INTERNATIONAL MONETARY FUND

IMF Country Report No. 15/242

FORMER YUGOSLAV REPUBLIC OF MACEDONIA

September 2015

2015 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR FORMER YUGOSLAV REPUBLIC OF MACEDONIA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2015 Article IV consultation with the Former Yugoslav Republic of Macedonia, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its August 28, 2015 consideration of the staff report that concluded the Article IV consultation with the Former Yugoslav Republic of Macedonia.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on August 28, 2015, following discussions that ended on July 7, 2015, with the officials of the Former Yugoslav Republic of Macedonia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on August 10, 2015.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for the Former Yugoslav Republic of Macedonia.

The documents listed below have been or will be separately released.

Selected Issues

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

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September 3, 2015

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

IMF Executive Board Concludes 2015 Article IV Consultation with Former Yugoslav Republic of Macedonia

On August 28, 2015, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Former Yugoslav Republic of Macedonia.

The economic recovery has strengthened. Real GDP growth accelerated to 3.8 percent in 2014, from 2.7 percent in 2013. Strong growth was attributed to double-digit growth in investment driven by activities in the Technological Industrial Development Zones and public infrastructure, as well as strong private consumption supported by robust credit growth and improving labor market conditions. Facing imported deflationary pressures, monetary stance has been broadly accommodative. The decline in associated bank lending rates has helped revive credit growth to over 9.5 percent y-o-y in May 2015 from the trough reached two years ago. Exports grew robustly following a pick-up in automobile, chemical and plastic products, although net exports' contribution to growth remained negative due to high investment-related imports.

However, GDP growth in 2015 is expected to moderate to 3.2 percent, with significant downside risks. A derailment of recent political agreement could negatively impact economic sentiment and growth. In the medium-term, this may also complicate the opening of negotiations for the EU accession, which remains deadlocked for nine years due to the name dispute with Greece. In addition, spillover risks from a prolonged and deep crisis in Greece could weigh down growth significantly.

Fiscal policy space has largely been depleted since 2008. Entering the global financial crisis with one of the lowest public debt to GDP ratios in emerging Europe served FYR Macedonia well, but public sector debt since then has nearly doubled reaching 43.3 percent of GDP in 2014. In 2014, fiscal deficit widened to 4.2 percent of GDP, mainly due to a shortfall in both non-tax and capital revenues. For the first half of 2015, profit and excise taxes outperformed due to the

[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.

removal of exemptions on non-reinvested profits and higher cigarette production from the government's strategic partnership project with Philip Morris. Nevertheless, the under-performance of VAT and non-tax revenues together with wage increases for the police force and additional capital expenditures entailed by the worsened security situation are likely to result in a deficit of around 4 percent of GDP in 2015, compared to 3.4 percent targeted in the budget.

Macroeconomic stability on both domestic and external fronts was sound. Deflation, mostly reflecting external prices and cuts in administered prices, ended in April 2015. Current account strengthened further in 2014 aided by strong export growth and resilient private transfers. FDI inflows held up and more than covered the current account deficit. A successful euro bond issuance in 2014 improved reserves coverage, allowing FYR Macedonia to pre-finance its 2015 external fiscal financing needs and repay the Fund earlier than scheduled.

The financial sector is well-capitalized, liquid, and profitable. Non-performing loans have stabilized at relatively low levels by regional standards, and remain fully provisioned. The steady decline in local currency to FX interest rate spreads shows improved confidence which has helped the de-euroization of both deposits and loans. Spillover risks from Greece to the financial sector are being closely monitored.

Executive Board Assessment[2]

Executive Directors praised the authorities' efforts to promote broad-based growth, noting the support provided by public investment, improved credit conditions, and robust exports and foreign direct investment. At the same time, Directors cautioned that downside risks to the outlook include domestic political uncertainties and regional pressures. Against this background, they encouraged the authorities to strengthen fiscal policy performance and enhance policy buffers, while promoting greater private-sector-led job growth.

Directors stressed the need for further fiscal consolidation, in light of the sharp rise in public debt and limited policy space. They stressed that further measures would be needed to achieve the target set in the 2015 supplementary budget, including by collecting tax arrears and scaling back the planned increase in goods and services spending. Looking ahead, Directors welcomed the authorities' intention to reduce the overall deficit to below 3 percent of GDP in line with their medium-term fiscal strategy and enshrine sustainability in fiscal rules. They recommended that the planned debt ceiling of 60 percent of GDP should be complemented by a lower operational threshold or debt brake to create adequate space for fiscal policy to counter macroeconomic and

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

demographic shocks. Directors also encouraged greater efforts to strengthen public finance management, improve revenue efficiency, and rationalize expenditures.

Directors considered the conduct of monetary policy to be appropriate and welcomed the authorities' efforts to preserve financial stability and contain possible spillovers from the crisis in Greece. They recommended that the authorities stand ready to tighten policies, including using macro-prudential instruments, in case of demand pressures or financial stability risks. Directors praised the authorities' efforts to strengthen the supervisory framework and crisis management tools, as well as the enhanced communication and exchange of information within the European Single Supervisory Mechanism. Given the limitations of the capital flow management measures including the possibility of circumventions, they viewed the enhanced monitoring and strengthened prudential measures currently in place as warranted to counter possible regional contagion effects.

Directors welcomed the authorities' efforts in attracting FDI and boosting exports and employment. They urged the authorities to continue with structural reforms to ensure stronger job creation and a broader sharing of prosperity through greater spillover into the domestic economy. Directors advised further efforts to ensure easier access to credit for firms, shorter delays in collecting payments, a more predictable legal and regulatory framework, better skills match, and streamlining of the numerous inspection bodies.

FYR Macedonia: Selected Economic Indicators

	2010	2011	2012	2013	2014	2015
	Annual percentage change, unless otherwise specified					
Real GDP	3.4	2.3	-0.5	2.7	3.8	3.2
Real domestic demand	1.0	0.4	3.5	-2.6	4.2	3.8
Consumption	3.8	-5.4	1.2	2.1	2.3	2.0
Gross investment	-3.8	17.9	10.2	-16.6	13.5	7.5
Net exports 1/	2.1	1.7	-3.9	5.0	-0.9	-1.1
CPI inflation (annual average)	1.7	3.9	3.3	2.8	-0.3	0.1
Unemployment rate (annual average)	32.1	31.4	31.0	29.0	28.0	27.3
	In percent of GDP					
Current account balance	-2.0	-2.5	-2.9	-1.8	-1.3	-3.2
Goods and services balance	-19.7	-20.5	-22.4	-18.5	-17.6	-18.7
Exports of goods and services	38.4	45.6	44.5	43.3	47.5	48.2
Imports of goods and services	58.1	66.1	66.9	61.7	65.1	66.9
Private transfers	18.6	18.7	20.6	18.3	17.9	17.6
External debt (percent of GDP)	57.8	64.2	68.2	64.3	69.8	68.3
Gross investment	24.5	26.9	28.9	28.5	30.6	33.4
Domestic saving	22.4	24.4	26.0	26.7	29.2	30.2
Public	1.1	1.3	0.2	-0.5	-0.9	-0.1
Private	21.3	23.1	25.8	27.2	30.1	30.3
Foreign saving	2.0	2.5	2.9	1.8	1.3	3.2
Gross general government debt	24.1	27.7	33.7	34.1	38.1	37.0
Public and publicly guaranteed debt 2/	26.4	30.1	36.3	38.2	43.5	44.2
Central government balance	-2.4	-2.5	-3.8	-3.9	-4.2	-4.0
Memorandum items:						
Nominal GDP (billions of denars)	437	464	467	499.6	525.8	549.2
Nominal GDP (billions of euros)	7.1	7.5	7.6	8.1	8.5	8.9
GDP per capita (EUR)	3459	3665	3680	3930	4126	...

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

1/ Contribution to growth.

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

INTERNATIONAL MONETARY FUND

FORMER YUGOSLAV REPUBLIC OF MACEDONIA

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION

August 10, 2015

KEY ISSUES

Context: The broad-based GDP growth supported by public investment, improved credit and labor market conditions, and robust exports is expected to moderate in the near term. Domestic political uncertainties and the crisis in Greece constitute significant downside risks. Fiscal policy space built up in pre-crisis years has largely been depleted. Rebuilding policy space and buffers to preserve macroeconomic and financial stability is a priority now.

Key policy recommendations

- **Fiscal Policy.** The solid economic recovery provides an opportunity to step up fiscal consolidation this year in order to achieve a deficit below 3 percent of GDP by 2017 in line with the authorities' medium-term fiscal strategy. Both revenue and expenditure measures are needed to achieve this outcome. The public debt limit at 60 percent of GDP under the envisaged fiscal rules should be complemented by a lower operational target, or debt brake at 50 percent of GDP to ensure adequate policy space to counter shocks and absorb spending pressures from an ageing population. Budgetary institutions and macroeconomic forecasting also need to be strengthened to ensure successful implementation of fiscal rules.

- **Monetary and Financial Policy**. The monetary policy easing cycle has ended but it is too early to start tightening in light of a still negative output gap and very low inflation. High structural liquidity serves as a buffer in the context of possible spillovers from Greece but also poses some risks in light of strong consumer credit growth. A tightening of policies, including using macro-prudential tools, should start if financial stability risks emerge or the de-euroization trend reverses. Enhanced monitoring and strengthened prudential measures currently in place are warranted to counter possible contagion effects from Greece. In this context, the recently-introduced capital flow measures have limitations, and their costs and benefits should be closely monitored.

- **Structural Policy**. The authorities' policies to attract FDI have borne fruit in terms of diversifying exports and increasing employment. Further and more lasting gains in exports and competitiveness will depend on reforms to improve skills and remove constraints on the operation of the domestic private sector as well as providing better infrastructure.

Approved By
James Gordon (EUR) and Dhaneshwar Ghura (SPR)

Discussions were held in Skopje, June 29–July 7, 2015. The mission met with Finance Minister and Deputy Prime Minister Stavreski, Deputy Prime Minister for Economic Affairs Peshevski, NBRM Governor Bogov, other senior officials, private sector and trade unions representatives, parliamentarians and envoys representing the international community.

The staff team comprised Ms. Rahman (head), Messrs. Gerard, Chai, and Na, Ms. Sodsriwiboon (all EUR), Mr. Last (FAD), and Messrs. Gitton and Nacevski (Resident Representative Office). Mr. Clicq (OED) and Mr. Shimbov (World Bank) attended most meetings. Ms. Mahadewa and Ms. Chen assisted in the preparation of the staff report.

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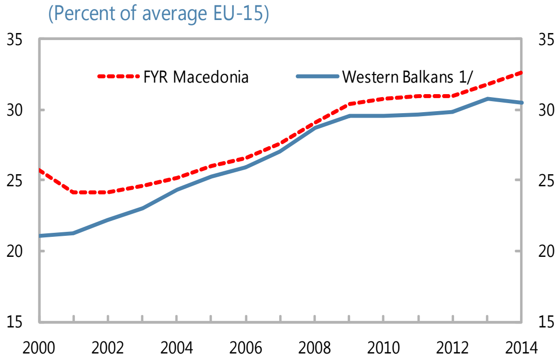
CONTEXT

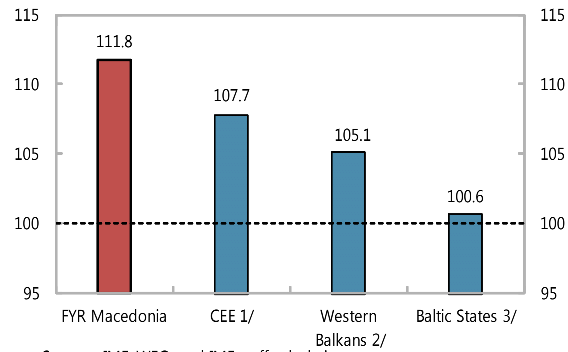
1. **Economic recovery has strengthened.** Benefiting from strong fiscal stimulus, credit growth and foreign investment, FYR Macedonia is experiencing one of the highest economic growth rates in the region. With output recovery more robust than in other emerging European countries, income convergence continued in post-crisis years and was faster than in other Western Balkan countries. GDP per capita in PPP terms now stands around one third of the EU-15 average (text chart).

Real GDP per Capita, Purchasing Power Parity (USD)
(Percent of average EU-15)



Sources: IMF, World Economic Outlook (WEO); and IMF staff calculations.
Note: 1/ Weighted average of Albania, Bosnia and Herzegovina, FYR Macedonia, Montenegro, and Serbia. Data for Kosovo is unavailable.

Real GDP, 2014
(Percent of pre-crisis GDP (2008) level)



Sources: IMF, WEO; and IMF staff calculations.
Notes: 1/ Weighted average of Bulgaria, Czech Republic, Hungary, Poland, Romania, Slovak Republic, and Slovenia.
2/ Weighted average of Albania, Bosnia and Herzegovina, Kosovo, FYR Macedonia, Montenegro, and Serbia.
3/ Weighted average of Estonia, Latvia, and Lithuania.

2. **Going forward, the challenge is to maintain economic recovery without jeopardizing sustainability, while also tackling downside risks.** The government's growth strategy focusing on attracting foreign investment and enhancing public infrastructure has produced robust growth and a well-diversified export portfolio. However, export success has come at a cost of rapidly rising external public and private indebtedness and resulting high financing needs**.** While improving infrastructure remains a key ingredient to support the export-led growth in this small, land-locked economy, going forward, a careful balancing is required to secure strong pay-off from the debt build-up. At the same time, the uncertain external environment, particularly with regards to Greece and possible spillovers, makes it urgent to bolster policy space.

3. **Domestic political climate has become more polarized**. The wiretapping scandal in early 2015 alleging vote rigging and large-scale government abuse of power led to the resignation of top officials and has made the domestic political discord a front and center issue. With mediation from the European Union (EU) and the US, the main political parties have reached an agreement to hold new elections on April 24, 2016. Transition arrangements are complex, spanning over a period of 9 months. They include the return of the opposition to the Parliament, the appointment of a special public prosecutor in September 2015, the appointment of opposition members to several high-level positions, the resignation of the incumbent government before mid-January 2016, and the formation of an interim government led by the current ruling coalition with a mandate limited to the organization of elections.

4. **The EU Accession, which anchors the authorities' long-term vision, remains at an impasse.** In its October 2014 progress report, the European Commission maintained its recommendation to open accession negotiations which have been blocked by the name dispute with Greece. Recently, the Commission fielded an expert mission that recommended urgent actions targeting intelligence, judicial and prosecution services, external oversight, conduct of elections and media freedom. Progress on this front will likely weigh in the Commission's decision to maintain its recommendation.

Text Box. Relations with the Fund and IMF Past Policy Advice

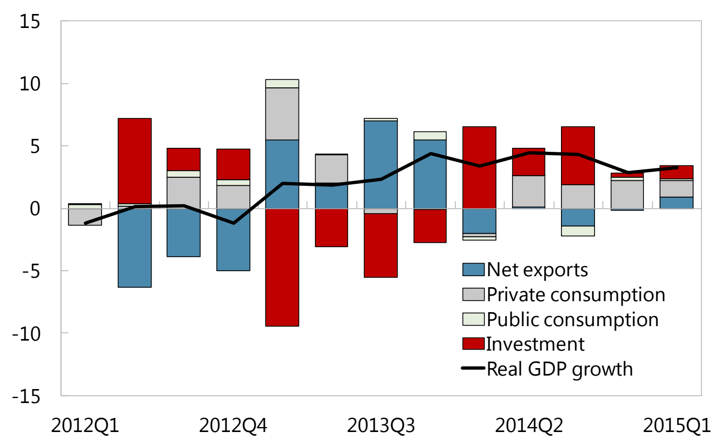
A two-year Precautionary and Liquidity Line (PLL) was approved on January 19, 2011. In March 2011, the authorities drew about US$305 million (286 percent of quota). Following the expiration of the PLL in January 2013, there was a period of post-program monitoring which terminated in January 2015. All outstanding Fund credit (about US$174 million) was repaid in advance in February 2015.

The authorities' policy actions in the areas of monetary and financial sector have generally been in line with the IMF advice. Traction in the areas of fiscal policy and public finance management has been limited over the past few years. The authorities are yet to implement a fiscal policy anchored in a medium-term fiscal strategy which ensures a gradual consolidation and stabilizes public debt, a key recommendation of the 2014 Article IV Consultation.

RECENT ECONOMIC AND FINANCIAL DEVELOPMENTS

5. **Real GDP growth accelerated in 2014 to 3.8 percent and strong growth continued in 2015Q1**. Double-digit growth in investment, and strong private consumption supported by credit growth and improved labor market conditions, boosted output (Table 1, text chart). Real export growth also accelerated, mostly owing to a pick-up in automobile, chemical and plastic products. However, the contribution of net exports to growth remained negative in 2014 due to high investment-related imports. Favorable developments in exports, domestic demand and credit continued through the first quarter, but there are some incipient signs of slowdown since May (Figure 1). Deflation, mostly reflecting developments in external and administered prices, ended in April 2015 (Box 1).

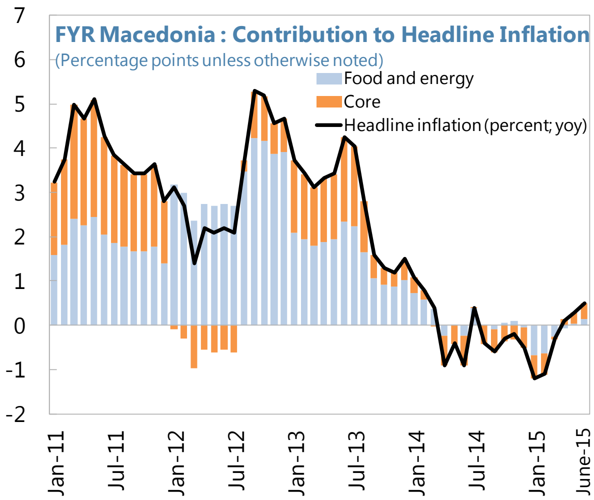
FYR Macedonia: Contribution to Real GDP Growth
(Percent)



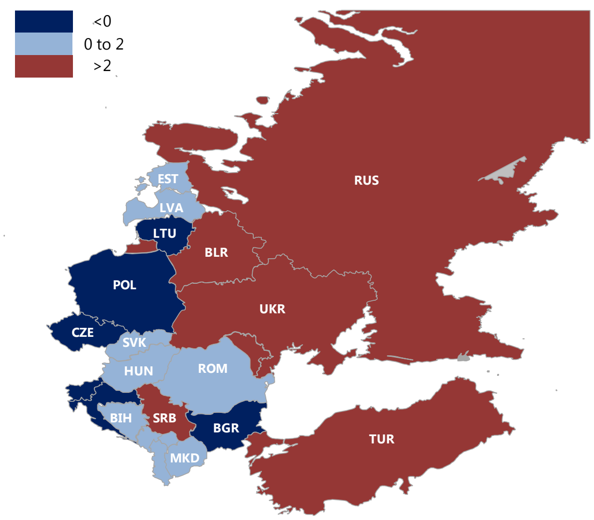
Sources: Republic of Macedonia State Statistical Office; and IMF staff calculations.

Box 1. Deflationary Developments and Drivers

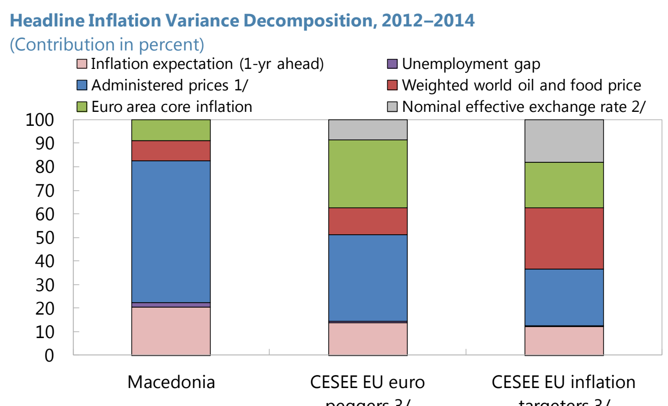
FYR Macedonia experienced deflation like several other countries in the region. Headline inflation in FYR Macedonia began to fall sharply in mid-2013 and turned negative in April 2014. The falling inflation was mostly due to falling food and energy prices and their pass-through to domestic prices. Many neighboring countries in Central, Eastern, and Southeastern Europe (CESEE), including Bosnia and Herzegovina, Bulgaria, Hungary, Kosovo, Montenegro and Poland, experienced deflation in 2014 (text charts).



Sources: Republic of Macedonia Stata Statistical Office; and IMF staff calculations.



The contribution from world food and energy prices, their pass-through to domestic prices via cuts in administered prices (mostly in energy), and low euro area inflation seem to be the main drivers. Falling food and energy prices as well as low core inflation in the euro area contributed another 20 percent to price developments. Reductions in administered prices during 2012–2014 are estimated to have contributed to 60 percent of the decline in headline inflation, according to a regression-based variance decomposition analysis. Administered prices consist of about 15 percent of the consumption basket (mostly fuels and electricity). These estimates are in line with the findings in Iossifov and Podpiera (2014) for other countries in the region (text chart).



Source: IMF staff estimates.
Note: 1/ Administered prices for CEEcountries includes tax.
2/ Nominal effective exchange rate is not show in Macedonia's decomposition, because the coefficient is very small and statistically insignificant.
3/ Based on Iossifov and Podpiera (2014).

Headline inflation turned positive since April 2015 and has been increasing. Deflation risks are low, despite recent downward revisions in world oil prices in the absence of any further cuts in administrative prices.

6. Despite strong growth, the government's budget deficit target was missed in 2014. At 4.2 percent of GDP, the deficit was higher than the supplementary budget target by ½ percent of GDP (¾ percent relative to the original budget). This was mostly due to underperformance in non-tax and capital revenues, a persistent trend since 2010, while spending remained within the budgeted amount (text table). The general government debt reached 38 percent of GDP at end-2014, a near doubling since 2008, while broader public sector debt (includes mainly two State Owned Enterprises (SOEs), the Public Enterprise for State Roads (PESR) and the Electricity Distribution Company (ELEM)) rose to 44 percent of GDP (Figure 2, Tables 2a and 2b).

FYR Macedonia: Central Government Budget Execution Rates, 2010 - 2014

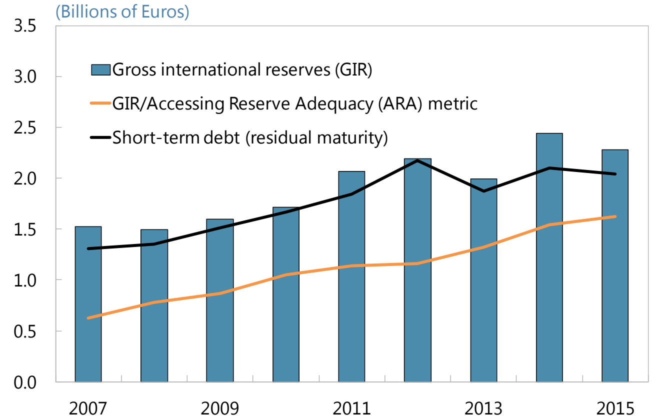
	2010	2011	2012	2013	2014
	(percent of target)				
Total Revenues	95	92	92	94	93
Tax Revenues and Contributions	99	97	95	96	98
Taxes 1/	99	98	92	96	101
Other Taxes	115	115	108	77	52
Social Contributions	96	94	98	100	99
Non-Tax Revenues	88	81	83	84	73
Capital Revenues	69	61	76	76	46
Grants	47	29	73	78	75
Expenditures	96	93	96	95	96
Current Expenditures	97	94	98	96	98
Capital Expenditures	87	84	88	82	84

Source: IMF staff calculations.
Note: 1/ Include PIT, CIT, VAT, Excises, and Custom Duties.

7. Credit growth strengthened further against the backdrop of relaxed monetary conditions. Facing imported deflationary pressures, the monetary stance has been broadly accommodative, with the key policy rate unchanged at 3.25 percent and relaxation measures on certain reserve requirements in place for more than 1½ years (Figure 3). The associated decline in bank lending rates has helped revive credit growth to about 9 percent y-o-y in June 2015 from the trough reached two years ago. The steady decline in local currency to FX interest rate spreads has helped the de-euroization process of both deposits and loans (Figure 3, Box 2).

8. Short-term external vulnerabilities have moderated. The current account strengthened further in 2014, aided by strong export growth and resilient private transfers (Figure 4, Table 3). FDI inflows held up and more than covered the current account deficit; yet external debt edged up to almost 70 percent of GDP, reflecting public sector borrowing and rising debt component in FDI. A successful Eurobond issuance in 2014 improved reserves coverage (text chart), allowing FYR Macedonia to pre-finance its 2015 external fiscal financing needs and repay the IMF earlier than scheduled.

FYR Macedonia: Reserve Adequacy Ratios
(Billions of Euros)



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

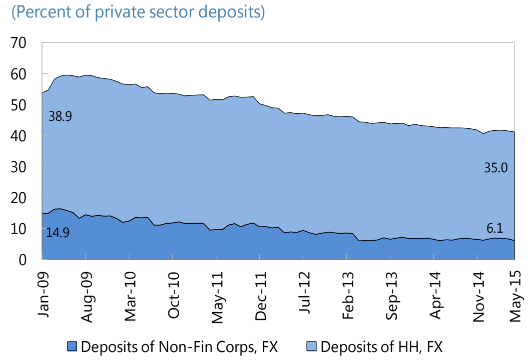
Box 2. Trends in De-Euroization

Similar to other Balkan countries that operate a fixed exchange rate regime, euroization has traditionally been high in FYR Macedonia. This has been driven by factors typically identified in the literature: low initial credibility of institutions, volatility of inflation and income, and lower interest rates offered on foreign currency-denominated loans by foreign bank subsidiaries. In addition, large private transfers, notably from Germany, have contributed to significant deposit euroization –prompting banks to extend foreign currency-denominated loans in order to match the asset and liability structure of their own balance sheets.

While price and exchange rate stability remains the primary objective of monetary policy in FYR Macedonia, fostering a continuous process of de-euroization has been an important policy goal. With a view to contain balance sheet risks of unhedged non-financial private sector agents, the monetary authorities have progressively put in place regulatory safeguards and buffers against excessive euroization since 2009. These have included: (i) differentiated reserve requirements for LC and FX liabilities; (ii) a cap on the daily net open FX position of banks to 30 percent of their own funds; and (iii) requirements from banks to identify and document the situation of large unhedged FX borrowers. More recently, the central bank continued to balance the needs for monetary stimulus with the objective of maintaining a significant spread between the central bank bill and ECB main policy rates, in order to incentivize the banks to offer a substantial currency deposit/loan spread.

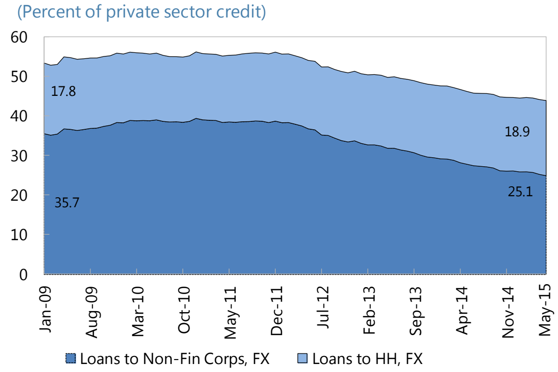
These policies have borne fruit, bringing down loan and deposit euroization levels, particularly for the non-financial private sector (text charts). In the context of declining LC and FX lending rates but of a slower decline in the currency spreads, the proportion of foreign currency-denominated loans has fallen below 45 percent of total loans at end-2014 compared to 53.5 percent in January 2009. The proportion of foreign currency-denominated deposits has fallen to below 42 percent of total deposits from the peak of about 59 percent observed during the 2009 financial crisis, driven by both corporates and households.

FYR Macedonia: Deposit Developments by Customer
(Percent of private sector deposits)



Sources: NBRM; and IMF staff calculations.

FYR Macedonia: Credit Developments by Customer
(Percent of private sector credit)



Sources: NBRM; and IMF staff calculations.

OUTLOOK AND RISKS

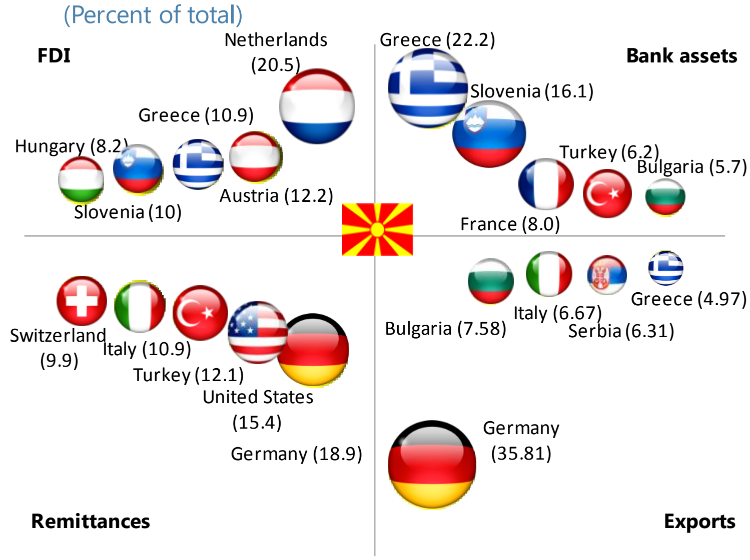
9. GDP growth is expected to remain broad-based but moderate to 3.2 percent in 2015 under the combined effects of domestic political uncertainties and the crisis in Greece, before gradually improving over the medium term**.** Some private investment plans, both domestic and foreign, are reportedly on hold until new elections, while private consumption is being affected by negative confidence effects. Output gap is projected to close in 2018 (Figure 1). The current account deficit is expected to improve in the medium term reflecting the build-up of export capacities in the Technological Industrial Development Zones (TIDZ) (Table 3). While private transfers are assumed to hold steady as proven during the global financial crisis, FDI would weaken to 3.1 percent of GDP in 2015 and 2016, and modestly strengthen thereafter. External debt would rise further reflecting public sector borrowing. As oil prices begin to stabilize, headline inflation is projected to reach 0.8 percent at end-2015.

10. Downside risks to this forecast are substantial (Box 3).

- ***Domestic political risks.*** A derailment or incomplete implementation of the complex political agreement could have further negative impact on economic sentiment and growth. This may also complicate the opening of negotiations for the EU accession affecting longer term prospects

- ***Spillover from Greece.*** More than a fifth of banking sector assets is held by the two subsidiaries of Greek banks. Although these subsidiaries operate on a standalone basis with limited exposure to parents, a prolonged and deep crisis in Greece could trigger contagion. Exports could weaken from the second-round effects of weaker euro area growth and possible disruption in the Thessaloniki port which processes most of the bulk trade. Staff's estimates under a downside scenario suggest a broad-based slowdown in growth to around 1½ percent in 2015–16 reflecting the impact through various direct and indirect spillover channels (Box 4).

FYR Macedonia: Top Five External Real and Financial Links
(Percent of total)



Sources: SNL Financial; NBRM; World bank; and IMF staff calculations.

Box 3. Risk Assessment Matrix[1]
(Scale—high, medium, or low)

Source of Risks	Relative Likelihood	Impact if Realized	Recommended policy response
Sustained domestic political uncertainty	High	High • Growth slowdown via lower consumption and investment • Possible delays in opening of EU accession negotiation	• Implementing the recently-reached agreement between major political parties is key to dampening political uncertainties.
Euro area bond market contagion (from delays in debt servicing by Greece, faltering reforms and political social upheavals)	Medium	High • Limited dependence of Greek subsidiaries on parent bank funding and their financial strength are important mitigating factors. • The recently adopted CFMs also reduce risks of BOP pressures emanating from capital outflows to Greece, although circumventions are possible. • However, a prolonged and deep turmoil in Greece could have a significant impact on the economy via dampened confidence, lower exports, and higher sovereign spreads.	• Continue to closely monitor possible contagion risks to the financial sector from Greece. • Banking supervision and crisis management framework are broadly in line with best practices, though some areas could be further strengthened, e.g. provision of ELA in foreign currency. • Further pre-emptive ring-fencing measures could be considered to avoid CFMs. • Tighten monetary policy in response to potential large capital outflows and pressures on reserves and currency. • Pre-finance 2016 financing needs, and cut low priority current spending.
Protracted period of slower growth in the euro area	High	Medium • Weaker FDI and exports, given significant direct trade and FDI linkages with euro area.	• Restart monetary policy easing to support demand • Recast fiscal policy to effectively support demand, without jeopardizing the goal to rebuild fiscal space in the medium term.

Box 3. Risk Assessment Matrix (concluded)[1]
(Scale—high, medium, or low)

Source of Risks	Relative Likelihood	Impact if Realized	Recommended policy response
Persistently low energy prices	Medium	Low (Positive) • Higher consumption, inflation may dip back into negative if followed by cuts in administrative prices	• Do not cut administrative prices, rather take advantage of low price to add fiscal space.
Heightened risk aversion related to Russia/Ukraine conflict	Medium	Low • Conflicts could depress international investor confidence and re-price risks in emerging markets, amid disturbances in global financial, trade and commodity markets. • Direct trade exposure with Russia/Ukraine is low, except for gas.	• Pre-finance fiscal financing needs for 2016 to avoid going to market in times of turbulence; • Improve fuel storage capacities and diversify sources for gas imports over the medium run.

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

Box 4. Linkages to Greece and Possible Spillovers

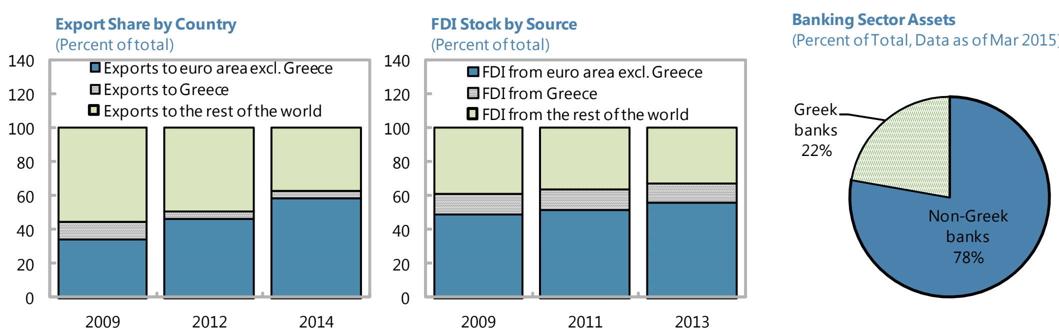
A prolonged and deep crisis in Greece could potentially affect FYR Macedonia's economy via direct and indirect real links, international financial linkages, as well as through the presence of Greek-owned banks in the domestic financial sector.

- Direct trade links with Greece are limited, but exports to the euro area (EA) constitute a large part of total exports (text chart). Exports to Greece have halved since the global financial crisis and now count for less than 5 percent of total. However, exports to other EA countries, particularly Germany, have rapidly increased in recent years due to FDI and activities in the Technological Industrial Development Zones (TIDZ). A significant slowdown in EA growth would, therefore, impact FYR Macedonia's exports. Additional impact could come from possible disruption of bulk trade at the harbor of Thessaloniki which processes most of this trade.

- **International financial linkages include FDI flows and external government financing.** FDI stock from the EA constitutes about half of the total stock, whereas a tenth of FDI stock consists of investment from Greece. Fiscal financing needs are likely to remain high for the coming years and stand at 15 percent of GDP in 2016 which include payments falling due externally. Increased uncertainty and risk aversion in the market could significantly increase sovereign risk spreads elevating debt servicing costs and effectively ruling out external bond issuance.

- **Greek-owned banks hold a significant share of FYR Macedonia's banking sector assets but appear sound.** About 22 percent of assets and 24 percent of deposits in the banking sector are Greek-owned, mainly through the Stopanska Bank (a subsidiary of National Bank of Greece holding one fifth of assets/deposits), and marginally through a small subsidiary of the Alpha Bank. Both subsidiaries are adequately capitalized, liquid, mostly deposit-funded, operate on a stand-alone basis, and do not hold Greek sovereign bonds. Exposures to parent banks are limited at less than 3 percent of assets.

FYR Macedonia: Real and Financial Sector Linkages with Greece

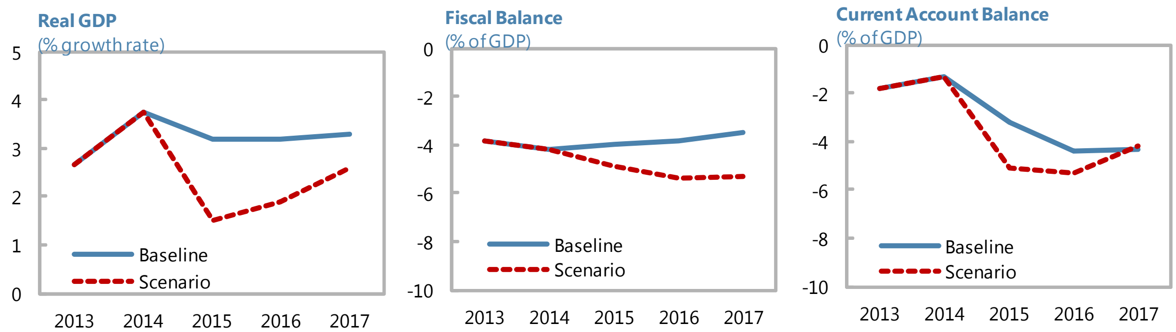


Sources: NBRM, IMF Staff Calculations

Spillovers from Greece through indirect channels could weigh significantly on growth, while the combination of higher financing needs, lower reserves and the inability to issue bond externally could create pressures on the foreign exchange market. Under the downside scenario, where the crisis in Greece is prolonged and deep, the main assumptions include: (i) a significant decline in overall exports due to lower demand in the EA and possible disruption of trade through Greece; (ii) lower FDI inflows from the EA as some EA investors may go into a long wait-and-see mode; (iii) deposit withdrawals from the Greek subsidiaries and a slowdown in credit growth due to general uncertainties, and (iv) a significant spike in sovereign spreads given uncertainties and risk aversion in the international financial market. Remittances are projected to remain unchanged. The resulting lower consumption, exports and investment would lower real GDP growth to around 1½ percent in 2015–16 (text chart). The lower growth would widen the overall fiscal deficit; additional financing needs for 2015 are likely to be met through domestic liquidity. The current account deficit would also widen on account of the trade deficit as the reduction in imports would not outweigh the fall in exports. A prolonged period of market stress and no sovereign issuance could create pressure on reserves and the exchange rate, particularly if deposit outflows are not contained within the domestic financial sector.

Box 4. Linkages to Greece and Possible Spillovers (concluded)

FYR Macedonia: Spillovers from Greece 1/



Source: IMF Staff Calculations
1/ The downside scenario with prolonged crisis in Greece assumes (i) 10 percent fall in export values in 2015-2016 along with associated drop in import values; (ii) 10 percent decline in FDI inflows from euro area in 2015-2016; (iii) a slowdown in private sector credit by half of that of baseline in 2015 with no recovery in 2016; and (iv) an increase in sovereign spreads by 300 bps in 2015 and 200 bps in 2016. Other relevant assumptions include no further deterioration in domestic political situations, remittances held-up, and secured intercompany repayments.

The authorities have stepped-up preemptive and contingency measures in the financial sector. Since 2010, the authorities have strengthened their supervision and crisis management tools to contain possible spillovers stemming from Greece. Banks have been subjected to stringent provisioning requirements for holding low rated assets and to *ex post* notification for any significant transactions with Greece. In addition, current prudential regulations limit intra-group exposure to 10 percent of capital. Bank deposits, liquidity position and developments in FX market are being monitored on a daily basis. In 2012, the authorities prohibited the early repayment of subordinated loans extended after July 1st, 2012 to parents. The lender of last resort (LOLR) framework is aligned with the international best practices (FSAP update, 2008). Emergency Liquidity Assistance in local currency is available against qualifying collateral which have recently been extended, but not in foreign currency. The NBRM has also a handful of bank resolution tools and intervention powers for broad triggers to address problems with capital adequacy and liquidity (such as corrective actions, administration, recapitalization, purchase and assumption transactions including removing shareholders, and revocation of license). On a forward-looking basis, stress tests conducted by the NBRM show both Greek subsidiaries being able to withstand strong liquidity pressures.

More recently, the authorities adopted capital flow measures (CFMs) against Greece.[1] These measures aim at preventing any Greek interest, including many Greek-owned companies of all sizes operating in FYR Macedonia, to suddenly borrow from Macedonian banks and send to Greece. While the magnitude of the risk is hard to quantify, the sizable presence of Greek businesses make the risk significant and the authorities wanted to prevent possible misconduct that would have undermined the soundness of the domestic financial sector or potentially cause a balance of payment crisis. The measures are time-bound (valid for a maximum of 6 months) and forward-looking: the authorities noted that their aim is not to affect current transactions.

[1]Please see the NBRM Press Release for details on these measures.
http://www.nbrm.mk/?ItemID=54D14FF11D232D4ABF074C20C393FBB8

11. The authorities broadly shared staff's views on the near-term outlook and risks, but were more optimistic on the medium term. While still in the process of revising their forecasts, they expect a broadly similar GDP growth rate for 2015. However, they view the negative impact of domestic political uncertainties to have peaked in May and the impact from Greece to be more short-lived. In particular, the authorities expect a faster improvement in confidence and, for the medium term, an accelerated FDI and public investment to support a growth of around 4 percent and stronger exports to produce lower current account deficits. Risks from a prolonged and deep crisis in Greece are viewed as significant, but manageable given the reorientation of trade flows that have already taken place since 2010 and policy actions taken to limit contagion, including recently-adopted capital flow measures (CFMs) (Box 4). The authorities also project a faster rebound in prices with headline inflation reaching 2 percent by 2016.

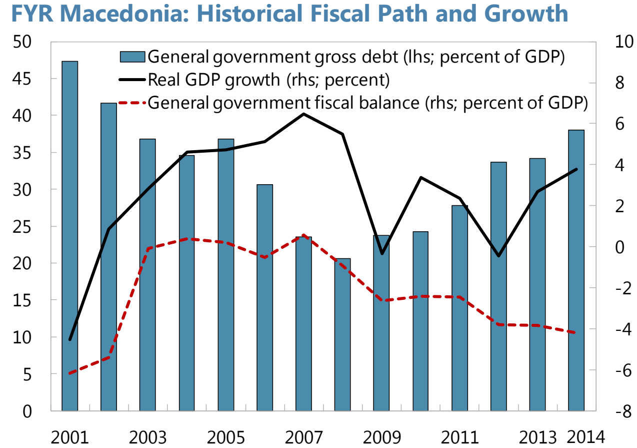
POLICY DISCUSSIONS

A. Fiscal Policy—Rebuilding Space

Diagnostics

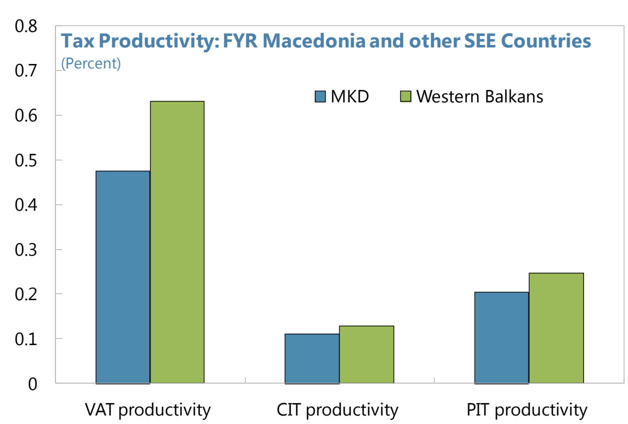
12. Fiscal policy space built up during the pre-crisis years has largely been depleted since 2008. Benefiting from strong economic growth, FYR Macedonia created a sizable fiscal space in the years leading up to the global financial crisis by maintaining a balanced overall fiscal position and entered the crisis with one of the lowest general government debt-to-GDP ratios in emerging Europe (text chart). Since 2008, there has been a reversal. This reflects fiscal support for the economy in the aftermath of the crisis, but also policy choices and low revenue efficiency.

FYR Macedonia: Historical Fiscal Path and Growth



Sources: IMF, WEO.

- ***Policy choices.*** The authorities' strategic decision to maintain a low tax environment and other incentives to attract FDI has borne fruit, but has also produced tax and pension and social insurance contribution rates that are among the lowest in the region (Figure 2). The social transfer system has remained generous even as contribution rates were cut.



Source: IMF staff calculations.
Note: Tax productivity is calculated as tax receipts in percent of GDP divided by the standard tax rates. Western Balkans includes Albania; Bosnia and Herzegovina; Kosovo; FYR Macedonia; Montenegro; and Serbia.

- ***Low revenue efficiency.*** FYR Macedonia's tax productivity and efficiency are low compared to regional peers, particularly for the VAT which contributes one third of tax revenues and social contributions (text chart).

13. Fiscal deficit is projected to reach 4 percent of GDP in 2015 compared to 3.4 percent targeted in the original budget. Revenue developments in the first sixth month showed a stronger-than-budgeted performance in profit taxes, resulting from the removal of exemptions on non-reinvested profits, and in excise taxes due to higher production from a strategic partnership with Philip Morris. However, most other revenue categories, particularly VAT, other taxes and non-tax revenues, underperformed. During the mission's visit, the authorities were in the process of preparing a supplementary budget which is currently being discussed in the parliament. Based on the details shared with the mission, which include wage increases for the police forces and additional capital expenditures entailed by the worsened security situation together in the amount of 1.1 billion denars, staff's preliminary estimates suggest a deficit of 4 percent of GDP for 2015.

14. With no policy changes, the overall deficit is likely to remain well above 3 percent of GDP in the medium term with general government debt rising to 45 percent of GDP by 2020. The broader public sector debt would reach 54 percent of GDP. The projected fiscal trajectory would produce a primary deficit (2.1 percent of GDP) that is 1.6 ppts higher than the debt-stabilizing primary balance and increase gross fiscal financing needs from 15 percent of GDP in 2015 to 18 percent by 2020 (Public DSA Annex).

15. The authorities' envisaged fiscal rules are likely to yield too little fiscal consolidation in the medium term. The planned fiscal rules, which are expected to be operational as of January 1, 2017, will cap the overall budget deficit at 3 percent of GDP and public debt at 60 percent. However, given the fixed exchange rate regime, a lower debt limit would serve FYR Macedonia better by creating a larger fiscal space needed to counter macroeconomic shocks and absorb medium-term spending pressures from population ageing. A lower debt level would also reduce risks emanating from elevated financing needs. Under the baseline (no policy change) scenario, the public debt rule is projected to be non-binding but the overall fiscal deficit is likely to miss the limit envisaged in the fiscal rule.

Discussion

16. Staff advised additional measures to contain the 2015 budget deficit. While details of the supplementary budget were still being worked out, the authorities expressed their intention to contain the deficit to around 3.6–3.7 percent of GDP. Staff considered this slightly higher deficit relative to the original budget target as

FYR Macedonia: Possible Measures underlying Fiscal Consolidation 2015–2020

(Percent of GDP)

	2015	2016	2017–2020
Overall	0.6	0.6	1.8
Revenue			
VAT arrears 1/	0.4	0.2	-
VAT efficiency 2/	-	-	1.0
Expenditure			
Goods and Services	0.2	0.2	0.2
Social transfers 3/	-	0.2	0.6

Source: IMF staff estimates.

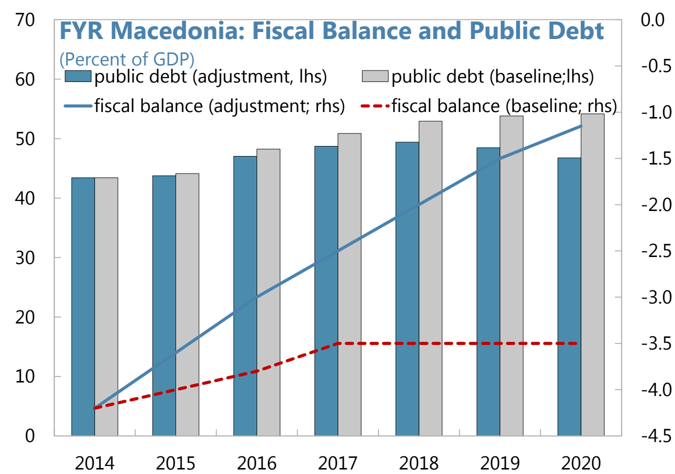
Notes: 1/ VAT arrears accumulated during 2014 stood at 2 percent of GDP.

2/ Assume VAT efficiency improves beginning in 2017 and reaches Western Balkans average by 2020.

3/ Transfers include pension, health, unemployment benefits, social assistance, subsidies, and transfers to local governments. A thorough expenditure review is needed to identify the exact items to be cut.

appropriate in light of the lower growth. Achieving this target would require saving the significant over-performance in profit tax revenues and adopting additional measures. These measures would include scaling back the increase in goods and services spending from 21 percent in the original budget to 14 percent in the supplementary budget, and collecting a part of the tax arrears which for 2014 alone amounted to 2 percent of GDP (text table). The recommended consolidation implies a reduction of 0.6 percent of GDP in the cyclically-adjusted primary balance for 2015 and 0.7 percent for 2016. The authorities considered staff's 2015 fiscal projections to be too pessimistic on the revenue side, particularly for VAT and social contributions, and thought the deficit target in the supplementary budget was achievable without additional measures.

17. In line with the authorities' medium term fiscal strategy (MTFS), staff recommended consolidation to keep public debt comfortably below 50 percent of GDP (text chart). The authorities' 2015–17 MTFS appropriately aims to reduce the overall deficit to below 3 percent of GDP by 2017; however, measures are yet to be identified. Working within the parameters of low tax rates, and, in the absence of a thorough public expenditure review, staff sees scope for adjustment (3 ppts of GDP over six years) to be delivered by the following measures.



Source: IMF staff estimate.

- ***Higher revenue efficiency.*** Staff's estimates suggest that increasing efficiency to the average level of Western Balkan countries could enhance tax revenues permanently between 1½–2 percent of GDP. A recent FAD TA mission identifies the following measures that would help achieve that aim: establishing a permanent risk management unit and a modernization unit in the Public Revenue Office; expanding the audit coverage focusing on large taxpayers; and commencing a high wealth individual program.

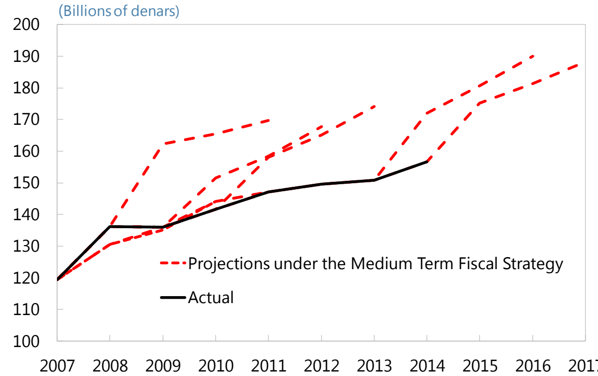
- ***Expenditure cuts.*** The composition of public expenditure is heavily skewed in favor of wages and social transfers (Figure 2). Transfers constitute 64 percent of total expenditure (18 percent in subsidies), which does not sit well with a catching-up economy requiring significant investment in infrastructure (Table 2). Staff recommended rationalization based on a thorough public expenditure review to identify areas of low efficiency.

18. Staff welcomed the authorities' intention to enshrine sustainability in fiscal rules but emphasized the need for adequate space and stronger budgetary institutions.

- Staff considered the 60 percent of GDP debt limit to be too high and suggested adopting a lower operational threshold or debt brakes at 50 percent of GDP as used in several other countries in the region.[1]

- The credibility of any fiscal rule also depends on institutional arrangements underpinning budgets. Currently, the fiscal framework suffers from a number of weaknesses: an absence of detailed budgetary estimates for central government institutions, a lack of reconciliation between the medium-term budget framework and the annual budget process, and over-optimistic growth projections which tend to produce revenue over-projections (text chart). These weaknesses underscore the importance of including effective oversight and corrective measures in the enabling legislation for the new fiscal rules, including establishing an independent body such as a fiscal council to inform macroeconomic forecasts.

FYR Macedonia: General Government Revenues, Actual and Projections in the Medium Term Fiscal Strategy
(Billions of denars)



Sources: IMF, WEO; and IMF staff calculations based on various budgets and Medium Term (3 years) Fiscal Strategies (MTFS).

- The inclusion of debt incurred by state-owned enterprises in the overall limit is appropriate given the full government guarantee. In this context, the projected scaling up of investment and borrowing by PESR, which is outside the budget, needs to be complemented by clear and transparent procedures to assess, select, prioritize and monitor these projects to ensure adequate debt-servicing capacity in future.

19. The authorities reiterated their commitment to the formal fiscal rules and were confident that the deficit would be below 3 percent of GDP by 2017. They noted the boost in growth and competitiveness from higher infrastructure spending and their plan to prioritize expenditures in favor of capital projects in roads, railway, energy, and health infrastructure. They were not overly concerned about the medium-term debt dynamics and stressed that debt would remain well below the 60 percent limit. They are closely monitoring the PESR debt which they see as relatively stable, with new borrowing netting out repayments. The authorities noted the shortcomings in their MTFS document– including the lack of sectoral guidance for detailed budget preparation, and the absence of reconciliation with the previous MTFS – which they propose to address in the public finance management reform program to be drafted later this year. The authorities are currently considering the design features taking into account regional experiences to include in their new Fiscal Responsibility Law.

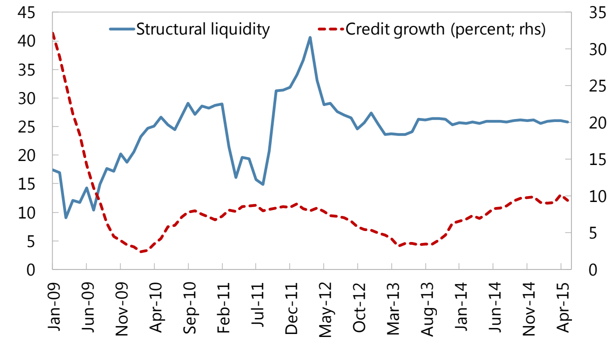
[1] Most emerging European countries that use a debt rule either cap the public debt at 50 percent of GDP (Hungary) or at a lower level (Kosovo and Serbia) or use debt brakes starting at 50 percent of GDP (Slovak Republic and Poland). See Selected Issues Paper, *FYR Macedonia: Fiscal Rules to Ensure Sustainability*.

B. Monetary and Financial Policies—Maintaining Stability

Diagnostics

20. A prolonged period of monetary accommodation has built up structural liquidity despite a pickup in credit growth (text chart). The amount of CB bills issued for sterilization purposes has persistently fallen short of absorbing excess liquidity since the volume was capped in April 2012, causing banks to hold deposits in the marginal liquidity facilities. Ample liquidity in the system provides a cushion against shocks to the financial sector, particularly in the current juncture, but may create risks to financial stability. This also results in the policy rate being higher than the "effective" short-term interest rate faced by banks for the purpose of liquidity management (Figure 3).

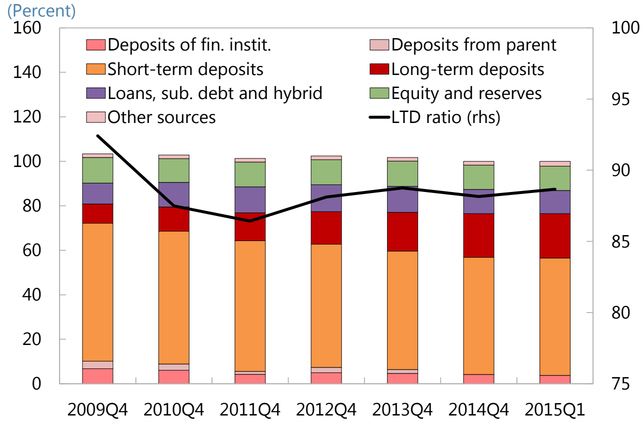
FYR Macedonia: Liquidity Developments
(Billions of Denars)



Sources: NBRM; and IMF staff calculations.
Note: Structural liquidity is calculated as the sum of net foreign assets, net public sector assets, net bank assets,other items net, minus currency in circulation and reserves held by banks at the central bank.

21. The banking sector remains sound and profitable. Banks are well-capitalized and liquid. Profitability has steadily risen to pre-crisis levels, reflecting contained overhead costs (53.6 percent of gross income in the first quarter) and comfortable interest margins (61 percent of gross income). Strong deposits growth has allowed credit to be increasingly funded by domestic deposits, preserving loan-to-deposit ratios below 90 percent on average and reducing risks from deleveraging by parent banks (text chart).

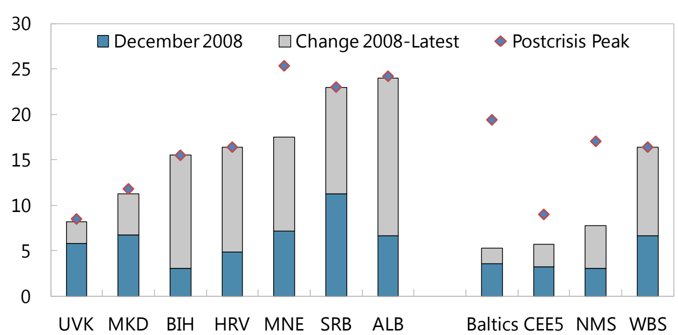
FYR Macedonia: Sources of Funding for Banks
(Percent)



Source: NBRM.

22. NPL ratios have been slow to decline reflecting structural bottlenecks. Although lower than in most other Western Balkan countries, NPLs have persisted since the crisis despite the credit recovery (text chart). These are mostly legacy loans and fully provisioned, hence financial stability risks are low. A faster resolution is held back by

FYR Macedonia and Peers: Non-Performing Loans
(Percent of total loans)



Sources: *The Western Balkans: 15 Years of Economic Transition*, IMF 2014; IMF, Financial Soundness Indicators Database; and country authorities.
Note: Group medians. Definition of NPL may differ by country. NMS includes Bulgaria; Czech Republic; Estonia; Hungary; Latvia; Lithuania; Poland; Romania; Slovak Republic; and Slovenia. WBS includes Albania (ALB); Bosnia and Herzegovina (BIH); Croatia (HRV); Kosovo (UVK); Macedonia (MKD); Montenegro (MNE); and Serbia (SRB).

structural bottlenecks: delays in collateral enforcement, infrequent utilization of out-of-court restructuring procedures, weaknesses in the corporate insolvency framework, and a lack of tax incentives and market for distressed debts.

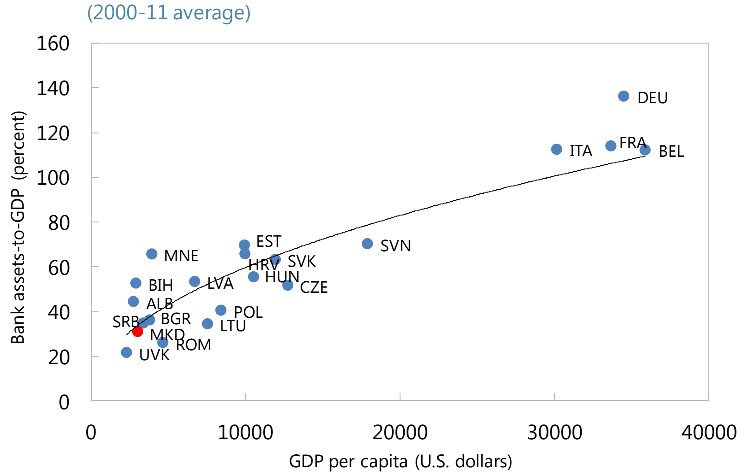
23. The two Greek-owned subsidiaries are sound but there are risks of contagion. Both subsidiaries are liquid and well-capitalized with limited links to parents and Greece (Box 4). Since 2010, NBRM has been pro-active in putting in place various prudential measures (stringent provisioning requirements for holding Greek assets, limitation of intra-group exposure to 10 percent of capital, *ex-post* notification for parent-sub transaction, daily monitoring of deposits, and pre-approval for subordinated loan repayment) that have led Greek-owned subsidiaries to drastically wind down exposure to the parent group. However, a short-term drain in the form of repatriation of non-distributed earnings or deposit outflows cannot be ruled out—which both banks appear capable of withstanding given high share of liquid assets. Risks of a broader contagion in the form of system-wide deposit withdrawal seem contained for now.

Discussion

24. The authorities and staff agreed that the monetary policy easing cycle has ended. Limited capital mobility allows FYR Macedonia to have some control over monetary policy despite a fixed exchange rate regime (officially classified as *stabilized arrangement*). Given the broad-based growth and the pick-up in credit so far, the room for monetary accommodation appears to be largely exhausted. At the same time, a still negative output gap and very low inflation do not yet call for monetary tightening. Overall, bank assets-to-GDP ratio appears in line with economic development (text chart). Credit growth is projected to moderate in the coming months due to high domestic and external uncertainties, but strengthen subsequently to continue the financial deepening process.

Bank Assets and Income per Capita

(2000-11 average)



Source: *The Western Balkans: 15 Years of Economic Transition*, IMF 2014; Data source: World Bank Global Financial Development Database (GFDD).

25. Staff recommended a tightening of monetary policies should demand pressures pick up, a low probability in the current environment, or risks to financial stability emerge. Consumer and mortgage lending growth rates have been in the double-digits, which require vigilance. The authorities agreed and expressed their intention to use targeted macro-prudential policies to address risks concentrated in specific borrower group, while an increase in the policy rate would be considered in case of external or price stability risks. Staff supports this approach. Reserves are adequate according to various metrics and are projected to remain so in the medium term dampening external instability concerns (text table). Nonetheless, some policy tightening may be needed to preserve the ongoing de-euroization, which has a bearing on financial stability, should external uncertainties negatively impact the pace of private transfer inflows and conversion of deposits from foreign to local currency.

Reserve adequacy ratios for Macedonia - 2012-2020

	2012	2013	2014	2015	2016	2017	2018	2019	2020
Reserve/STD (percent)[1/]	101.0	106.5	115.9	111.5	121.3	118.5	120.6	134.4	133.2
Reserve/Months of prospective import goods [2/]	6.2	5.2	6.0	5.2	5.2	5.2	5.0	4.6	4.8
Reserve/Broad money (percent) [3/]	50.7	43.7	48.3	44.1	45.4	45.3	42.0	39.0	37.0
Expanded 'Greenspan-Guidotti' metric: Reserves/(STD + CA deficit)	91.6	98.8	110.0	97.7	100.9	100.0	103.1	113.6	112.9
Reserves/Fund combination metric (percent) [4/]	135.1	125.3	133.3	123.2	123.4	196.4	191.0	187.6	187.4

Notes: 1/ Suggested threshold for adequacy: 100 percent; 2/ Suggested range for adequacy: 3-6 months; 3/ Suggested threshold for adequacy: 20 percent; 4/ Suggested range for adequacy: 100-150 percent

26. Staff supported maintaining the strengthened surveillance currently in place to fend off contagion risks. The prudential measures that have been in place for some time has served to protect the stability of the financial sector. The revised Banking Law provides the central bank with powers to intervene in insolvent banks or ring-fence illiquid but solvent ones. More recently, as discussed in Box 4, the authorities, fearing possible capital outflows by Greek businesses operating in FYR Macedonia, adopted CFMs which ban new capital flows to Greece.[2] These measures have limitations, including the possibility to circumvent. While agreeing with the staff that prudential measures would have been preferable to address these concerns, the authorities explained that, in the absence of any clear signs of financial instability, they were unable to intensify surveillance of financial transactions in solvent banks via further prudential measures. There has been no noticeable impact of CFMs on the domestic economy to date, including on the regular operations of Greek banks and businesses. There have also been no signs of circumventions via third parties or spillovers on other countries' policy responses. The costs and benefits of the CFMs, however, need to be assessed on an ongoing basis.

27. The authorities noted good progress regarding supervisory cooperation in the context of the Single Supervisory Mechanism (SSM). The supervision department of the central bank successfully passed the European Banking Authority (EBA) assessment on the equivalence of confidentiality regimes in April, hence paving the way for its formal participation in supervisory colleges on cross-border banking groups. In practice, the exchange of information on the Greek-owned banks has taken place on a regular basis in the last few months within the SSM. The authorities eagerly await further EBA assessments scheduled in 2016, as passing these would authorize lifting the current EU requirement that subsidiaries of EU banks fully provision their holding of non-EU public assets. This requirement comes at a high cost to the domestic banking sector.

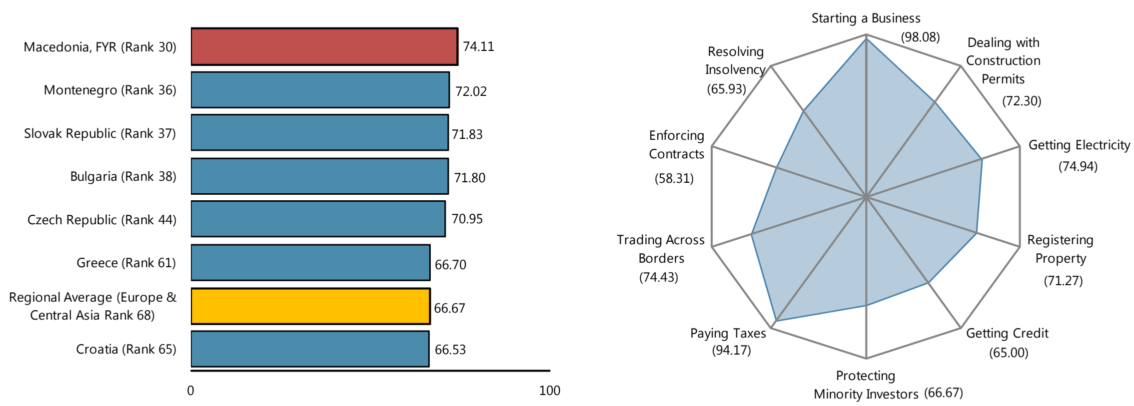
[2] Staff is seeking additional clarifications from the authorities to ascertain the possible jurisdictional implications of the recent measures.

C. Structural Policy—Cementing Gains in Exports

Diagnostics

28. A low tax regime, competitive wages and improved business environment have been successful in attracting FDI and benefiting exports and employment. FYR Macedonia, ranked overall at 30th, is among the best performers in the region according to the World Bank's Doing Business indicators. FDI, particularly in manufacturing, has helped transform the structure of exports in favor of automobile and chemical products in recent years. Major German, American, British, and, more recently, Belgian firms have started outsourcing the production of components. These trends have resulted in steady gains in the world market and the EU.[3]

FYR Macedonia and Comparator Economies: Rank on the Ease of Doing Business, 2015 1/



Source: World Bank Doing Business 2015.
Note: 1/ Graphed as distance from frontier score, indicated on a scale from 0 to 100, where 0 represents the worst performer and 100 the frontier.

29. An assessment of FYR Macedonia's external sustainability shows no major misalignment of the exchange rate. The real effective exchange rate, which has remained stable in recent years, partly driven by the deflation experienced since 2014 shows a moderate undervaluation in assessment under all three approaches: macroeconomic balance, equilibrium exchange rate and external stability (Box 5). Other price competitiveness indicators, such as labor costs, are more or less in line with productivity (Figure 4). The current account deficit is projected to stay below the level estimated as the norm according to the macroeconomic balance approach (between 4½–5 percent of GDP) throughout the medium term.

30. While these developments are evidence of FYR Macedonia's export competitiveness, high private sector indebtedness poses risks (text chart). FYR Macedonia is one of the few countries in the region where private sector debt has continued to increase in post-crisis years, driven by external borrowing. Recent FDI inflows have largely been in the form of intercompany debt, as opposed to equity. A cross-country analysis shows FYR Macedonia's private sector debt level to be too high compared to fundamentals, such as interest costs and growth potential, despite

[3] See Selected Issues Paper, *Export Competitiveness in FYR Macedonia*.

a favorable medium-term growth outlook (see Central, Eastern and Southeastern Europe Spring 2015 Regional Economic Issues).

Box 5. External Sustainability Assessment

Updated CGER estimates suggest some moderate undervaluation of the real exchange rate relative to the level consistent with medium-term fundamentals—partially reflecting the headline deflation experienced throughout 2014 and, for the Macroeconomic Balance approach, the sharp reduction of the current account deficit recorded at the end of the year.

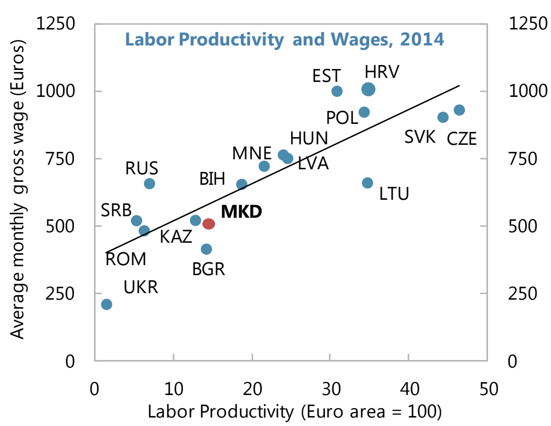
FYR Macedonia: Estimated REER Misalignment

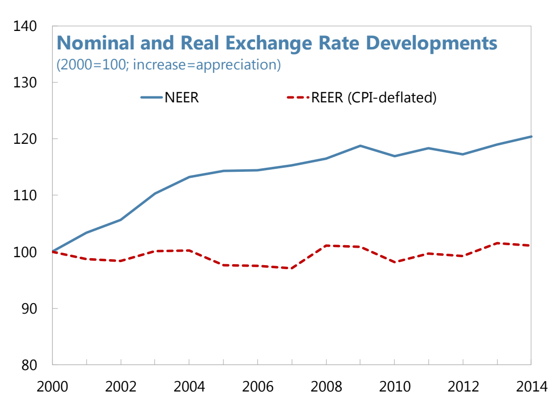
Approach	Magnitude of Misalignment
Macroeconomic Balance	-7.0
Equilibrium REER	0.3
External Stability	-3.8
Overall Assessment	No Significant Misalignment

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

Under the EBA-lite methodology, with "desirable policy values" set as follows: (i) cyclically adjusted fiscal balance corresponding to the debt-stabilizing primary balance of -1.3 percent of GDP minus long-term interest payments estimated at 1.3 percent of GDP; (ii) constant capital control index, (assessed so far at 0.55); (iii) constant share of private credit to GDP (slightly below 50 percent); and (iv) constant reserve-to-GDP ratio (at 28.5 percent at the end of 2014), the undervaluation of the real exchange rate appears even larger, with a computed gap of -7.3 percent. The EBA estimations improve on CGER methodology by expanding the range of explanatory variables used to calculate the real exchange rate and current account norms, notably including foreign aid and remittances in the case of emerging economies.

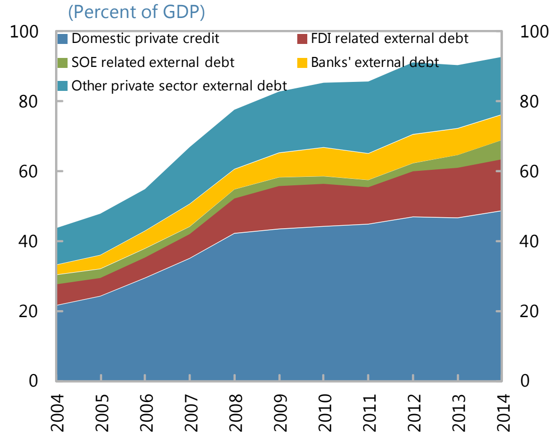
Both sets of results should, however, be interpreted with some cautions for a country where the goods and services deficit is above 17 percent of GDP in 2014, offset by foreign remittances. While remittances flows have traditionally proven quite stable over time, they should be considered an exhaustible resource for external vulnerability assessment in the long run. Ensuring competitiveness would require vigilance so that remittances do not create Dutch disease-type developments, for example by increasing reservation wages too high. So far, cost competitiveness seems broadly in line with productivity developments and the real effective exchange rate remains stable.



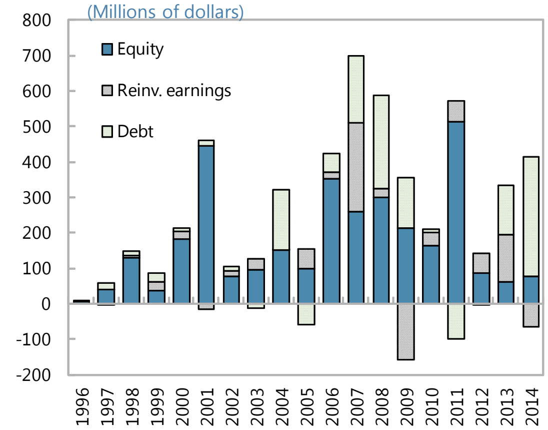


Sources: IMF, IFS; and IMF staff calculations.

[1] International Monetary Fund (2013), "External Assessment in Special Cases", October.



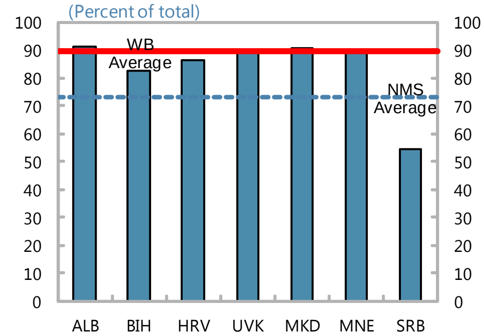
Source: NBRM.



Source: NBRM.

31. Spillovers from the TIDZ to the domestic economy remain limited. Export products stemming from these zones, which represent more than a third of total exports in 2014, have large import contents, and anecdotal evidence suggests limited spillover to domestic suppliers, partly owing to their inability to meet technical and safety requirements for exports to the EU.

32. In addition, the domestic private sector seems to have benefited less from the improving business environment. Small domestic firms face credit constraints due to high collateral requirements, which on average stand at 250 percent of the loan value. Over 90 percent of firm loans require collateral, which reflects banks' practice to lend on the basis of physical assets that can be pledged rather than on the basis of business plans and cash flow projections, resulting in high reliance on self finance. Delays in collecting payments, which on average require four months, also create widespread liquidity constraints for the domestic private sector.



Sources: World Bank Enterprise Survey; and IMF staff calculations.
Notes: NMS includes Bulgaria; Czech Republic; Estonia; Hungary; Latvia; Lithuania; Poland; Romania; Slovak Republic; and Slovenia. WB includes Albania (ALB); Bosnia and Herzegovina (BIH); Croatia (HRV); Kosovo (UVK); Macedonia (MKD); Montenegro (MNE); and Serbia (SRB).

Discussion

33. The authorities agreed with staff's assessment that continued success in FDI will require second generation reforms. Given that tax rates are among the lowest in the region, further success in FDI and exports, particularly to increase their domestic value added content, will require structural reforms to boost higher education and skills, and providing better infrastructure. These reforms will also enhance growth potential which is needed to carry the rising debt burden.

34. Staff stressed the need to remove impediments affecting the domestic private sector. Policies to help build technical and managerial skills that would improve reliability and quality of products and business planning would help link the domestic private sector with foreign companies operating in the TIDZ. In addition, improving access to finance, reducing payment delays and removing regulatory hurdles are important, particularly for small businesses. The authorities are aware of these challenges and mentioned regular dialogue with both domestic private sector and foreign investors. However, private sector stakeholders point to the weak implementation of the Financial Discipline Law that aims to enforce timely payments and noted little progress regarding the clarification of the mandate of the numerous inspection bodies.

STAFF APPRAISAL

35. The broad-based GDP growth is expected to continue in 2015 but moderate to 3.2 percent. Benefiting from strong fiscal stimulus, dynamic credit growth and improving foreign investment, FYR Macedonia has been experiencing one of the highest economic growth rates in the region. However, more recently, domestic political uncertainties and the crisis in Greece are serving to slow momentum as confidence weakens. A possible worsening on both fronts constitute significant downside risks to the outlook.

36. Fiscal consolidation should be a priority. The general government debt to GDP ratio has nearly doubled since 2008. In light of the broad-based economic recovery and looming risks facing the outlook, fiscal consolidation needs to be stepped up. Underperformance of VAT and non-tax revenues, as well as wage increases and additional security-related capital expenditures, are likely to result in a higher-than-budgeted overall fiscal deficit in 2015 despite strong performance in profit and excise tax revenues. The supplementary budget currently under consideration should identify compensating measures, including scaling back increase in goods and services spending and collecting tax arrears, to ensure a deficit of 3.6 percent of GDP. Fiscal consolidation should continue in the medium-term to reduce the overall deficit to below 3 percent of GDP in line with the authorities' medium-term fiscal strategy and keep public debt comfortably below 50 percent of GDP.

37. The plan to enshrine sustainability in fiscal rules is a step in the right direction, but more needs to be done to ensure adequate policy space. The planned debt ceiling of 60 percent of GDP is too high for a country like FYR Macedonia where fiscal policy serves as the main counter-cyclical policy tool, and further room needs to be created to accommodate long-term spending pressures in pension and health from an ageing population. The proposed debt ceiling should be complemented by a lower operational threshold or debt brake at 50 percent of GDP in line with other countries in the region to create adequate policy space.

38. Successful implementation of fiscal rules also requires a robust public finance infrastructure. The current weak linkages between the medium-term and the annual budget process, and over-optimistic revenue projections reveal weaknesses which would need to be resolved prior to the fiscal rules coming into force in 2017. Strengthening institutional arrangements to support a robust medium-term budgeting framework, better macroeconomic forecasting, and effective and transparent budget execution would be important. In this context, the expansion of public investment in infrastructure needs to be complemented by clear and transparent procedures to assess, select, prioritize, and monitor projects.

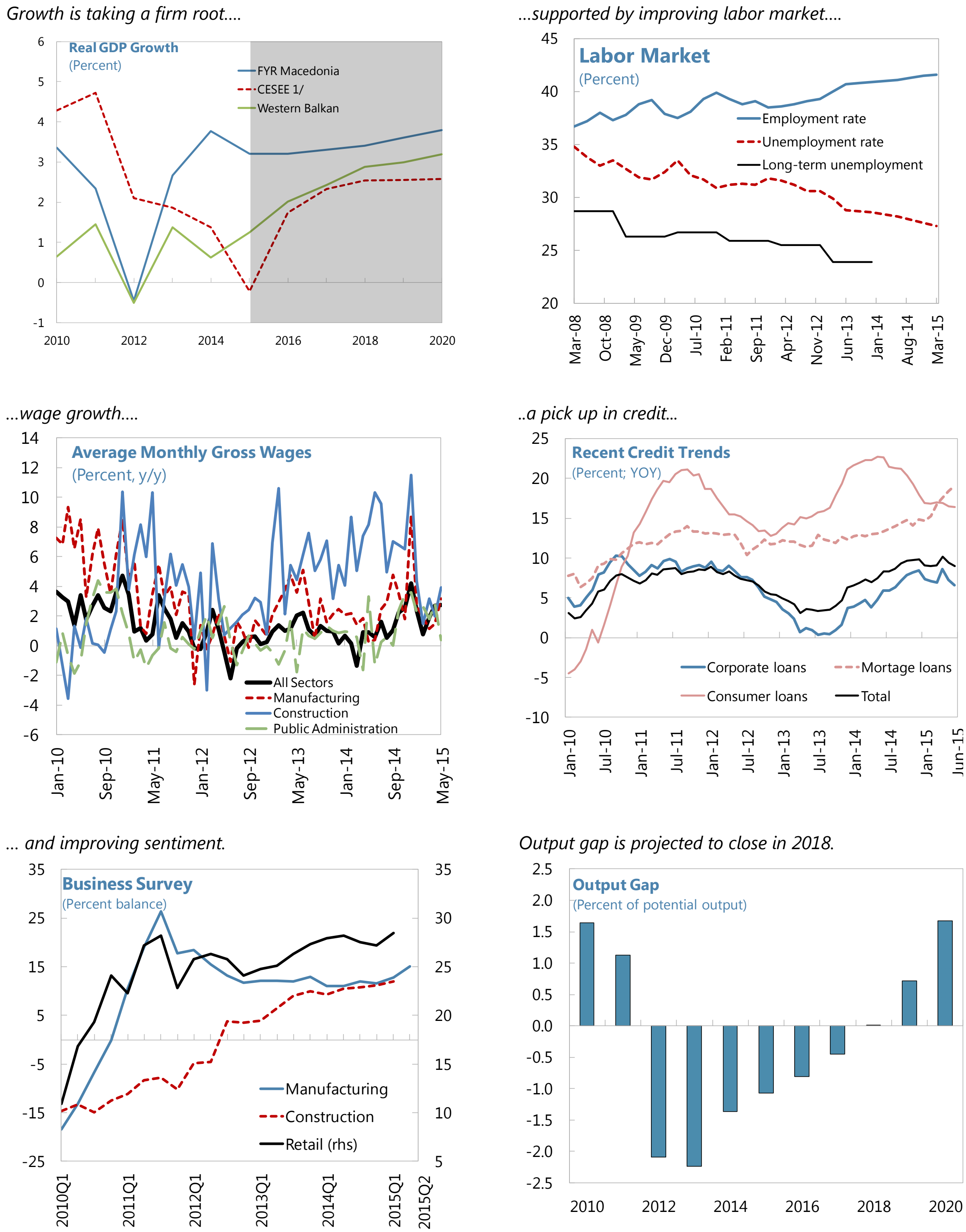
39. Monetary tightening should start in case of signs of demand pressures or financial stability risks. Over the past two years, the central bank has used reserve requirements and the low policy rate to appropriately support the resumption of credit growth. A negative output gap and very low inflation do not yet call for monetary tightening while high excess liquidity also serves as a buffer against possible spillovers from Greece. However, with credit growth picking up, the authorities should stand ready to tighten policies, including using macro-prudential instruments, in case of domestic demand pressures or signs of financial stability risks. This would also help preserve the ongoing process of de-euroization.

40. The financial sector remains healthy, while spillover risks from Greece are being closely monitored. Banks, including the two Greek-owned subsidiaries, are well-capitalized, highly liquid and increasingly funded by domestic deposits. Nonperforming loan ratios have stabilized and these loans remain fully provisioned. Since 2010, the authorities have strengthened their supervisory framework and crisis management tools to contain possible spillovers from Greece. Communication and exchange of information within the European Single Supervisory Mechanism (SSM) has also been intensified. Given the limitations of the CFMs, including the possibility of circumventions, enhanced monitoring and strengthened prudential measures currently in place are warranted to counter possible contagion effects from Greece.

41. A key challenge going forward is to cement recent gains in exports and FDI to raise potential growth. A low tax regime, competitive wages and improving business environment have been successful in attracting FDI and boosting exports and employment. However, the domestic private sector has benefited less from improving business environment while spillovers from the Technological Industrial Development Zones to the domestic economy remain limited. Going forward, structural reforms are needed to ensure a broad-based sharing of prosperity. This would entail further efforts to ensure easier access to credit for firms, shortening delays in collecting payments, including from the public sector, a more predictable legal and regulatory framework, boosting labor skills, and streamlining the role of numerous inspection bodies.

42. It is recommended that the next Article IV consultation with FYR Macedonia be held on the standard 12-month cycle.

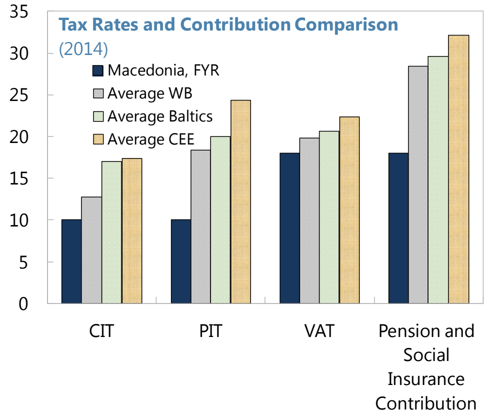
Figure 1. FYR Macedonia: Real Sector Developments, 2010–2015



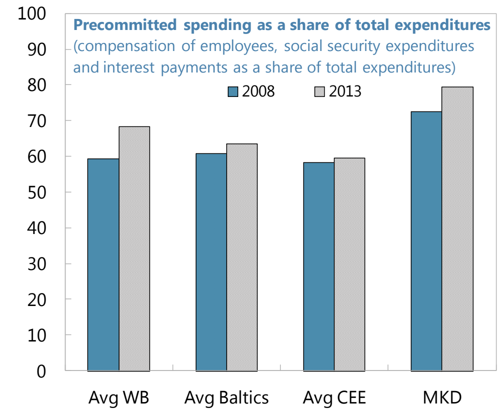
Sources: National authorities; and IMF staff calculations.
Note: 1/ CESEE: Albania, Belarus, Bulgaria, FYR Macedonia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, FYR Macedonia, Moldova, Poland, Romania, Russia, Serbia, Slovakia, Slovenia, Ukraine, and Turkey. Western Balkan includes Albania, Bosnia, Bulgaria, FYR Macedonia, Kosovo, FYR Macedonia , Montenegro, and Serbia.

Figure 2. FYR Macedonia: Fiscal Sector Developments, 2008–2014

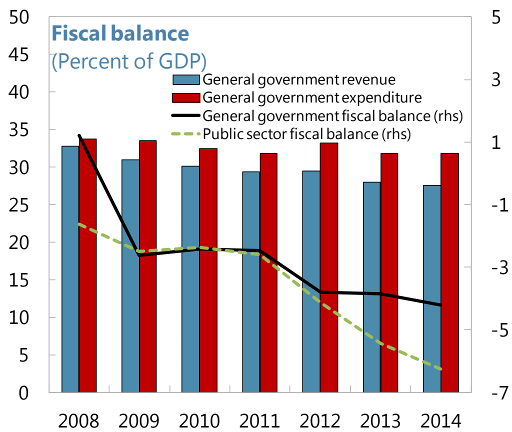
Low tax and contribution rates....



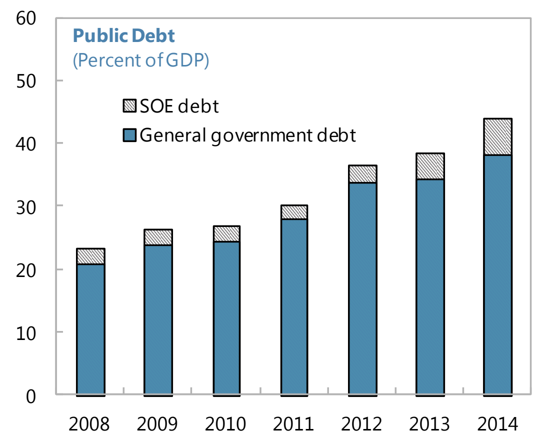
..and a high share of pre-committed spending....



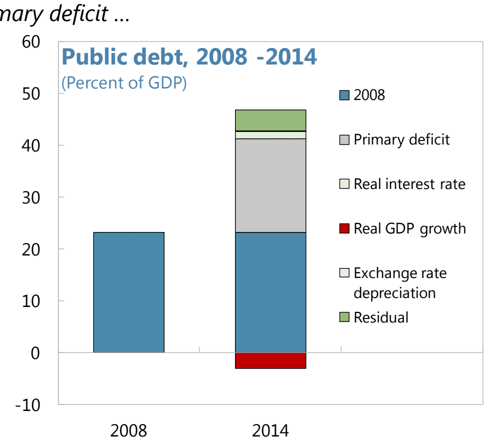
..have contributed to widening deficits ....



...and a near-doubling of public debt since 2008.



Most of the increase in public debt is due to higher primary deficit ...



..with FYR Macedonia among the countries in the region with a non-debt-stabilizing primary deficit. 1/

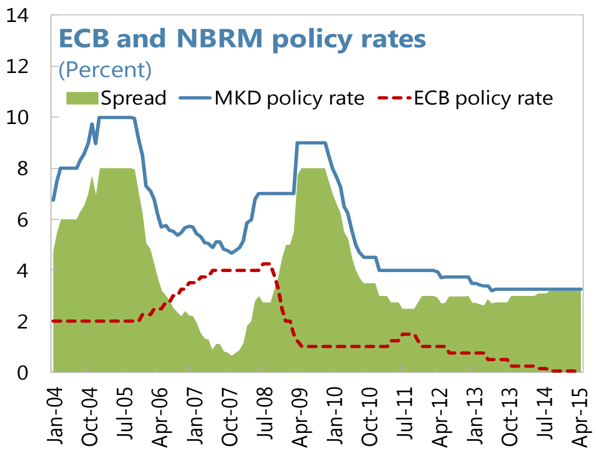
Gap between debt-stabilizing and actual primary balance

Country	2008	2011	2013
Belarus	-4.8	-4	0.1
Bosnia	-1.7	1.1	-0.5
Bulgaria	-4.6	3.9	-0.1
Croatia	-1.1	3.5	2.8
Czech Republic	-0.8	2.2	-0.5
Hungary	-1	2.1	-0.8
Latvia	4.1	1.1	-0.5
Lithuania	2.7	3.1	-0.3
Macedonia, FYR	-0.1	1.3	1.7
Poland	0.6	1.4	0.8
Romania	2.5	2	-0.3
Russia	-0.2	-0.5	1
Serbia	0.3	1.5	3.8
Slovak Republic	1.2	2.3	0.3
Slovenia	-1.3	4.7	3.5
Turkey	-1.5	-2.2	-1.1
Ukraine	1.5	1.4	-1

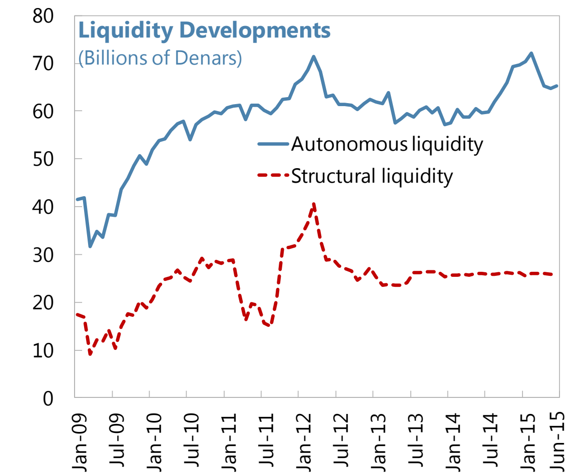
Sources: National authorities; and IMF staff calculations. Note: 1/ The color red indicates a non-stabilizing primary balance. WB stands for Western Balkan countries: Albania, Bosnia and Herzegovina, FYR Macedonia and Montenegro and CEE include Bulgaria, Czech Republic, Hungary, Poland, Slovak Republic, and Slovenia.

Figure 3. FYR Macedonia: Monetary Sector Development, 2004–2015

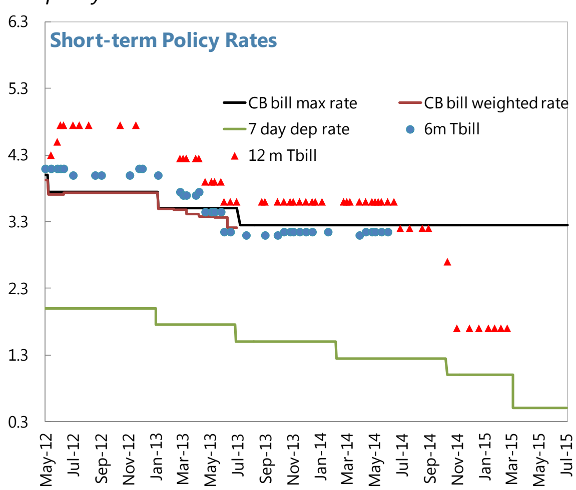
The easing cycle has stopped....



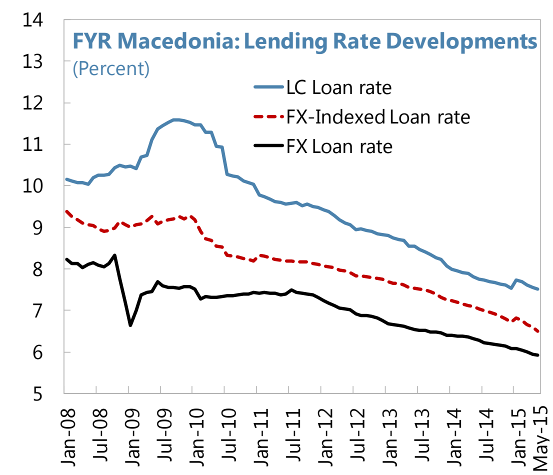
.. with high liquidity in the system.



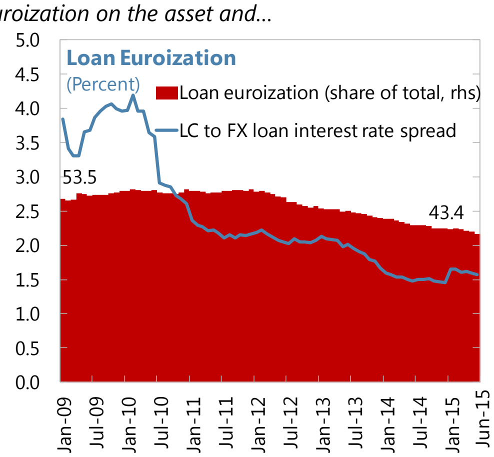
Low policy rates...



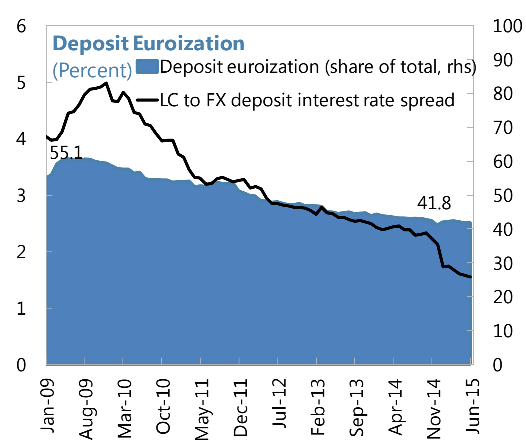
.. ..have put downward pressures on lending rates.



However positive LC/FX spreads have helped reduce euroization on the asset and...



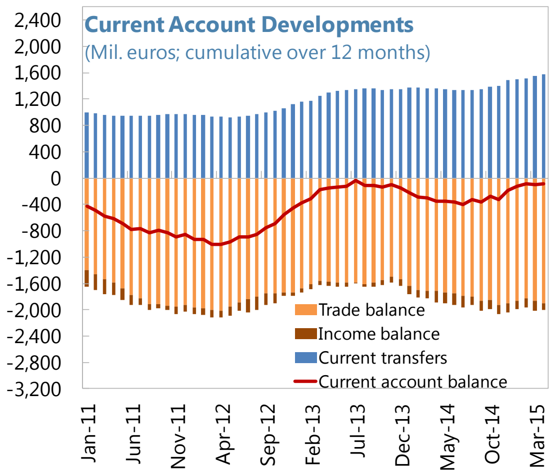
... the liability side.



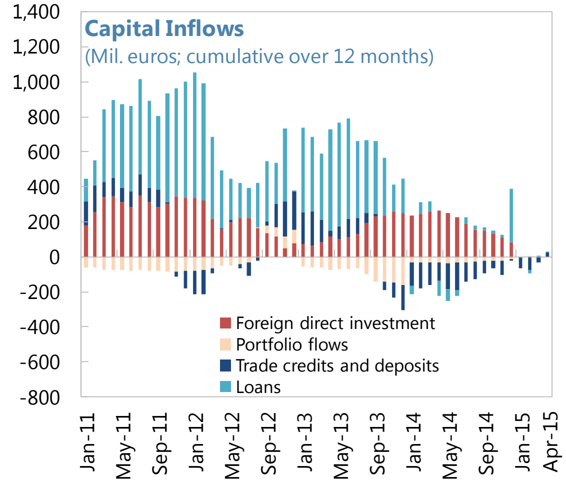
Sources: NBRM; and IMF staff calculations.
Note: Autonomous liquidity is computed as the sum of net foreign assets, net public sector assets, net bank assets, other items net, minus currency in circulation. Structural liquidity is calculated as autonomous liquidity minus reserves held by banks at the central bank.

Figure 4. FYR Macedonia: External Sector Developments, 2008–2015

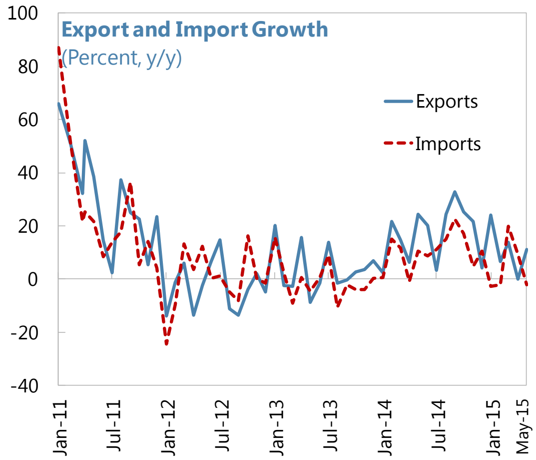
The current account has improved since 2012....



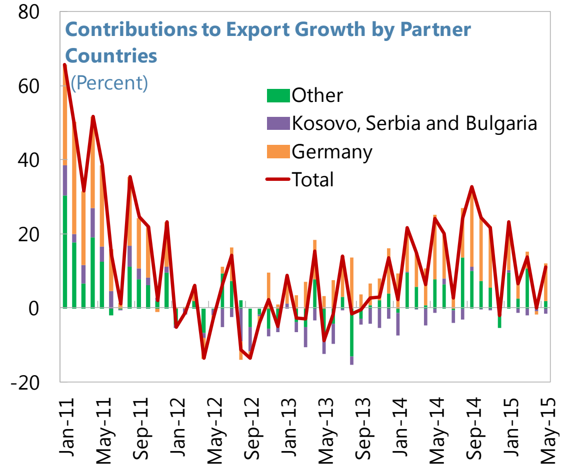
..and is largely financed by FDI.



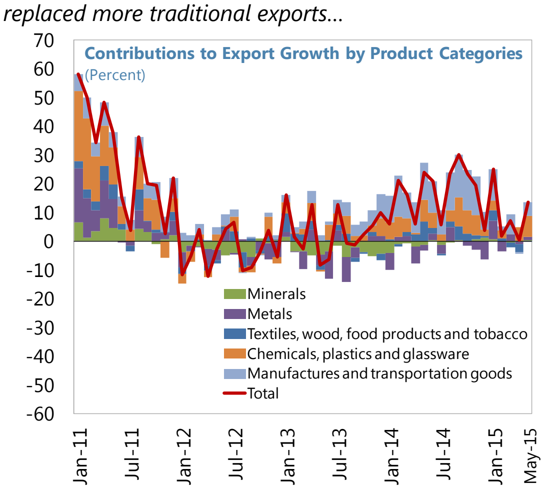
Exports continue to grow strongly..



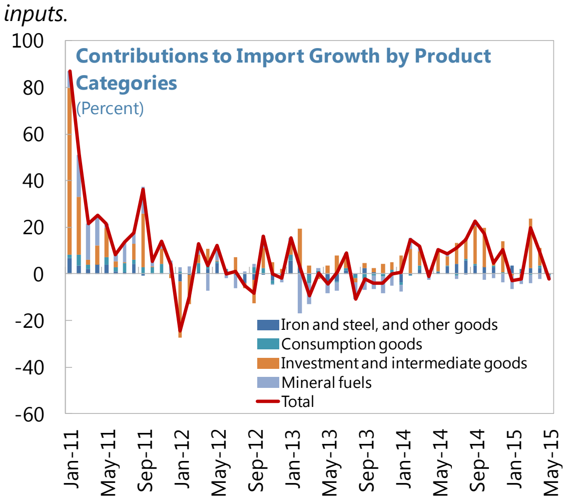
..notably to partners outside the Balkan region.



The automobile and chemical sectors have increasingly replaced more traditional exports...



..while imports growth is largely driven by intermediate inputs.



Sources: Macedonian authorities; and IMF staff calculations.

Table 1. FYR Macedonia: Macroeconomic Framework, 2011–2020

(Year-on-year change, unless otherwise indicated)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
					Proj.					
Real GDP	2.3	-0.5	2.7	3.8	3.2	3.2	3.3	3.4	3.6	3.8
Real domestic demand	0.4	3.5	-2.6	4.2	3.8	3.5	3.1	3.1	3.2	3.2
Private consumption	-5.4	1.2	2.1	2.3	2.0	2.1	2.2	2.4	2.6	2.6
Gross investment	17.9	10.2	-16.6	13.5	7.5	6.5	5.6	5.4	5.0	5.0
Exports (volume)	16.1	2.0	-2.7	17.0	7.7	6.7	8.8	8.2	7.6	6.9
Imports (volume)	8.0	8.2	-10.0	14.5	7.7	6.5	7.1	6.7	6.1	5.3
Contributions to growth 1/										
Domestic demand	0.5	4.0	-3.1	5.1	4.3	4.0	3.5	3.6	3.7	3.6
Net exports	1.7	-3.9	5.0	-0.9	-1.1	-0.8	-0.2	-0.2	-0.1	0.2
Output gap (percent of potential GDP)	1.1	-2.1	-2.2	-1.4	-1.1	-0.8	-0.5	0.0	0.7	1.7
General government operations (percent of GDP)										
Revenues	29.4	29.4	28.0	27.6	29.1	29.1	28.9	28.9	28.9	28.9
Expenditures	31.9	33.3	31.8	31.8	33.1	33.0	32.4	32.4	32.4	32.4
Of which: capital	3.8	4.0	3.3	3.4	3.9	4.1	3.9	3.9	3.9	3.9
Balance	-2.5	-3.8	-3.9	-4.2	-4.0	-3.8	-3.5	-3.5	-3.5	-3.5
Savings and investment (percent of GDP)										
Domestic saving	24.4	26.0	26.7	29.2	30.2	30.6	31.0	31.4	31.3	31.0
Public	2.5	0.2	-0.5	-0.9	-0.1	0.2	0.4	0.4	0.4	0.4
Private	19.2	25.8	27.2	30.1	30.3	30.4	30.6	31.0	30.9	30.6
Foreign saving	2.5	2.9	1.8	1.3	3.2	4.4	4.3	3.8	3.6	3.5
Gross investment	26.9	28.9	28.5	30.6	33.4	35.0	35.3	35.2	34.9	34.5
Consumer prices										
Period average	3.9	3.3	2.8	-0.3	0.1	1.3	1.8	1.9	2.0	2.0
End-period	2.8	4.7	1.4	-0.4	0.8	1.7	1.8	2.0	2.0	2.0
Private sector credit growth	7.7	5.2	6.3	9.8	7.6	6.4	7.5	7.4	7.3	7.1
Memorandum items:										
Current account balance (percent of GDP)	-2.5	-2.9	-1.8	-1.3	-3.2	-4.4	-4.3	-3.8	-3.6	-3.5
Gross official reserves (millions of euros)	2,069	2,193	1,993	2,434	2,277	2,476	2,704	2,789	2,859	2,998
in percent of ST debt	112	101	107	116	111	121	118	121	134	133
in months of prospective imports	4.9	5.3	4.3	4.9	4.1	4.0	4.0	3.8	3.5	3.7
Gross general government debt (percent of GDP)	27.7	33.7	34.1	38.1	37.0	39.5	41.0	42.5	43.8	44.8
Public and publicly guaranteed debt (percent of GDP) 2	30.1	36.3	38.2	43.5	44.2	48.3	50.9	52.9	53.8	54.1
Foreign direct investment (percent of GDP)	4.6	1.5	3.3	3.3	3.1	3.1	3.4	3.6	3.7	3.8
External debt (percent of GDP)	64.2	68.2	64.3	69.8	68.3	72.2	75.6	76.1	75.9	75.6
Nominal GDP (billions of denars)	464	467	500	526	549	574	602	633	668	708
Nominal GDP (millions of euros)	7,544	7,585	8,112	8,533	8,912	9,322	9,776	10,278	10,844	11,481
GDP per capita (PPP, constant USD 2005)	9,356	9,323	…	…	…	…	…	…	…	…
Gini coefficient	39.2	…	…	…	…	…	…	…	…	…

Sources: NBRM; SSO; MOF; World Bank; and IMF staff estimates and projections. National Accounts are revised by SSO, using ESA 2010 Methodology.

Note: 1/ The inconsistency between Real GDP growth and contributions to growth results from discrepancies in the official data on GDP and its components.
Note: 2/ Including general government and public sector non-financial enterprises.

Table 2A. FYR Macedonia: Central Government Operations, 2010–2020

(Billions of denars)

	2010	2011	2012	2013	2014			2015		2016		2017		2018	2019	2020
					Buget			Budget								
					Original	Revised	Act.	Original	Proj.	MTS	Proj.	MTS	Proj.	Proj.	Proj.	Proj.
Total Revenues	131.6	136.4	137.4	139.7	158.2	155.6	145.2	162.5	159.9	168.1	167.3	174.4	173.9	182.8	192.9	204.2
Tax Revenues and Contributions	112.4	118.7	117.4	121.0	133.9	131.4	129.3	137.7	138.0	142.5	145.2	148.5	151.5	159.3	168.1	178.0
PIT	8.9	9.5	9.6	10.3	10.7	11.2	12.3	11.5	12.5	11.8	11.8	12.3	12.3	12.9	13.7	14.5
CIT	3.7	3.9	3.7	4.4	4.2	5.0	5.1	5.1	11.8	5.3	10.6	5.5	11.0	11.6	12.2	12.9
VAT (net)	37.7	42.2	38.5	39.8	48.5	44.5	43.9	45.7	41.1	47.1	44.8	48.9	46.6	49.0	51.7	54.7
Excises	14.9	15.5	16.6	16.0	15.8	16.9	17.4	17.4	18.6	17.9	19.5	18.6	20.4	21.5	22.6	24.0
Custom Duties	4.7	3.8	4.1	4.3	4.1	4.7	4.2	4.8	4.8	5.0	5.0	5.2	5.2	5.5	5.8	6.1
Other Taxes	3.9	4.0	4.3	3.8	5.3	4.4	2.3	4.4	2.3	4.5	4.5	4.6	4.6	4.9	5.2	5.5
Social Contributions	38.7	39.8	40.8	42.5	45.2	44.7	44.2	48.7	46.8	51.0	49.0	53.3	51.4	54.0	57.0	60.3
Pensions	26.1	26.9	27.5	28.7	30.6	30.2	29.7	33.3	31.7	34.8	33.2	36.5	36.5	38.4	40.5	42.9
Unemployment	1.7	1.7	1.7	1.8	1.9	1.9	1.9	2.0	2.0	2.1	2.1	2.1	2.1	2.2	2.3	2.4
Health	10.9	11.2	11.5	12.0	12.6	12.6	12.6	13.4	13.1	14.1	13.7	14.8	14.8	15.5	16.4	17.4
Non-Tax Revenues	12.1	12.5	12.4	11.6	14.5	14.2	10.4	17.1	14.5	17.9	15.2	18.2	15.4	16.2	17.1	18.1
Capital Revenues	5.6	4.1	4.6	3.7	5.7	4.6	2.1	4.2	3.7	4.2	3.4	4.2	3.4	3.5	3.7	3.9
Grants	1.5	1.1	3.0	3.5	3.5	4.5	3.4	3.6	3.6	3.6	3.6	3.6	3.6	3.8	4.0	4.2
Expenditures	142.2	147.9	155.2	159.0	176.5	175.2	167.3	181.0	181.7	187.1	189.4	192.6	195.0	205.0	216.3	229.0
Current Expenditures	127.4	130.9	137.1	142.9	154.1	154.1	150.4	160.6	161.2	165.7	166.8	171.2	172.3	181.2	191.1	202.4
Wages and salaries	22.6	23.1	22.7	22.6	23.7	23.6	23.1	24.5	25.1	24.4	25.1	24.4	25.1	26.3	27.8	29.4
Goods and services	14.7	14.0	14.7	14.9	18.7	18.6	15.5	18.7	18.7	18.7	18.7	18.7	18.7	19.7	20.8	22.0
Transfers	86.9	90.4	95.5	100.8	107.4	107.4	106.8	111.4	111.4	115.5	115.5	119.9	119.9	126.0	133.0	140.8
Pensions	37.6	39.2	40.9	44.9	48.1	48.2	48.1	50.2	50.2	53.2	53.2	56.4	56.4	59.3	62.5	66.2
Health	19.3	20.5	20.9	21.4	22.2	22.2	22.1	23.5	23.5	24.4	24.4	25.5	25.5	26.8	28.3	30.0
Other	29.9	30.6	33.7	34.5	37.1	37.0	36.6	37.8	37.8	37.8	37.8	38.0	38.0	39.9	42.1	44.6
Interest	3.2	3.5	4.2	4.6	4.4	4.4	5.1	6.0	6.0	7.0	7.5	8.2	8.7	9.1	9.6	10.2
Capital Expenditures	15.3	17.7	18.8	16.6	22.4	21.1	17.6	21.2	21.3	22.2	23.4	22.2	23.4	24.6	26.0	27.5
Lending minus repayment 1/	-0.5	-0.8	-0.6	-0.6	-0.6	-0.8	-0.7	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8	-0.9	-0.9
Overall fiscal balance	-10.5	-11.5	-17.8	-19.3	-18.3	-19.6	-22.1	-18.5	-21.8	-19.0	-22.1	-18.3	-21.1	-22.1	-23.4	-24.7
Financing	10.5	11.5	17.7	19.3	18.3	19.6	22.1	18.5	21.9	19.0	22.1	18.3	21.1	22.2	23.4	24.8
Domestic	5.3	-9.4	13.3	13.1	22.0	-8.3	-6.1	22.2	40.2	9.9	11.4	9.0	13.6	21.3	18.6	18.5
Central Bank deposits	3.4	-7.3	-12.3	-0.3	13.9	-12.7	-5.4	23.4	19.4	0.3	-1.4	-1.0	0.7	0.0	0.0	0.0
Other domestic financing	1.9	-2.1	25.6	13.4	8.1	4.4	-0.8		20.7		12.8		12.8	21.3	18.6	18.5
Privatization receipts	0.0	0.3	0.1	0.6	0.1	0.1	0.5	0.1	0.0	0.1	0.0	0.1	0.0	0.0	0.0	0.0
Foreign	5.2	20.6	4.3	5.6	-3.9	27.8	27.8	-3.8	-18.3	9.0	10.7	9.1	7.5	0.9	4.8	6.3
Memo items:																
Gross general government debt (in percent of GDP)	24.1	27.7	33.7	34.2			38.2		37.1		39.6		41.1	42.6	43.9	44.9
Nominal GDP (billions of denars)	437	464	467	500	526	526	526	549	549	574	574	602	602	633	668	708
Stock of government deposits at the NBRM (EUR mln eop)	11.4	7.7	19.5	18.8			370.0		54.8		77.3		65.2	65.2	65.2	65.2
Public and publicly guaranteed debt (in percent of GDP) 2/							43.5		44.2		48.3		50.9	52.9	53.8	54.1

Sources: IMF Staff and MoF estimates.

Notes:

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

2/ Including general government and non-financial SOEs.

Table 2B. FYR Macedonia: Central Government Operations, 2010–2020

(Percent of GDP)

	2010	2011	2012	2013	2014			2015		2016		2017		2018	2019	2020
					Buget			Budget								
					Original	Revised	Act.	Original	Proj.	MTS	Proj.	MTS	Proj.	Proj.	Proj.	Proj.
Total Revenues	30.1	29.4	29.4	28.0	30.1	29.6	27.6	29.6	29.1	29.3	29.1	28.9	28.9	28.9	28.9	28.9
Tax Revenues and Contributions	25.7	25.6	25.2	24.2	25.5	25.0	24.6	25.1	25.1	24.8	25.3	24.7	25.2	25.2	25.2	25.2
PIT	2.0	2.0	2.0	2.1	2.0	2.1	2.3	2.1	2.3	2.1	2.1	2.0	2.0	2.0	2.0	2.0
CIT	0.8	0.8	0.8	0.9	0.8	1.0	1.0	0.9	2.2	0.9	1.8	0.9	1.8	1.8	1.8	1.8
VAT (net)	8.6	9.1	8.2	8.0	9.2	8.5	8.3	8.3	7.5	8.2	7.8	8.1	7.7	7.7	7.7	7.7
Excises	3.4	3.3	3.6	3.2	3.0	3.2	3.3	3.2	3.4	3.1	3.4	3.1	3.4	3.4	3.4	3.4
Custom Duties	1.1	0.8	0.9	0.9	0.8	0.9	0.8	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Other Taxes	0.9	0.9	0.9	0.8	1.0	0.8	0.4	0.8	0.4	0.8	0.8	0.8	0.8	0.8	0.8	0.8
Social Contributions	8.8	8.6	8.7	8.5	8.6	8.5	8.4	8.9	8.5	8.9	8.5	8.9	8.5	8.5	8.5	8.5
Pensions	6.0	5.8	5.9	5.7	5.8	5.7	5.7	6.1	5.8	6.1	5.8	6.1	6.1	6.1	6.1	6.1
Unemployment	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.3	0.3	0.3	0.3	0.3
Health	2.5	2.4	2.5	2.4	2.4	2.4	2.4	2.4	2.4	2.4	2.4	2.5	2.5	2.5	2.5	2.5
Non-Tax Revenues	2.8	2.7	2.7	2.3	2.8	2.7	2.0	3.1	2.6	3.1	2.6	3.0	2.6	2.6	2.6	2.6
Capital Revenues	1.3	0.9	1.0	0.7	1.1	0.9	0.4	0.8	0.7	0.7	0.6	0.7	0.6	0.6	0.6	0.6
Grants	0.3	0.2	0.7	0.7	0.7	0.9	0.6	0.7	0.7	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Expenditures	32.5	31.9	33.3	31.8	33.6	33.3	31.8	33.0	33.1	32.6	33.0	32.0	32.4	32.4	32.4	32.4
Current Expenditures	29.1	28.2	29.4	28.6	29.3	29.3	28.6	29.2	29.3	28.8	29.0	28.4	28.6	28.6	28.6	28.6
Wages and salaries	5.2	5.0	4.9	4.5	4.5	4.5	4.4	4.5	4.6	4.3	4.4	4.1	4.2	4.2	4.2	4.2
Goods and services	3.4	3.0	3.1	3.0	3.5	3.5	2.9	3.4	3.4	3.3	3.3	3.1	3.1	3.1	3.1	3.1
Transfers	19.9	19.5	20.5	20.2	20.4	20.4	20.3	20.3	20.3	20.1	20.1	19.9	19.9	19.9	19.9	19.9
Pensions	8.6	8.5	8.8	9.0	9.2	9.2	9.1	9.1	9.1	9.3	9.3	9.4	9.4	9.4	9.4	9.4
Health	4.4	4.4	4.5	4.3	4.2	4.2	4.2	4.3	4.3	4.3	4.3	4.2	4.2	4.2	4.2	4.2
Other	6.8	6.6	7.2	6.9	7.0	7.0	7.0	6.9	6.9	6.6	6.6	6.3	6.3	6.3	6.3	6.3
Interest	0.7	0.7	0.9	0.9	0.8	0.8	1.0	1.1	1.1	1.2	1.3	1.4	1.4	1.4	1.4	1.4
Capital Expenditures	3.5	3.8	4.0	3.3	4.3	4.0	3.4	3.9	3.9	3.9	4.1	3.7	3.9	3.9	3.9	3.9
Lending minus repayment 1/	-0.1	-0.2	-0.1	-0.1	-0.1	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Overall fiscal balance	-2.4	-2.5	-3.8	-3.9	-3.5	-3.7	-4.2	-3.4	-4.0	-3.3	-3.8	-3.0	-3.5	-3.5	-3.5	-3.5
Financing	2.4	2.5	3.8	3.9	3.5	3.7	4.2	3.4	4.0	3.3	3.8	3.0	3.5	3.5	3.5	3.5
Domestic	1.2	-2.0	2.8	2.6	4.2	-1.6	-1.2	4.0	7.3	1.7	2.0	1.5	2.3	3.4	2.8	2.6
Central Bank deposits	0.8	-1.6	-2.6	-0.1	2.6	-2.4	-1.0	4.3	3.5	0.0	-0.2	-0.2	0.1			
Other domestic financing	0.4	-0.5	5.5	2.7	1.5	0.8	-0.1		3.8		2.2		2.1	3.4	2.8	2.6
Privatization receipts	0.0	0.1	0.0	0.1	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	1.2	4.4	0.9	1.1	-0.7	5.3	5.3	-0.7	-3.3	1.6	1.9	1.5	1.2	0.1	0.7	0.9
Memo items:																
Gross general government debt (in percent of GDP)	24.1	27.7	33.7	34.2			38.2		37.1		39.6		41.1	42.6	43.9	44.9
Nominal GDP (billions of denars)	437.3	464.2	466.7	499.6	525.8	525.8	525.8	549.2	549.2	574.5	574.5	602.4	602.4	633.4	668.3	707.5
Stock of government deposits at the NBRM (EUR mln eop)	11.4	7.7	19.5	18.8			370.0		54.8		77.3		65.2	65.2	65.2	65.2
Public and publicly guaranteed debt (in percent of GDP) 2/							43.5		44.2		48.3		50.9	52.9	53.8	54.1

Sources: IMF Staff and MoF estimates.

Notes:

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

2/ Including general government and non-financial SOEs.

Table 3. FYR Macedonia: Balance of Payments, 2011–2020

(Millions of euros, unless otherwise indicated)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
					Projections					
Current account	-189	-224	-147	-114	-289	-413	-422	-393	-390	-405
Trade balance	-1905	-2008	-1858	-1856	-2030	-2225	-2345	-2444	-2523	-2566
Exports	2396	2307	2370	2779	2818	3056	3401	3765	4141	4529
Imports	4301	4315	4228	4635	4848	5281	5746	6209	6664	7095
Services (net)	359	309	361	358	367	425	485	565	632	671
Primary Income (net)	-131	-148	-212	-225	-270	-324	-356	-392	-431	-517
Secondary Income (transfers, net)	1487	1622	1563	1609	1644	1711	1793	1877	1932	2007
Of which										
Official	77	60	74	83	72	77	77	75	76	76
Private	1411	1562	1488	1526	1572	1634	1716	1802	1856	1930
Of which: Cash exchange	1054	1190	1107	1093	1125	1170	1229	1290	1329	1382
Capital account (net)	-2	9	15	9	7	7	9	9	8	8
Net lending (+) / Net borrowing (-)	-192	-215	-132	-105	-282	-406	-413	-383	-381	-397
Financial account	-511	-338	-72	-482	-125	-605	-640	-468	-452	-535
Direct investment (net)	-345	-117	-264	-278	-276	-289	-332	-370	-401	-436
Portfolio investment (net)	76	-77	159	-482	175	-282	-188	-116	-144	-146
Of which: Eurobonds amortizations	0	0	175	0	150	0	0	0	0	0
Of which: Eurobonds disbursements	0	0	0	491	0	300	200	125	150	150
Other investment	-242	-144	32	279	-24	-34	-120	18	93	47
Trade credits (net)	40	-156	113	0	-113	-65	-68	-72	-76	-80
MLT loans (net)	-528	-43	-341	-65	-105	-204	-294	-130	-60	-98
Public sector	-378	-57	-282	36	148	127	79	111	72	48
Disbursements	457	161	379	117	71	74	70	110	110	110
of which : IMF credit	221	0	0	0	0	0	0	0	0	0
Amortization	-89	-99	-102	-149	-219	-201	-149	-221	-182	-158
Banks	-53	26	-26	-19	10	-45	-63	-57	-85	-95
Other sectors	-97	-13	-33	-82	-263	-286	-310	-184	-47	-52
ST loans (net)	25	-48	16	2	-36	-37	-39	-41	-43	-46
Currency and deposits (net)	220	104	245	342	230	272	281	261	272	271
Of which: Commercial banks	87	-124	28	81	-5	35	37	22	31	30
Other (net)	0	0	0	0	0	0	0	0	0	0
Errors and omissions	12	19	16	32	0	0	0	0	0	0
Overall Balance	331	142	-44	409	-157	200	228	84	71	139
				(Percent of GDP)						
Current account	-2.5	-2.9	-1.8	-1.3	-3.2	-4.4	-4.3	-3.8	-3.6	-3.5
Of which										
Goods and services balance	-20.5	-22.4	-18.5	-17.6	-18.7	-19.3	-19.0	-18.3	-17.4	-16.5
Private transfers	18.7	20.6	18.3	17.9	17.6	17.5	17.6	17.5	17.1	16.8
FDI (net)	4.6	1.5	3.3	3.3	3.1	3.1	3.4	3.6	3.7	3.8
				(Percentage change, year-on-year)						
Exports of G&S (Value)	26.1	-2.0	4.0	15.6	5.9	12.9	14.0	12.3	9.7	8.6
Volume	16.1	2.0	-2.7	17.0	7.7	6.7	8.8	8.2	7.6	6.9
Price	8.6	-3.8	6.9	-1.2	-1.6	5.8	4.8	3.8	2.0	1.5
Imports of G&S (Value)	20.8	1.7	-1.3	10.9	7.3	11.6	11.1	9.5	7.6	6.7
Volume	8.0	8.2	-10.0	14.5	7.7	6.5	7.1	6.7	6.1	5.3
Price	11.9	-6.0	9.7	-3.1	-0.4	4.8	3.7	2.6	1.4	1.4
Terms of trade (2008=100)	93.7	95.9	93.4	95.3	94.1	95.0	96.0	97.1	97.7	97.9
Memorandum Items:										
Nominal GDP	7544	7585	8112	8533	8912	9322	9776	10278	10844	11481
ST debt at residual maturity (year-end)	2059	2382	2073	2287	2043	2044	2284	2314	2130	2252
Gross foreign exchange reserves	2069	2193	1993	2434	2277	2476	2704	2789	2859	2998
Months of prospective imports of G&S	4.9	5.3	4.3	4.9	4.1	4.0	4.0	3.8	3.5	3.7
Percent of short-term debt (residual maturity)	112.1	101.0	106.5	115.8	111.4	121.2	118.4	120.5	134.2	133.1
External debt (percent of GDP)	64.2	68.2	64.3	69.8	68.3	72.2	75.6	76.1	75.9	75.6
Medium and long-term	45.7	48.5	49.3	54.6	49.1	52.9	56.1	56.5	56.2	56.0
Short-term	18.5	19.7	15.0	15.2	19.2	19.4	19.5	19.6	19.6	19.6
External debt service	1718	1892	2214	1917	2147	2095	2101	2345	2378	2475
Percent of exports of G&S	49.9	56.1	63.1	47.2	50.0	43.2	38.0	37.8	34.9	33.5
Percent of exports of G&S and transfers	35.4	38.3	44.3	34.3	36.6	32.3	29.0	29.3	27.4	26.5

Sources: NBRM; and IMF staff estimates.

Table 4. FYR Macedonia: Monetary Survey, 2011–2020

(Billions of denars, unless specified otherwise)

	2011	2012	2013				2014				2015	2016	2017	2018	2019	2020
			1Q-13	2Q-13	3Q-13	4Q-13	1Q-14	2Q-14	3Q-14	4Q-14						
NFA	124.7	126.1	128.6	114.3	119.6	114.8	110.9	105.9	145.5	146.4	136.6	147.9	159.9	163.1	164.4	156.9
Central Bank	122.5	128.9	132.8	121.8	122.5	118.2	115.3	111.0	145.5	145.0	135.3	146.5	158.6	161.7	163.1	155.6
Commercial Banks	2.2	-2.8	-4.2	-7.6	-2.9	-3.4	-4.4	-5.0	-0.1	1.3	1.3	1.3	1.3	1.3	1.3	1.3
NDA	130.3	140.2	141.9	152.0	154.2	165.6	175.4	181.8	152.7	163.5	180.9	188.1	207.5	245.6	287.1	341.3
Credit to Government (net)	-1.8	1.9	5.0	6.5	7.7	10.8	19.8	22.8	-6.1	-2.6	26.0	32.6	43.0	54.9	68.7	88.1
From Banks (net)	14.0	29.1	32.4	32.9	34.0	37.0	40.7	37.9	37.4	31.4	39.5	47.5	57.7	71.5	85.4	104.8
of which: Credit (Tbills)	16.7	31.7	34.3	34.7	35.8	38.8	42.5	39.6	39.0	33.3	41.3	49.4	59.5	73.4	87.2	106.7
From Central Bank (net)	-15.8	-27.2	-27.4	-26.4	-26.3	-26.2	-20.9	-15.1	-43.5	-33.9	-13.5	-14.9	-14.7	-16.7	-16.7	-16.7
of which: Deposits	-19.1	-30.4	-30.4	-29.3	-29.2	-29.5	-24.0	-18.0	-46.6	-37.1	-17.6	-19.0	-18.3	-18.3	-18.3	-18.3
Credit to Private Sector (Gross)	208.2	218.9	220.0	224.1	225.5	232.7	236.0	242.7	246.3	255.5	275.0	292.5	314.5	337.8	362.4	388.2
From Banks	208.1	218.8	220.0	224.1	225.4	232.7	236.0	242.6	246.2	255.4	274.9	292.4	314.5	337.7	362.4	388.2
Denars	150.6	164.4	165.0	168.3	171.3	178.4	181.4	187.7	191.1	199.2	214.4	228.1	245.2	263.4	282.6	302.7
FX	57.6	54.4	55.0	55.8	54.1	54.3	54.6	54.9	55.1	56.2	60.5	64.4	69.2	74.3	79.8	85.4
From Central Bank	0.1	0.1	0.1	0.1	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other Items (net)	-76.0	-80.6	-83.1	-78.6	-79.0	-78.0	-80.5	-83.7	-87.4	-89.4	-89.4	-89.4	-89.4	-89.4	-89.4	-89.4
Broad Money (M3)	255.0	266.3	270.5	266.3	273.8	280.4	286.2	287.7	298.2	309.9	317.4	335.9	367.3	408.6	451.5	498.3
Currency in Circulation	19.3	20.1	20.7	20.1	20.0	20.7	20.9	21.2	22.1	23.2	14.6	15.2	16.0	16.8	17.7	18.7
Total Deposits	235.7	246.2	249.8	246.2	253.8	259.7	265.4	266.5	276.1	286.7	302.9	320.7	351.4	391.9	433.8	479.5
Denars	122.3	135.1	137.4	138.4	142.7	147.9	152.1	153.2	159.4	171.1	174.5	184.8	202.4	225.7	249.9	276.2
FX	113.5	111.1	112.4	107.8	111.0	111.7	113.3	113.3	116.7	115.5	128.4	136.0	149.0	166.1	183.9	203.3
	(Percentage change, year-on-year)															
Private Sector Credit	7.7	5.2	3.9	3.1	3.3	6.3	7.3	8.3	9.2	9.8	7.6	6.4	7.5	7.4	7.3	7.1
Broad Money	9.7	4.4	5.0	3.0	5.1	5.3	5.8	8.0	8.9	10.5	2.4	5.8	9.3	11.2	10.5	10.3
Private Sector Deposits	9.3	4.4	4.2	2.7	5.2	5.5	6.2	8.3	8.8	10.4	5.7	5.9	9.6	11.5	10.7	10.5
	(Contribution to annual growth in broad money)															
NFA	10.7	0.5	2.7	-0.4	-1.7	-4.2	-6.6	-3.1	9.5	11.3	-3.2	3.6	3.6	0.9	0.3	-1.7
NDA	-1.0	3.9	2.3	3.5	6.8	9.5	12.4	11.2	-0.5	-0.7	5.6	2.3	5.8	10.4	10.2	12.0
	(Percent of GDP)															
Private Sector Credit	44.8	46.9	46.7	46.5	46.2	46.6	46.1	46.9	47.2	48.7	50.1	50.9	52.2	53.3	54.2	54.9
Broad Money	54.9	57.1	57.4	55.3	56.1	56.2	55.9	55.5	57.1	59.0	57.8	58.5	61.0	64.5	67.6	70.4
Private Sector Deposits	50.8	52.7	53.0	51.1	52.0	52.0	51.8	51.5	52.9	54.6	55.2	55.8	58.3	61.9	64.9	67.8
Memorandum Items:																
Money Multiplier	4.8	4.8	4.9	5.0	5.2	5.2	5.4	5.3	5.3	5.1	6.0	6.0	6.1	6.2	6.3	6.4
Reserve Requirement Ratio (% of deposits)																
Denars	10.0	10.0	10.0	10.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0
FX Indexed	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0
FX	13.0	13.0	13.0	13.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0
Velocity	1.8	1.8	1.7	1.8	1.8	1.8	1.8	1.8	1.8	1.7	1.7	1.7	1.6	1.6	1.5	1.4

Sources: NBRM; and IMF staff estimates.

Table 5. FYR Macedonia: Central Bank Survey, 2011–2020

(Billions of denars, unless specified otherwise)

	2011	2012	2013				2014				2015	2016	2017	2018	2019	2020
			1Q-13	2Q-13	3Q-13	4Q-13	1Q-14	2Q-14	3Q-14	4Q-14						
NFA	122.5	128.9	132.8	121.8	122.5	118.2	115.3	111.0	145.5	145.0	135.3	146.5	158.6	161.7	163.1	155.6
Assets	141.6	143.3	156.2	148.2	144.5	122.7	138.6	134.3	169.1	149.9	140.1	152.4	166.4	171.6	175.9	184.4
Liabilities	-19.1	-14.4	-23.5	-26.3	-22.0	-4.5	-23.3	-23.4	-23.5	-4.8	-4.8	-5.8	-7.8	-9.8	-12.8	-28.8
NDA	-68.9	-73.0	-77.5	-68.4	-70.2	-64.7	-62.0	-56.4	-89.3	-84.2	-82.3	-90.8	-98.4	-96.1	-91.7	-78.0
Banks (net)	-32.2	-26.1	-29.9	-29.3	-31.3	-28.2	-29.6	-29.2	-32.6	-35.6	-54.2	-61.2	-69.1	-64.8	-60.4	-46.7
of which:																
NBRM Bills and short-term facilities	-32.2	-27.1	-31.2	-29.3	-31.3	-28.3	-29.6	-29.3	-32.6	-35.6	-30.6	-47.6	-60.6	-57.6	-54.6	-45.6
Central Government (net)	-13.4	-24.9	-24.8	-23.8	-23.8	-24.1	-18.6	-12.5	-41.0	-31.4	-10.9	-12.3	-12.1	-14.1	-14.1	-14.1
of which:																
Deposits at Central Bank	-19.1	-30.4	-30.4	-29.3	-29.2	-29.5	-24.0	-18.0	-46.6	-37.1	-17.6	-19.0	-18.3	-18.3	-18.3	-18.3
Denar	-7.0	-19.5	-8.2	-11.1	-14.4	-16.3	-12.3	-7.7	-7.1	-8.2	0.6	-0.1	0.3	0.3	0.3	0.3
FX	-12.1	-10.9	-22.1	-18.2	-14.8	-13.1	-11.8	-10.3	-39.6	-28.9	-18.2	-18.9	-18.5	-18.5	-18.5	-18.5
State and Local Governments (net)	-2.3	-2.3	-2.6	-2.5	-2.5	-2.1	-2.3	-2.5	-2.5	-2.6	-2.6	-2.6	-2.6	-2.6	-2.6	-2.6
Other items (net)	-20.9	-19.7	-20.2	-12.8	-12.7	-10.2	-11.5	-12.1	-13.2	-14.6	-14.6	-14.6	-14.6	-14.6	-14.6	-14.6
Reserve Money	53.6	55.9	55.3	53.4	52.3	53.5	53.3	54.6	56.2	60.9	52.9	55.8	60.1	65.6	71.4	77.7
Currency in Circulation	19.3	20.1	20.7	20.1	20.0	20.7	20.9	21.2	22.1	23.2	14.6	15.2	16.0	16.8	17.7	18.7
Other	34.3	35.8	34.6	33.3	32.3	32.8	32.4	33.4	34.0	37.6	38.4	40.5	44.1	48.8	53.7	58.9
Cash in Vaults	3.5	3.9	3.8	4.0	4.1	4.3	4.3	4.2	4.2	4.9	4.9	5.1	5.3	5.5	5.7	5.9
Total Reserves	30.9	32.0	30.8	29.3	28.2	28.4	28.1	29.2	29.8	32.8	33.5	35.5	38.9	43.4	48.0	53.1
on Denar Deposits	16.7	18.9	17.7	16.3	15.7	16.2	15.8	16.7	17.1	20.2	19.4	20.6	22.6	25.2	27.9	30.8
on FX Deposits	14.1	13.0	13.2	13.0	12.6	12.2	12.3	12.5	12.7	12.6	14.1	14.9	16.3	18.2	20.1	22.3
	(Contribution to annual growth in reserve money)															
NFA	44.7	11.9	21.0	4.3	-4.2	-19.2	-31.6	-20.3	44.0	50.3	-16.1	21.3	21.5	5.3	2.1	-10.5
NDA	-35.2	-7.7	-7.7	-1.9	3.0	14.8	28.0	22.5	-36.5	-36.5	3.1	-16.0	-13.8	3.8	6.7	19.3
	(Percentage change, year-on-year)															
Reserve Money	9.5	4.3	13.3	2.3	-1.2	-4.4	-3.6	2.2	7.5	13.8	-13.0	5.4	7.8	9.1	8.8	8.8
Memorandum Items:	(Percent of GDP)															
NBRM Bills	6.9	5.6	5.1	5.0	5.2	5.1	5.0	4.9	4.9	4.9	3.9	6.8	8.8	7.9	7.0	5.3
Government Deposits at Central Bank	4.1	6.5	6.4	6.1	6.0	5.9	4.7	3.5	8.9	7.1	3.2	3.3	3.0	2.9	2.7	2.6

Sources: NBRM; and IMF staff estimates.

Table 6. FYR Macedonia: Financial Soundness Indicators, 2010–2015

(Percent)

	2010	2011	2012	2013				2014				2015
				2013Q1	2013Q2	2013Q3	2013Q4	2014Q1	2014Q2	2014Q3	2014Q4	2015Q1
Capital adequacy												
Regulatory capital/risk weighted assets	16.1	16.8	17.1	17.3	17.3	17.3	16.8	16.7	16.9	16.5	15.7	16.0
Tier I capital/risk weighted assets 1/	13.4	14.1	14.5	14.7	14.7	14.6	14.4	14.3	14.7	14.2	13.7	13.9
Equity and reserves to Assets	10.6	11.0	11.2	11.1	11.2	11.3	11.3	11.2	11.5	11.2	10.8	10.9
Asset composition												
Structure of loans												
Enterprises (loans to enterprises/total loans)	58.9	58.2	56.9	56.7	56.2	55.5	55.4	55.4	55.1	54.7	55.2	54.7
Households (loans to households/total loans)	37.1	36.5	36.4	36.5	37.1	37.9	37.7	37.9	38.5	39.1	38.7	39.3
Lending with foreign currency component to private sector	58.8	59.2	55.4	55.0	54.6	53.5	52.7	52.0	50.8	50.5	49.4	49.2
Foreign currency lending/total credit to private sector	25.8	28.2	25.5	25.5	25.4	24.5	23.8	23.5	23.0	22.8	22.4	22.6
Foreign currency indexed lending/total credit to private sector	33.0	31.0	29.8	29.5	29.2	29.1	28.9	28.4	27.8	27.8	27.0	26.6
NPLs 2/												
NPLs/gross loans	9.0	9.5	10.1	11.4	11.8	11.2	10.9	10.6	11.3	11.7	10.8	11.1
NPLs net of provision/own funds	-0.3	-0.9	-3.7	-0.1	0.4	-2.7	-1.8	-4.3	-1.0	-0.4	-3.0	-3.6
Provisions to Non-Performing Loans	100.7	101.9	107.1	100.1	99.4	104.7	103.1	107.4	101.7	100.5	104.6	105.5
Large exposures/own funds	200.4	189.6	205.1	208.0	195.4	195.0	188.5	200.0	193.7	197.6	233.1	211.6
Connected lending												
Banking system exposure to subsidiaries and shareholders/own funds	6.3	4.6	3.5	1.5	1.3	1.9	4.2	3.4	3.5	3.8	4.3	5.0
Banking system equity investments/own funds	1.5	1.6	1.8	1.7	1.6	1.6	1.7	1.7	1.7	1.8	2.6	3.4
Earning and profitability												
ROAA 3/	0.8	0.4	0.4	0.0	0.2	0.4	0.6	0.4	0.6	0.9	0.8	0.6
ROAE 3/	7.3	3.4	3.8	-0.4	1.8	3.9	5.7	4.0	5.4	7.6	7.4	5.5
Interest margin/gross income 4/	61.8	60.0	60.7	62.5	62.9	63.3	62.2	65.0	64.0	64.5	63.5	61.2
Noninterest expenses/gross income 5/	68.2	69.7	65.3	62.9	62.2	62.1	62.8	60.9	61.0	58.7	58.1	53.6
Personnel expenses/noninterest expenses	36.1	34.1	33.1	35.3	35.5	35.6	35.0	35.6	35.5	35.8	35.5	37.3
Interest Rates												
Local currency spreads	2.3	3.2	3.5	3.6	3.6	3.7	3.6	3.7	3.7	3.8	4.0	4.1
Foreign currency spreads	4.4	4.8	4.6	4.8	4.6	4.8	4.8	4.9	4.9	4.9	4.9	4.5
Interbank market interest rate	2.7	2.2	2.1	1.9	2.0	2.0	2.2	1.9	1.9	1.9	1.5	1.1
Liquidity												
Highly liquid assets/total assets 6/	25.3	25.3	29.4	29.6	28.7	28.8	27.3	27.4	26.0	27.7	25.5	24.5
Highly liquid assets/total short-term liabilities 7/	38.5	39.6	48.2	49.1	49.0	49.9	47.6	48.2	45.8	49.0	45.5	44.0
Liquid assets/total assets	30.9	31.2	32.4	33.1	32.0	32.2	31.2	31.5	30.5	31.6	29.8	29.2
Liquid assets/total short-term liabilities	46.9	48.9	53.0	54.9	54.6	55.9	54.5	55.5	53.9	56.0	53.2	52.4
Customer deposits/total (noninterbank) loans	114.3	115.7	113.5	114.2	110.8	113.3	112.7	113.6	111.1	113.1	113.4	112.8
Foreign currency deposits/total deposits	53.5	50.8	47.3	47.3	45.8	45.7	44.9	44.5	44.5	44.2	42.3	43.3
Including foreign exchange-indexed 8/	55.5	52.7	48.3	48.2	46.2	46.2	45.5	45.2	44.8	44.7	42.8	44.0
Central bank credit to banks/bank liabilities	0.01	0.01	0.4									
Sensitivity to market risk												
Net open foreign exchange position/own funds	18.9	21.3	11.4	7.3	12.1	16.1	15.6	11.0	9.7	14.0	17.5	10.3

Sources: NBRM's Financial Stability Unit.

Notes:

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.

Annex 1. Public Debt Sustainability Analysis

A fast rising public debt largely denominated in foreign currency and high financing requirements are key risk factors. Stress tests show that while debt level does not pose significant risks of debt distress under shock scenarios, rapid debt accumulation, large gross financing needs and large share of FX debt call for caution in debt management. Stronger fiscal consolidation is needed to stabilize debt and rebuild fiscal policy space.

1. General government debt is expected to rise by 7 percentage points of GDP over the forecast horizon, to about 45 percent at end-2020. Debt level is expected to briefly dip in 2015 as a large Eurobond issuance in July 2014 pre-financed debt repayment and reduced financing needs for this year. Debt accumulation over the medium term is mainly driven by high primary deficit and partially offset by favorable growth prospects.

2. While the level of debt is not alarmingly high, large gross financing needs and a high share of FX debt pose significant risks. The baseline gross financing needs are higher than regional average and exceed the benchmark for stress tests throughout the projection period. Foreign-currency denominated debt averages about 73 percent of general government debt over the projection period, presenting high risk of debt distress due to currency mismatch.

3. Stronger fiscal consolidation is needed to stabilize debt and rebuild fiscal space. General government debt has almost doubled since 2008 as a share of GDP, severely eroding available fiscal buffers essential for weathering shocks. . The primary deficit is expected to reach 2.1 percent of GDP by 2020, 1.6 percentage points higher than the debt-stabilizing primary balance, revealing a pressing need for stronger fiscal consolidation.

4. Public sector debt, including that of non-financial public sector, is expected to rise to 56 percent of GDP over the forecast horizon from 44 percent of GDP in 2014. Debt of public non-financial enterprises, mostly reflecting borrowing by two SOEs, Public Enterprise for State Roads (PESR) and Electricity Production Company (ELEM), is expected to nearly double over the projection period, from 5.4 percent of GDP to 10.3 percent in 2020. Aside from the fast buildup, debt by non-financial SOEs is predominantly denominated in foreign currency, presenting risks of currency mismatch.

FYR Macedonia General Government Debt Sustainability Analysis (DSA) - Baseline Scenario

(in percent of GDP unless otherwise indicated)

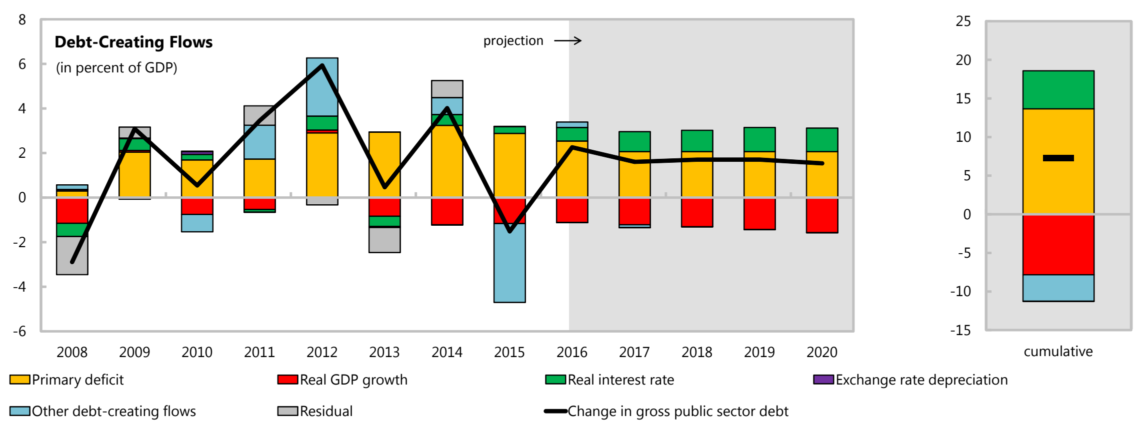
Debt, Economic and Market Indicators

	Actual			Projections					
	2008-2012 1/	2013	2014	2015	2016	2017	2018	2019	2020
Nominal gross general government debt	26.0	34.1	38.1	36.6	38.9	40.5	42.2	43.9	45.4
General government gross financing needs	4.4	14.9	14.2	14.9	13.5	12.8	13.9	15.5	18.3
Real GDP growth (in percent)	2.1	2.7	3.8	3.2	3.2	3.3	3.4	3.6	3.8
Inflation (GDP deflator, in percent)	2.5	4.3	1.4	1.2	1.4	1.5	1.7	1.8	2.0
Nominal GDP growth (in percent)	4.7	7.0	5.3	4.4	4.6	4.9	5.1	5.5	5.9
Effective interest rate (in percent) 3/	3.1	2.9	3.0	2.1	3.2	4.0	4.2	4.6	4.6

As of April 16, 2015		
Sovereign Spreads		
Spread (bp) 2/		268
CDS (bp)		290
Ratings	Foreign	Local
Moody's	n.a.	n.a.
S&Ps	BB-	BB-
Fitch	BB+	BB+

Contribution to Changes in General Government Debt

	Actual			Projections							
	2008-2012	2013	2014	2015	2016	2017	2018	2019	2020	cumulative	debt-stabilizing primary balance 8/
Change in gross general government debt	2.0	0.47	4.02	-1.5	2.3	1.6	1.7	1.7	1.5	7.3	
Identified debt-creating flows	2.2	1.59	3.25	-1.5	2.3	1.6	1.7	1.7	1.5	7.3	
Primary deficit	1.7	2.9	3.2	2.9	2.5	2.1	2.1	2.1	2.1	13.7	-0.5
Primary (noninterest) revenue and grants	30.5	28.0	27.6	29.1	29.1	28.9	28.9	28.9	28.9	173.7	
Primary (noninterest) expenditure	32.3	30.9	30.9	32.0	31.7	30.9	30.9	30.9	30.9	187.3	
Automatic debt dynamics 4/	-0.3	-1.3	-0.8	-0.9	-0.5	-0.3	-0.4	-0.4	-0.5	-2.9	
Interest rate/growth differential 5/	-0.3	-1.3	-0.7	-0.9	-0.5	-0.3	-0.4	-0.4	-0.5	-2.9	
Of which: real interest rate	0.1	-0.5	0.5	0.3	0.6	0.9	1.0	1.1	1.1	4.9	
Of which: real GDP growth	-0.4	-0.8	-1.2	-1.2	-1.1	-1.2	-1.3	-1.4	-1.6	-7.8	
Exchange rate depreciation 6/	0.0	0.0	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.7	-0.1	0.8	-3.5	0.2	-0.1	0.0	0.0	0.0	-3.4	
Privatization receipts (negative)	-0.3	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Changes in cash, deposits, and securities held for liqu	1.0	0.1	0.8	-3.5	0.2	-0.1	0.0	0.0	0.0	-3.4	
Residual, including asset changes 7/	-0.1	-1.1	0.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	



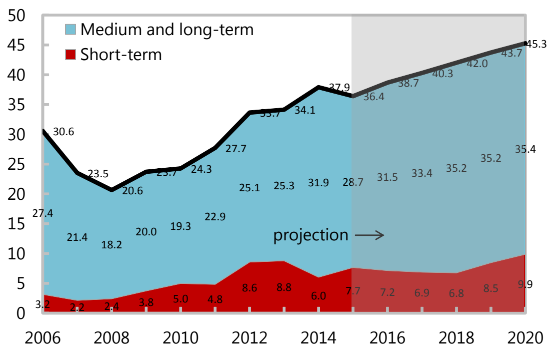
Source: IMF staff.
1/ Based on available data.
2/ Bond Spread over German Bonds.
3/ Defined as interest payments divided by debt stock at the end of previous year.
4/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; 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).
5/ The real interest rate contribution is derived from the denominator in footnote 4 as r - π (1+g) and the real growth contribution as -g.
6/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).
7/ For projections, this line includes exchange rate changes during the projection period.
8/ 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.

FYR Macedonia General Government DSA - Composition of General Govt. Debt and Alternative Scenarios

Composition of General Government Debt

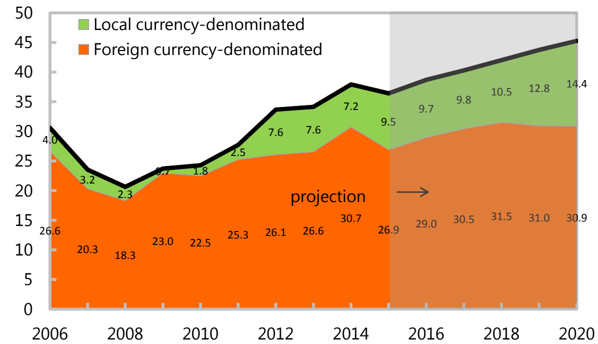
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

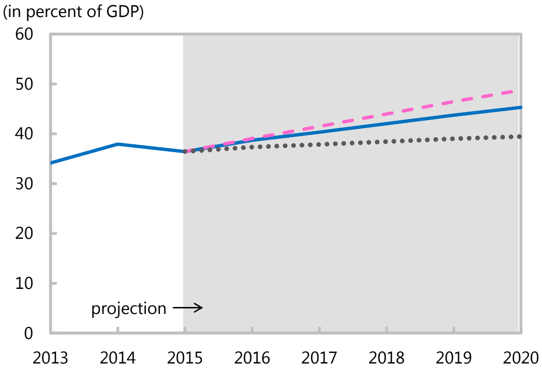


Alternative Scenarios

Baseline   Historical   Constant Primary Balance

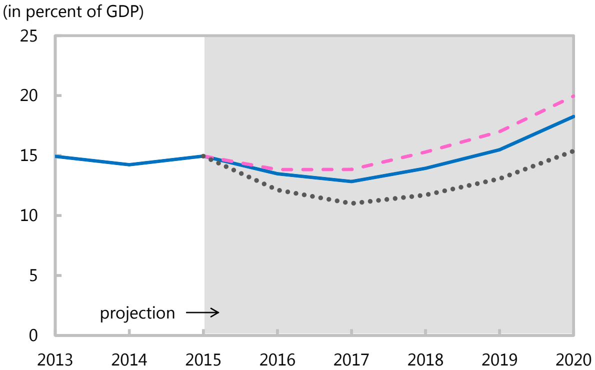
Gross Nominal General Government Debt

(in percent of GDP)



General Government Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

Baseline Scenario	2015	2016	2017	2018	2019	2020
Real GDP growth	3.2	3.2	3.3	3.4	3.6	3.8
Inflation	1.2	1.4	1.5	1.7	1.8	2.0
Primary Balance	-2.9	-2.5	-2.1	-2.1	-2.1	-2.1
Effective interest rate	2.1	3.2	4.0	4.2	4.6	4.6
Constant Primary Balance Scenario						
Real GDP growth	3.2	3.2	3.3	3.4	3.6	3.8
Inflation	1.2	1.4	1.5	1.7	1.8	2.0
Primary Balance	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9
Effective interest rate	2.1	3.2	4.0	4.2	4.6	4.5

Historical Scenario	2015	2016	2017	2018	2019	2020
Real GDP growth	3.2	3.3	3.3	3.3	3.3	3.3
Inflation	1.2	1.4	1.5	1.7	1.8	2.0
Primary Balance	-2.9	-1.2	-1.2	-1.2	-1.2	-1.2
Effective interest rate	2.1	3.2	3.3	3.4	3.5	3.3

Source: IMF staff.

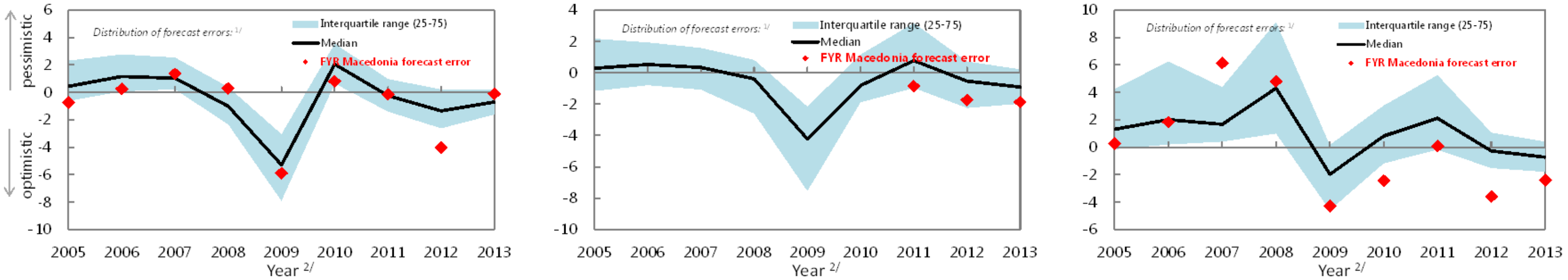
FYR Macedonia General Government DSA - Realism of Baseline Assumptions

Forecast Track Record, versus all countries

Real GDP Growth
(in percent, actual-projection)
FYR Macedonia median forecast error, 2005-2013: -0.1
Has a percentile rank of: 0.51

Primary Balance
(in percent of GDP, actual-projection)
FYR Macedonia median forecast error, 2005-2013: -1.74
Has a percentile rank of: 0.21

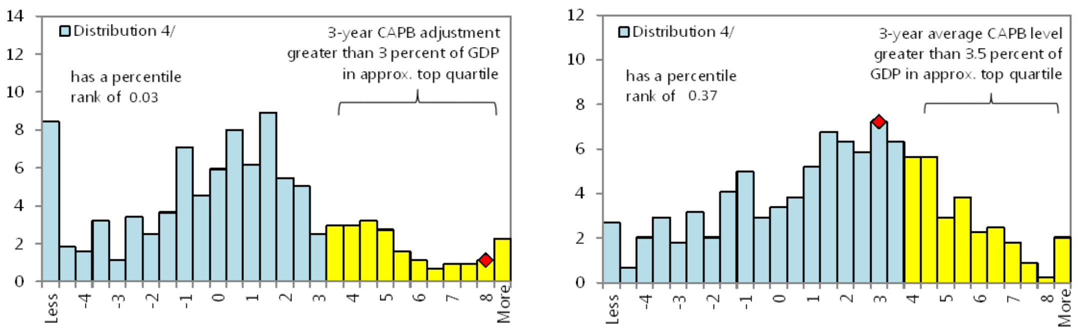
Inflation (Deflator)
(in percent, actual-projection)
FYR Macedonia median forecast error, 2005-2013: 0.09
Has a percentile rank of: 0.29



Assessing the Realism of Projected Fiscal Adjustment

3-Year Adjustment in Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)

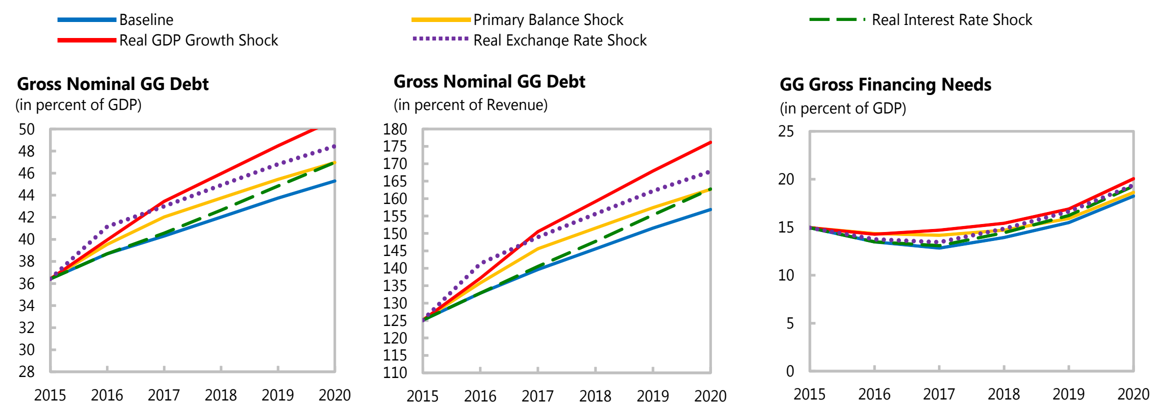
3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)



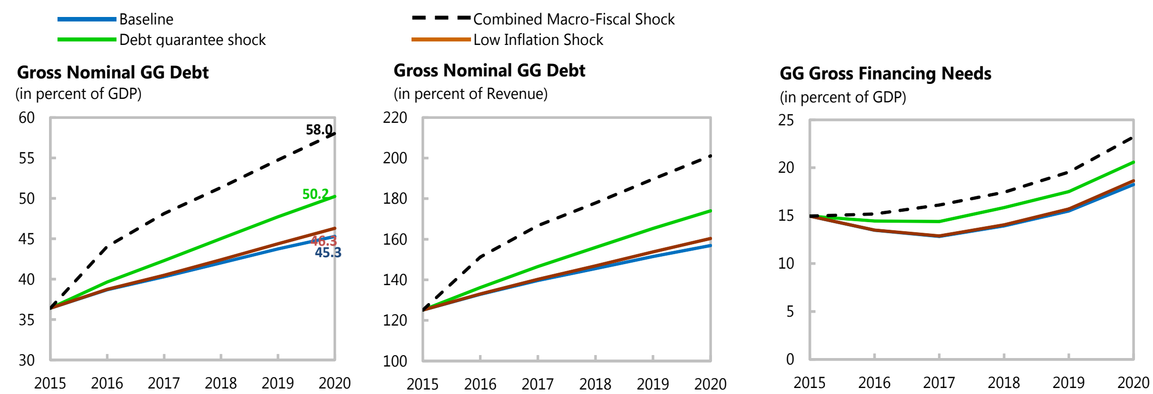
Source : IMF Staff.
1/ Plotted distribution includes all countries, percentile rank refers to all countries.
2/ Projections made in the spring WEO vintage of the preceding year.
3/ Not applicable for Macedonia, Former Yugoslav Republic of.
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

FYR Macedonia General Government DSA - Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

Primary Balance Shock	2015	2016	2017	2018	2019	2020
Real GDP growth	3.2	3.2	3.3	3.4	3.6	3.8
Inflation	1.2	1.4	1.5	1.7	1.8	2.0
Primary balance	-2.9	-3.4	-2.9	-2.1	-2.1	-2.1
Effective interest rate	2.1	3.2	4.1	4.3	4.6	4.6
Real Interest Rate Shock						
Real GDP growth	3.2	3.2	3.3	3.4	3.6	3.8
Inflation	1.2	1.4	1.5	1.7	1.8	2.0
Primary balance	-2.9	-2.5	-2.1	-2.1	-2.1	-2.1
Effective interest rate	2.1	3.2	4.7	5.2	5.8	6.1
Combined Shock						
Real GDP growth	3.2	1.7	1.8	1.9	2.1	2.3
Inflation	1.2	1.0	1.1	1.3	1.5	1.6
Primary balance	-2.9	-3.4	-3.2	-2.1	-2.1	-2.1
Effective interest rate	2.1	3.5	4.7	5.1	5.8	6.0
Debt guarantee shock						
Real GDP growth	3.2	3.2	3.3	3.4	3.6	3.8
Inflation	1.2	1.4	1.5	1.7	1.8	2.0
Primary balance	-2.9	-3.5	-3.0	-2.9	-2.9	-2.8
Effective interest rate	2.1	3.2	4.3	4.6	5.1	5.1

Real GDP Growth Shock	2015	2016	2017	2018	2019	2020
Real GDP growth	3.2	1.7	1.8	1.9	2.1	2.3
Inflation	1.2	1.0	1.1	1.3	1.5	1.6
Primary balance	-2.9	-3.1	-3.2	-2.1	-2.1	-2.1
Effective interest rate	2.1	3.2	4.0	4.3	4.6	4.7
Real Exchange Rate Shock						
Real GDP growth	3.2	3.2	3.3	3.4	3.6	3.8
Inflation	1.2	4.7	1.5	1.7	1.8	2.0
Primary balance	-2.9	-2.5	-2.1	-2.1	-2.1	-2.1
Effective interest rate	2.1	3.5	4.0	4.2	4.6	4.6
Baseline Scenario						
Real GDP growth	3.5	3.8	3.9	4.0	4.0	4.0
Inflation	1.6	1.5	1.6	2.0	2.2	2.5
Primary Balance	-2.8	-2.2	-2.2	-2.2	-2.2	-2.2
Effective interest rate	2.5	2.7	2.9	3.0	3.6	2.9
Low Inflation Shock						
Real GDP growth	3.2	3.2	3.3	3.4	3.6	3.8
Inflation	1.2	1.2	1.2	1.2	1.2	1.2
Primary balance	-2.9	-2.5	-2.1	-2.1	-2.1	-2.1
Effective interest rate	2.1	3.2	4.0	4.2	4.6	4.6

Source: IMF staff.

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

Name	Description	Impact on debt 1/
Primary Balance Shock	Minimum shock equivalent to 50 percent of planned adjustment (50 percent implemented), or baseline minus half of the 10-year historical standard deviation, whichever is larger. There is an increase in interest rates of 25bp for every 1 percent of GDP worsening in the primary balance.	4.5
Real GDP Growth Shock	Real GDP growth is 1.5 percentage point lower in the period 2015–20; revenue-to-GDP ratio remains the same as in the baseline; level of non-interest expenditures is the same as in the baseline; deterioration in primary balance leads to higher interest rate (see above); decline in growth leads to lower inflation (0.25 percentage points per 1 percentage point decrease in GDP growth).	6.6
Interest Rate Shock	Interest rate increases by difference between average real interest rate level over projection and maximum real historical level, or by 200bp, whichever is larger.	2.1
Real Exchange Rate Shock	Estimate of overvaluation or maximum historical movement of the exchange rate, whichever is higher; pass-through to inflation with default elasticity of 0.25 for EMs and 0.03 for AEs.	3.9
Combined Macro-Fiscal Shock	Shock size and duration based on the underlying shocks.	17.8

Notes:

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

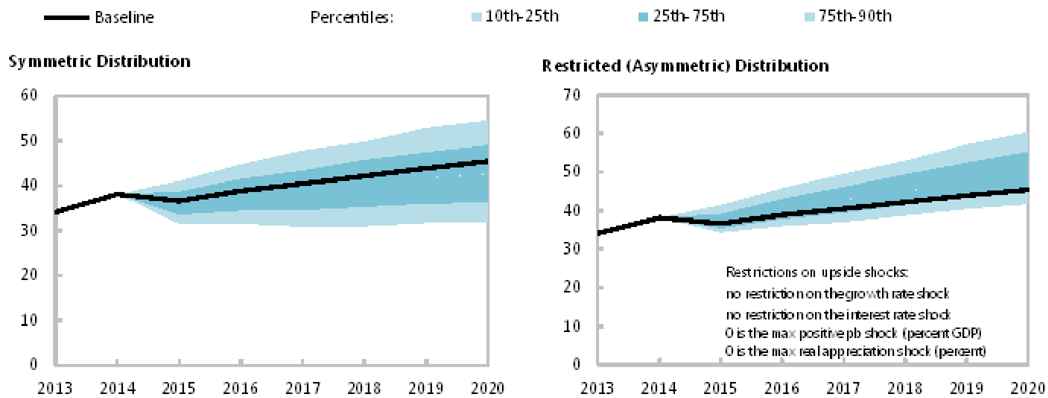
FYR Macedonia General Government DSA Risk Assessment

Heat Map

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

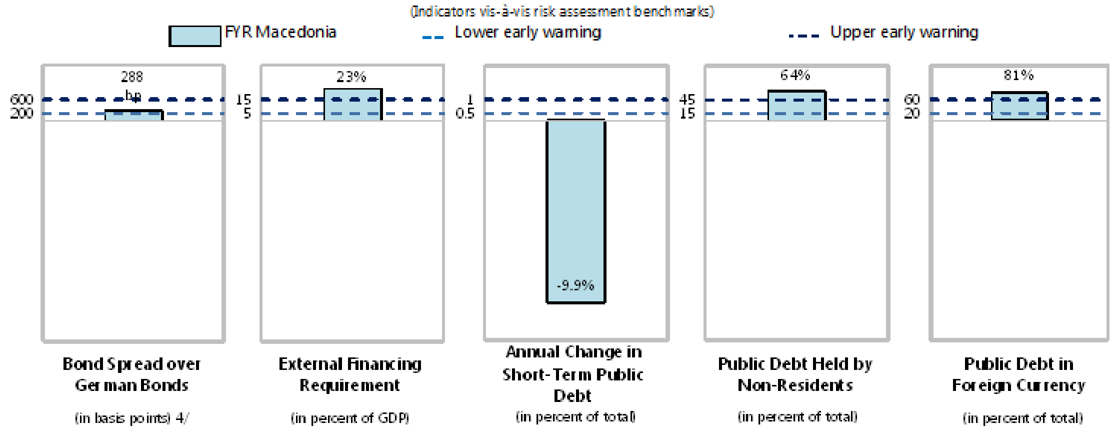
Evolution of Predictive Densities of Gross Nominal General Government Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks)



Source: IMF staff.

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

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

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

Lower and upper risk-assessment benchmarks are:

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

4/ An average over the last 3 months, 16-Jan-15 through 16-Apr-15.

FYR Macedonia Non-Financial Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario

(in percent of GDP unless otherwise indicated)

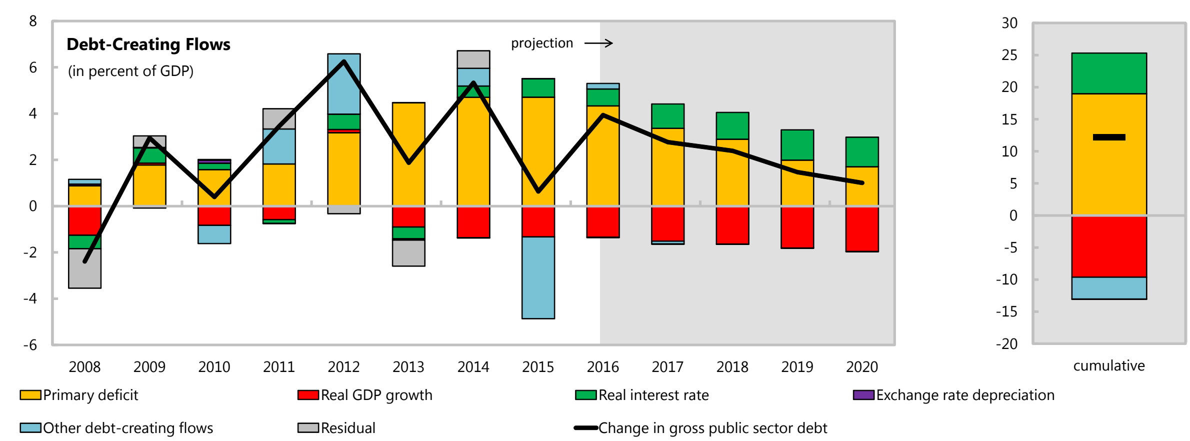
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2008-2012 [2/]	2013	2014	2015	2016	2017	2018	2019	2020
Nominal gross public debt	28.5	38.2	43.5	44.2	48.1	50.9	53.3	54.7	55.8
Public gross financing needs	9.5	16.9	16.1	17.8	16.4	15.4	16.1	16.3	19.1
Real GDP growth (in percent)	2.1	2.7	3.8	3.2	3.2	3.3	3.4	3.6	3.8
Inflation (GDP deflator, in percent)	2.5	4.3	1.4	1.2	1.4	1.5	1.7	1.8	2.0
Nominal GDP growth (in percent)	4.7	7.0	5.3	4.4	4.6	4.9	5.1	5.5	5.9
Effective interest rate (in percent) [4/]	3.2	2.9	2.8	3.2	3.1	3.9	4.1	4.5	4.5

As of April 16, 2015		
Sovereign Spreads		
Spread (bp) 3/		268
CDS (bp)		290
Ratings	Foreign	Local
Moody's	n.a.	n.a.
S&Ps	BB-	BB-
Fitch	BB+	BB+

Contribution to Changes in Public Debt

	Actual			Projections							
	2008-2012	2013	2014	2015	2016	2017	2018	2019	2020	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	2.1	1.87	5.33	0.6	3.9	2.8	2.4	1.5	1.0	12.2	
Identified debt-creating flows	2.3	3.00	4.57	0.6	4.0	2.8	2.4	1.5	1.0	12.3	
Primary deficit	1.8	4.5	4.7	4.7	4.3	3.4	2.9	2.0	1.7	19.0	-0.7
Primary (noninterest) revenue and grants	30.5	28.0	27.6	29.1	29.1	28.9	28.9	28.9	28.9	173.7	
Primary (noninterest) expenditure	32.4	32.4	32.3	33.8	33.5	32.2	31.8	30.8	30.6	192.7	
Automatic debt dynamics [5/]	-0.3	-1.4	-0.9	-0.5	-0.6	-0.5	-0.5	-0.5	-0.7	-3.3	
Interest rate/growth differential [6/]	-0.3	-1.4	-0.9	-0.5	-0.6	-0.5	-0.5	-0.5	-0.7	-3.3	
Of which: real interest rate	0.2	-0.5	0.5	0.8	0.7	1.1	1.2	1.3	1.3	6.3	
Of which: real GDP growth	-0.5	-0.9	-1.4	-1.3	-1.4	-1.5	-1.6	-1.8	-2.0	-9.6	
Exchange rate depreciation [7/]	0.0	0.0	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.7	-0.1	0.8	-3.5	0.2	-0.1	0.0	0.0	0.0	-3.4	
Privatization receipts (negative)	-0.3	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Changes in cash, deposits, and securities held for liqui	1.0	0.1	0.8	-3.5	0.2	-0.1	0.0	0.0	0.0	-3.4	
Residual, including asset changes [8/]	-0.1	-1.1	0.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	



Source: IMF staff.

1/ Public sector is defined as non-financial public sector.

2/ Based on available data.

3/ Bond Spread over German Bonds.

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

5/ 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).

6/ The real interest rate contribution is derived from the denominator in footnote 4 as r - π (1+g) and the real growth contribution as -g.

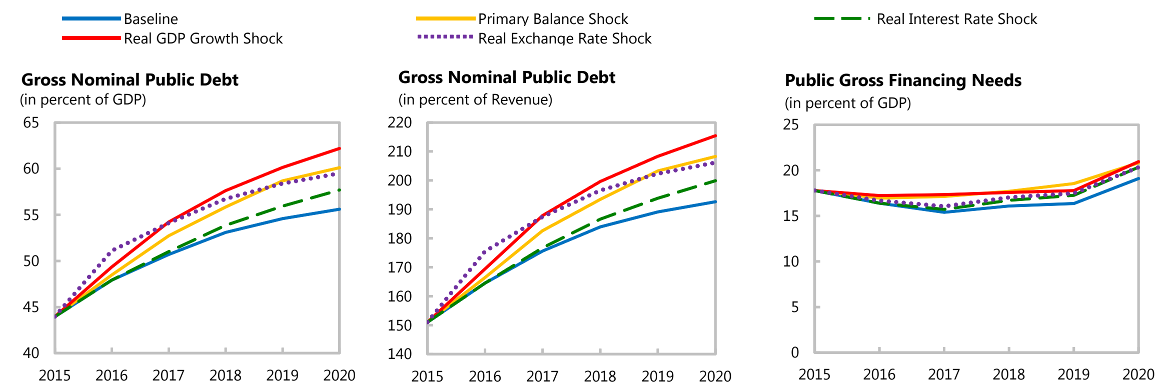
7/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).

8/ For projections, this line includes exchange rate changes during the projection period.

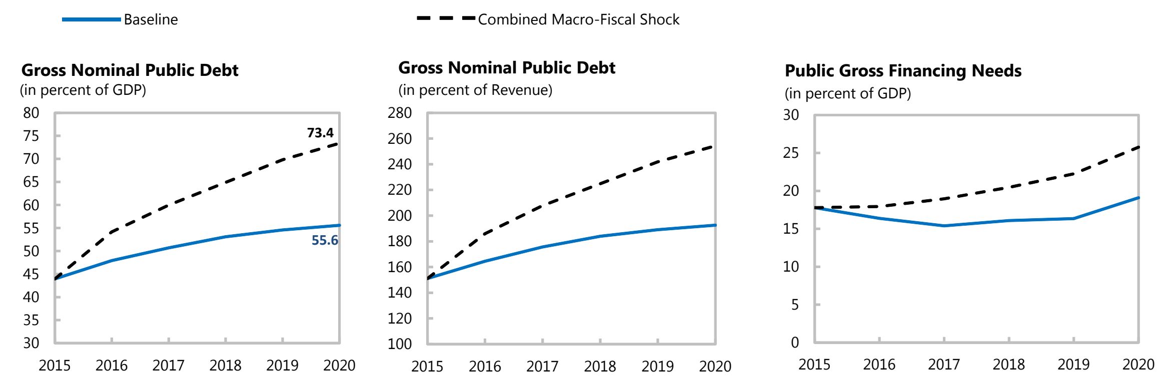
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

FYR Macedonia Non-Financial Public Sector DSA - Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

	2015	2016	2017	2018	2019	2020
Primary Balance Shock						
Real GDP growth	3.2	3.2	3.3	3.4	3.6	3.8
Inflation	1.2	1.4	1.5	1.7	1.8	2.0
Primary balance	-4.7	-4.9	-4.8	-3.6	-3.3	-2.1
Effective interest rate	3.2	3.1	3.9	4.2	4.6	4.6
Real Interest Rate Shock						
Real GDP growth	3.2	3.2	3.3	3.4	3.6	3.8
Inflation	1.2	1.4	1.5	1.7	1.8	2.0
Primary balance	-4.7	-4.3	-3.4	-2.9	-2.0	-1.7
Effective interest rate	3.2	3.1	4.6	5.1	5.7	6.0
Combined Shock						
Real GDP growth	3.2	1.7	1.8	1.9	2.1	2.3
Inflation	1.2	1.0	1.1	1.3	1.5	1.6
Primary balance	-4.7	-5.0	-4.8	-3.6	-3.3	-2.1
Effective interest rate	3.2	3.5	4.6	5.1	5.7	5.9

	2015	2016	2017	2018	2019	2020
Real GDP Growth Shock						
Real GDP growth	3.2	1.7	1.8	1.9	2.1	2.3
Inflation	1.2	1.0	1.1	1.3	1.5	1.6
Primary balance	-4.7	-5.0	-4.6	-2.9	-2.0	-1.7
Effective interest rate	3.2	3.1	3.9	4.2	4.5	4.6
Real Exchange Rate Shock						
Real GDP growth	3.2	3.2	3.3	3.4	3.6	3.8
Inflation	1.2	4.7	1.5	1.7	1.8	2.0
Primary balance	-4.7	-4.3	-3.4	-2.9	-2.0	-1.7
Effective interest rate	3.2	3.5	3.9	4.2	4.5	4.5
Baseline Scenario						
Real GDP growth	3.5	3.8	3.9	4.0	4.0	4.0
Inflation	1.6	1.5	1.6	2.0	2.2	2.5
Primary Balance	-2.8	-2.2	-2.2	-2.2	-2.2	-2.2
Effective interest rate	2.5	2.7	2.9	3.0	3.6	2.9

Source: IMF staff.

FORMER YUGOSLAV REPUBLIC OF MACEDONIA

Annex II. External Debt Sustainability Analysis

FYR Macedonia: External Debt Sustainability Framework, 2010–2020

(Percent of GDP, unless otherwise indicated)

	2010	2011	2012	2013	2014			Projections 2015	2016	2017	2018	2019	2020	Debt-stabilizing non-interest current account 6/
Baseline: External debt	57.8	64.2	68.2	64.3	69.8			**68.3**	**72.2**	**75.6**	**76.1**	**75.9**	**75.6**	**-1.5**
Change in external debt	1.9	6.5	3.9	-3.8	5.4			-1.5	3.9	3.4	0.5	-0.3	-0.2	
Identified external debt-creating flows (4+8+9)	-44.8	-83.2	-64.6	-12.0	-39.5			-1.4	12.4	7.3	3.3	3.4	2.9	
Current account deficit, excluding interest payments	1.3	1.8	2.3	1.3	0.8			2.7	3.9	3.7	3.2	3.0	2.9	
Deficit in balance of goods and services	19.7	20.5	22.4	18.5	17.6			18.7	19.3	19.0	18.3	17.4	16.5	
Exports	38.4	45.6	44.5	43.3	47.5			48.2	52.1	56.6	60.4	62.8	64.4	
Imports	58.1	66.1	66.9	61.7	65.1			66.9	71.4	75.6	78.7	80.3	80.9	
Net non-debt creating capital inflows (negative)	-44.1	-82.4	-67.2	-9.3	-37.6			-2.5	10.1	5.3	1.9	2.5	2.1	
Automatic debt dynamics 1/	-2.0	-2.6	0.3	-3.9	-2.6			-1.6	-1.5	-1.7	-1.9	-2.0	-2.1	
Contribution from nominal interest rate	0.7	0.7	0.6	0.5	0.5			0.5	0.6	0.6	0.6	0.6	0.6	
Contribution from real GDP growth	-1.8	-1.3	0.3	-1.7	-2.3			-2.1	-2.1	-2.3	-2.4	-2.6	-2.7	
Contribution from price and exchange rate changes 2/	-0.9	-2.1	-0.6	-2.7	-0.9			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	46.6	89.7	68.6	8.1	44.9			-0.1	-8.5	-4.0	-2.7	-3.7	-3.1	
External debt-to-exports ratio (in percent)	150.5	140.8	153.3	148.7	146.8			141.6	138.8	133.6	126.0	120.8	117.4	
Gross external financing need (in billions of euros) 4/	1.7	1.9	2.1	2.3	2.0			2.4	2.5	2.5	2.7	2.7	2.8	
in percent of GDP	23.3	24.6	27.3	28.6	23.3			26.8	26.4	25.2	26.0	24.9	24.5	
Scenario with key variables at their historical averages 5/						10-Year Historical Average	10-Year Standard Deviation	**67.7**	**69.6**	**71.3**	**70.7**	**70.0**	**69.6**	
Key Macroeconomic Assumptions Underlying Baseline														
Real GDP growth (in percent)	3.4	2.3	-0.5	2.7	3.8	3.3	2.3	3.2	3.2	3.3	3.4	3.6	3.8	
GDP deflator in euros (change in percent)	1.6	3.7	1.0	4.2	1.4	3.1	1.8	1.2	1.4	1.5	1.7	1.8	2.0	
Nominal external interest rate (in percent)	1.3	1.3	1.0	0.8	0.9	0.6	0.5	0.8	0.8	0.8	0.8	0.8	0.8	
Growth of exports (euro terms, in percent)	27.3	26.1	-2.0	4.0	15.6	13.1	17.3	5.9	12.9	14.0	12.3	9.7	8.6	
Growth of imports (euro terms, in percent)	12.2	20.8	1.7	-1.3	10.9	10.1	13.8	7.3	11.6	11.1	9.5	7.6	6.7	
Current account balance, excluding interest payments	-1.3	-1.8	-2.3	-1.3	-0.8	-3.6	3.9	-2.7	-3.9	-3.7	-3.2	-3.0	-2.9	
Net non-debt creating capital inflows	44.1	82.4	67.2	9.3	37.6	-322.4	793.8	2.5	-10.1	-5.3	-1.9	-2.5	-2.1	

Source: IMF Staff Calculations

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).

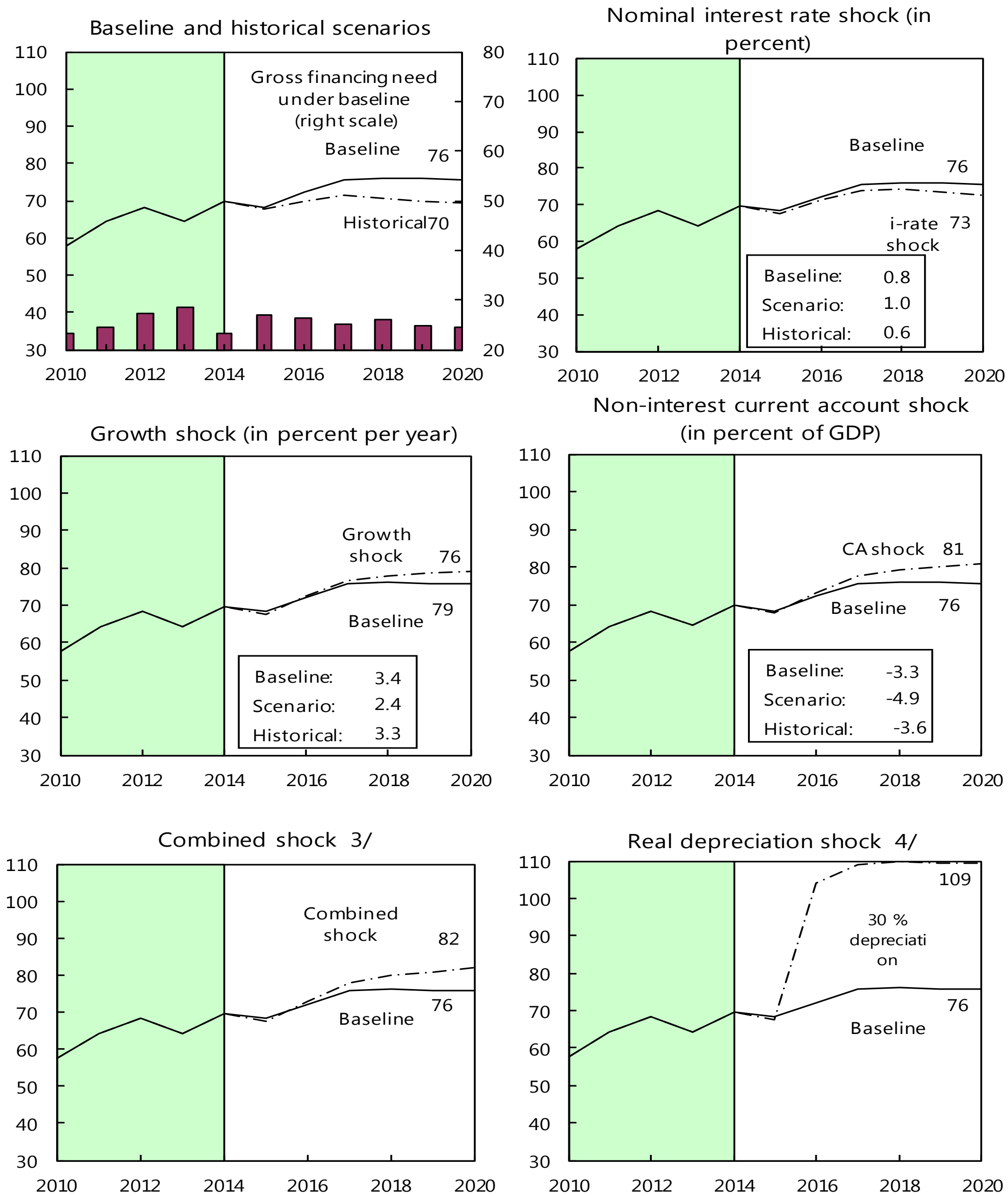
3/ For projection, line includes the impact of price and exchange rate changes.

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.

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.
4/ One-time real depreciation of 30 percent occurs in 2014

INTERNATIONAL MONETARY FUND

FORMER YUGOSLAV REPUBLIC OF MACEDONIA

August 10, 2015

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By European Department

CONTENTS

FUND RELATIONS

(As of July 07, 2015)

Missions. Article IV, Skopje, June 29th–July 7th, 2014. Concluding statement is available at: http://www.imf.org/external/np/ms/2015/070815.htm

Staff team. Jesmin Rahman (head), Marc Gerard, Hua Chai, Jubum Na, Piyaporn Sodsriwiboon (all EUR), Duncan Last (FAD), Patrick Gitton (Resident Representative), and Gjorgji Nacevski (local economist).

Discussions. The staff team met with Deputy Prime Minister and Minister of Finance Stavreski, Deputy Prime Minister for Economic Affairs Peshevski, National Bank Governor Bogov, other senior officials, and representatives of the banking, business, political and international communities.

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	68.90	100.92
Reserve position	0.00	0.00

SDR Department:	SDR Million	Percent of Allocation
Net cumulative allocation	65.62	100.00
Holdings	3.79	5.78

Outstanding Purchases and Loans: None

Latest Financial Arrangements:

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

1/ Formerly PCL

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

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

	Forthcoming				
	2015	2016	2017	2018	2019
Principal					
Charges/Interest	0.02	0.03	0.03	0.03	0.03
Total	0.02	0.03	0.03	0.03	0.03

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 15 percent, while that on FX-indexed denar deposits are set at 20 percent.

At end-June 2014, the official exchange rate was 55.4 denars per U.S. dollar and 61.69 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 August 28, 2015. The FYR Macedonia is on the standard 12-month Article IV consultation cycle.

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

Table 1. Technical Assistance Since 2006

Purpose	Department		Date
Banking Law	LEG/MCM		June 2006
Central Bank Law	LEG/MCM		July 2007
FX Reserves Modeling	RES/MCM		February 2012 February 2013
Macroeconomic Modeling at NBRM	MCM		March 2009 November 2009 September 2010 November 2010 May 2011 November 2011 February 2012 November 2012 March 2013 November 2013 March 2014
Liquidity, Cash and Debt Management	MCM		April 2007
Contingency Planning and Crisis Preparedness	MCM		February 2009
Stress Testing	MCM		February 2011
Domestic Debt Market Development	MCM		October 2011
Provisioning Regulation	MCM		November 2012
Monetary and FX Policy	MCM		March 2013 July 2013
Expenditure Rationalization	FAD		November 2007
Public Financial Management	FAD		September 2009
Medium-Term Budgeting	FAD		May 2011
Budgeting Framework/Payment Arrears	FAD		March 2012
Public Financial Management	FAD		November 2012
Tax Policy	FAD		September 2006 July 2007
Tax Administration	FAD		April 2007 July 2009 April 2010 June 2011 September 2013 December 2014
Tax Arrears Management	FAD		March 2013 October 2014
Tax Compliance	FAD		November 2013 March 2014 October 2014

Table 1. Technical Assistance Since 2006 (concluded)			
National Accounts	STA		April 2007 January 2008
			May 2008 September 2008 December 2008 June 2009 August 2011 September 2012 March 2013 October 2013
Export and Import Deflators	STA		December 2007
GFS 2001	STA		December 2007
Government Finance Statistics	STA		October 2008
Balance of Payments Statistics	STA		October 2008
SDDS Subscription	STA		December 2010
STA TA Evaluation	STA		September 2012
Government Finance Statistics	STA		January 2015
National Accounts Statistics	STA		June 2007
Balance of Payments Statistics	STA		October 2006
Government Finance Statistics	STA		June 2006
Safeguards Assessment	FIN		February 2011
Regional Advisors			
Revenue Administration	FAD		2015-
Public Financial Management	FAD		2015-
National Accounts	STA		2012–2014
Resident Experts			
Tax Administration	FAD		October 2006–August 2011
Banking Supervision	MCM		May 2006–May 2008
FSAP Participation and ROSCs (since 2003)			
FSAP	MCM/WB		May–June 2003
FSAP update	MCM/WB		March 2008
Data ROSC	STA		February 2004
Fiscal ROSC	FAD		February 2005

IMF–WORLD BANK COLLABORATION

Background

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

Key Areas of World Bank Involvement

- The World Bank program in FYR Macedonia focuses on two interrelated themes: i) Growth and Competitiveness; and ii) Skills and Inclusion. For Growth and Competitiveness, successful poverty reduction would need sustained private sector led growth, making FYR Macedonia more attractive as a destination for investments and as a country whose private companies can compete at the regional and global level. For Skills and Inclusion, the fruits of growth can be shared broadly if more Macedonians have access to better jobs and if public services are of good quality and delivered efficiently. Since FYR Macedonia's future is clearly linked to the European integration, the Bank's Country Partnership Strategy actively promotes the EU accession agenda and this represents a cross-cutting theme of the strategy.
- A series of two budget support operations (Competitiveness DPL) were made available to the Government with the aim to improve the competitiveness of the economy to develop a stronger export-oriented enterprise sector. The second DPL was disbursed in 2014.
- The Regional and Local Roads Program Support Project (US$105 million) and the new National and Regional Roads Rehabilitation Project (US$ 71 million) are helping with the rehabilitation of the regional and local roads and provide 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), and the Skills Development and Innovation Support Project (US$24 million).
- The World Bank has recently completed negotiations for the new Roads Upgrading and Development Project in the amount of EUR 83 million. The project objectives are to improve transport connectivity for road users along Corridor VIII between Skopje and Deve Bair, and to improve the asset management and planning function of Public Enterprise for State Roads.

FYR Macedonia–Bank and Fund Planned Activities in Macrocritical Structural Reform Areas June 2015–May 2016			
Title	**Products**	**Provisional Timing of Missions**	**Expected Delivery Date**
1. Fund work	Article IV Report	Spring 2016	June 2016
	Technical assistance on Tax Compliance and Risk Management	Short-term expert visits second half of 2015	TA report after the mission
	Technical assistance on Tax Arrears Management	Short-term expert visits second half of 2015	TA report after the mission
	Technical assistance on Revenue Administration Reforms	Fall 2015	TA report after the mission
	Technical Assistance on Revenue Administration Reforms	Regular short-term visits of region-based long-term expert FY 2015	
2. Bank work program	Public Expenditure Review	Ongoing, most recent mission June 2015	Report scheduled for September 2015
	Southeastern Europe Regular Economic Update	Continuous and periodic missions	June and December
	Municipal Services Improvement Project	Continuous	Project closing March 2019
	Regional and Local Roads Program Support Project	Continuous	Project closing December 2015
	National and Regional Road Rehabilitation Project	Continuous	Project closing September 2019
	Conditional Cash Transfers Project	Continuous	Project closing December 2015
	Energy Community South East Europe Adaptable Program Loan 3	Continuous	Project closing November 2015
	Balkan Financial Sector Technical Assistance Facility (TA to NBRM and MoF on bank resolution; LoLR, etc.)	Ongoing, most recent consultations with authorities May 2015	Project closing December 2015
	Skills Development and Innovation Support Project	Continuous	Project closing May 2019

STATISTICAL ISSUES

(As of August 6, 2015)

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: The quality of national account measurement needs to improve. Some discrepancies between GDP and its components, as well as between annual and quarterly figures remain. Timely and consistent provision of data is still an issue. In 2013, by the decision of the Government of FYR Macedonia, amendments were made to the National Classification of Activities—NKD Rev.2—which entailed significant changes in the decomposition of historical data. The primary objective was to make Macedonian national statistics comparable with that of other European countries, for example, ensuring that the content and structure of national statistics is completely harmonized with the European Classification of Activities NACE Rev.2. **Price statistics:** Improvements to the CPI have been introduced in accordance with international standards and EU regulations to align the Classification of Individual Consumption According to Purpose (COICOP).
Government finance statistics: Debt data on a disaggregated basis 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* (GFSY) 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 August 6, 2015)

	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	8/5/15	8/6/15	D	W	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	6/30/15	7/14/15	D	W	M		
Reserve/Base Money	Jun. 15	7/21/15	M	M	M	O, LO, LO, O	O, LO, O, O, O
Broad Money	Jun. 15	7/21/15	M	M	M		
Central Bank Balance Sheet	Jun. 15	7/21/15	M	M	M		
Consolidated Balance Sheet of the Banking System	Jun. 15	7/21/15	M	M	M		
Interest Rates[2]	Jun. 15	7/31/15	M	M	M		
Consumer Price Index	May 15	6/08/15	M	M	M	O, O, O, LO	LO, O, LNO, O, LO
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Dec. 14	Mar. 15	A	A	A	LO, LNO, LO, O	LO, LO, LO, LO, LNO
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	June 30	8/01/15	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Mar. 15	Apr. 15	Q	Q	Q		
External Current Account Balance	May 15	7/31/15	M	M	M	O, LO, O, LO	LO, O, LO, O, LO
Exports and Imports of Goods and Services	May 15	7/31/15	M	M	M		
GDP/GNP	Mar. 15	6/12/15	Q	Q	Q	O, LO, O, LO	LO, O, LNO, O, O
Gross External Debt	Mar. 15	Jun. 15	Q	Q	Q		
International Investment Position[6]	Mar. 15	Jun. 15	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; mission took place during February 18 – March 3, 2004). 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 validation of intermediate data and statistical outputs, and revision studies.

Statement by Mr. Menno Snel, Executive Director for Former Yugoslav Republic of Macedonia and Mr. Jeroen Clicq, Advisor to Executive Director
August 28, 2015

On behalf of our Macedonian authorities, we thank staff for the candid and constructive exchange of views during the mission. This year's Article IV mission took place at a time when the situation in Greece and the domestic political situation were quite uncertain. Not surprisingly, the staff report has listed those two issues as the main downside risks for the Macedonian economy.

We are happy to report that **significant progress has been made** on both fronts. With the timely and forward-looking measures to contain negative spillovers from Greece and the agreement reached in the Eurogroup on Greece on August 14, the scenario of a prolonged and deep crisis in Greece, set forward in box 4 of the report, has been avoided and **possible negative spillovers from Greece will likely be contained**. Also, the **domestic political situation has significantly improved**. On July 15, the four main political parties reached an agreement that put the political crisis to an end. All parties agreed to ensure full implementation of the agreement facilitated by EU Commissioner Hahn, Members of the European Parliament, and the EU and US Ambassadors to Skopje. Parliamentary elections will take place in Macedonia on April 24, 2016. The incumbent government will submit its formal resignation to Parliament in time to enable the caretaking Government, headed by a new Prime Minister, to be sworn in 100 days before the Parliamentary elections. All current ministers will hold their positions in the interim government. It was also agreed that by September 15, a new Special Prosecutor with full autonomy will be appointed to lead the investigations arising from the interception of communications.

Unemployment reduction is the top priority of the Macedonian authorities.
Unemployment at almost 27 percent, and reaching 50 percent among young people, is the central economic problem of Macedonia. Reducing unemployment is the top priority of the Government. In recent years, good progress has been achieved in this area by implementing structural reforms and active labor market policies. As a result, the unemployment rate is on a declining path from 37 percent in 2005 to 27 percent in 2015. We would have liked that the staff paper devotes more attention to this main challenge for economic policymaking. The authorities' strategy to reduce unemployment, and by doing so reducing social tensions in this multiethnic society, is essential to understand the broader economic policy choices of the Macedonian authorities. In a small land-locked economy like Macedonia, unemployment reduction will only materializes if investments take place. To attract foreign investors, the Macedonian authorities offer a favorable tax environment, are undertaking the necessary infrastructure investments and are creating a favorable business environment. This development strategy is bearing fruit and **Macedonia is experiencing the highest economic growth rate in the region.** The country has successfully diversified its exports. The strategy of strengthening the export base resulted in a shrinking trade deficit, which is an important factor for monetary policy under the chosen monetary strategy of exchange rate targeting. It

is expected that total job creation of FDIs will exceed more than 30,000 jobs in the next 2 to 3 years, with significant positive impacts on disposable income, tax and social contributions and VAT related revenues.

The Macedonian experience illustrates that in countries where infrastructure bottlenecks are constraining growth, the gains from increased and efficient public investments by alleviating these bottlenecks are large. We believe that the report should have elaborated more on the long-term growth potential of the economy instead of being overly concerned about the short-term fiscal consequences of the country's development strategy given that the authorities are firmly committed to ensure fiscal sustainability, sound public finances and are in the process of adopting a fiscal rule.

Macro-economic situation

In 2014, growth reached 3.8 percent, the highest in the region. The economy is growing at a solid pace without inflationary pressures. July data show a mildly negative (-0.3 percent) headline inflation, while core annual inflation was, on average, 0.2 percent in the first seven months of the year.

In July 2015, the authorities have **revised GDP growth for 2015 from 4 percent to 3.5 percent** reflecting the likely impact of a prolonged political crisis and the Greek crisis casting uncertainty on the economy during June and July. The authorities' growth forecast is somewhat higher than the 3.2 percent set forward in the staff report because a faster improvement in confidence, especially in the construction and trade sector, is expected. Downside risks have recently abated, bringing the projected growth well within reach. The quality of the macroeconomic forecasts of the authorities has markedly improved. Over the last two years there have been no significant forecasting errors.

Fiscal policy

As stated in our introductory remarks, the authorities are **firmly committed to sound fiscal policies. Sound public finance management is a top priority**. With the support of the EU, the authorities are enhancing medium-term budget planning and fiscal reporting. The authorities acknowledge that maintaining stability and sustainability of the budget and public debt levels is important for a small country like Macedonia. At the same time, they consider that at this stage **prioritization of capital expenditures** for roads, railway, energy and health infrastructure **is still needed to help the economy grow and further reduce unemployment**. Against this background and because of countercyclical fiscal policy measures, public debt has indeed increased but debt dynamics illustrate that the debt will remain well below the theoretical 60 percent limit. Staff's comparison between public debt levels in 2008 and 2014 is somewhat misleading since the low debt level in 2008 was due to early repayment of debt under unfavorable terms. Assessing debt developments in the period

2006 -2014 illustrates that debt levels increased by 12.8 p.p., mainly due to capital investments which are generating economic growth. Both public debt at 43.7 percent and general government debt at 36.1 percent are among the lowest in Europe.

The authorities expect for 2015 a budget deficit of 3.6 percent compared to the 4 percent set forward in the staff paper. The authorities also project significant lower financing needs for 2015 (8.86 percent) than those calculated by the staff (15 percent). The authorities consider staff's fiscal projections too pessimistic especially on the revenue side. For the first half of 2015, the budget deficit was 1.7 percent of GDP. Compared with the same period in 2014, budget revenues are already 14 percent higher, tax revenues are 15.6 percent higher and social contributions are 8.2 percent higher. The good results are mainly due to higher revenues from both profit tax and excises. The supplementary budget adopted by the authorities on July 16 does not entail major changes to the basic macroeconomic parameters but rather reallocates some expenditures to support government policies and projects such as intensifying the construction of the gas pipeline network from Klecovce to Stip. Increasing salaries for the police is another additional spending item.

The Selected Issues paper on fiscal rules is a valuable input for the ongoing domestic discussions. The authorities are in the process of adopting a fiscal rule and are currently looking at developing proper institutional settings, including the development of a proper legal basis, automatic correction mechanisms and brakes, top-down processes and escape clause at times of significant natural and economic distress. **The authorities are highly committed to a deficit below 3 percent of GDP by 2017**. The authorities are also thankful for the technical assistance received by the Fund which has contributed to increased revenue collection.

Monetary and financial sector policy

The economic and financial conditions prove that the current monetary policy setup is adequate. **Exiting from accommodative monetary policy will mainly depend on changes in the external position of the economy and its effects on foreign reserves**. As of June 30, 2015 the gross foreign reserves stood at EUR 2,254.8 million and foreign reserves registered a somewhat higher decrease than expected in the second quarter. Yet, foreign reserves adequacy indicators remain within the safe zone. The continuing process of de-euroization reflected by an upward trend of the share of Denar deposits in total deposits indicates the credibility of the monetary authority, the strengthened confidence in local currency and the preferences to favor domestic savings.

The Macedonian banking system is largely funded by domestic deposits and is very well capitalized. The legal minimum capital adequacy is 8 percent. In addition the authorities use moral suasion to induce large banks to maintain capital adequacy of at least 12 percent. Total deposit growth in June was somewhat influenced by lower household deposits due to the domestic political developments and the crisis in Greece but total deposits still increased by 8.8 percent on an annual basis at the end of the second quarter. Nonperforming loan ratios have stabilized and are fully provisioned. Solid monthly growth of total loans to the private sector was recorded in June and the annual growth rate of total loans in June was 9.1 percent.

The authorities have put in place **sound prudent bank supervision** and are experiencing good cross-border cooperation in the banking supervision with the Single Supervisory Mechanism. More recently, the National Bank of Macedonia has taken a number of actions to improve the contingency framework. The authorities (i) have established a Financial Stability Committee with involvement of the Governor and the Minister of Finance, (ii) have improved the regulation on collateral, and (iii) have improved, in cooperation with the World Bank, the contingency planning for dealing with high risk banks and introduced contagion metrics for assessing systemic risk. For the three largest banks and one small Greek subsidiary, a written strategy has been prepared, based on the current law, outlining how the central bank would resolve each of them if they would become problematic.

In the context of the decision of the ECB to freeze the level of emergency liquidity to Greece and the risk of Greece's non-payment to the Fund on June 30, the Macedonian authorities adopted, on June 28, **protective measures to safeguard the balance of payments and financial stability** given the imminent threat of negative spillovers. These measures are in line with the Fund's institutional view on capital controls; i.e. they are transparent, temporary, precautionary and don't disturb the normal conduct of business. Indeed, until now, the authorities did not receive any complaints about these measures from banks or businesses and the trade relations with Greek companies have continued normally from the Macedonian side. The authorities have, in the meantime, with the expertise of the Fund, slightly amended the decisions to bring **the restrictions fully in line with the Fund's Articles of Agreement**.

Structural reforms

Macedonia **lists at the top among regional peers in the last 9 years, including the latest World Bank Doing Business report.**

In line with Fund advice and with the support of the World Bank and IFC, the authorities are intensifying their efforts to strengthen the links between the companies operating in the Technological Industrial Development Zones and the domestic private sector. The authorities agree with the staff's recommendations on the **importance to continue to ease the operating environment for the domestic private sector**. This is why the authorities have intensified the dialogue with the business community and the chambers of commerce. Recently, the authorities took measures to reduce the fines for the domestic companies and are continuing their efforts to improve access to finance for SMEs, through the European

Investment Bank and the Macedonian Bank for Development Promotion, and to boost education systems to reduce skill mismatches and develop entrepreneurial spirit and skills.

To **strengthen the innovative capacity of the Macedonian economy**, the Fund for Innovations and Technology Development has launched in the beginning of 2015 its first call for co-financing grants for start-up, spin-off companies and innovations and will co-finance in 2015 for €458.700 projects in the area of IT, electrical, engineering, education, food and machinery industries. It is expected that the Fund for Innovations and Technology Development will contribute to generate new businesses and jobs (especially for young and highly qualified persons) and to better connect research and entrepreneurship.

It is also worth noting that the authorities are preparing an Action Plan to address shortcomings in the areas of rule of law and judiciary, public administration, media, electoral reform, inter-ethnic relations and economic governance. All these reform measures will continue to enhance economic growth, competiveness and provide a boost to job creation.

Concluding remarks

Unemployment reduction is a top priority for Macedonia and the authorities are delivering on this objective. Sound fiscal policies and strengthening medium-term budget planning are high on the political agenda and the authorities look forward to a continued collaboration with the EU and the Fund on this. Macedonia is transitioning towards a knowledge-based economy and the authorities are well aware that the economic prospects of Macedonia depend on the developments in the European economies. Against the background of the EU accession objective, for which Macedonia fulfilled all the criteria necessary to start accession negotiations already in 2009, there is clear political consensus and orientation towards both EU and NATO membership.

On a final note, we observe that Macedonia has completed, on February 27, 2015, the early repayment of its entire outstanding obligations to the Fund, amounting to SDR 123.1 million. This reflects the country's improved access to domestic and international capital markets.