	-0.5	-0.7	0.8	-0.6	-1.0	-1.0	-0.8	-0.6	-0.5	
8 Contribution from interest rate/growth differential 3/	-2.1	0.6	-0.5	-0.7	0.8	-0.6	-1.0	-1.0	-0.8	-0.6	-0.5	
9 Of which contribution from real interest rate	-1.0	0.5	0.1	0.0	0.8	0.0	0.0	0.2	0.5	0.7	0.9	
10 Of which contribution from real GDP growth	-1.1	0.2	-0.7	-0.7	0.1	-0.6	-1.0	-1.1	-1.3	-1.4	-1.4	
11 Contribution from exchange rate depreciation 4/	0.0	-0.1	0.1	0.0	...	...	...	...	...	...	...	
12 Other identified debt-creating flows	0.5	0.4	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
13 Privatization receipts (negative)	-0.4	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
14 Recognition of implicit or contingent liabilities	0.9	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
15 Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
16 Residual, including asset changes (2-3) 5/	-2.0	0.0	-0.8	2.6	2.3	-1.1	-1.1	-0.4	0.0	0.0	0.0	
Public sector debt-to-revenue ratio 1/	63.7	77.9	82.0	96.7	116.9	122.2	122.2	123.9	126.6	128.9	131.1	
Gross financing need 6/	4.1	6.1	7.1	8.3	9.5	16.2	14.4	17.0	13.7	16.9	17.5	
in billions of Euros	0.3	0.4	0.5	0.6	0.7	1.3	1.2	1.5	1.3	1.7	1.9	
Scenario with key variables at their historical averages 7/						**31.9**	**30.0**	**28.9**	**28.2**	**27.6**	**27.0**	**-1.0**
Scenario with no policy change (constant primary balance) in 2012-2018						**35.1**	**35.9**	**37.4**	**39.5**	**41.7**	**44.1**	**-0.6**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	5.0	-0.9	2.9	2.9	-0.3	2.0	3.0	3.5	4.0	4.0	4.0	
Average nominal interest rate on public debt (in percent) 8/	3.0	2.9	3.2	3.3	3.3	2.7	2.7	3.4	4.4	5.1	5.5	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-4.4	2.2	0.5	-0.1	2.8	0.1	0.1	0.6	1.6	2.3	2.6	
Nominal appreciation (increase in US dollar value of local currency, in percent)	-0.3	0.4	-0.5	0.0	...	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	7.4	0.7	2.7	3.4	0.5	2.5	2.6	2.8	2.8	2.8	2.8	
Growth of real primary spending (deflated by GDP deflator, in percent)	11.6	-1.5	-1.2	0.3	4.1	-0.4	1.2	2.8	2.8	3.1	3.5	
Primary deficit	0.3	2.1	1.7	1.7	2.9	2.6	2.1	1.9	1.5	1.3	1.1	

1/ Consolidated central government gross debt.

2/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = 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).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as r - π (1+g) and the real growth contribution as -g.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).

5/ For projections, this line includes exchange rate changes.

6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

8/ Derived as nominal interest expenditure divided by previous period debt stock.

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.

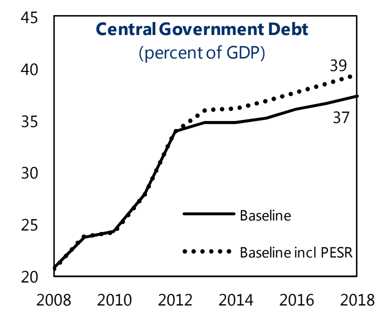
Annex I. Public Debt Sustainability Analysis (DSA)

1. The key assumptions underlying the dynamics of the DSA include the growth rate, the level of the deficit, and real interest rates.

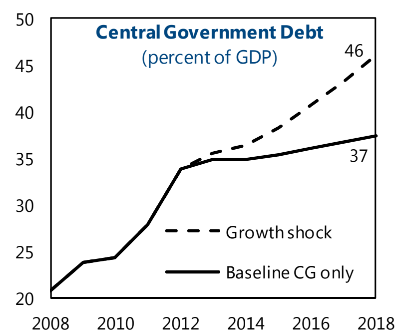
- Economic growth is assumed to gradually revert to the 4 percent potential growth rate.
- The baseline forecast assumes a 3 percent of GDP central government deficit over the medium term (consistent with an analysis of sustainability on current policies, in the absence of specified adjustment measures), and a 3.5 percent cash deficit for the current year.
- The deficit is assumed to be financed through a mix of domestic and external issuance and by drawing on government deposits at the NBRM. These deposits stood at MKD 19.6 billion at end-2012, and are assumed to gradually decrease and stabilize around a level of MKD 5.5–6 billion by 2015.
- The analysis takes as a starting point the level of central government debt of 33.8 percent of GDP at end-2012.
- Average real interest rates are expected to gradually increase from 2014 onwards. This is due in part to the expected gradual normalization of the nominal interest rates domestically and abroad, and in part to a shift in the composition of financing. On the external side, the DSA reflects a gradual shift from official to private financing, as official lending is amortized over the next few years: specifically, official external debt is assumed to gradually fall from 37 percent of total central government debt to 20 percent by 2018. The dynamics also incorporate a gradual shift towards domestic financing, with the share of domestic debt out of total central government debt to gradually rise from 32 percent in 2012 to 38 percent by 2018.

2. Another critical assumption is the relevant concept of the public sector. As some capital expenditure is being moved off-budget, it will be important to take into consideration the evolution of the debt and deficits of the broader public sector aggregate in setting budgetary targets, so as to appropriately balance the risks to debt against the growth benefits of infrastructure building. With the transformation of the Road Fund (previously part of the central government) into the Public Enterprise for State Roads (PESR), the central government debt concept would no longer capture a considerable portion of infrastructure-related borrowing. In order to show the effect of this shift, staff's DSA attempts to model the dynamics of both concepts of debt. The PESR deficit is assumed to stay constant at its current level of 0.3 percent of GDP until 2018. This level is in line with last year's cash deficit and the projected 2013 deficit, and does not include an expansion of construction activity that could lead to an increase of the PESR deficit.

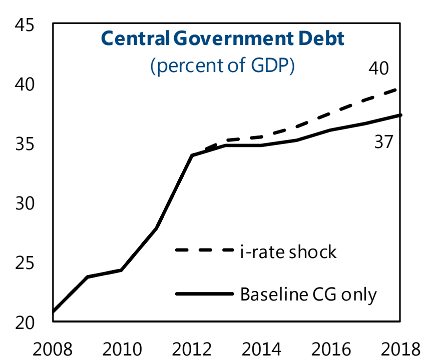
3. **Under these baseline assumptions, central government debt continues to rise over the forecast horizon.** The difference between debt including and excluding PESR currently amounts to 1.2 percent of GDP, equivalent to about half of the total debt incurred for the purpose of building new road infrastructure. The remainder of the debt incurred for road construction consists of debt associated with European transport Corridor X, which remains on-budget.



4. **A plausible shock to growth worsens the debt dynamics substantially**. A plausible growth shock adds 9 percentage points to the baseline projections for the central government debt level over the 5-year forecast horizon, with central government debt breaching what could be plausibly considered long term sustainable debt levels for Macedonia. The employed (standard) growth shock is modest. It is equivalent to ½ a standard deviation, calculated over a ten year horizon between 2002 and 2011, translating into growth of about 3 percent in the outer years, compared to 4 percent under the baseline scenario.



5. **An interest rate shock has a lower impact.** The real interest rate shock employed is equivalent to ½ standard deviation, and translates into a real interest rate level of 3.8 percent in 2018, compared to 2.6 percent under the baseline. As interest rates are volatile over longer time horizons, this shock can be considered as mild. Larger shocks would lead to larger increases in debt.



6. **Modeling the dynamics of total public sector debt is beyond the current scope of the DSA.** Public sector debt includes the central government, sub-national governments such as municipalities, public agencies, state-owned enterprises, and public financial institutions such as the development banks and the National Bank. However, as most of these debts are ultimately guaranteed by the government, and hence are either direct or contingent claims on the sovereign (as is the case for example for government guarantees), the broader public debt concept is indeed relevant for debt sustainability. At end-2012 total public debt (excluding NBRM debt) stood at 38.7 percent of GDP, or 4.9 percentage points above central government debt. While it would be useful to assess the debt dynamics of this broader category of the public sector, insufficient information on the medium-term plans—including deficit projections—of all these entities, and particularly of public corporations, constrains such an exercise.

Annex II. FYR Macedonia: Risk Assessment Matrix[1]

Nature/Source of Main Threats	Likelihood of Risk	Expected Impact of Risk (high, medium, or low)
1. Financial stress in the euro area re-emerges and bank-sovereign links re-intensify (triggered by a stalled or incomplete delivery of euro area policy commitments)	**Medium**	**Low/Medium** • **Financial channels for transmission are relatively limited**. Public sector external financing requirements are met for 2013, and banks are funded mainly by resident deposits. • **Real channels dominate.** Any further drag on growth in the euro area would be transmitted through strong trade links. Direct exports to the euro area account for 50 percent of total exports. Indirect exposure to the euro area is even higher, given large export shares to Kosovo, Serbia, and Bulgaria. The high import content of exports and the increased reliance on specialized exports facing more robust demand, mitigate to some degree the effects on the balance of payments.
2. Protracted period of slower European growth	**Medium**	**Medium** • **Setbacks in the implementation of FDI plans would lead to weaker than expected investment**, reducing medium term potential growth. Debt dynamics would worsen.
3. Stress in the Greek or Slovenian parent banks	**Low**	**High** • **Confidence shocks could result in deposit outflows**—particularly corporate deposits which have shown volatility in past episodes of stress. This could put pressure on the peg and require sharp tightening of monetary policy. **Mitigating Factors**: • High bank liquidity, as well as the NBRM's capacity to supply the system with ample liquidity on a short notice should serve to stabilize the system. • Deposit insurance coverage limits are adequate. The authorities could consider expanding the coverage of the Deposit Insurance Fund, which currently includes only deposits of natural persons.

[1] The Risk Assessment Matrix shows events that could materially alter the baseline path discussed in this report.

INTERNATIONAL MONETARY FUND

FORMER YUGOSLAV REPUBLIC OF MACEDONIA

May 30, 2013

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION AND FIRST POST-PROGRAM MONITORING DISCUSSIONS—INFORMATIONAL ANNEX

Prepared By European Department

CONTENTS

FUND RELATIONS

(As of April 30, 2013)

Missions. Article IV and first Post-Program Monitoring mission, Skopje, April 3-16, 2013. Concluding statement is available at: http://www.imf.org/external/np/ms/2013/041613.htm

Staff team. Ivanna Vladkova Hollar (head), Marc Gerard, Alexis Meyer Cirkel, (all EUR), and Alexander Tieman (Resident Representative).

Discussions. The staff team met Deputy Prime Minister and Minister of Finance Stavreski, National Bank Governor Bogov, 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	68.90	100.00
Fund holdings of currency	265.90	385.92
Reserve position	0.00	0.00

SDR Department:	SDR Million	Percent of Allocation
Net cumulative allocation	65.62	100.00
Holdings	2.60	3.96

Outstanding Purchases and Loans:	SDR Million	Percent of Allocation
Precautionary and Liquidity Line [1/]	197.00	285.92

[1/] Formerly Precautionary Credit Line (PCL)

Latest Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
PLL [1/]	01/19/2011	10/18/2013	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)
(SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2013	2014	2015	2016	2017
Principal		73.88	98.50	24.63	
Charges/Interest	1.62	2.04	1.14	0.20	0.04
Total	1.62	75.91	99.64	24.82	0.04

Exchange Arrangement:
The currency of the FYR of Macedonia is the denar. The FYR of Macedonia maintains a managed floating exchange rate system with a de facto stabilized arrangement against the Euro. Households can transact through commercial banks or through foreign exchange bureaus that act as agents of banks; enterprises can transact through the banking system. The reserve requirement on foreign currency deposits is set at 13 percent, while that on FX-indexed denar deposits is set at 20 percent.

At end-December 2012, the official exchange rate was 46.7 denars per U.S. dollar and 61.5 denars per euro. The FYR of Macedonia has accepted the obligations of Article VIII, Sections 2, 3, and 4 with effect from June 19, 1998.

Article IV Consultations:
The first consultation with the FYR of Macedonia was concluded in August 1993. The last consultation was concluded on June 1, 2012 (IMF Country Report 12/133). The FYR Macedonia is on the standard 12-month Article IV consultation cycle, while Post-Program Monitoring is expected to take place every 6 months.

Technical Assistance (since 2006):

Purpose	**Department**	**Date**
FX Reserves Modeling	RES/MCM	February 2012
Public Financial Management	FAD	November 2012
Provisioning Regulation	MCM	November 2012

STA TA Evaluation	STA	September 2012
National Accounts	STA	September 2012
Assessing the Budgeting Framework and Investigation of Payment Arrears	FAD	March 2012
Macroeconomic Modeling at NBRM	MCM	March, November 2009; September and November 2010; May and November 2011; February and November 2012
Domestic Debt Market Development	MCM	October 2011
National Accounts	STA	August 2011
Tax Administration	FAD	June 2011
Medium-Term Budgeting	FAD	May 2011
Safeguards Assessment	FIN	February 2011
Stress Testing	MCM	February 2011
SDDS Subscription	STA	December 2010
Tax Administration	FAD	April 2010
Public Financial Management	FAD	September 2009
Tax Administration	FAD	July 2009
National Accounts	STA	June 2009
Contingency Planning and Crisis Preparedness	MCM	February 2009
Government Finance Statistics	STA	October 2008
Balance of Payments Statistics	STA	October 2008
National Accounts Statistics	STA	April 2007; January, May, September, and December 2008
Export and Import Deflators	STA	December 2007

GFS 2001	STA	December 2007
Expenditure Rationalization	STA	November 2007
Central Bank Law	FAD	July 2007
Tax Policy	MCM	July 2007
National Accounts Statistics	FAD	June 2007
Liquidity, Cash and Debt Management	STA	April 2007
Tax Administration	MCM	April 2007
Balance of Payments Statistics	FAD	October 2006
Tax Policy	FAD	September 2006
Government Finance Statistics	STA	June 2006
Banking Law	LEG, MCM	June 2006
Resident Experts		
Tax Administration	FAD	October 2006– August 2011
Banking Supervision	MCM	May 2006–May 2008

FSAP Participation and ROSCs (since 2003)

Purpose	**Department**	**Date**
FSAP update	MCM/WB	March 2008
Fiscal ROSC	FAD	February 2005
Data ROSC	STA	February 2004
FSAP	MCM/WB	May 2003 and June 2003

Resident Representative

The Fund has had a resident representative in Skopje since 1995. Mr. Alexander Tieman has held this position since August 2009.

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, particularly in the context of the latest Public Expenditure Policy Based Guarantee (PEPBG), for which the Fund provided an Assessment Letter in November 2012. The area of public financial management has been at the center of discussions over the last year, and the measures supported by the PEPBG on public finance management have benefited from the findings and recommendations of the recent IMF TA mission.

Key Areas of World Bank Involvement

The World Bank program in FYR Macedonia focuses on three pillars: (i) faster growth by improving competitiveness; (ii) more inclusive growth by strengthening employability and social protection, and continued improvement of social programs; and (iii) more sustainable resource use and an analysis of options for "greener" economic growth. Because FYR Macedonia's future growth and development depends fundamentally on the pace of EU accession, virtually every intervention in the program is designed to help it prepare for the EU membership.

- A series of two budget support operations (Competitiveness DPL) has been made available to the Government with the aim to improve the competitiveness of the economy to develop a stronger export-oriented enterprise sector. The first of these has been approved and is under implementation; the second loan is under preparation.
- The World Bank also provided recently two Policy Based Guarantees for two loans the Government contracted with commercial Banks, together in the amount of €380 million. The Policy Based Guarantees supported critical reforms needed to strengthened robustness of public financial management and help mitigate the impact of the euro zone turmoil.
- The Real Estate Cadastre and Registration Project (US$26 million) is supporting the digitalization of cadastral maps and securing land and real estate titles. The Regional and Local Roads Program Support Project (US$105 million) is helping with the rehabilitation of the regional and local roads and provides institutional support to improve the management of roads. The World Bank finances the energy sector through the Electric Power Development Energy Community of South East Europe Project APL3 (US$44 million) to improve the transmission grid, including an interconnection with Serbia. Local development is assisted through the Municipal Services Improvement Project (US$75 million), which is helping to improve transparency, financial sustainability and delivery of targeted municipal services in selected municipalities. The World Bank is also active in the human development sector through the Conditional Cash Transfer Project (US$25 million).

Appendix: Macedonia: Bank and Fund Planned Activities in Macrocritical Structural Reform Areas, June 2012–May 2014

Title	Products	Provisional Timing of Missions	Expected Delivery Date
1. Fund work program	2nd Post-Program Monitoring Report	September/October 2013	December 2013
	Article IV consultation and 3rd Post-Program Monitoring Report	Spring 2014	June 2014
	Technical assistance on budget procedures	September/October 2013 (tentative)	TA report after the mission
	Technical Assistance to help the SSO improve its National Account statistics	Ongoing through a resident advisor (based in Sarajevo)	TA reports after each mission
	Technical assistance to the Public Revenue Office on modernizing revenue administration	Multiple short-term expert visits, the first one scheduled for June 2013 (tentative)	TA reports after each mission
	Technical assistance to further improve macroeconomic forecasting at the NBRM	2 short-term missions, Fall 2013 and Spring 2014	TA reports after each mission
2. Bank work program	Macro-monitoring	Continuous and periodic missions, next mission planned in May 2013.	BTORs and Aide memoires after mission
	South eastern Europe Regular Economic Update	Continuous and periodic missions, next mission planned in May 2013.	Editions published every June and December
	Policy Based Guarantee supervision and assessment	Ongoing, most recent mission in March 2013.	Implementation Completion Report expected in June 2013.
	Public Expenditure Policy Based Guarantee	Continuous and periodic missions, most recently in	BTORs and Aide memoires after

Title	Products	Provisional Timing of Missions	Expected Delivery Date
	supervision	March 2013.	mission
	Treasury and Revenue forecast practitioner exchange	MOF Treasury and Revenue forecast team invited to visit Washington DC later in 2013	Continuous
	Real Estate Cadaster and Registration project supervision	Continuous	Project closing December 2014
	Municipal Services Improvement project supervision	Continuous	Project closing November 2017
	Regional and Local Roads Program Support project supervision	Continuous	Project closing December 2015
	CCT project supervision	Continuous	Project closing February 2014
	ECSEE APL 3 supervision	Continuous	Project closing March 2014
	Balkan Financial Sector Technical Assistance Facility (TA to NBRM and MoF on bank resolution; LoLR etc.)	TBD	
	Green Growth and Climate Change Analytic and Advisory Services	TBD	August 2013

STATISTICAL ISSUES

(As of April 30, 2013)

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: Significant progress has been made in improving the scope and quality of national accounts. Quarterly GDP data in constant prices from the production approach have been published since September 2011. Improvements with regards to estimates of changes in inventories and household consumption expenditure are needed. Employment data from the company survey continue to be unreliable. **Price statistics:** Improvements to the CPI have been introduced in accordance with international standards and EU regulations concerning the treatment of seasonal products and the use of the geometric mean for the calculation of elementary indices.
Government finance statistics: Data coverage on government below-the-line financing from the National Bank deposits is inadequate, as a result of different coverage of accounts between the Ministry of Finance and the National Bank – the government does not regularly report Treasury Single Account and budgetary FX account balances. Debt data for the broader public sector are not available on a regular basis. Macedonia does not report government finance statistics to the Fund for publication in either the *Government Finance Statistics Yearbook* (GFSMY) or the *International Financial Statistics* (*IFS*).
Monetary sector: EUR receives a monthly electronic report of monetary statistics, covering the balance sheet of the central bank, the commercial banks and other depository corporations.
External sector: External sector statistics meet international standards. In additional to monthly 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 participates in the General Data Dissemination System (GDDS), and, since November 2011, in the Special Data Dissemination Standard (SDDS).	Data ROSC published on September 29, 2004.

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

(as of April 30, 2013)

	Date of Latest Observation	Date Received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]	Memo Items: Data Quality – Methodological Soundness[8]	Memo Items: Data Quality – Accuracy and Reliability[9]
Exchange Rates	4/26/13	4/30/13	D	W	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	4/25/13	4/19/13	D	W	Q		
Reserve/Base Money	4/28/13	4/30/13	W	W	M	O, LO, LO, O	O, LO, O, O, O
Broad Money	Mar. 13	4/19/13	M	M	M		
Central Bank Balance Sheet	Mar. 13	4/12/13	M	M	M		
Consolidated Balance Sheet of the Banking System	Mar. 13	4/19/13	M	M	M		
Interest Rates[2]	Mar. 13	4/30/13	M	M	M		
Consumer Price Index	Mar. 13	4/2/13	M	M	M	O, O, O, LO	LO, O, LNO, O, LO
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Mar.13	4/5/13	A	A	A	LO, LNO, LO, O	LO, LO, LO, LO, LNO
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	Mar. 13	4/25/13	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Mar. 13	4/5/13	A	A	A		
External Current Account Balance	Jan. 13	3/29/13	M	M	M	O, LO, O, LO	LO, O, LO, O, LO
Exports and Imports of Goods and Services	Feb. 13	4/5/13	M	M	M		
GDP/GNP	Dec. 12	3/15/13	Q	Q	Q	O, LO, O, LO	LO, O, LNO, O, O
Gross External Debt	12/31/12	3/29/13	Q	Q	Q		
International Investment Position[6]	12/12	3/29/13	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 annually 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).

[8] Reflects the assessment provided in the data ROSC or the Substantive Update (published on September 29, 2004, and based on the findings of the mission that took place during February 18 – March 3, 2004) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).

[9] Same as footnote 8, except referring to international standards concerning source data, assessment and validation of source data,, statistical techniques, assessment and alidation of intermediate data and statistical outputs, and revision studies.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 13/70
FOR IMMEDIATE RELEASE
June 26, 2013

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2013 Article IV Consultation and First Post-Program Monitoring with the Former Yugoslav Republic of Macedonia

On June 14, 2013, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation and First Post-Program Monitoring with Macedonia.[1]

Background

Following a shallow recession in 2012, a modest recovery is forecast for 2013, with baseline growth expected to reach 2 percent. So far, industrial production has strengthened in February and March, but indicators do not yet point to a solid recovery in domestic demand. Nonetheless, the baseline growth forecast remains feasible, provided that public infrastructure works and foreign investment projects accelerate as planned. The weak external environment and difficult liquidity conditions for the domestic private sector present important downside risks.

[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. 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 summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

The central objective of PPM is to provide for closer monitoring of the policies of members that have substantial Fund credit outstanding following the expiration of their arrangements. Under PPM, members undertake more frequent formal consultation with the Fund than is the case under surveillance, with a particular focus on macroeconomic and structural policies that have a bearing on external viability.

Inflation is expected to moderate to 2.5 percent in 2013, as the effects of energy price hikes wear off and food prices decline. Cost side pressures are limited, with nominal wage growth of 0.2 percent in 2012, and 1.2 percent in early 2013. The current account widened to 3.9 percent of GDP in 2012, with the impact of weaker trade partly offset by high private transfers. Private financial flows, particularly FDI flows, have been modest, but public sector net external borrowing has helped build up reserves, which remain adequate.

Weaker revenues and the start of the arrears clearance process widened the 2012 cash deficit to 3.8 percent of GDP. Keeping the cash deficit contained required expenditure compression beyond the ceilings established in the supplementary budget, and the adjustment fell mainly on capital expenditure. Central government debt rose to 33.8 percent of GDP at end-2012.

The deficit for the first quarter of 2013, at 2.4 percent of projected 2013 GDP, already represents two thirds of the annual target of 3.5 percent of GDP. The revenue outturn was dominated by large VAT refunds, in accordance with the authorities' commitment to clear arrears. On the expenditure side, subsidies and other transfers rose substantially relative to the same quarter of the previous year. While this appears to be an intra-annual reallocation of expenditure, further expenditure compression will likely be needed to meet the deficit target. The authorities were not considering a supplementary budget at the time of the discussions, noting that on current revenue trends the required adjustment could be accommodated within normal buffers.

Substantial net domestic issuance in 2012 as well as in the first quarter of 2013 has helped finance the higher deficits. In line with previous IMF advice, the Treasury has continuously sought to lengthen debt maturities. As a result, longer dated securities currently make up 25 percent of the total debt stock, up from 5 percent at end-2011.

Banking sector indicators suggest that the system is in overall sound shape, but non-performing loans (NPLs) are increasing. As of December 2012, the capital adequacy ratio stood at 17.1 percent, and over 29 percent of total assets were highly liquid. Deposits provide the main funding source. The NPL ratio rose to 11.7 percent in February 2013, but provisions exceed NPLs.

After steadily decelerating in 2012, credit growth is expected to remain subdued in 2013. Loan growth declined from 5.2 percent (year-on-year) in December 2012 to 4.4 percent in February 2013, even as deposit growth accelerated from 4.4 percent to 5.1 percent.

The absence of pressures on the exchange rate allowed the National Bank of the Republic of Macedonia (NBRM) to lower the policy rate by 25 basis points to 3.5 percent in January 2013, and to gradually reduce its stock of outstanding central bank bills (its main sterilization instrument) over the last six months. In addition, in order to stimulate private credit growth, the NBRM lowered reserve requirements by the amount of new loans to domestic net exporters and electricity producers, effective January 1, 2013.

Adoption of amendments to the banking law early this year closed some long standing gaps in the crisis management framework. The amendments ensure that the NBRM is able to impose fit-and-proper requirements on bank management and owners, and pave the way for the central bank to widen the class of collateral that banks may use to access liquidity support.

Executive Board Assessment

Executive Directors commended the authorities for their economic management, which has helped maintain financial and external stability despite difficult circumstances. While the economy is poised for a moderate recovery in 2013, underpinned by acceleration in public investment and FDI projects, it still faces a challenging external environment but with limited policy space. Directors called for continued commitment to sound policies and structural reforms. Efforts should focus on reducing risks to the outlook, preserving macroeconomic stability, generating stronger growth, and boosting income convergence and employment.

Directors agreed that the near-term policy mix should remain supportive to sustain the still fragile recovery, particularly given monetary policy constraints. However, as the crisis subsides, fiscal policy should be anchored in a well-articulated and credible medium-term strategy. The strategy should strike a balance between increasing growth and ensuring fiscal and debt sustainability, reducing debt and the deficit over time. They emphasized that a greater focus on multi-annual budgeting would provide a good framework for assessing fiscal space and avoiding payment arrears. Directors commended the clearance of arrears and encouraged the authorities to implement measures to improve fiscal management, including public financial management. With some infrastructure spending shifting off-budget, they urged tight control on the pace of indebtedness of public sector enterprises. Directors highlighted the need to analyze the evolution of, and risks to, the broader public sector debt in setting budgetary targets and prioritizing spending.

Directors took note that the exchange rate peg has served Macedonia well. They generally agreed that the still-weak growth, contained inflation, adequate reserves, and the absence of immediate balance of payments pressures may allow for an accommodative stance to stimulate credit growth. However, the central bank should stand ready to raise rates in the event that risks materialize and exchange rate pressures emerge.

Directors noted that the banking sector is sound, with high capital adequacy ratios and ample liquidity. Nonetheless, they emphasized that continued vigilance is necessary in light of potential shocks. It will also be important to monitor the increasing nonperforming loans. Directors commended the authorities for the recent changes to the banking law, which have closed all but one of the identified gaps in the crisis management framework.

Directors welcomed the improvements in the business climate and the progress made in attracting foreign direct investment. Further structural reforms will be essential to generate sustainable strong growth, speed up income convergence, and reduce unemployment. Developing stronger linkages between FDI projects and the domestic economy, building the needed infrastructure, and strengthening education and training opportunities should be key priorities going forward.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The staff report (use the free Adobe Acrobat Reader to view this pdf file) for the 2013 Article IV Consultation and First Post-Program Monitoring with Macedonia is also available.

Former Yugoslav Republic of Macedonia: Selected Economic Indicators

	2008	2009	2010	2011	2012
	Annual percentage change, unless otherwise specified				
Real GDP	5.0	-0.9	2.9	2.9	-0.3
Real domestic demand	6.7	-2.9	-0.1	5.3	1.8
Consumption	6.9	-4.7	1.4	4.0	-0.9
Gross investment	4.7	1.0	-3.6	13.5	11.0
Net exports 1/	-3.1	2.7	3.0	-3.3	-2.4
CPI inflation (annual average)	8.4	-0.8	1.5	3.9	3.3
Unemployment rate (annual average)	33.8	32.2	32.1	31.4	31.3
	Percent of GDP				
Current account balance	-12.8	-6.8	-2.0	-3.0	-3.9
Trade balance	-26.2	-23.3	-20.5	-22.4	-23.7
Exports of goods	40.1	28.8	35.5	42.3	41.1
Imports of goods	-66.3	-52.1	-56.0	-64.8	-64.8
Private transfers	13.9	16.4	18.9	18.7	20.9
External debt (percent of GDP)	49.2	56.4	58.2	64.6	68.6
Gross investment	26.8	25.9	25.5	27.2	28.8
Domestic saving	14.0	19.1	23.5	24.2	24.9
Public	3.9	0.6	1.1	1.3	0.2
Private	10.0	18.5	22.4	22.8	24.7
Foreign saving	12.8	6.8	2.0	3.0	3.9
Central Government Gross Debt	20.6	23.8	24.2	27.8	33.8
Central Government & Road Fund Gross Debt	20.7	23.8	24.2	27.8	33.8
Central Government Balance	-0.9	-2.7	-2.4	-2.5	-3.8
Memorandum items:					
Nominal GDP (billions of denars)	412	411	434	462	463
Nominal GDP (billions of euros)	6.7	6.7	7.1	7.5	7.5
GDP per capita (EUR)	3280	3265	3430	…	…

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

1/ Contribution to growth.

Statement by Mr. Snel and Mr. Hadzi-Vaskov
on the Former Yugoslav Republic of Macedonia
June 14, 2013

The Macedonian authorities would like to thank the IMF team for the open and constructive discussions during the mission and the useful analysis and recommendations included in the staff report. They consider that the report adequately reflects the macroeconomic situation in Macedonia and presents a well-balanced assessment of the strengths and risks, especially those related to the challenges in the eurozone. Moreover, the authorities' macroeconomic projections are generally in line with staff's. The authorities consistently value Fund advice on fiscal, monetary, financial, and other issues and make use of it in favorable as well as in challenging times. Following a well-established practice, they have continued to implement policies in line with Fund advice. In particular, they have made progress in deepening domestic debt markets, lengthening domestic debt maturities, and strengthening the crisis management framework.

Economic Developments and Outlook

The recovery in economic activity in the second half of 2012 was not sufficient to offset the decline in the first half, resulting in an overall output drop of 0.3 percent. Economic activity is expected to moderately recover in 2013 with a growth rate of about 2 percent, primarily driven by investments, exports and public infrastructure projects, and to further accelerate to 3 percent in 2014 against the backdrop of stronger domestic consumption and an increase in exports from new production facilities. This will help close the negative output gap in the second half of 2014. Several recent positive developments point to better growth prospects. Following a continued 16-month long decline, largely reflecting lower external demand related to the crisis in the eurozone, industrial production has been increasing in each of the last three months by more than 4 percent yoy. The gradually increasing number of export-oriented FDI facilities is expected to continue broadening the export base and to further advance the geographic diversification of export markets, thereby strengthening the economy's resilience to external shocks.

After peaking in September 2012, headline inflation has further decelerated in Q1 of 2013 and is expected to gradually decline and gravitate around 2 percent in line with staff's projections. The external position is expected to remain stable and favorable. The current account deficit is expected to widen in the next two years, against the backdrop of higher import demand related to new investment projects. Strong capital inflows are expected to be more than sufficient to cover the current account deficit, leading to a further steady accumulation of foreign exchange reserves beyond the current historically highest level, which can serve as a buffer against possible future shocks. Given the solid fundamentals, including ample liquidity and adequate capitalization of banks, the ongoing recovery, and the accommodative monetary policy, it is expected that the banking sector will provide further support to the economy through growth in credit activity of about 7 percent in 2013 and about 8 percent in 2014.

The unemployment rate has been continuously declining (by 6.3 percentage points over the last 7 years), reaching its lowest level in the last 10 years in Q4 of 2012. Moreover, Macedonia has been a rare example in Europe where the unemployment rate was reduced by about 3 percentage points since the beginning of the crisis in 2008. The continued reduction in the unemployment rate on a sustainable basis remains the authorities' key priority.

Fiscal Policy

The fiscal deficit in 2012 was raised to 3.8 percent of GDP and the fiscal deficit target for 2013 to 3.5 percent of GDP in order to mitigate the adverse effects from the protracted eurozone crisis on the domestic economy, including full clearance of accumulated arrears. The authorities emphasize that they were the first in the wider region to publicly announce the amount of arrears and to present a robust action plan for their clearance, which was successfully completed as promised by the end of February 2013. The clearance of arrears and the execution of all payment orders on a regular basis since then have significantly improved the liquidity of the private sector. In order to prevent reoccurrence of arrears, the authorities have undertaken comprehensive measures, including improved procedures, strengthened reporting requirements for multi-annual commitments, and enhanced control functions of the Treasury system.

The authorities proceeded with the transformation of the Agency for State Roads into Public Enterprise for State Roads (PESR) in order to accelerate the implementation of projects. The newly established enterprise will operate under the same legal framework as all other public enterprises. Given the legal obligation of these enterprises to submit their financial plans and quarterly and annual reports to the Ministry of Finance and the Government for approval, the authorities emphasize that they have full control over their indebtedness process.

The authorities are fully committed to maintaining prudent fiscal policy and ensuring debt sustainability. They are currently preparing a medium-term fiscal strategy, which will include forecasts and commitments for sustainable fiscal targets and will be submitted to Parliament together with a debt management strategy in the second half of 2013. In the coming period, the authorities will be focused on gradually reducing the level of central government deficit, giving priority to the full implementation of the capital infrastructure projects. They point out that the pace of adjustment will depend on several factors, especially the strength of the domestic recovery and prospects for economies in Europe.

Monetary and Exchange Rate Policies

Notwithstanding pressures related to the challenging external environment, the National

Bank of the Republic of Macedonia (NBRM) successfully extended its strong track record of maintaining price stability and ensuring stability of the financial sector. The NBRM authorities continue to be fully committed to basing monetary policy on the overriding objective of protecting the exchange rate peg and ensuring price stability. They share staff's view that the exchange rate peg has served Macedonia well, delivering low inflation and a stable real exchange rate.

The changes in the monetary policy operational framework introduced in 2012 contributed to higher flexibility, more active use of different instruments by banks in their liquidity management, and creating conditions for further development of money markets. In January 2013, the NBRM reduced the policy rate by 25 basis points to 3.5 percent against the backdrop of decelerating inflationary pressures, faster-than-expected pace of foreign reserves accumulation at end-2012, subdued economic activity, and weak credit growth. Towards the end of 2012, monetary policy has been further relaxed with a change in reserve requirements, aimed at stimulating credit for sectors that directly contribute to reducing the economy's external vulnerability. The authorities continue to view the monetary policy stance as appropriately accommodative and would like to reiterate their readiness to adjust interest rates if needed to respond to any potential future exchange rate pressures.

Financial Sector

The banking system in Macedonia remains stable, liquid, and well-capitalized. While nonperforming loans (NPLs) continued to increase somewhat, they remain more than fully covered by provisions. The authorities expect the level of NPLs to stabilize given that the recent rise can be entirely attributed to a few weak clients. The Macedonian banks, including subsidiaries of parent banks from the eurozone, are mostly financed by domestic resident deposits, do not depend on external wholesale funding, and have very limited credit exposure to countries or clients from the eurozone.

By adopting amendments to the Banking Law in accordance with past Fund advice, the authorities have strengthened the crisis management framework. In particular, these changes ensure that the NBRM can impose fit and proper requirements on bank management and owners, and create scope for widening the class of collateral that banks may use to access liquidity support from the NBRM.

The short-lived episode of deposit withdrawals from the Macedonian subsidiary of a Slovenian bank in late March, triggered by high uncertainty related to the situation with Cyprus, was an isolated case, swiftly contained thanks to the bank's strong liquidity and the authorities' timely public reaction. The authorities continue to closely monitor developments in the banking sector on a daily basis and, based on their adequate crisis management framework and appropriate set of instruments, remain confident that they can react promptly and effectively to tail risk events.

Business Environment

The authorities' strong track record demonstrates their full commitment to the continued implementation of comprehensive structural reforms aimed at further improving the business environment, accelerating economic growth, attracting foreign investments, and enabling faster job creation. The pursuit of decisive regulatory reforms aimed at improving the business environment continued to be acknowledged by respected international rankings. The latest World Bank Doing Business report ranked Macedonia as 1st in its region, 23rd in the world, and 5th best reformer in the world on the list of countries that have most narrowed the distance since 2005. Moreover, during roughly the same period Macedonia progressed by 35 places on the Index of Economic Freedom, 45 places on the Forbes list of best countries for business, and 15 places on the Global Competitiveness Index. All of these rankings place Macedonia at the top in its region.

Macedonia has been successful in attracting FDI projects recently. The extensive pipeline of ongoing and planned FDI projects provides tangible and important recognition of the improvements in the business environment, complementing the progress recorded by the international rankings.

Moreover, the authorities pay particular attention to matching improvements in the regulatory framework with the implementation of capital infrastructure projects. In this way, they aim to strengthen the position of Macedonia as an attractive destination for foreign investors, but also to facilitate linkages and spillovers with the domestic economy and enhance competitiveness. Some of the key infrastructure investments include: construction of the last remaining highway section of Corridor X, reconstruction and rehabilitation of several railway sections along Corridors VIII and X, as well as construction of new energy generation capacities and enhancement of the electricity transmission network.

Concluding Remarks

The Macedonian authorities are fully committed to preserving Macedonia's sound economic fundamentals, extending the strong track record of prudent economic policies, and maintaining macroeconomic and financial stability. They also remain committed to the continued implementation of structural reforms aimed at further improving the business environment, enhancing competitiveness and strengthening the job-creating capacity of the economy. Through investments in infrastructure, education, and training, the authorities aim to capitalize on their success in attracting FDI and further strengthen linkages with the domestic economy, in order to accelerate economic growth and reduce unemployment on a sustainable basis. The authorities are aware of the risks, mainly stemming from outside, continue to closely monitor the developments, and remain ready to undertake necessary measures to mitigate possible adverse effects on the domestic economy and preserve stability.