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FORMER YUGOSLAV REPUBLIC OF MACEDONIA

2014 ARTICLE IV CONSULTATION AND THIRD POST-PROGRAM MONITORING DISCUSSIONS—STAFF REPORT; PRESS RELEASE; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA

July 2014

In the context of the 2014 Article IV Consultation and Third Post-Program Monitoring Discussions, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on July 1, 2014, following discussions that ended on May 19, 2014, 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 June 17, 2014.
- An **Informational Annex**
- A **Press Release**
- A **Statement by the Executive Director** for the Former Yugoslav Republic of Macedonia.

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

Selected Issues

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

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FORMER YUGOSLAV REPUBLIC OF MACEDONIA

June 17, 2014

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION AND THIRD POST-PROGRAM MONITORING DISCUSSIONS

KEY ISSUES

Context. Growth accelerated to 3.1 percent in 2013, driven by a positive net exports contribution. The broad policy direction is supportive of near term macroeconomic stability. The key challenge is to transition from stability into an acceleration of medium term growth. Uncertainty with respect to EU accession remains, and weighs on longer term prospects.

Fiscal Policy. The 2014 central government deficit target must be met, even in the face of weaker revenues—lower central government spending is unlikely to derail the recovery and debt stability considerations should weigh more heavily. Laying out the measures underpinning the medium-term adjustment path will reduce implementation risks and ensure a sustainable and growth-friendly consolidation. Large public infrastructure works will support both near term and potential growth, but their substantial impact on public finances needs better monitoring and disclosure.

External Stability. With external risks on the downside, and a baseline drawdown of reserves, the balance of payments outlook for 2014 is fragile. In that context, the focus of monetary policy has appropriately shifted away from providing stimulus toward preserving reserve adequacy in the context of the exchange rate peg. Over the medium term, external sustainability hinges on accelerating FDI flows and continuing to strengthen the tradable sector.

Financial Sector. The financial system remains liquid and relatively healthy, but inefficient intermediation carries substantial opportunity costs for the economy. Strong domestic deposit growth has been increasingly channeled into government securities; a lending culture based on physical collateral results in inefficient allocation of credit and constrains financing for more dynamic entrepreneurial sectors.

Growth and Jobs. A determined effort to alleviate key business environment constraints should invigorate the domestic private sector and may have important catalyzing effects on diaspora investment. Strengthening supply chain linkages between foreign and domestic firms would create more jobs and facilitate knowledge spillovers.

Approved By
Philip Gerson and Dhaneshwar Ghura

Discussions were held in Skopje, May 6–May 19, 2014. A team comprised of Ms. Vladkova Hollar (head), Messrs. Gerard and Impavido, Ms. Taheri Sanjani (all EUR), and Messrs. Gitton and Nacevski (Resident Representative office) met with Finance Minister and Deputy Prime Minister Stavreski, NBRM Governor Bogov, other senior officials, and private sector representatives. Mr. Hadzi–Vaskov (OED) and Mr. Shimbov (World Bank) joined some of the discussions. A joint press conference was held at the conclusion of the mission. Ms. Mahadewa and Ms. S. Chen assisted in the preparation of the staff report.

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CONTEXT

1. **The broad policy direction is supportive of near term macroeconomic stability.** Presidential and parliamentary elections in April handed down a broadly unchanged mandate. Fiscal consolidation—needed to stabilize central government debt—is expected to proceed as planned, with the authorities reaffirming the targets set in the 2014–2016 medium term fiscal strategy. This is being complemented by an envisaged strengthening of the fiscal framework, through building capacity for preparing medium term expenditure frameworks and introducing multi-annual budgets, and, potentially, through the adoption of a fiscal rule.

2. **The key challenge remains to transition from stability into an acceleration of medium term growth**. While income per capita has almost doubled since 1998, income convergence—first interrupted by the 2001 conflict and then by the global crisis in 2008—has been slow to come (Figure 1). In that respect:

- **Important elements of the structural agenda are being put in place.** The need for capital deepening, human capital accumulation and structural transformation is well understood, and underpins the authorities' public infrastructure policy, labor market initiatives, and strategy to attract FDI.

- **Uncertainty with respect to EU accession remains**. The Former Yugoslav Republic of Macedonia has been a candidate country since 2005, but a date for the start of accession talks has not been set. In the absence of a negotiation process, the European Commission continues to engage in a High Level Accession Dialogue (HLAD), looking for progress along key reform priorities in the areas of media freedom, judicial independence and electoral legislation, as well as good neighborly relations[1]. The 2014 progress report will be released in October.

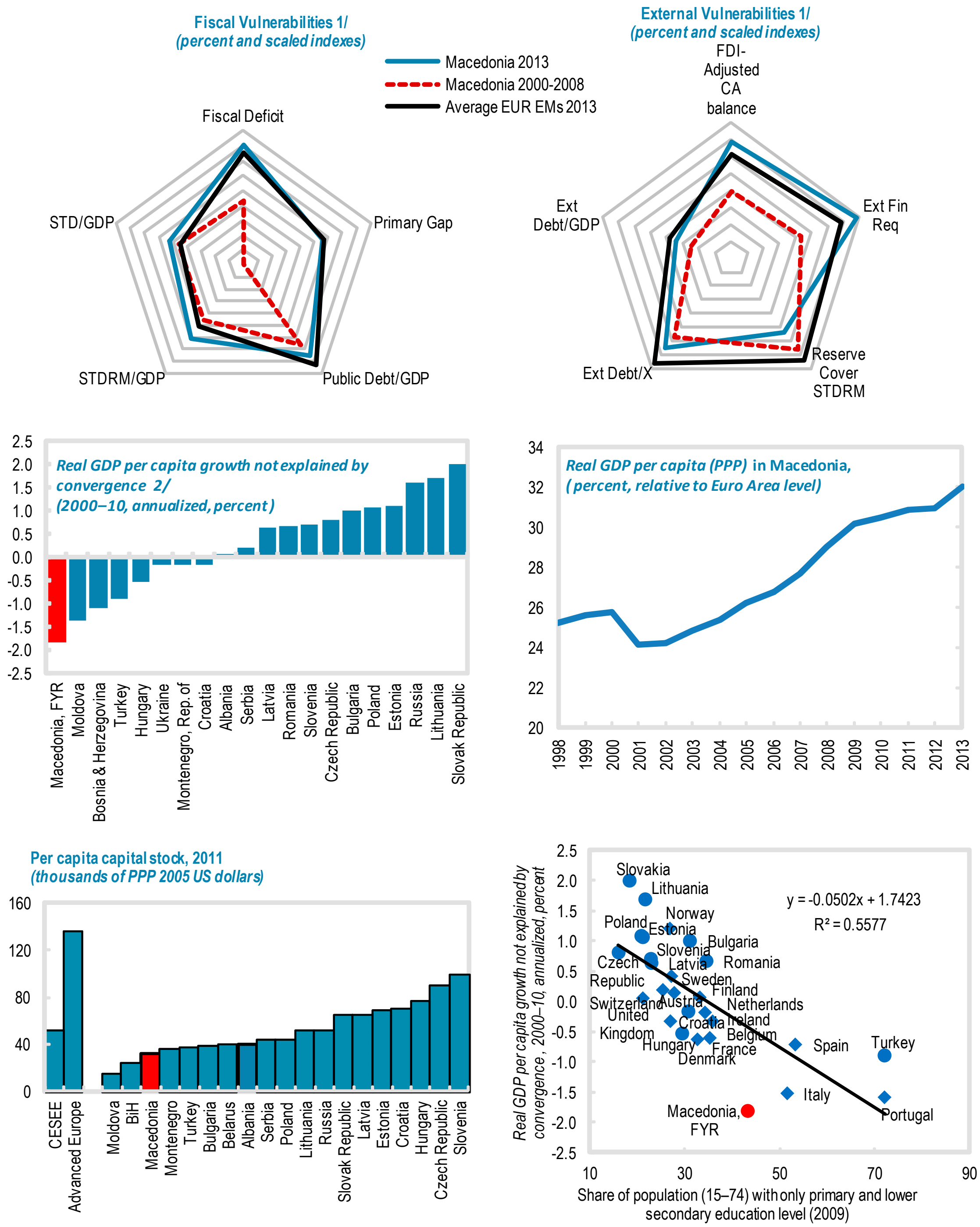
Relations with the Fund and IMF Past Policy Advice

A two-year Precautionary and Liquidity Line (PLL) was approved on January 19, 2011. In March 2011, the authorities drew 286 percent of quota (about US$305 million). Following the expiration of the PLL in January 2013, the authorities engaged in post-program monitoring. In January 2014, the Board concluded the Ex-Post Evaluation (EPE) for exceptional access. Repayments of the PLL are due over three years in equal quarterly installments, with the first repayment of US$38 million scheduled to take place in June 2014.

Policy implementation has generally been consistent with IMF recommendations, although Fund traction on public financial management, and in particular on payment arrears, has been limited over the past few years. In line with recommendations of the 2013 Article IV Consultation, the authorities have anchored fiscal policy in a medium term fiscal strategy, which envisages a gradual consolidation, starting with the 2014 budget.

[1] http://europa.eu/rapid/press-release_IP-14-294_en.htm. The resignation of 33 out of 123 newly elected MPs in May complicates the assessment of political inclusiveness, and may introduce near-term political volatility.

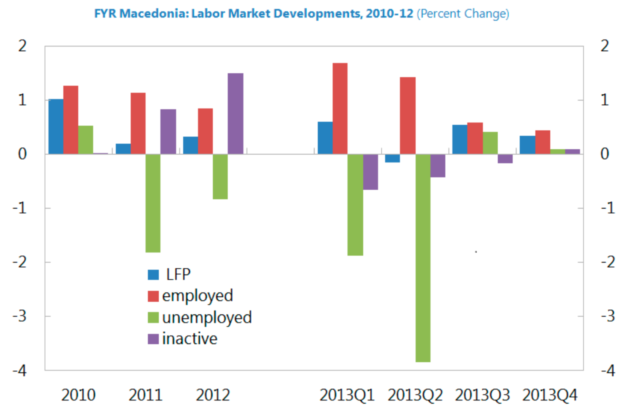
Figure 1. FYR Macedonia: Vulnerabilities and Challenges



Source: Eurostat, IMF Regional Economic Outlook: Europe (October 2011), and IMF staff calculations.
1/ Variables Public Debt, STDRM/GDP, ST/GDP, Ext Debt/GDP, Ext Debt/X, Reserve Cover STDRM are expressed in percent; variables FDI-Adjusted CA deficit , Ext Fin Req , Fiscal Balance, and Primary Gap are expressed in terms of specific indexes . A widening of the web represents increased vulnerability.
2/ The adjusted growth measures the difference between each country's actual growth rate and the growth rate that could expected given initial income levels.

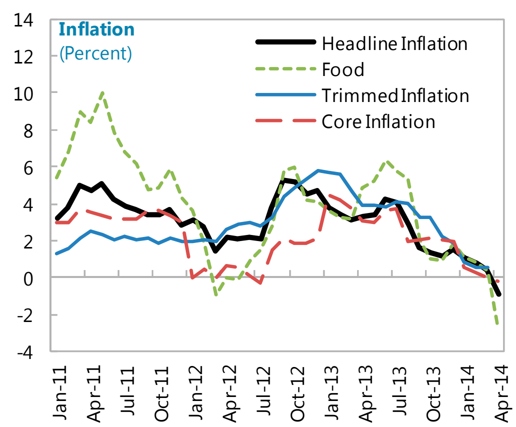
RECENT ECONOMIC DEVELOPMENTS

3. **Growth in 2013 appears to have been more job-friendly than in the past, aided by active labor market policies**. The decline in the unemployment rate—down 2 percentage points to 28.6 percent by end-2013—reflects both a decline in the number of unemployed as well as an increase in the labor force. The latter is a positive indication of improving perceptions of labor market conditions. The pickup in participation rate is explained mainly by young and older workers and employment among the main working age group (25–49 year olds) has grown more modestly, suggesting that the labor market improvement is still tentative (text figure).

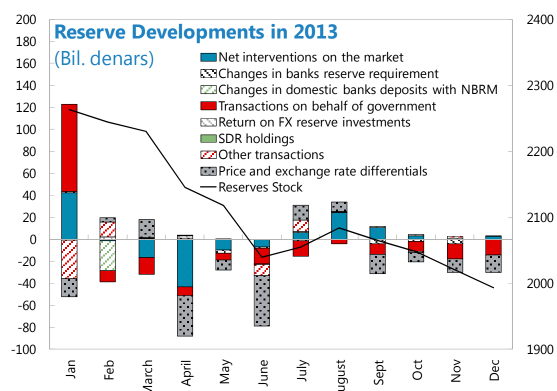


Source: Haver, IMF staff calculation

4. **Inflation has been rapidly trending downward, driven by lower food and commodity prices**. CPI inflation averaged 2.8 percent in 2013, but price growth in 2014 has been weak and consumer prices declined in April, bringing average monthly inflation to just 0.2 percent for the year to date. Average trimmed inflation over the first four months stood at 0.6 percent. Staff projects a pickup in inflation in the second half of the year, bringing average inflation to about 1 percent.



5. **Foreign exchange reserves continued to decline through April**. Despite a narrowing of the current account in 2013 and net FX purchases by the central bank, reserves declined EUR 200 million, or 10 percent from end-2012 levels, mostly due to negative valuation effects. In the first few months of 2014, a weak financial account has resulted in reserves declining further; the trade balance has improved some EUR 8 million through March, on the back of strong exports.



Source: NBRM.

6. **Credit growth has been gathering pace.** The banking sector has remained healthy, with capital adequacy ratios hovering around 17 percent, and liquidity ratios around 30 percent. Monetary conditions remained accommodative throughout 2013, with the main policy rate reduced twice, in January and July, to 3.25 percent and the successive relaxation of reserve requirements for long-term deposits and specific categories of liabilities (Box 1).

As a result, overall credit growth started strengthening in the second half of 2013, bouncing back to 7.5 percent year-on-year in March. However, dynamic mortgage lending growth contrasts with still weak lending growth to the corporate sector.

7. **The nominal cash budget deficit target for 2013 was met, resulting, nonetheless, in a higher than targeted deficit as a share of GDP**. The 2013 deficit reached 4.1 percent of GDP, some 0.2 percentage points above the authorities' revised target. Revenue underperformance relative to the budget was about MKD 9 billion—a notable 1.9 percent of GDP, of which roughly half was due to a one-off clearance of VAT refund arrears. Expenditure adjustment was spread across goods and services, transfers, and capital expenditure.

8. **As of end-April, growth in expenditures had outpaced that of revenues, resulting in a cumulative budget deficit of 2.5 percent of GDP**. A third of the way through 2014, expenditure stood at 33 percent of the total budget. As in 2013, subsidies and other transfers were frontloaded, with almost 50 percent of the budgeted amount spent in the first four months. On the revenue side, early weakness in revenues reflects divergent developments: strong collections of PIT and social contributions seem buoyed by a continued improvement in labor market conditions; CIT performance has also been strong, likely reflecting the effect of legal changes to fight evasion; these positive developments have not, however, offset weaker VAT revenues.

FYR Macedonia: Central Government Budget Execution, Jan-Apr 2014

	Outturn 2013	Budget 2014	Outturn till April 2014	Outturn over Budget 2014	2014 Staff Proj.
	MKD Billion				MKD Billion
Total Revenues 1/	139.7	157.6	45.3	28.7	153.9
Tax Revenues and Contributions	121.0	133.9	39.9	29.8	131.7
VAT (net)	39.8	48.5	13.7	28.2	46.0
Non-Tax Revenues 3/	11.6	14.5	3.4	23.5	14.5
Capital Revenues 4/	3.7	5.7	1.3	22.0	4.2
Grants	3.5	3.5	0.7	19.4	3.5
Expenditures 1/	159.0	175.9	57.6	32.7	170.9
Current Expenditures 5/	142.9	154.1	51.8	33.6	152.2
Capital Expenditures	16.6	22.4	6.0	26.8	19.4
Fiscal Balance - Surplus(Deficit)	-19.3	-18.3	-12.3	67.3	-17.0
In percent of GDP	-4.1	-3.7	-2.5		-3.5
Primary Balance - Surplus(Deficit)	-14.6	-13.9	-10.8	78.1	-12.7
In percent of GDP	-3.1	-2.8	-2.2		-2.6

Notes:
1/ Excluding revenues from lending.
2/ Including Tax Revenues (SRA).
3/ Excluding profits from financial institutions.
4/ Including profits from financial institutions.
5/ Excluding lending guarantees.

OUTLOOK AND RISKS

Baseline outlook

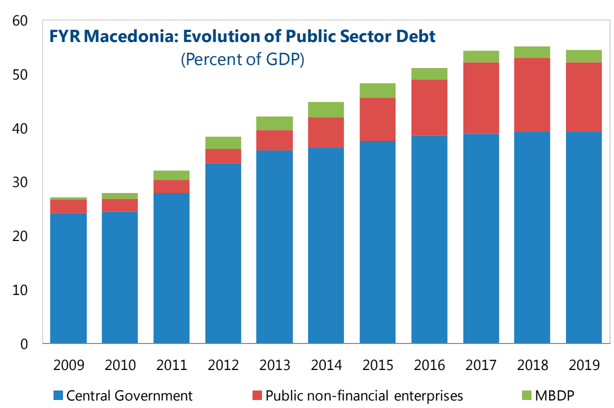
9. **Growth is expected to gather pace—to 3½ percent this year—and to broaden**. Private consumption will be supported by household credit, employment growth, and higher public wages and pensions, while investment will be bolstered by large public infrastructure projects. The contribution of net exports will turn negative again as higher investment-related imports offset the positive impact of increasing exports. In the medium run, the growth in private demand should moderate while the contribution of external demand should strengthen along with improving export capacity. Current fundamentals could support growth of 4 percent over the medium term; a realization of planned investment would raise growth potential.

10. Credit conditions are expected to continue improving. Private sector credit growth of about 7 percent per year seems feasible, particularly as risk aversion in the system abates. Credit supply appears driven by banks' expectations on the outlook (Box 2); thus, a perceived improvement in growth prospects should help sustain credit growth. Increased competition from smaller banks looking for market share gains and the assumed normalization of the situation of foreign parent banks NBG (Greece) and NLB (Slovenia) would support that baseline.

11. Reserve losses are expected to halt and partially reverse in the second half of 2014. The current account deficit is expected to widen to about 4.5 percent of GDP, driven by a rebound in imports—partly reflecting stronger investment, partly higher imports of services linked to the implementation of foreign-financed construction projects—and slightly declining private transfers. FDI inflows are expected to pick up to about 3.8 percent of GDP, notably reflecting the impact of several big projects in the free trade zones. The financial account would be buoyed by inflows to the public sector both from external multilateral (World Bank) and bilateral (Chinese EX-IM Bank) project loan disbursements. This should allow for a gradual buildup of reserve assets in the second half of 2014, which, however, is not expected to fully offset the losses recorded in the first quarter.

12. The balance of payments position is expected to gradually improve over the medium term, preserving reserve adequacy. Export growth is expected to progressively outpace import growth, reflecting the expansion of export production capacity (notably in the free trade zones) as well as some import substitution. After peaking at 5.6 percent of GDP, the current account deficit should progressively improve in line with the trade balance, and despite slowly decreasing private transfers. Along with continued public sector borrowing, this would allow for an acceleration of GIR accumulation.

13. Central government debt is expected to stabilize, but debt of non-financial SOEs is projected to increase to almost EUR 1.4 billion by 2019. Local governments have limited debt; staff does not project a change in this trend and expects general government debt to remain close to central government debt of EUR 4.3 billion at end-2019. The Macedonian Bank for Development Promotion (MBDP)—which has intermediated about EUR 250 million for SME financing from the EIB since 2009—has contracted a new EUR 100 million credit line at the end of 2013, but no new financing is expected. Overall, staff projects public sector debt to increase from 44 to 55 percent of GDP in the period 2014–19 (text graph).



Sources: Ministry of Finance; and IMF staff calculations.
PESR debt is projected to increase from 1.5 to 6 percent of GDP in the period 2014-18, at a pace of about EUR100 million per year until 2018 for the Miladnovic-Stip and Kicevo-Ohrid motorways; debt of other SOEs is projected to decrease from 3.8 to 3.3 percent of GDP over the 2014-18 period, based on amortization of existing debt and no new investment activity.

Risks

14. **Surges in global financial market volatility in 2014 are not a key near term risk, given the weak integration of Macedonia in global capital markets**. Dependence on cross-border lending is less pronounced than in peer countries. The scope for portfolio investment outflows is constrained by the limited availability of equity and debt instruments; CPIS data suggest that non-resident holdings of portfolio investment liabilities are less than 2½ percent of GDP. Central government external financing requirements in 2014 (just over 1 percent of GDP) are expected to be met exclusively by official lending. The rollover of a EUR 150 million eurobond maturing in 2015 will need to be skillfully managed.

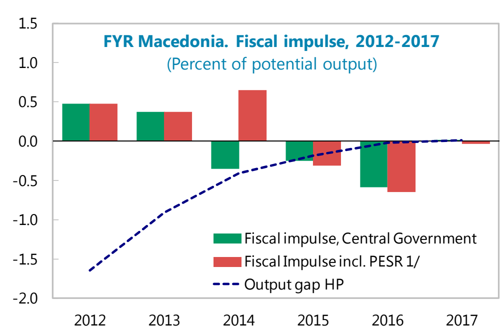
15. **Nonetheless, any further stress in parent banks could lead to renewed tightening of credit conditions**. The standalone strength of the systemic Greek and Slovenian subsidiaries mitigates some of this risk, as does a largely domestic deposit-based funding strategy. However, as was most acutely the case in 2012, even in the absence of funding constraints, group-level restrictions on the growth of credit portfolios in these two banks would jeopardize the recovery in credit. Implications from the AQR and stress tests of euro area banks in the context of the transition to the single supervisory mechanism (SSM) are not clear.

16. **In the short run, commodity price shocks from Ukraine-related disruptions could exert some pressure on the balance of payments**. Direct trade exposure to both Russia and Ukraine is low, except for natural gas. A 15 percent oil price shock, however, would have the potential to widen the current account by an estimated 1.9 percent of GDP.

17. **The main macroeconomic risk over the medium term pertains to a protracted period of slower growth in advanced European economies**. In a small open economy characterized by increasing real integration with Europe, notably Germany, a prolonged period of weak growth in advanced economies would further weaken FDI, depress export growth, and weigh on consumption as private transfers slow. This could, in turn, put increasing pressure on external reserves under the pegged exchange rate regime.

POLICY DISCUSSIONS

The authorities broadly agreed with staff's advice on the policy mix, namely that, given the balance of risks, further monetary policy support to credit and activity would not be appropriate, and that fiscal consolidation should proceed as spelled out in the medium-term strategy, while preserving the envelope for infrastructure projects. The medium term growth agenda—and the fiscal, financial, and structural policies that would support it—were a key focus of the discussions.



Source: IMF staff estimates.
Note: HP stands for Hedrick-Prescott Filter. The fiscal impulse is the difference in the cyclically-adjusted primary balance between the previous and the current year (a negative fiscal impulse means a cyclically-adjusted contraction).
1/ Assumes PESR investment spending of EUR 80 million a year, starting in 2014.

A. Fiscal Policy

18. In the short run, fiscal policy should be geared toward meeting the 3.5 percent of GDP deficit target. Containing the central government fiscal deficit will be important to keep debt on a sustainable path. Capital revenues will likely fall short by about MKD 1.5 billion[2], but this can be accommodated within normal buffers in the budget. Staff projects a shortfall of VAT revenues of about MKD 2.5 billion, particularly in the face of weak price developments; should that risk materialize, and absent a notable overperformance of other revenues, meeting the deficit target may require further expenditure compression, particularly as some additional space may need to be created for a yet-to-be finalized debt relief program for socially vulnerable debtors.

19. The recovery is unlikely to be derailed by a tighter budget spending envelope. The effect on growth of lower spending at the central government level will be partially mitigated by the positive impact on employment and investment from large infrastructure works implemented by SOEs (text chart). Staff's estimated fiscal impulse associated with spending by the Public Enterprise for State Roads (PESR) is about 0.7 percentage points in 2014.

20. Debt stability considerations require that the authorities continue to consolidate, reducing the central government deficit to 2.6 percent of GDP by 2016. The central government debt ratio is expected to peak at around 39.4 percent in 2018—some 3½ percent above end-2013 levels—and stabilize thereafter (see Appendix I). Overall public sector debt is projected to rise to about 55 percent of GDP in 2019, some 9 percentage points of GDP above staff's previous baseline, about half of which is due to the envisaged infrastructure investment program. On balance, this higher path remains broadly consistent with debt sustainability given the importance of such investment to potential growth, the long- term nature of debt, and safeguards that limit fiscal risks from the Public Enterprise for State Roads. Nonetheless, it underscores the need to stabilize central government debt, as well as to focus sustainability analysis on broader public sector operations.

21. Laying out the measures underpinning the medium term adjustment will reduce implementation risks. The planned consolidation path relies on revenue growth outpacing expenditure growth. An articulation of measures—in the context of the next medium-term fiscal strategy—will help the authorities reduce the deficit while achieving their desired growth-friendly expenditure mix. The strategy could usefully be guided by policy measures to be identified under the forthcoming World Bank-led Public Finance Review. Key considerations, in staff's view, are the following:

- On the revenue side, policy commitments to maintain a low-tax business environment have permanently reduced CIT revenues by about 1.2 percent of GDP since 2008. Trade liberalization has reduced customs duties by 0.6 percent of GDP over the same time horizon. Absent further tax policy changes, the revenue envelope is therefore some 1.8 percent of GDP lower than pre-crisis.

[2] This reflects a lower realization of the budgeted Telecom dividend.

- On the expenditure side, crisis measures, which have frozen wages and employment, have delivered a decline in the wage bill, from 5.1 percent in 2008 to 4.8 percent of GDP in 2013. Staff sees potential for upward pressure on wage spending over the medium term, as public administration resources become strained.

- To avoid building in new permanent expenditure commitments in pensions and transfers that could jeopardize the consolidation, fiscal space for new policy initiatives should be assessed on the basis of prudent macroeconomic assumptions, particularly in the context of the current low inflation environment.

- To strengthen the medium term expenditure framework, building explicit contingency margins under aggregate expenditure ceilings would allow for adjustments due to changes in macroeconomic and macro-fiscal forecasting assumptions and to protect against volatility of budget revenues.

22. Strengthening public investment policy remains a priority. Large investments in transport and energy infrastructure are crucial for further regional integration, competitiveness, and catalyzing further domestic and foreign private investment. The small size of domestic private sector balance sheets relative to the significant infrastructure investment needs have resulted in a public sector-led strategy, reliant on long-term financing from IFIs. While higher infrastructure spending should result in an acceleration of potential growth, the transition period toward that result is challenging and exposes the country to increased risk associated with carrying a higher debt stock. In that light, clear procedures to assess, prioritize, and monitor public investment projects should enable higher long-term economic return.

23. Public sector financing entails external and fiscal risks that should be articulated and disclosed in a debt management strategy. Hence, the medium-term fiscal strategy should be accompanied by a debt management strategy that strikes a balance between achieving an efficient mix of external and domestic financing and maintaining overall macroeconomic stability. In particular, the debt issuance and the currency financing mix should integrate the following policy priorities: preserve adequate foreign exchange reserves, minimize debt-servicing costs subject to acceptable risks, smooth the amortization profile, and avoid crowding out the private sector[3]. The strategy should take a broad perspective and consider contingent liabilities—most of the financing of SOEs is external, in foreign currency, and carries a government guarantee.

Authorities' views

24. The authorities reiterated their commitment to the 3.5 percent deficit target, and saw more substantial upside risk to revenues. They noted that there were significant one-off factors, including pre-election postponement of durable goods purchases, which compressed VAT revenues

[3] See International Monetary Fund and World Bank (2007), "Strengthening Debt Management Practices: Lessons from Country Experiences and Issues Going Forward", http://www.imf.org/external/np/pp/2007/eng/032707m.pdf

early in 2014. Higher frequency unofficial data suggests that more recently an acceleration of revenue growth may indeed be underway. Thus, the authorities considered the need for a few more data points to be able to judge whether the early weakness in revenues requires a reprioritization of expenditure beyond the use of buffers.

25. More broadly, the authorities outlined their fiscal agenda for stability and growth. The authorities concurred that reducing the central government deficit to 2.6 percent is required to maintain moderate debt levels. They were cognizant of the need to preserve fiscal space for growth-critical capital expenditure: both in the budget, namely for multiyear railway and gas infrastructure projects, as well as through SOEs, for road infrastructure. In securing that space,

- **Tax policy changes are not envisaged**. The authorities noted that exemptions in the tax system are limited. At the margin, and mostly on efficiency grounds, there may be scope to abolish the zero income tax rate on profits that are retained but not reinvested. Harmonization of excise taxes over the medium term, up to the EU minimum, may provide a boost. Overall, policies will focus more on improving revenue administration than increasing rates.

- **Future scope for wage and pension increases will be carefully considered**. The authorities did not see any significant size distortions in the civil service that would call for a more comprehensive public administration review. A new law on civil servants, to come into effect in 2015, aims to upgrade the professionalism of public servants, establishing integrity tests and language requirements; the authorities noted that some decompression in the wage structure—increasing pay differentials—would be needed. Pressure on current expenditure from subsidies would be contained by capping the spending envelope for agricultural subsidies at EUR 150 million per year over 2015–18.

B. Monetary and Financial Sector Policy

26. Monetary policy remains the first line of defense to ensure a reserve level consistent with the sustainability of the peg[4]. While restrictions on capital movements and limited integration with global financial markets provide some buffers against the buildup of immediate pressures on the exchange rate, the evolution of reserve adequacy metrics warrants attention. Were pressures on reserves to materialize, the NBRM should stand ready to raise its policy rate, and to abruptly tighten reserve requirements on FX and FX-linked deposits. Given the limited size of interest sensitive flows, this would mainly induce a reversal of commercial bank foreign asset accumulation (as in 2009), and, at the margin, attract some non-resident deposits of parent companies.

[4] Formally, the official (de jure) exchange rate classification is "floating", even though the NBRM buys or sells foreign exchange to keep the denar trading in a very narrow band around the rate of 61.5 denars per euro. Accordingly, the de facto exchange rate regime is classified as "stabilized".

Reserve adequacy ratios for Macedonia - 2011-2019

	2011	2012	2013	2014	2015	2016	2017	2018	2019
Reserve/STD (percent)[1/]	112.1	101.1	99.6	90.3	96.9	99.3	101.2	109.0	125.3
Reserve/Months of prospective import goods [2/]	5.1	5.5	4.6	3.9	3.7	3.7	3.8	3.9	3.7
Reserve/Broad money (percent) [3/]	49.9	50.7	43.7	40.2	38.4	39.2	39.6	40.9	42.2
Expanded 'Greenspan-Guidotti' metric: Reserves/(STD + CA deficit)	101.7	91.5	93.1	77.4	78.7	82.6	84.4	90.8	103.1
Reserves/Fund combination metric (percent) [4/]	127.3	128.8	117.7	109.1	104.9	105.5	163.4	169.0	170.8

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

27. **In this context, the authorities should refrain from further relaxation of the monetary policy stance**. With credit gradually picking up, there does not seem to be further scope for monetary stimulus, especially as the experience of the past two years suggests that the transmission to banks' lending rates works at best with considerable lags. In addition, ample liquidity in the banking sector does not call for any further lowering of reserve requirements.

28. **The authorities should remain closely involved in the design of an institutional arrangement that would establish effective coordination between the SSM and non-EU members**. The central bank's intention to preserve a conservative approach to bank supervision in a changing European framework is appropriate. At the moment, the NBRM holds supervisory colleges with the Bank of Greece and the Bank of Slovenia twice a year, as well as more ad hoc discussions with Austrian supervisors. As the ECB assumes its new supervisory role in late 2014, continued good cross-border cooperation in banking supervision in the context of the SSM will be key, in light of the systemic importance of euro area subsidiaries to the domestic banking system.

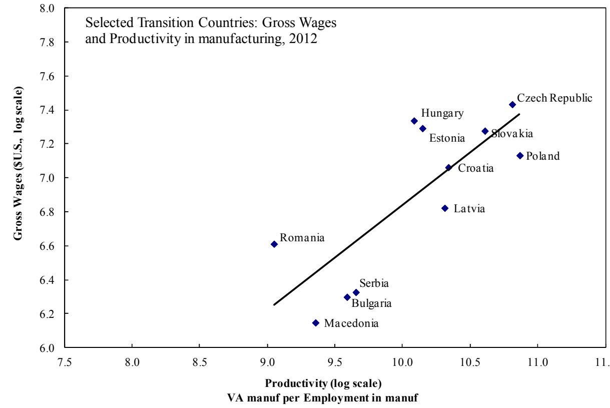
29. **A prompt reinstatement of the NBRM's powers to address unfit shareholders is needed to preserve a strong regulatory and supervisory framework**. A recent Constitutional Court ruling invalidated sections of the Banking Law that allow the supervisor to dispose of shares held by shareholders who have been declared unfit. The invalidated provisions were in line with international best practices, and their removal weakens the supervisory framework. Staff supports the NBRM's chosen course of action—namely sending to the government a revised set of provisions that clarify both supervisory powers and individual property rights.

Authorities' views

30. **The authorities concurred with the need to put priority on preserving the sustainability of the peg and shifting away from further stimulating credit growth**. They reiterated their commitment to tighten the monetary stance as needed in the face of any further deterioration. They emphasized that reserves were still adequate on a number of metrics, and that there were a number of upside risks to the conservative balance of payments baseline.

31. **The authorities stressed the challenges to supervisory cooperation in the context of the SSM**. While they would like to see their current cooperation through supervisory colleges extended to other supervisors of foreign parent banks, they expressed concerns that such bilateral arrangements might be discontinued in favor of a centralized European supervision. The authorities suggested that the EBA devote more resources to the region, in particular to support and assess the equivalence of supervisory and legal systems with respect to compliance with EU standards.

C. Growth and Competitiveness Policies



32. **Cost competitiveness in manufacturing is high, and standard tools do not point to exchange rate misalignment**. A simple competitiveness index, defined as productivity over gross wage, suggests that Macedonia ranks fourth out of a set of eleven regional comparators in manufacturing competitiveness. The Fund's exchange rate assessment framework does not identify significant misalignment. The slight undervaluation signaled by the macroeconomic balance approach is driven by a low estimated current account norm (a deficit of 5 percent). By contrast, the external sustainability methodology signals a slight overvaluation of the real exchange rate compared to the level needed to stabilize the NFA position.

FYR Macedonia: Estimated REER Misalignment

Approach	Magnitude of Misalignment
Macroeconomic Balance	-2.8
Equilibrium REER	-1.7
External Stability	1.0
Overall Assessment	No Significant Misalignment

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

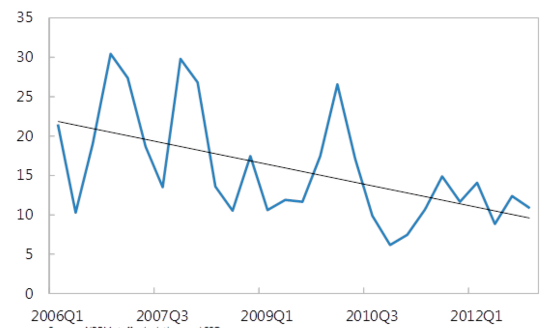
33. **Nonetheless, the large structural trade deficit suggests that export and import-competing sectors remain underdeveloped, and remittances may have played a role**. Large-scale migration of labor over the last two decades has resulted in sustained large private transfers, which undoubtedly bring important economic benefits, including for poverty reduction and external stability (see accompanying Selected Issues Paper). However, the increase in households' disposable incomes associated with remittances may also support excessive consumption and import growth, exerting upward pressure on the relative price of non-tradable goods and on reservation wages. Over time, these price distortions may induce a reallocation of resources towards the non-tradable sector, thus weakening the overall competitiveness of the economy (Box 3). To counteract such dynamics, cross-country experience suggests scope for (i) setting up financial vehicles aimed at harnessing remittance flows to productive investment (such as diaspora bonds for financing capital projects), and (ii) improving infrastructure and the business environment—catalyzing diaspora investment may exact higher standards of their home country in both areas.

34. While Macedonia has risen to a notable 25th place in the Doing Business 2014 index, the private sector continues to face binding constraints. Enforcing payment discipline in both public and private sector contracts, clarifying the mandate and rights of inspection bodies, and improving firms' access to finance are priority areas in that respect.

35. Inefficient intermediation likely carries a substantial opportunity cost for growth. Strong domestic deposit growth (as well as retirement savings within the two second pillar pension funds) has been increasingly channeled into government securities. The lending culture of banks based on physical collateral likely under-allocates credit to more dynamic entrepreneurial sectors; an upgrade in credit scoring technologies would likely help. In addition, previous staff research (SM/13/179) suggests addressing weaknesses in accounting practices in the corporate sector, encouraging more realistic valuation of collateral by banks and improving the efficiency of legal procedures.

36. To lock in the ongoing reduction in unemployment, efforts to alleviate key employment constraints should continue. Labor market institutional factors (labor market flexibility, social assistance, and labor taxation) appear in line with those of EU new member states and are therefore not likely to be the main explanatory factor of the poor labor market outcomes in FYR Macedonia.

Skill Mismatch Index



Sources: NBRM staff calculations and SSO.
1/ Skill mismatch index (SMI) is calculated as $SMI_t = \Sigma_j \left(S_{jt} - D_{jt}\right)^2$
Where j denotes the education degrees; t denotes the time; is the demand for labor, computed as a share of the employees belonging to the education group j in the total number of employees in the period t. is the supply of labor, computed as a share of the active population in the education group j in the total active population in period t.

- ***Investment in training and education should be a priority***. Empirical analysis[5] shows that nearly two-thirds of long-term unemployment is explained by skill mismatches between supply and demand for labor. Active labor market policies and education reform have been successful in reducing the mismatch, but the effects will likely be felt slowly, as jobseekers need to acquire the relevant skills before being able to benefit from newly created jobs.

- ***Strengthening supply chain linkages between newly-established foreign enterprises and domestic firms would create more job opportunities and facilitate knowledge spillovers***. This would require proactive information sharing and the reduction of any costs associated with doing business with the free trade zones.

Authorities' views

37. The authorities concurred with the view that remittances flows could contribute more to potential growth, but advised caution in interpreting remittances data. Measurement issues point to the need to draw only tentative conclusions. The authorities stressed that a non-trivial share of private transfers likely represents unrecorded exports of services, leading to an underestimation

[5] See NBRM, Quarterly Report, July 2013.

of the economy's competitiveness. Nonetheless, the authorities concurred that there is scope to better channel these flows to productive investment. This could possibly be done by creating dedicated savings and investment instruments for the diaspora. In this context, the authorities suggested that municipal level instruments and projects are more likely to succeed.

38. **The authorities acknowledged the challenges associated with excess liquidity and risk aversion in the banking sector**. The structure of the banking system has certainly posed specific challenges—systemic euro area subsidiaries have faced externally-imposed portfolio restrictions, a diluted shareholding structure in a key domestic bank has likely distorted incentives, and the size distribution of banks in the system does not generate sufficient competition. Policy actions have aimed at spurring bank lending (Box 1), but also at trying to encourage alternative sources of financing—notably, the introduction of a zero reserve requirement on corporate bonds. The authorities noted that the role of the stock exchange is still limited, but they are pushing forward with a regional joint stock exchange platform which they hope would stimulate more equity financing.

39. **The authorities highlighted key actions aimed at strengthening the business environment and facilitating job growth**. The Law on Financial Discipline, aimed at improving liquidity in the private sector, came into effect on May 1. A newly established inspection council will govern all inspection bodies, previously under the jurisdiction of separate line ministries; the goal of the reform is to reduce lobbying pressure and upgrade the professionalism of the inspectorates. Significant efforts have been made in cleaning up unemployment registers to improve the targeting of active labor market policies. The authorities have also looked to outside experts to help in developing policy tools for effective development of domestic private sector linkages with FDI firms.

POST-PROGRAM MONITORING

40. **Macedonia's capacity to repay remains adequate**. Risks are broadly balanced:

- ***Upside risks to FDI and public sector inflows***. The baseline forecast for foreign direct investment is conservative. At 3¾ percent of GDP per year over the medium term, projected FDI flows are about one percentage point of GDP below their historical average. Public sector borrowing is mainly linked to the implementation of investment projects articulated with already secured lending commitments, from official and private sources. The baseline reflects staff's lower bound estimates for these flows, as well as upper bounds estimates for possible outflows in the forms of imports of services.

- ***Uncertainty associated with the rollover rates of trade credit and intercompany loans***. These flows account for the bulk of short-term external liabilities, and projections conservatively assume repayment of the stock accumulated in the preceding years. Rollover rates for these flows have remained stable throughout the global crisis—at about 95 percent—as well as through 2013. Shocks seem unlikely, but at 20 percent of GDP, the stock of short term debt does represent a source of vulnerability.

FYR Macedonia: External Financing Requirements
(Millions of euros, unless specified otherwise)

	2012	2013	2014	2015	2016
			Projections		
Gross financing requirements	2157	2359	2360	2628	2512
Current account deficit	226	140	359	476	447
ST debt amortization (original maturity)	1588	1725	1653	1691	1731
MLT debt amortization 1/	344	320	348	311	334
of which: Syndicated loan amortization	0	0	0	0	0
Sovereign Eurobond amortization	0	175	0	150	0
Financing sources	2157	2359	2360	2628	2512
FDI (net)	78	246	303	322	344
ST debt disbursements	1725	1653	1691	1731	1860
MLT debt disbursements	410	662	473	644	408
of which: Syndicated loan disbursment	74	250	0	0	0
Sovereign Eurobond disbursment	0	0	0	150	270
Other 2/	67	-424	-156	-163	-179
Net change in reserves (-: increase)	-123	222	49	-57	-191
Gross international reserves (GIR)	2193	1993	1944	2001	2192
Short-term debt (residual maturity)	2170	2001	2152	2065	2208
GIR as % of ST debt	101.1	99.6	90.3	96.9	99.3
GIR as % of Fund Metric	128.8	117.7	109.1	104.9	105.5

Sources: NBRM; and IMF staff estimates.

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

STAFF APPRAISAL

41. The authorities should continue their efforts to achieve the 2014 central government deficit target of 3.5 percent of GDP, even in the face of weaker revenues. Containing the central government fiscal deficit will be important to keep debt on a sustainable path. Any effect on growth from spending cuts at the central government level to safeguard the target should be mitigated by the positive impact on employment and investment from large infrastructure works implemented outside the central government budget. In addition, prospects for recovery seem firm: external demand is still supportive, export growth is strong, and a number of factors—higher pensions, employment, public sector wages, as well as a healthy pace of credit growth—will provide support to private consumption.

42. Over the medium term, the planned course for fiscal policy remains appropriate; laying out the measures underpinning the adjustment will reduce implementation risks. The planned reduction of the deficit to 2.6 percent of GDP in 2016 remains appropriate. An articulation of the measures to contain expenditure—in the context of the next medium-term fiscal strategy—will help the authorities reduce the deficit while achieving their desired growth-friendly expenditure mix. Continuing to base annual budgets on prudent macroeconomic assumptions, particularly in the context of the current low inflation environment, will avoid overstating fiscal space. Strengthening public investment policy to better assess, prioritize, and monitor public investment projects should enhance the transparency of the decision-making process and enable higher realization of budgeted capital spending, a long-term economic return, and a sustainable public debt position. The associated increase in public sector debt underscores the need to continue reducing the central government deficit, as well as to focus sustainability analysis on broader public sector operations.

43. The medium-term fiscal strategy should be accompanied by a debt management strategy. The public debt management strategy should ensure that the government's financing needs are met at the lowest possible cost consistent with a prudent degree of risk, but also reach for broader objectives, namely, consistency with monetary and fiscal policy goals and the development of an efficient market for government securities. In line with international best practices for sound debt management, the objectives and relevant measures of risk and cost should be publicly disclosed, and the impact of contingent liabilities on the government's financial position should be considered.

44. The focus of monetary policy has appropriately shifted away from providing stimulus to preserving reserve adequacy in the context of the euro peg. With credit gradually but so far convincingly picking up, and with ample liquidity in the banking sector, a more accommodative stance would be counterproductive in the face of a baseline drawdown of reserves and risks to export growth and investment from lower euro area growth.

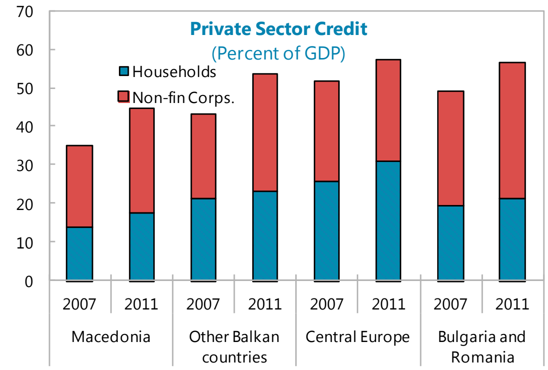
45. The financial system remains liquid and relatively healthy, but structural factors impede more efficient intermediation. Strong domestic deposit growth has been increasingly channeled into government securities. The banking sector landscape – dominated by three large banks facing various shareholder-imposed constraints and a fragmented segment of very small banks—has likely distorted incentives and limited competition and innovation. A lending culture based on physical collateral likely results in inefficient allocation of credit and constrains financing for more dynamic entrepreneurial sectors.

46. An effective framework for continuing close cooperation with foreign supervisory authorities will be needed in the context of the SSM. The authorities should remain closely involved in the design of an institutional arrangement that would establish effective coordination between the SSM and non-EU members. In light of the systemic importance of euro area subsidiaries to the domestic banking system, preserving the established level of cooperation between home and host country authorities will be important.

47. The jobs and growth agenda should remain a central policy concern. A determined effort to alleviate key business environment constraints should invigorate the domestic private sector and may have important catalyzing effects on diaspora investment. Key in that respect would be proper implementation and monitoring of recent initiatives to enforce payment discipline in both public and private sector contracts, as well to upgrade the professional status of inspection bodies and clarify their mandate. Important progress in targeting and designing labor market activation policies should be sustained. Strengthening supply chain linkages between newly-established foreign enterprises and domestic firms would create more jobs and facilitate knowledge spillovers.

48. The Former Yugoslav Republic of Macedonia should remain on a standard 12-month Article IV cycle.

Box 1. Credit Support Measures, 2012–2013



Sources: Haver; FSI; EBRD; and IMF staff estimates.

Credit growth has dropped sharply since mid-2008. Credit to the private sector grew rapidly in the mid-2000s, reaching 44 percent year-on-year in May 2008, funded by an equally rapid growth of domestic deposits. As the global crisis hit in late 2008 and the first half of 2009, severe current account pressures elicited a rapid and sharp policy tightening response. Credit growth fell to under 3½ percent and has averaged 5¾ percent through 2012–2013.

Starting in 2012, the monetary policy stance was gradually eased. Since early 2012, the main policy rate has been reduced by 75 basis points down to 3.25 percent in three steps (May 2012, January and July 2013). The change in the policy stance was pursued against the backdrop of a weak growth outlook and contained inflationary pressures, expectations for a moderate current account deficit, and financial inflows that allowed for a further accumulation of international reserves.

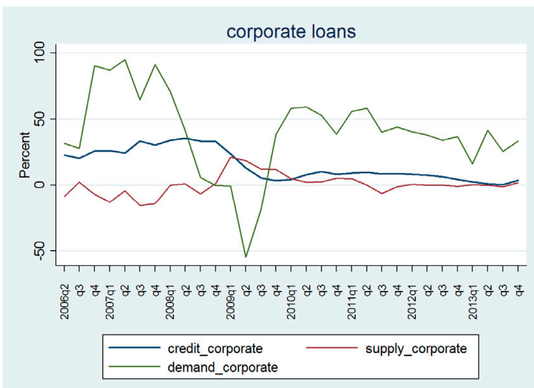
This was complemented by a series of macro-prudential measures:

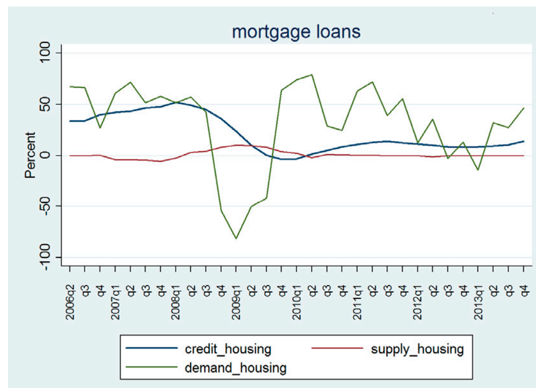
- Starting in January 2012, the reserve requirement on time deposits with contractual maturity above two years was reduced to zero, to encourage long-term saving and release banks' assets for lending. A zero reserve requirement ratio was also applied to liabilities on denar repo transactions to foster the development of a market for this instrument.
- Effective January 2013, with the objective to further stimulate anemic private credit growth while also strengthening the balance of payments, the central bank lowered reserve requirements by the amount of new loans to domestic net exporters and electricity producers.
- In July, reserve requirements on liabilities in domestic currency were lowered again while those on short-term FX deposits were tightened, with the dual objectives of stimulating deposit growth in local currency and encouraging long-term foreign capital funding of domestic banks.

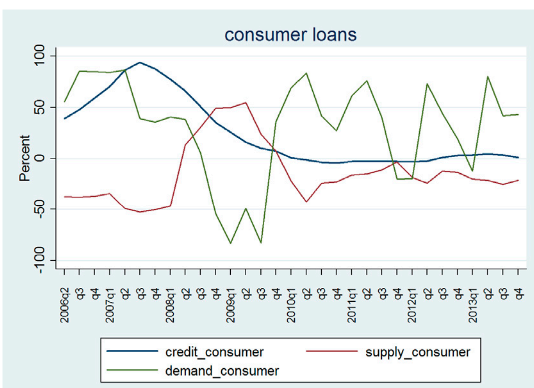
Additional credit support measures were taken in late 2013. The NBRM adopted a decision aiming at deterring banks from overbidding the central bank's monthly auctions and requiring banks bidding above their potential to place the difference in seven-day deposits. It also abolished the remuneration of required reserves (1 percent on domestic currency and 0.1 percent on foreign currency).

Box 2. Supply- and Demand-Side Drivers of Credit Growth

A decomposition of credit developments in recent years confirms that supply-side factors relating to bank balance sheets—namely, capital and liquidity—have not played a key role. Using quarterly data from bank surveys over the period 2006Q2–2013Q4, we replicate for Macedonia the methodology implemented in the October 2012 GFSR[1] to disentangle the influence of supply- and demand-side factors on credit growth. First, the supply-related tightening of credit standards is regressed on explanatory variables standing for various balance sheet indicators as well as banks' expectations on outlook, for various categories of loans. Setting all but the coefficients on balance sheet-related variables to zero allows for the construction of a filtered series standing for 'pure' supply-side developments, exclusively reflecting capitalization and liquidity constraints. Second, overall credit growth is regressed on the filtered supply-side variable and an overall demand variable, controlling for hysteresis effects. The overall decomposition indicates that mortgage, consumer and corporate lending have all been primarily driven by demand-side developments, while balance-sheet related constraints have exerted a constant but moderate drag on growth.







Risk aversion by banks appears to be the most critical supply-side factor. In comparison with other countries, most balance sheet characteristics are found to be generally insignificant to explain changes in credit standards. In contrast, however, for each category of loans, banks' expectations regarding overall economic activity turns out to be the most significant explanatory factor behind the tightening of credit standards. These results are fully consistent with the observation that banks are very liquid and well capitalized, but may be excessively risk averse.

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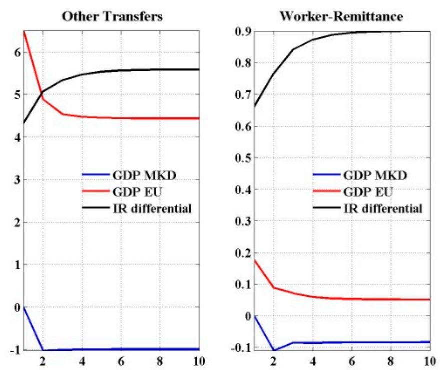
[1] IMF (2013), Global Financial Stability Report – Transition Challenges to Stability, Chapter 2, October 2013.

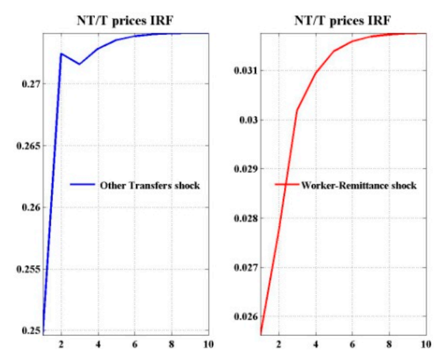
Box 3. The Macroeconomic Impact and Drivers of Remittances in FYR Macedonia

In order to explore the macroeconomic impact of remittance flows in FYR Macedonia, we estimate a mixed-frequency structural VAR model[1], over the 2005–2013 period. The model consists of two blocks—a home economy and a foreign economy. The foreign economy block includes real EU GDP. The domestic economy block includes the following six variables: real GDP, real consumption, NT/T prices, transfers, worker's remittances, and 3 month interest rate differentials. Note that we decompose private transfers into "workers' remittances" and "other transfers" to explore to what extent measurement issues might affect our findings. We use a zero restrictions identification to impose no spillovers from the domestic economy to the external block, and compute the impulse response functions (IRF) to different exogenous innovations[2].

Key results are as follows:



1) **Remittances appear to be countercyclical with respect to Macedonian GDP and pro-cyclical with respect to EU GDP**. A countercyclical response to shocks in the domestic economy is consistent with a stabilizing role of remittances and in line with findings in the literature. Noteworthy is the role of "push" factors—the elasticity of the response to EU shock is significantly higher.
2) **Remittances are interest-sensitive**. An exogenous increase in the interest rate differential encourages migrant workers to choose their home economy for saving.



3) **Remittances do put some upward pressure on the internal real exchange rate.** The IRF analysis presents mild evidence of Dutch disease effects on the Macedonian economy. Shocks to remittances push the prices in the non-tradable goods sector higher than in the tradable goods sector; however, the elasticities are small.
4) **Finally, the results are robust to different specifications of the "remittances" variable**. Subcomponents of remittances respond similarly to different exogenous shocks, although the magnitude of the response is different: i.e., the IRFs of workers' remittances exhibit a smaller elasticity than other transfers' IRFs.

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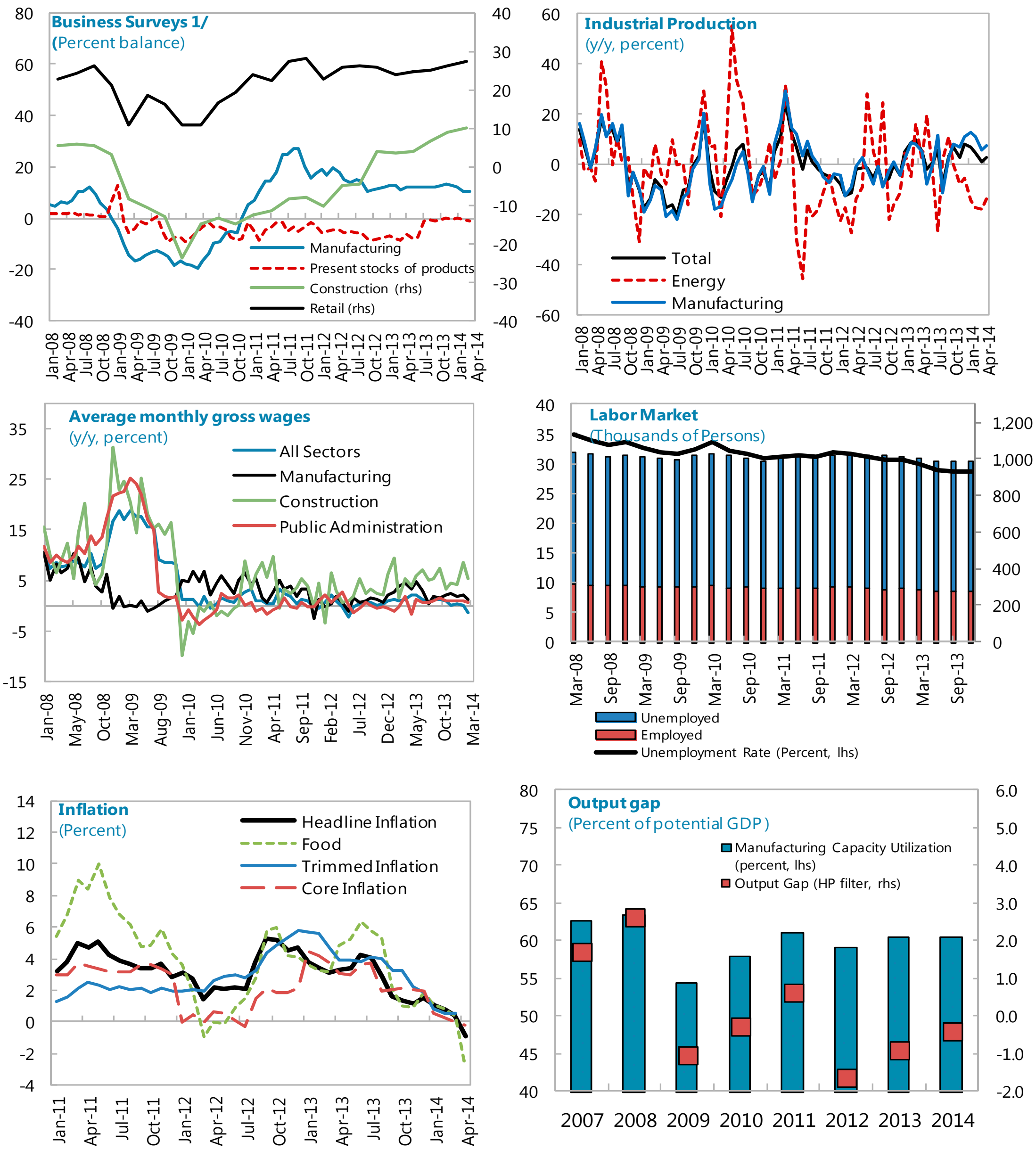
[1] See Solmaz and Taheri Sanjani (2014).

[2] See accompanying Selected Issues Paper for a full description of the model and methodology.

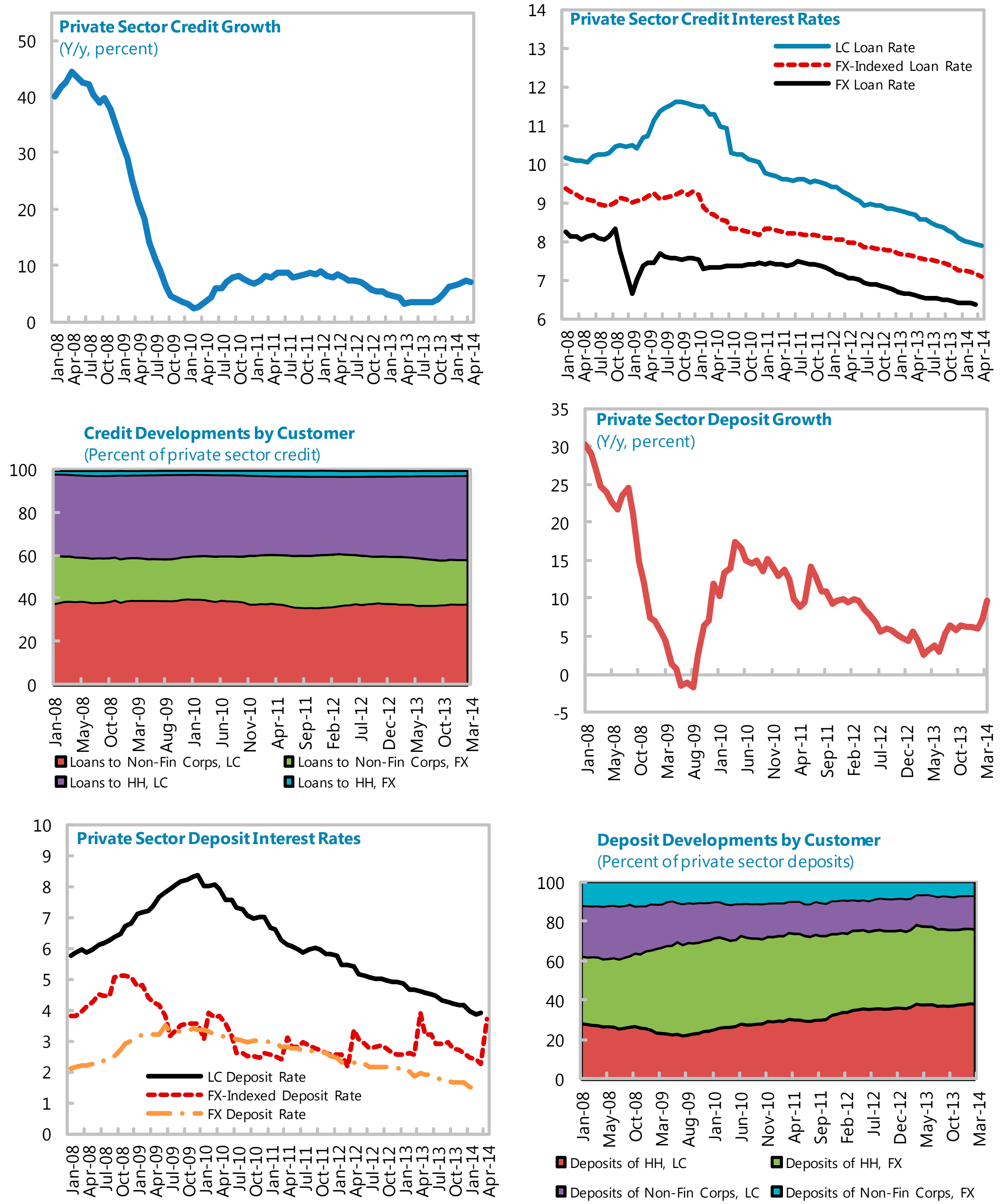
Figure 2. FYR Macedonia: Real Sector Developments, 2008-2014



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

Figure 3. FYR Macedonia: Credit Developments, 20008-2013

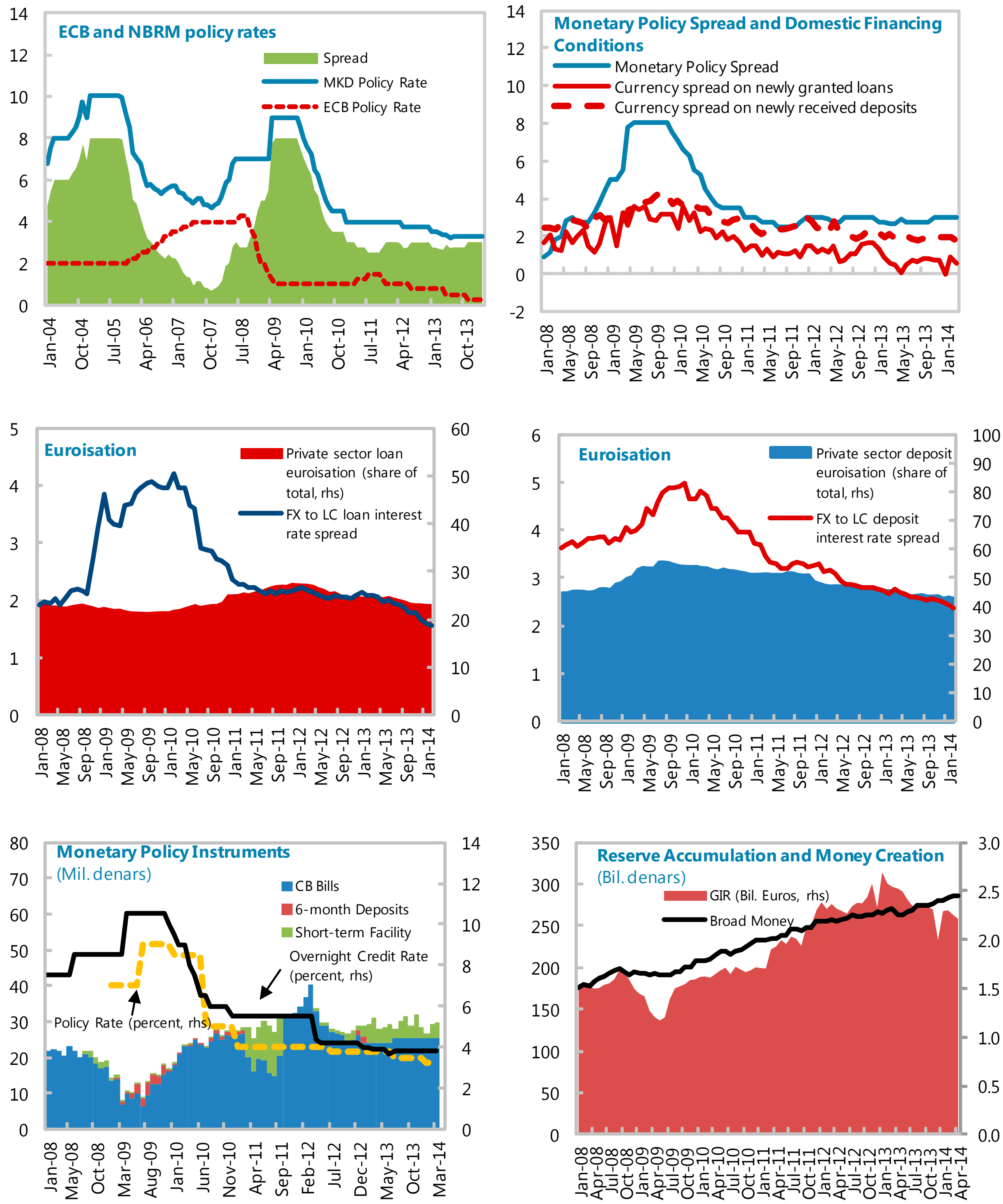
(Percent, unless otherwise indicated)



Sources: NBRM; and IMF staff calculations.

Figure 4. FYR Macedonia: Monetary Policy Developments, 2004-2013

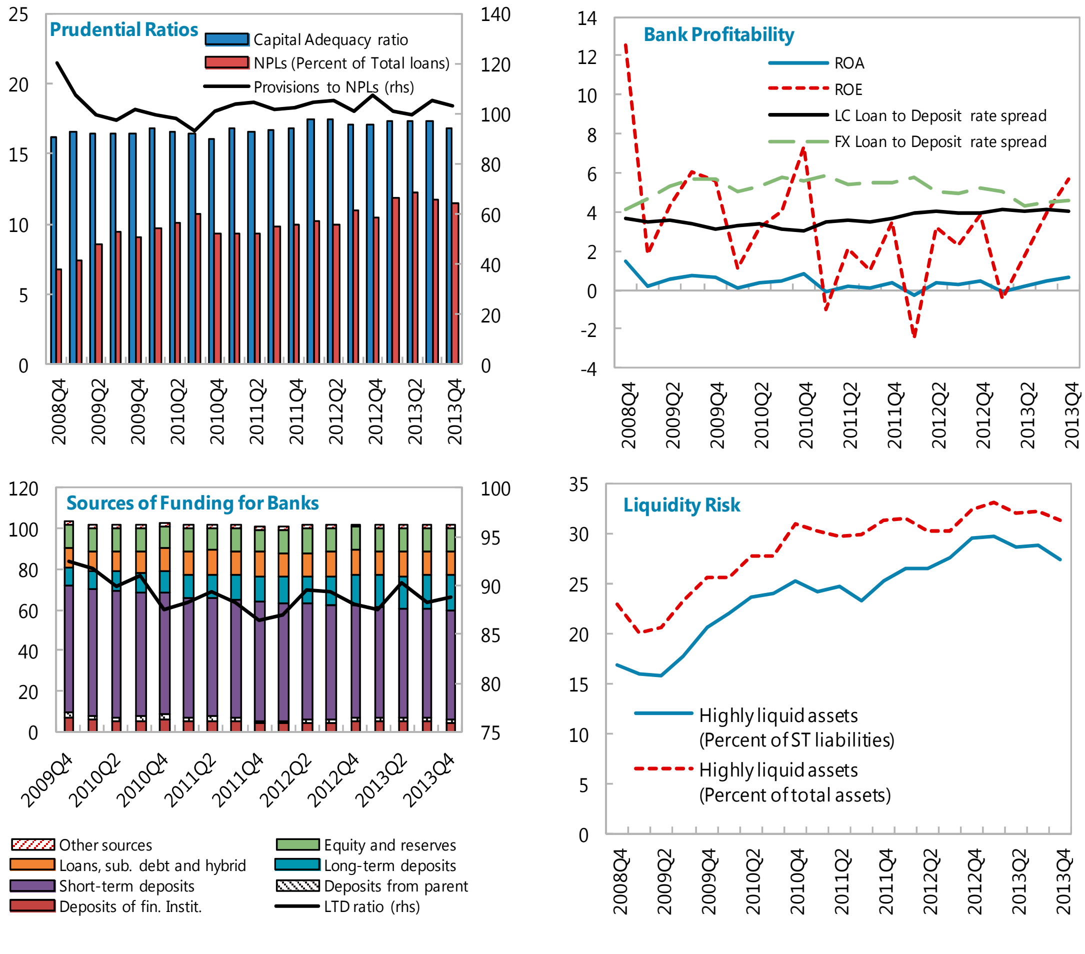
(Percent, unless otherwise indicated)



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

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

(Percent, unless otherwise indicated)



Sources: NBRM; and IMF staff calculations.

Table 1. FYR Macedonia: Macroeconomic Framework, 2010–2019

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

Table 1. FYR Macedonia: Macroeconomic Framework, 2010–2019

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

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
					Proj.					
Real GDP	2.9	2.8	-0.4	3.1	3.4	3.6	3.9	4.0	4.0	4.0
Real domestic demand	-0.3	3.9	2.0	-0.6	4.1	3.7	3.6	3.5	3.5	3.6
Consumption	1.3	2.5	-2.7	2.9	3.3	3.1	3.1	3.1	3.1	3.2
Private	2.1	2.9	-3.0	4.3	3.5	3.4	3.4	3.4	3.4	3.4
Public	-2.0	0.6	-1.4	-3.5	2.6	1.7	1.6	1.5	1.5	1.7
Gross investment	-6.7	9.6	20.0	-11.5	7.0	5.5	5.3	5.0	4.8	4.8
Exports (volume)	23.6	10.3	0.0	4.6	9.9	9.4	9.2	8.4	7.9	7.5
Imports (volume)	9.5	10.5	4.2	-2.1	7.9	8.0	7.4	6.6	6.3	6.1
Contributions to growth										
Domestic demand	-0.4	2.9	2.4	-0.8	4.8	4.3	4.2	4.2	4.1	4.1
Net exports	3.0	-1.1	-2.8	3.5	-0.5	-0.7	-0.3	-0.1	-0.1	-0.1
Central government operations (percent of GDP)										
Revenues	30.3	29.7	30.0	29.5	31.4	31.3	31.1	31.1	31.1	31.1
Expenditures	32.7	32.2	33.8	33.5	34.8	34.5	33.7	33.7	33.7	33.7
Of which: capital	3.5	3.9	4.1	3.5	3.9	3.9	3.5	3.5	3.5	3.5
Balance	-2.4	-2.5	-3.9	-4.1	-3.5	-3.2	-2.6	-2.6	-2.6	-2.6
Savings and investment (percent of GDP)										
Domestic saving	23.5	23.7	26.4	22.6	21.1	20.8	21.5	21.8	21.8	21.8
Public	1.1	1.4	0.2	-0.6	0.5	0.7	0.9	0.9	0.9	0.9
Private	22.4	22.3	26.2	23.2	20.6	20.1	20.6	20.9	20.8	20.8
Foreign saving	2.0	2.5	3.0	1.8	4.5	5.6	4.9	4.9	4.7	4.5
Gross investment	25.5	26.2	29.4	24.4	25.6	26.4	26.5	26.7	26.4	26.3
Consumer prices										
Period average	1.5	3.9	3.3	2.8	1.0	1.5	2.3	2.3	2.3	2.3
End-period	3.0	2.8	4.7	1.4	0.6	2.3	2.3	2.3	2.3	2.3
Private sector credit growth	7.3	7.7	5.2	6.3	6.8	7.1	7.4	7.4	7.6	7.7
Memorandum items:										
Current account balance (percent of GDP)	-2.0	-2.5	-3.0	-1.8	-4.5	-5.6	-4.9	-4.9	-4.7	-4.5
Gross official reserves (millions of euros)	1,715	2,069	2,193	1,993	1,944	2,001	2,192	2,366	2,602	2,866
in percent of ST debt	103	112	101	100	90	97	99	101	109	125
in months of prospective imports	3.7	4.4	4.7	3.9	3.3	3.1	3.1	3.1	3.2	3.2
Gross Central Government Debt (percent of GDP)	24.4	27.9	33.4	35.8	36.4	37.6	38.5	38.9	39.4	39.3
Public Sector Gross Debt (percent of GDP) 1/	28.0	32.1	38.3	42.1	44.8	48.3	51.1	54.3	55.2	54.5
Foreign direct investment (percent of GDP)	2.2	4.5	1.0	3.2	3.8	3.8	3.8	3.8	3.8	3.8
External debt (percent of GDP)	58.2	64.8	69.4	63.0	60.3	58.4	57.0	55.6	54.7	53.9
Nominal GDP (billions of denars)	434	460	459	474	491	522	557	592	628	668
Nominal GDP (millions of euros)	7,057	7,475	7,456	7,709	7,979	8,485	9,055	9,625	10,213	10,860

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

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

Table 2. FYR Macedonia: Central Government Operations, 2012–2019

(Billions of denars)

	2012	2013	2014		2015	2016	2017	2018	2019
			Budget	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Total Revenues 1/	137.4	139.7	157.6	153.9	163.2	173.3	184.2	195.4	207.8
Tax Revenues and Contributions	117.4	121.0	133.9	131.7	139.9	149.0	158.4	168.1	178.7
PIT	9.6	10.3	10.7	10.7	11.4	12.2	13.0	13.7	14.6
CIT	3.7	4.4	4.2	4.5	4.8	5.1	5.5	5.8	6.2
VAT (net)	38.5	39.8	48.5	46.0	49.5	53.5	56.9	60.4	64.2
Excises	16.6	16.0	15.8	15.8	16.9	18.1	19.2	20.4	21.7
Custom Duties	4.1	4.3	4.1	4.1	3.5	2.9	3.1	3.3	3.5
Other Taxes 2/	4.3	3.8	5.3	5.3	5.6	6.0	6.4	6.8	7.2
Social Contributions	40.8	42.5	45.2	45.2	48.2	51.2	54.4	57.7	61.4
Pensions	27.5	28.7	30.6	30.6	32.9	35.2	37.4	39.7	42.2
Unemployment	1.7	1.8	1.9	1.9	2.1	2.2	2.3	2.5	2.6
Health	11.5	12.0	12.6	12.6	13.2	13.8	14.7	15.6	16.6
Non-Tax Revenues 3/	12.4	11.6	14.5	14.5	15.4	16.5	17.5	18.6	19.8
Capital Revenues 4/	4.6	3.7	5.7	4.2	4.1	3.9	4.1	4.4	4.7
Of which: Telecom dividend	2.5	2.2	2.5	1.0	1.0	0.9	1.0	1.0	1.1
Grants	3.0	3.5	3.5	3.5	3.7	3.9	4.1	4.4	4.7
Expenditures 1/	155.2	159.0	175.9	170.9	179.9	187.8	199.6	211.8	225.2
Current Expenditures 5/	137.1	142.9	154.1	152.2	160.4	168.8	179.4	190.3	202.4
Wages and salaries	22.7	22.6	23.7	23.3	24.1	24.9	26.5	28.1	29.9
Goods and services	14.7	14.9	18.7	17.2	18.0	18.9	20.1	21.3	22.7
Transfers	95.5	100.8	107.4	107.4	113.3	119.5	127.0	134.8	143.3
Pensions	40.9	44.9	48.1	48.1	51.2	54.4	57.8	61.4	65.2
Health	20.9	21.4	22.2	22.2	22.4	22.5	23.9	25.4	27.0
Local Governments	15.4	15.6	16.0	16.0	17.4	18.7	19.9	21.1	22.4
Other	18.3	18.8	21.0	21.0	22.4	23.9	25.4	26.9	28.6
Interest	4.2	4.6	4.4	4.3	4.9	5.5	5.8	6.2	6.6
Capital Expenditures	18.8	16.6	22.4	19.4	20.1	19.7	21.0	22.3	23.7
Lending minus repayment 6/	-0.6	-0.6	-0.6	-0.6	-0.7	-0.7	-0.8	-0.8	-0.9
Overall fiscal balance	-17.8	-19.3	-18.3	-17.0	-16.7	-14.5	-15.4	-16.3	-17.4
Financing	17.7	19.3	18.3	17.0	16.7	14.5	15.4	16.3	17.4
Domestic	13.3	13.1	22.0	20.4	7.2	4.9	11.6	11.1	11.2
Central Bank deposits	-12.3	-0.3	13.9	14.0	0.7	-1.4	-1.3	-0.7	0.6
Other domestic financing	25.6	13.4	8.1	6.4	6.5	6.2	12.9	11.8	10.6
Privatization receipts	0.1	0.6	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Foreign	5.1	6.1	-3.9	-4.4	6.6	6.2	3.8	5.2	6.2
Memo items:									
Gross debt (as share of GDP)	33.4	35.8	…	36.3	37.6	38.5	38.9	39.4	39.3
Nominal GDP (billions of denars)	458.6	474.2	490.8	490.8	521.9	557.0	592.1	628.2	668.0
Stock of government deposits at the NBRM (EUR mln eop)	19.5	18.8	…	6.0	5.2	6.6	7.9	8.6	8.0

Sources: IMF Staff and MoF estimates.

Notes:

1/ Excluding revenues from lending.

2/ Including Tax Revenues (SRA).

3/ Excluding profits from financial institutions.

4/ Including profits from financial institutions.

5/ Excluding lending guarantees.

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

Table 2. FYR Macedonia: Central Government Operations, 2012–2019 (concluded)

(Percent of GDP)

	2012	2013	2014		2015	2016	2017	2018	2019
			Budget	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Total Revenues 1/	30.0	29.5	32.1	31.4	31.3	31.1	31.1	31.1	31.1
Tax Revenues and Contributions	25.6	25.5	27.3	26.8	26.8	26.8	26.8	26.8	26.8
PIT	2.1	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
CIT	0.8	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9
VAT (net)	8.4	8.4	9.9	9.4	9.5	9.6	9.6	9.6	9.6
Excises	3.6	3.4	3.2	3.2	3.2	3.2	3.2	3.2	3.2
Custom Duties	0.9	0.9	0.8	0.8	0.7	0.5	0.5	0.5	0.5
Other Taxes 2/	0.9	0.8	1.1	1.1	1.1	1.1	1.1	1.1	1.1
Social Contributions	8.9	9.0	9.2	9.2	9.2	9.2	9.2	9.2	9.2
Pensions	6.0	6.0	6.2	6.2	6.3	6.3	6.3	6.3	6.3
Unemployment	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Health	2.5	2.5	2.6	2.6	2.5	2.5	2.5	2.5	2.5
Non-Tax Revenues 3/	2.7	2.4	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Capital Revenues 4/	1.0	0.8	1.2	0.9	0.8	0.7	0.7	0.7	0.7
Of which: Telecom dividend	0.6	0.5	0.5	0.2	0.2	0.2	0.2	0.2	0.2
Grants	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Expenditures 1/	33.8	33.5	35.8	34.8	34.5	33.7	33.7	33.7	33.7
Current Expenditures 5/	29.9	30.1	31.4	31.0	30.7	30.3	30.3	30.3	30.3
Wages and salaries	5.0	4.8	4.8	4.8	4.6	4.5	4.5	4.5	4.5
Goods and services	3.2	3.1	3.8	3.5	3.5	3.4	3.4	3.4	3.4
Transfers	20.8	21.3	21.9	21.9	21.7	21.5	21.5	21.5	21.5
Pensions	8.9	9.5	9.8	9.8	9.8	9.8	9.8	9.8	9.8
Health	4.6	4.5	4.5	4.5	4.3	4.0	4.0	4.0	4.0
Local Governments	3.3	3.3	3.3	3.3	3.3	3.4	3.4	3.4	3.4
Other	4.0	4.0	4.3	4.3	4.3	4.3	4.3	4.3	4.3
Interest	0.9	1.0	0.9	0.9	0.9	1.0	1.0	1.0	1.0
Capital Expenditures	4.1	3.5	4.6	3.9	3.9	3.5	3.5	3.5	3.5
Lending minus repayment 6/	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Overall fiscal balance	-3.9	-4.1	-3.7	-3.5	-3.2	-2.6	-2.6	-2.6	-2.6
Financing	3.9	4.1	3.7	3.5	3.2	2.6	2.6	2.6	2.6
Domestic	2.9	2.8	4.5	4.2	1.4	0.9	2.0	1.8	1.7
Central Bank deposits	-2.7	-0.1	2.8	2.9	0.1	-0.2	-0.2	-0.1	0.1
Other domestic financing	5.6	2.8	1.6	1.3	1.2	1.1	2.2	1.9	1.6
Privatization receipts	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	1.1	1.3	-0.8	-0.9	1.3	1.1	0.6	0.8	0.9
Memo items:									
Gross debt (as share of GDP)	33.4	35.8	…	36.3	37.6	38.5	38.9	39.4	39.3
Nominal GDP (billions of denars)	458.6	474.2	490.8	490.8	521.9	557.0	592.1	628.2	668.0
Stock of government deposits at the NBRM (EUR mln eop)	19.5	18.8	…	6.0	5.2	6.6	7.9	8.6	8.0

Sources: IMF Staff and MoF estimates.

Notes:

1/ Excluding revenues from lending.

2/ Including Tax Revenues (SRA).

3/ Excluding profits from financial institutions.

4/ Including profits from financial institutions.

5/ Excluding lending guarantees.

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

Table 3. FYR Macedonia: Balance of Payments, 2010–2019

(Millions of euros, unless otherwise indicated)

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
					Projections					
Current account	-144	-189	-226	-140	-359	-476	-447	-467	-478	-493
Trade balance	-1448	-1648	-1757	-1584	-1785	-1899	-1960	-2038	-2108	-2173
Exports	2530	3211	3107	3206	3468	4038	4560	4993	5448	5929
Imports	-3978	-4859	-4863	-4791	-5253	-5937	-6520	-7031	-7556	-8102
Services (net)	37	97	46	78	21	-51	-22	-3	19	44
Income (net)	-100	-131	-148	-175	-184	-193	-203	-244	-292	-351
Transfers (net)	1367	1494	1632	1542	1589	1667	1738	1817	1904	1987
Of which										
Official	31	77	60	43	60	55	53	56	54	54
Private	1337	1417	1572	1499	1529	1613	1685	1761	1849	1932
Of which: Cash exchange	1155	1237	1389	1321	1365	1440	1512	1576	1642	1711
Capital and financial account	203	512	328	91	310	533	638	641	714	757
Capital account (net)	12	9	20	18	16	15	16	17	16	16
Financial account	191	503	308	73	294	518	623	624	697	741
Direct investment (net)	159	337	78	246	303	322	344	366	388	413
Portfolio investment (net)	-57	-76	77	-159	-23	-16	259	212	194	176
Of which: Eurobonds disbursements	0	0	0	0	0	150	270	220	200	180
Of which: Eurobonds amortizations	0	0	0	-175	0	-150	0	0	0	0
Other investment	89	242	153	-14	14	212	20	47	115	153
Trade credits (net)	71	-13	170	-122	-24	-24	63	67	71	76
MLT loans (net)	67	463	67	342	125	333	73	104	171	192
Public sector	39	367	62	276	9	189	-88	-78	-34	-39
Disbursements	98	457	161	373	186	390	156	202	202	161
of which : IMF credit	0	221	0	0	0	0	0	0	0	
Amortization	-59	-89	-99	-98	-177	-201	-244	-280	-236	-201
of which : Repayment to the IMF	0	0	0	0	86	115	29	0	0	
Banks (net)	94	53	-24	35	64	73	84	97	112	128
Non-Banks (net)	-66	43	29	31	52	71	77	85	94	103
ST loans (net)	62	-27	-4	18	32	34	36	39	41	43
Currency and deposits (net)	-171	-232	-115	-254	-119	-131	-153	-163	-168	-159
Of which: Commercial banks	-81	-98	113	-37	0	0	0	0	0	0
Other (net)	60	50	35	2	0	0	0	0	0	0
Errors and omissions	1	9	18	26	0	0	0	0	0	0
Overall Balance	61	332	120	-22	-49	57	191	174	236	264
				(Percent of GDP)						
Current account	-2.0	-2.5	-3.0	-1.8	-4.5	-5.6	-4.9	-4.9	-4.7	-4.5
Of which										
Trade balance	-20.5	-22.1	-23.6	-20.6	-22.4	-22.4	-21.6	-21.2	-20.6	-20.0
Private transfers	18.9	19.0	21.1	19.4	19.2	19.0	18.6	18.3	18.1	17.8
FDI (net)	2.2	4.5	1.0	3.2	3.8	3.8	3.8	3.8	3.8	3.8
				(Year-on-year percent change)						
Exports of G&S (Value)	25.9	24.8	-2.1	3.9	8.2	16.4	12.9	9.5	9.1	8.8
Volume	22.9	10.3	0.0	4.6	9.9	9.4	9.2	8.4	7.9	7.5
Price	2.5	13.1	-2.1	-0.6	-1.6	6.4	3.4	1.0	1.1	
Imports of G&S (Value)	12.9	20.3	1.4	-0.9	10.6	14.8	9.8	7.8	7.5	7.2
Volume	7.6	10.5	4.2	-2.1	7.9	8.0	7.4	6.6	6.3	6.1
Price	4.9	8.8	-2.8	1.2	2.5	6.3	2.2	1.2	1.1	
Terms of trade (2008=100)	94.0	97.7	98.4	96.6	92.8	93.0	94.0	93.9	93.9	94.0
Memorandum Items:										
Nominal GDP	7057	7475	7456	7709	7979	8485	9055	9625	10213	10860
ST debt at residual maturity (year-end)	1666	1846	2170	2001	2152	2065	2208	2337	2387	2287
Gross foreign exchange reserves	1715	2069	2193	1993	1944	2001	2192	2366	2602	2866
Months of prospective imports of G&S	3.7	4.4	4.7	3.9	3.3	3.1	3.1	3.1	3.2	3.2
Percent of short-term debt (residual maturity)	102.9	112.1	101.1	99.6	90.3	96.9	99.3	101.2	109.0	125.3
External debt (percent of GDP)	58.2	64.8	69.4	63.0	60.3	58.4	57.0	55.6	54.7	53.9
Medium and long-term	39.6	43.6	46.2	41.6	39.1	38.0	36.5	34.8	33.7	32.8
Short-term	18.6	21.2	23.1	21.4	21.2	20.4	20.5	20.7	20.9	21.1
External debt service	1608	1796	1970	2296	2123	2278	2195	2339	2472	2527
Percent of exports of G&S	50.1	44.8	50.2	56.3	48.1	44.3	37.8	36.8	35.7	33.5
Percent of exports of G&S and private transfers	35.1	32.6	35.4	40.8	35.4	33.5	29.1	28.6	28.0	26.5

Sources: NBRM; and IMF staff estimates.

Table 4. FYR: Macedonia - Monetary Survey, 2010-2019

(Billions of denars, unless specified otherwise)

	2010	2011	2012	2013				2014	2015	2016	2017	2018	2019
				1Q-13	2Q-13	3Q-13	4Q-13						
NFA	99.9	124.7	126.1	128.6	114.3	119.6	114.8	115.2	119.7	139.4	150.1	153.6	156.7
Central Bank	100.6	122.5	128.9	132.8	121.8	122.5	118.2	118.5	123.0	142.8	153.5	157.0	160.1
Commercial Banks	-0.7	2.2	-2.8	-4.2	-7.6	-2.9	-3.4	-3.4	-3.4	-3.4	-3.4	-3.4	-3.4
NDA	132.7	130.3	140.2	141.9	152.0	154.2	165.6	182.3	200.5	204.4	217.6	237.8	260.8
Credit to Government (net)	9.0	-1.8	1.9	5.0	6.5	7.7	10.8	16.9	23.4	28.6	30.7	34.6	39.2
From Banks (net)	15.0	14.0	29.1	32.4	32.9	34.0	37.0	40.5	46.3	52.8	60.3	65.8	70.8
of which: Credit (Tbills)	18.1	16.7	31.7	34.3	34.7	35.8	38.8	42.3	48.1	54.6	62.0	67.6	72.5
From Central Bank (net)	-6.0	-15.8	-27.2	-27.4	-26.4	-26.3	-26.2	-23.6	-22.9	-24.3	-29.5	-31.2	-31.6
of which: Deposits	-9.0	-19.1	-30.4	-30.4	-29.3	-29.2	-29.5	-16.7	-15.9	-17.3	-18.6	-19.3	-18.7
Credit to Private Sector (Gross)	193.4	208.2	218.9	220.0	224.1	225.5	232.7	248.5	266.2	286.0	307.0	330.3	355.7
From Banks	191.9	208.1	218.8	220.0	224.1	225.4	232.7	248.5	266.2	285.9	307.0	330.3	355.6
Denars	143.6	150.6	164.4	165.0	168.3	171.3	178.4	190.5	204.1	219.2	235.4	253.2	272.7
FX	48.3	57.6	54.4	55.0	55.8	54.1	54.3	58.0	62.1	66.7	71.6	77.1	83.0
From Central Bank	1.5	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Items (net)	-69.7	-76.0	-80.6	-83.1	-78.6	-79.0	-78.0	-78.0	-78.0	-78.0	-78.0	-78.0	-78.0
Broad Money (M3)	232.6	255.0	266.3	270.5	266.3	273.8	280.4	297.5	320.2	343.8	367.8	391.4	417.5
Currency in Circulation	17.0	19.3	20.1	20.7	20.1	20.0	20.7	21.4	22.8	24.3	25.9	27.4	29.2
Total Deposits	215.6	235.7	246.2	249.8	246.2	253.8	259.7	276.0	297.4	319.5	341.9	364.0	388.3
Denars	106.8	122.3	135.1	137.4	138.4	142.7	147.9	155.2	167.2	179.7	192.3	204.7	218.4
FX	108.8	113.5	111.1	112.4	107.8	111.0	111.7	120.8	130.2	139.8	149.7	159.3	170.0
(Year-on-year percent change)													
Private Sector Credit	7.3	7.7	5.2	3.9	3.1	3.3	6.3	6.8	7.1	7.4	7.4	7.6	7.7
Broad Money	12.2	9.7	4.4	5.0	3.0	5.1	5.3	6.1	7.6	7.4	7.0	6.4	6.7
Private Sector Deposits	12.9	9.3	4.4	4.2	2.7	5.2	5.5	6.3	7.7	7.4	7.0	6.5	6.7
(Contribution to annual growth in broad money)													
NFA	2.5	10.7	0.5	2.7	-0.4	-1.7	-4.2	0.1	1.5	6.2	3.1	1.0	0.8
NDA	9.7	-1.0	3.9	2.3	3.5	6.8	9.5	6.0	6.1	1.2	3.8	5.5	5.9
(Percent of GDP)													
Private Sector Credit	44.5	45.3	47.7	48.1	48.3	48.1	49.1	50.6	51.0	51.3	51.9	52.6	53.2
Broad Money	53.6	55.5	58.1	59.1	57.4	58.5	59.1	60.6	61.3	61.7	62.1	62.3	62.5
Private Sector Deposits	49.7	51.3	53.7	54.6	53.1	54.2	54.8	56.2	57.0	57.4	57.7	57.9	58.1
Memorandum Items:													
Money Multiplier	4.7	4.8	4.8	4.9	5.0	5.2	5.2	5.1	5.1	5.2	5.2	5.2	5.3
Reserve Requirement Ratio (% of deposits)													
Denars	10.0	10.0	10.0	10.0	10.0	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
FX	13.0	13.0	13.0	13.0	13.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0
Velocity	1.9	1.8	1.7	1.7	1.7	1.7	1.7	1.7	1.6	1.6	1.6	1.6	1.6

Sources: NBRM; and IMF staff estimates.

Table 5. FYR: Macedonia - Central Bank Survey, 2010-2019

(Billions of denars, unless specified otherwise)

	2010	2011	2012	2013				2014	2015	2016	2017	2018	2019
				1Q-13	2Q-13	3Q-13	4Q-13						
NFA	100.6	122.5	128.9	132.8	121.8	122.5	118.2	118.5	123.0	142.8	153.5	157.0	160.1
Assets	105.5	141.6	143.3	156.2	148.2	144.5	122.7	124.1	129.6	150.3	162.0	166.5	170.6
Liabilities	-4.9	-19.1	-14.4	-23.5	-26.3	-22.0	-4.5	-5.5	-6.5	-7.5	-8.5	-9.5	-10.5
NDA	-51.6	-68.9	-73.0	-77.5	-68.4	-70.2	-64.7	-60.2	-60.8	-76.4	-83.0	-82.3	-80.8
Banks (net)	-26.9	-32.2	-26.1	-29.9	-29.3	-31.3	-28.2	-36.6	-37.9	-52.2	-57.4	-56.1	-55.2
of which:													
NBRM Bills and short-term facilities	-25.9	-32.2	-27.1	-31.2	-29.3	-31.3	-28.3	-28.3	-28.3	-28.3	-28.3	-28.3	-28.3
Central Government (net)	-3.5	-13.4	-24.9	-24.8	-23.8	-23.8	-24.1	-11.3	-10.6	-12.0	-13.2	-13.9	-13.3
of which:													
Deposits at Central Bank	-9.0	-19.1	-30.4	-30.4	-29.3	-29.2	-29.5	-16.7	-15.9	-17.3	-18.6	-19.3	-18.7
Denar	-5.9	-7.0	-19.5	-8.2	-11.1	-14.4	-16.3	-10.6	-10.2	-10.9	-11.4	-11.7	-11.5
FX	-3.1	-12.1	-10.9	-22.1	-18.2	-14.8	-13.1	-6.1	-5.7	-6.5	-7.2	-7.5	-7.2
State and Local Governments (net)	-2.5	-2.3	-2.3	-2.6	-2.5	-2.5	-2.1	-2.1	-2.1	-2.1	-2.1	-2.1	-2.1
Other items (net)	-18.7	-20.9	-19.7	-20.2	-12.8	-12.7	-10.2	-10.2	-10.2	-10.2	-10.2	-10.2	-10.2
Reserve Money	49.0	53.6	55.9	55.3	53.4	52.3	53.5	58.3	62.2	66.3	70.5	74.7	79.3
Currency in Circulation	17.0	19.3	20.1	20.7	20.1	20.0	20.7	21.4	22.8	24.3	25.9	27.4	29.2
Other	32.0	34.3	35.8	34.6	33.3	32.3	32.8	36.9	39.4	42.0	44.7	47.3	50.1
Cash in Vaults	3.2	3.5	3.9	3.8	4.0	4.1	4.3	4.3	4.3	4.3	4.3	4.3	4.3
Total Reserves	28.8	30.9	32.0	30.8	29.3	28.2	28.4	32.6	35.1	37.7	40.3	42.9	45.8
on Denar Deposits	15.7	16.7	18.9	17.7	16.3	15.7	16.2	18.5	20.0	21.5	23.0	24.5	26.1
on FX Deposits	13.2	14.1	13.0	13.2	13.0	12.6	12.2	14.0	15.1	16.2	17.4	18.5	19.7
(Contribution to annual growth in reserve money)													
NFA	16.0	44.7	11.9	21.0	4.3	-4.2	-19.2	0.7	7.7	31.7	16.1	5.0	4.2
NDA	-9.4	-35.2	-7.7	-7.7	-1.9	3.0	14.8	8.3	-1.1	-25.1	-9.8	0.9	2.0
Reserve Money	6.6	9.5	4.3	13.3	2.3	-1.2	-4.4	9.1	6.6	6.7	6.3	5.9	6.2
Memorandum Items:													
NBRM Bills (percent of GDP)	6.0	7.0	5.7	5.2	5.2	5.4	5.4	5.4	5.2	4.9	4.6	4.3	4.1
Govt Deposits at Central Bank (Percent of GDP)	2.1	4.2	6.6	6.6	6.3	6.2	6.2	3.6	3.4	3.7	3.9	3.9	3.6

Sources: NBRM; and IMF staff estimates.

Table 6. FYR Macedonia: Financial Soundness Indicators of the Macedonian Banking System, 2007–2013

(Percent)

	2007	2008	2009	2010	2011	2012	2013			
							2013Q1	2013Q2	2013Q3	2013Q4
Capital adequacy										
Regulatory capital/risk weighted assets	17.0	16.2	16.4	16.1	16.8	17.1	17.3	17.3	17.3	16.8
Tier I capital/risk weighted assets 1/	15.7	14.0	13.8	13.4	14.1	14.5	14.7	14.7	14.6	14.4
Equity and reserves to Assets	11.4	11.5	11.4	10.6	11.0	11.2	11.1	11.2	11.3	11.3
Asset composition										
Structure of loans										
Enterprises (loans to enterprises/total loans)	54.9	54.2	58.7	58.9	58.2	56.9	56.7	56.2	55.5	55.4
Households (loans to households/total loans)	37.7	38.5	37.9	37.1	36.5	36.4	36.5	37.1	37.9	37.7
Lending with foreign currency component to private sector	54.7	57.0	58.5	58.8	59.2	55.4	55.0	54.6	53.5	52.7
Foreign currency lending/total credit to private sector	24.6	22.9	22.6	25.8	28.2	25.5	25.5	25.4	24.5	23.8
Foreign currency indexed lending/total credit to private sector	30.1	34.1	35.9	33.0	31.0	29.8	29.5	29.2	29.1	28.9
NPLs 2/										
NPLs/gross loans	7.5	6.7	8.9	9.0	9.5	10.1	11.4	11.8	11.2	10.9
NPLs net of provision/own funds	-5.0	-6.2	-0.6	-0.3	-0.9	-3.7	-0.1	0.4	-2.7	-1.8
Provisions to Non-Performing Loans	114.3	118.1	101.4	100.7	101.9	107.1	100.1	99.4	104.7	103.1
Large exposures/own funds	181.4	118.0	213.3	200.4	189.6	205.1	208.0	195.4	195.0	188.5
Connected lending										
Banking system exposure to subsidiaries and shareholders/own funds	5.6	3.1	4.6	6.3	4.6	3.5	1.5	1.3	1.9	4.2
Banking system equity investments/own funds	4.9	3.9	1.5	1.5	1.6	1.8	1.7	1.6	1.6	1.7
Earning and profitability										
ROAA 3/	1.8	1.4	0.6	0.8	0.4	0.4	0.0	0.2	0.4	0.6
ROAE 3/	15.0	12.5	5.6	7.3	3.4	3.8	-0.4	1.8	3.9	5.7
Interest margin/gross income 4/	57.0	58.9	62.6	61.8	60.0	60.7	62.5	62.9	63.3	62.2
Noninterest expenses/gross income 5/	60.3	64.0	64.5	68.2	69.7	65.3	62.9	62.2	62.1	62.8
Personnel expenses/noninterest expenses	38.4	36.5	36.9	36.1	34.1	33.1	35.3	35.5	35.6	35.0
Interest Rates										
Local currency spreads	4.5	3.2	2.8	2.3	3.2	3.5	3.6	3.6	3.7	3.6
Foreign currency spreads	6.5	4.2	4.2	4.4	4.8	4.6	4.8	4.6	4.8	4.8
Interbank market interest rate	3.1	5.3	6.2	2.7	2.2	2.1	1.9	2.0	2.0	2.2
Liquidity										
Highly liquid assets/total assets 6/	20.9	16.9	20.6	25.3	25.3	29.4	29.6	28.7	28.8	27.3
Highly liquid assets/total short-term liabilities 7/	28.2	24.0	30.1	38.5	39.6	48.2	49.1	49.0	49.9	47.6
Liquid assets/total assets	34.7	22.9	25.6	30.9	31.2	32.4	33.1	32.0	32.2	
Liquid assets/total short-term liabilities	46.8	32.4	37.4	46.9	48.9	53.0	54.9	54.6	55.9	
Customer deposits/total (noninterbank) loans	128.4	107.7	108.2	114.3	115.7	113.5	114.2	110.8	113.3	112.7
Foreign currency deposits/total deposits	44.5	48.1	56.2	53.5	50.8	47.3	47.3	45.8	45.7	44.9
Including foreign exchange-indexed 8/	51.5	54.8	60.9	55.5	52.7	48.3	48.2	46.2	46.2	45.5
Central bank credit to banks/bank liabilities	0.1	0.01	0.01	0.01	0.01	0.4				
Sensitivity to market risk										
Net open foreign exchange position/own funds	38.2	25.1	13.0	18.9	21.3	11.4	7.3	12.1	16.1	15.6

Sources: NBRM's Financial Stability Unit.

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

2/ Includes loans to financial and nonfinancial sector.

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

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

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

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

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

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

Table 7. FYR Macedonia: Capacity to Repay Indicators, 2013-2018

	2013	2014	2015	2016	2017	2018
Exposure and Repayments (Millions of SDR)						
GRA credit to Macedonia 1/	197.0	123.1	24.6	0.0	0.0	0.0
(In percent of quota)	286	179	36	0	0	0
Charges 2/	2.1	2.0	1.1	0.2	0.1	0.1
Repurchase	0.0	73.9	98.5	24.6	0.0	0.0
Debt and Debt Service Ratios						
In percent of GDP						
Total external debt	63.0	60.1	58.1	56.5	55.0	54.0
External debt, public	20.7	20.0	20.3	20.5	20.0	19.6
Total public debt	38.4	39.9	41.9	43.4	44.4	45.4
GRA credit to Macedonia	2.9	1.8	0.3	0.0	0.0	0.0
Total external debt service	29.8	26.6	26.9	24.2	24.3	24.2
Public external debt service	3.6	2.5	4.4	3.0	3.3	2.7
Debt service due on GRA credit	0.0	1.1	1.3	0.3	0.0	0.0
In percent of Central Government Revenues						
Public external debt service	12.2	7.9	14.1	9.8	10.5	8.6
Debt service due on GRA credit	0.0	3.4	4.2	1.0	0.0	0.0
In percent of Gross International Reserves						
Total external debt	243.9	254.5	263.9	260.2	259.4	254.3
External debt, public	79.9	84.7	92.1	94.5	94.2	92.6
GRA credit to Macedonia	11.3	7.5	1.5	0.0	0.0	0.0
Debt service due on GRA credit	0.0	4.5	6.0	1.4	0.0	0.0
In percent of Exports of Goods and Services						
Total external debt service	56.3	48.1	44.3	37.8	36.8	35.6
Public external debt service	6.8	4.5	7.3	4.7	5.0	3.9
Debt service due on GRA credit	0.0	1.9	2.2	0.5	0.0	0.0
In percent of Total External Debt						
GRA credit to Macedonia	4.6	2.9	0.6	0.0	0.0	0.0
In percent of Total External Debt Service						
Debt service due on GRA credit	0.0	4.0	4.9	1.3	0.0	0.0
In percent of Total Public External Debt						
GRA credit to Macedonia	14.2	8.8	1.6	0.0	0.0	0.0
In percent of Total Public External Debt Service						
Debt service due on GRA credit	0.0	42.6	29.8	10.1	0.0	0.0

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

1/ Repurchases are assumed to be made as scheduled.

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

Table 8. FYR Macedonia: External Debt Sustainability Framework, 2008-2018

(Percent of GDP, unless otherwise indicated)

	2008	2009	2010	2011	2012	2013	Projections 2014	2015	2016	2017	2018	Debt-stabilizing non-interest current account 6/
Baseline: External debt	49.2	56.4	58.2	64.8	69.4	**63.0**	**60.1**	**58.1**	**56.5**	**55.0**	**54.0**	**-6.8**
Change in external debt	1.5	7.2	1.8	6.7	4.5	-6.3	-3.0	-2.0	-1.6	-1.5	-1.0	
Identified external debt-creating flows (4+8+9)	2.4	1.7	-1.9	-3.7	1.7	-2.8	-0.1	1.3	-2.4	-1.7	-1.5	
Current account deficit, excluding interest payments	11.5	5.7	0.6	0.8	1.4	0.2	3.5	4.8	4.3	4.4	4.3	
Deficit in balance of goods and services	26.1	23.0	20.0	20.8	22.9	19.5	22.7	23.7	22.7	22.1	21.4	
Exports	50.4	38.0	45.5	53.6	52.7	52.9	55.3	60.7	64.1	66.1	68.0	
Imports	76.5	61.1	65.5	74.4	75.6	72.5	78.0	84.4	86.8	88.2	89.4	
Net non-debt creating capital inflows (negative)	-5.1	-5.3	-1.1	-2.9	-1.5	-2.6	-3.0	-3.0	-6.0	-5.3	-5.0	
Automatic debt dynamics 1/	-4.0	1.2	-1.4	-1.5	1.8	-0.5	-0.5	-0.6	-0.7	-0.8	-0.8	
Contribution from nominal interest rate	1.4	1.1	1.4	1.7	1.7	1.6	1.5	1.5	1.4	1.3	1.3	
Contribution from real GDP growth	-2.1	0.5	-1.6	-1.5	0.2	-2.1	-2.1	-2.0	-2.1	-2.1	-2.1	
Contribution from price and exchange rate changes 2/	-3.3	-0.3	-1.3	-1.7	-0.1	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	-0.8	5.6	3.6	10.3	2.9	-0.7	-1.6	1.5	-0.5	-1.9	0.1	
External debt-to-exports ratio (in percent)	97.6	148.2	127.8	120.9	131.7	119.1	108.6	95.8	88.2	83.2	79.4	
Gross external financing need (in billions of euros) 4/	2.2	1.9	1.7	2.1	2.2	2.2	2.4	2.7	2.7	2.9	3.0	
in percent of GDP	32.7	28.2	24.4	28.5	29.6	29.0	30.6	32.2	30.0	30.1	29.9	
Scenario with key variables at their historical averages 5/						**67.9**	**65.0**	**65.3**	**63.5**	**60.4**	**59.4**	**-6.6**
Key Macroeconomic Assumptions Underlying Baseline												
Real GDP growth (in percent)	5.0	-0.9	2.9	2.8	-0.4	3.1	3.4	3.6	3.9	4.0	4.0	
GDP deflator in euros (change in percent)	7.3	0.7	2.3	3.1	0.1	0.3	0.1	2.5	2.9	2.1	2.0	
Nominal external interest rate (in percent)	3.2	2.2	2.6	3.2	2.6	2.4	2.5	2.6	2.6	2.5	2.5	
Growth of exports (euro terms, in percent)	10.3	-24.7	25.9	24.8	-2.1	3.9	8.2	16.4	12.9	9.5	9.1	
Growth of imports (euro terms, in percent)	21.7	-20.3	12.9	20.3	1.4	-0.9	11.4	14.9	9.9	7.9	7.5	
Current account balance, excluding interest payments	-11.5	-5.7	-0.6	-0.8	-1.4	-0.2	-3.5	-4.8	-4.3	-4.4	-4.3	
Net non-debt creating capital inflows	5.1	5.3	1.1	2.9	1.5	2.6	3.0	3.0	6.0	5.3	5.0	

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

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

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

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

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

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

Appendix I. Debt Sustainability Analysis

Public debt dynamics[1]—contingent on meeting the outlined medium-term fiscal targets—are stable under the baseline. However, the short maturity of debt poses a rollover risk, with large financing needs each year. Another risk factor is the high ratio of foreign currency denominated debt; mitigating this is the high share of non-market, long-term, project linked financing. Stress tests show that the debt path is robust to individual shock scenarios, but sensitive to a combined macro-fiscal shock.

1. **The public debt ratio is expected to peak at around 39.4 percent in 2018 and stabilize thereafter**. The trajectory assumes a financing strategy for 2017–19 that targets a level of government deposits in the central bank equal to 3–4 months of the gross financing needs of the following year. Should authorities target a zero government deposit balance toward the end of the financing period, central government debt would peak at around 38.6 percent in 2017 before stabilizing at around 38.3 percent in 2019.

2. **Primary deficit and real GDP growth are the largest positive and negative debt creating flows as percentage of GDP, respectively.** While the primary balance is projected to decrease from 2.6 to 1.6 percent over the forecast horizon, it will remain slightly above the debt-stabilizing primary deficit of 1.1 percent for 2019. In cumulative terms, a slowly closing primary gap is the main debt creating flow, adding about 11.4 percentage points of GDP to debt over the same period. However this is offset by the impact of real GDP growth and by a decline in the government's cash position.

3. **The debt ratio remains under 60 percent under both symmetric and asymmetric shocks over the forecast horizon.** Fan charts suggest that the 10 to 90 percentile range of debt ratio under symmetric shocks are between 34 and 58 percent, in 2019. While an asymmetric distribution of shocks with no upside on primary balance and real exchange rate projections results in percentile range of 42 and 62 percent of GDP.

4. **Despite the low debt level, gross financing needs are large and pose a risk**. The maturity of public debt has increased from 9 to 38 months in the last two years, notably reducing rollover risk. Nonetheless, the average maturity of outstanding debt is relatively low which means that gross financing needs are large, between around 13 to 15 percent of GDP during the forecast horizon despite the low fiscal deficit.

5. **Another risk to the debt profile is the high ratio of foreign currency denominated debt.** Foreign currency denominated debt declined to 58 percent of total debt in 2013, but it is expected to rise to 85 percent by 2019 as part of the authorities' current debt management strategy. While this will allow the country to maintain a stable reserve path against external shocks, higher

[1] The analysis is based on central government debt.

recourse to international debt market instruments could increase market risk or, particularly in the face of weak growth and foreign direct investment, trigger a reassessment by markets of the stability of the peg.

6. **The debt path is fairly robust to individual shock scenarios, but a combined macro-fiscal shock could lead to a large increase in debt** (text table). A primary balance shock of 50 percent of planned consolidation as well as a real GDP shock of 1.5 p.p. below the base line or a real interest shock equivalent to around 200 bps above projections will maintain the debt ratio at around 40–45 percent at the end of the forecast horizon. However, a call on SOEs' guaranteed debt over the 2015–19 horizon will increase the debt ratio to around 45 percent. Finally, a shock the combines the aforementioned macro shocks would increase the debt ratio to about 52 percentage points at the end of the forecasting period.

Table 1. Debt Stress Test Scenarios

Name	Description	Impact on debt 1/
Primary Balance Shock	Minimum shock equivalent to 50% of planned adjustment (50% implemented), or baseline minus half of the 10-year historical standard deviation, whichever is larger. There is an increase in interest rates of 25bp for every 1% of GDP worsening in the primary balance.	2.2
Real GDP Growth Shock	Real GDP growth is reduced to 2.5 percent in the period 2017-19 relative to a baseline of 4 percent; 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).	5.6
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.	2.3
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.	4.0
Combined Macro-Fiscal Shock	Shock size and duration based on the underlying shocks.	13.1
Debt guarantee shock	Central Government gurantees as of 2013 on SOEs borrowing fully called over 2015-19 forecast horizon. There is an increase in interest rates of 100bps for every 1% of GDP worsening in the primary balance.	5.7
Pension Shock	5% ad hoc annual increase in pension entitlements during the period 2015-18	2.9

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

7. **The planned cumulative change in primary balance of about 1 percentage points of GDP over the forecast horizon appears realistic?** The maximum cumulative change in cyclically adjusted primary balance (CAPB) planned by the authorities in any given 3 years over the forecast horizon is well within the range achieved by other countries.[2] Also, the maximum 3-year rolling average CAPB that the government will maintain over the forecast horizon is lower than reference countries. Therefore, the planned cumulative change in primary balance of about 1 percentage points of GDP over the forecast horizon appears realistic.

8. **Forecast error analysis suggests systemic positive bias in historical estimations of primary balance but no bias for real GDP growth and inflation.** Staff's estimates of the primary balance projections have been historically on the optimistic side. While this is mainly due to the surprise deterioration of balances in 2012 and subsequent intra-year revisions of budgetary targets, it demonstrates the need for caution and the importance of sensitivity analysis when projecting fiscal adjustment.

[2] Reference countries are high debt countries with public debt greater than 60 percent of GDP.

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

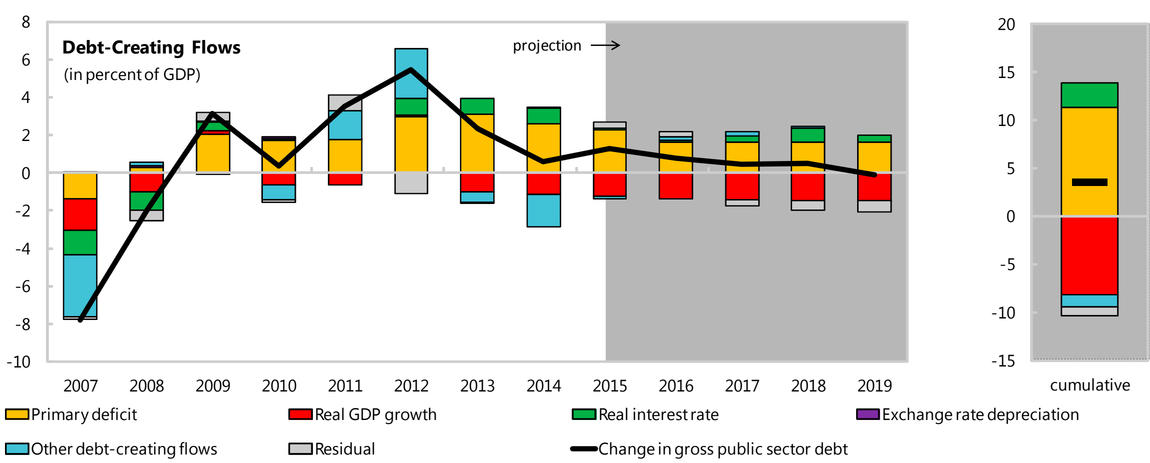
(in percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators [1/]

	Actual			Projections						As of May 15, 2014		
	2007-2011 [2/]	2012	2013	2014	2015	2016	2017	2018	2019	Sovereign Spreads		
Nominal gross public debt	24.1	33.4	35.8	36.4	37.7	38.5	38.9	39.4	39.3	Spread (bp) 3/		268
Public gross financing needs	2.1	9.0	15.0	13.2	17.0	15.1	14.4	13.3	14.7	CDS (bp)		401
Real GDP growth (in percent)	3.2	-0.4	3.1	3.4	3.6	3.9	4.0	4.0	4.0	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	4.3	0.1	0.3	0.1	2.6	2.7	2.2	2.0	2.2	Moody's	n.a.	n.a.
Nominal GDP growth (in percent)	7.6	-0.3	3.4	3.5	6.1	7.0	6.3	6.1	6.3	S&Ps	BB-	BB-
Effective interest rate (in percent) [4/]	3.1	3.3	3.0	2.5	3.0	3.1	3.2	4.1	3.4	Fitch	BB+	BB+

Contribution to Changes in Public Debt

	Actual			Projections							
	2007-2011	2012	2013	2014	2015	2016	2017	2018	2019	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	-0.6	5.49	2.34	0.6	1.3	0.8	0.4	0.5	-0.1	3.5	
Identified debt-creating flows	-0.7	6.60	2.40	0.6	1.0	0.5	0.8	1.0	0.5	4.4	
Primary deficit	0.9	3.0	3.1	2.6	2.3	1.6	1.6	1.6	1.6	11.4	-1.1
Primary (noninterest) revenue and grants	31.4	30.0	29.5	31.4	31.3	31.1	31.1	31.1	31.1	187.1	
Primary (noninterest) expenditure	32.3	32.9	32.6	34.0	33.6	32.7	32.7	32.7	32.7	198.5	
Automatic debt dynamics [5/]	-1.1	1.0	-0.1	-0.3	-1.1	-1.3	-1.1	-0.7	-1.1	-5.7	
Interest rate/growth differential [6/]	-1.1	1.0	-0.1	-0.3	-1.1	-1.3	-1.1	-0.7	-1.1	-5.7	
Of which: real interest rate	-0.3	0.9	0.9	0.8	0.1	0.1	0.3	0.7	0.4	2.5	
Of which: real GDP growth	-0.8	0.1	-1.0	-1.2	-1.2	-1.4	-1.4	-1.5	-1.5	-8.2	
Exchange rate depreciation [7/]	0.0	0.0	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	-0.5	2.7	-0.6	-1.7	-0.2	0.2	0.3	0.1	0.0	-1.3	
Privatization receipts (negative)	-0.2	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Changes in cash, deposits, and securities held for	-0.2	2.7	-0.4	-1.7	-0.2	0.2	0.3	0.1	0.0	-1.3	
Residual, including asset changes [8/]	0.1	-1.1	-0.1	0.0	0.3	0.3	-0.3	-0.5	-0.6	-0.8	



Source: IMF staff.

1/ Public sector is defined as central government.

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.

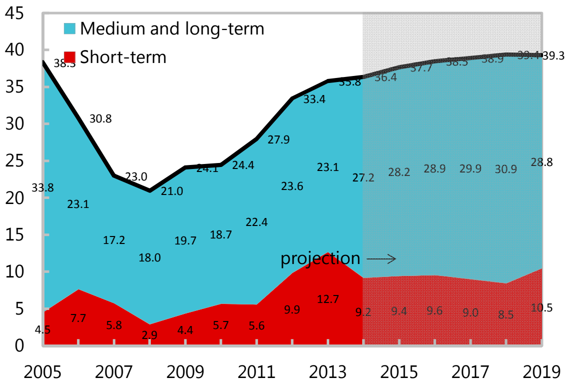
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

FYR Macedonia Public DSA - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

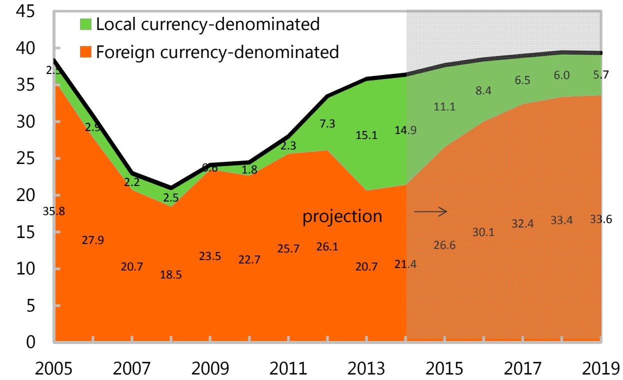
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

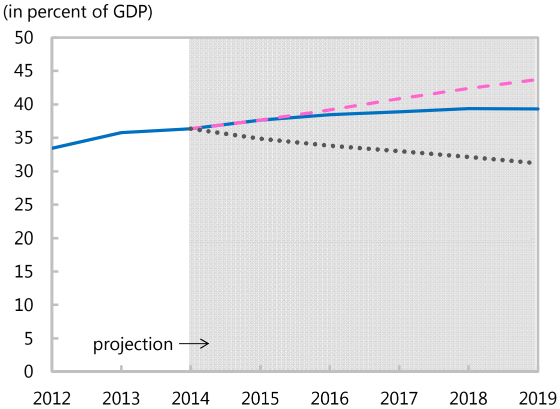


Alternative Scenarios

Baseline Historical Constant Primary Balance

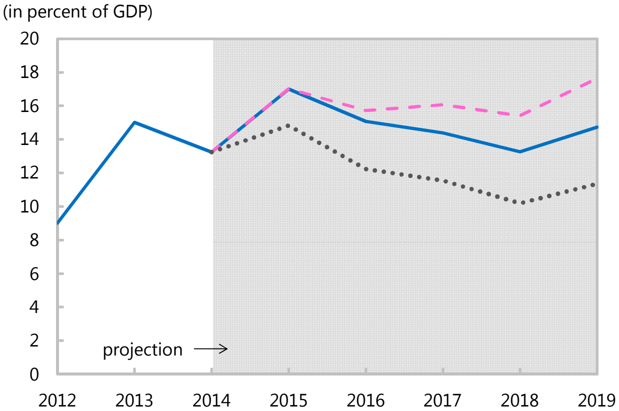
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

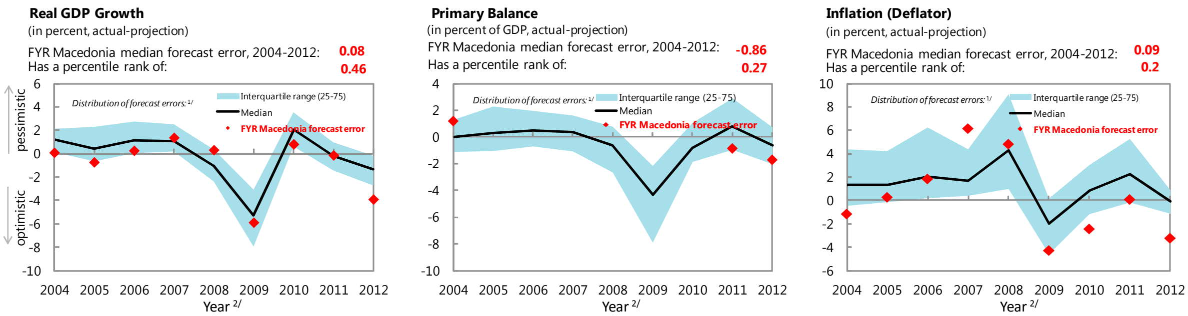
Baseline Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	3.4	3.6	3.9	4.0	4.0	4.0
Inflation	0.1	2.6	2.7	2.2	2.0	2.2
Primary Balance	-2.6	-2.3	-1.6	-1.6	-1.6	-1.6
Effective interest rate	2.5	3.0	3.1	3.2	4.1	3.4
Constant Primary Balance Scenario						
Real GDP growth	3.4	3.6	3.9	4.0	4.0	4.0
Inflation	0.1	2.6	2.7	2.2	2.0	2.2
Primary Balance	-2.6	-2.6	-2.6	-2.6	-2.6	-2.6
Effective interest rate	2.5	3.0	3.1	3.2	3.2	3.2

Historical Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	3.4	6.4	6.4	6.4	6.4	6.4
Inflation	0.1	2.6	2.7	2.2	2.0	2.2
Primary Balance	-2.6	-0.8	-0.8	-0.8	-0.8	-0.8
Effective interest rate	2.5	3.0	2.9	2.9	3.0	3.0

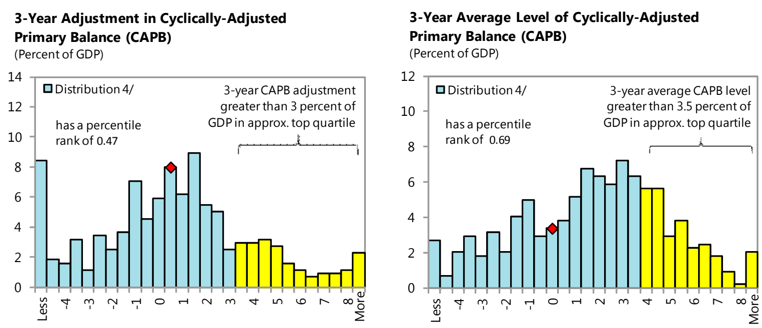
Source: IMF staff.

FYR Macedonia Public DSA - Realism of Baseline Assumptions

Forecast Track Record, versus all countries



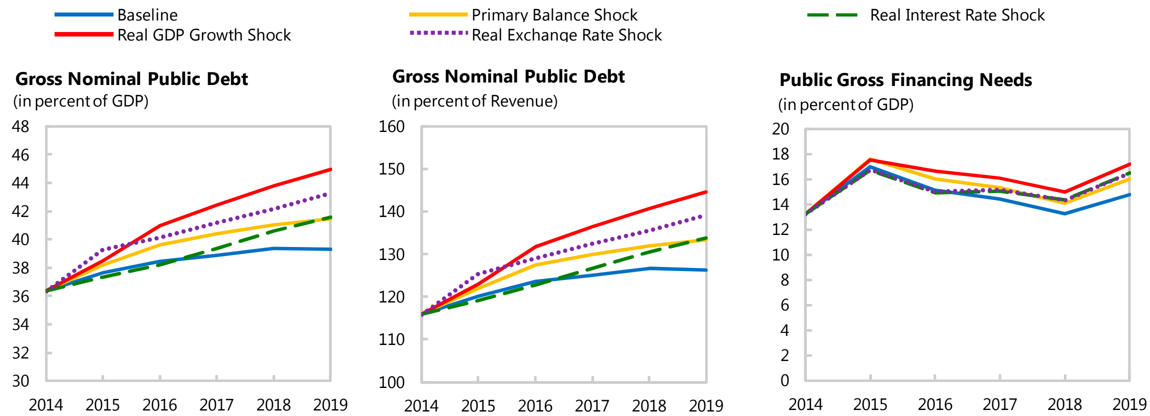
Assessing the Realism of Projected Fiscal Adjustment



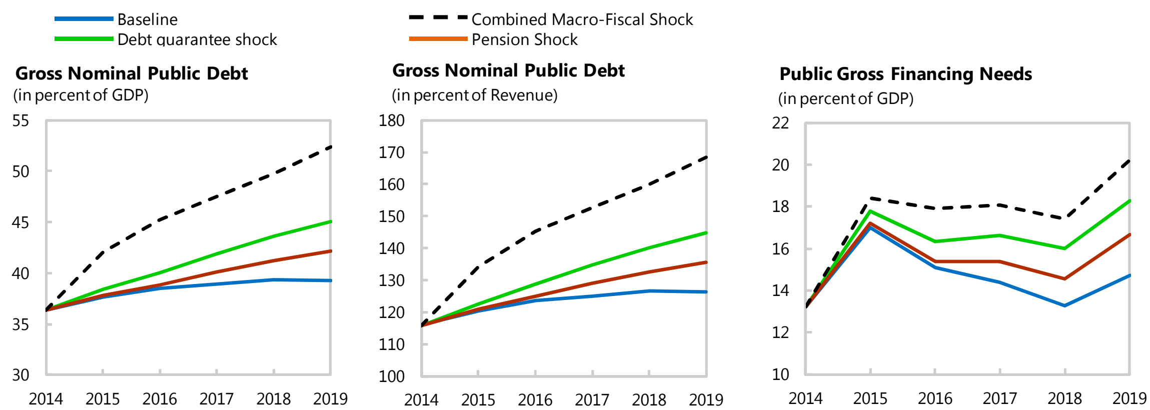
Source : IMF Staff.
1/ Plotted distribution includes all countries, percentile rank refers to all countries.
2/ Projections made in the spring WEO vintage of the preceding year.
3/ Macedonia, Former Yugoslav Republic of has had a positive output gap for 3 consecutive years, 2011-2013. For Macedonia, Former Yugoslav Republic of, t corresponds to 2014; for the distribution, t corresponds to the
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 Public DSA - Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

	2014	2015	2016	2017	2018	2019
Primary Balance Shock						
Real GDP growth	3.4	3.6	3.9	4.0	4.0	4.0
Inflation	0.1	2.6	2.7	2.2	2.0	2.2
Primary balance	-2.6	-3.2	-2.5	-1.6	-1.6	-1.6
Effective interest rate	2.5	3.0	3.2	3.2	3.3	3.3
Real Interest Rate Shock						
Real GDP growth	3.4	3.6	3.9	4.0	4.0	4.0
Inflation	0.1	2.6	2.7	2.2	2.0	2.2
Primary balance	-2.6	-2.3	-1.6	-1.6	-1.6	-1.6
Effective interest rate	2.5	3.0	4.0	4.4	4.6	4.8
Combined Shock						
Real GDP growth	3.4	2.1	2.4	2.5	2.5	2.5
Inflation	0.1	2.3	2.3	1.8	1.7	1.9
Primary balance	-2.6	-3.2	-2.8	-1.6	-1.6	-1.6
Effective interest rate	2.5	3.2	3.9	4.2	4.5	4.6
Debt guarantee shock						
Real GDP growth	3.4	3.6	3.9	4.0	4.0	4.0
Inflation	0.1	2.6	2.7	2.2	2.0	2.2
Primary balance	-2.6	-3.3	-2.6	-2.6	-2.5	-2.5
Effective interest rate	2.5	3.0	3.6	3.7	3.8	3.8

	2014	2015	2016	2017	2018	2019
Real GDP Growth Shock						
Real GDP growth	3.4	2.1	2.4	2.5	2.5	2.5
Inflation	0.1	2.3	2.3	1.8	1.7	1.9
Primary balance	-2.6	-2.8	-2.8	-1.6	-1.6	-1.6
Effective interest rate	2.5	3.0	3.2	3.3	3.3	3.3
Real Exchange Rate Shock						
Real GDP growth	3.4	3.6	3.9	4.0	4.0	4.0
Inflation	0.1	6.0	2.7	2.2	2.0	2.2
Primary balance	-2.6	-2.3	-1.6	-1.6	-1.6	-1.6
Effective interest rate	2.5	3.2	3.1	3.2	3.2	3.3
Pension Shock						
Real GDP growth	3.4	3.6	3.9	4.0	4.0	4.0
Inflation	0.1	2.6	2.7	2.2	2.0	2.2
Primary balance	-2.6	-2.8	-2.1	-2.1	-2.1	-2.1
Effective interest rate	2.5	3.0	3.1	3.2	3.2	3.3

Source: IMF staff.

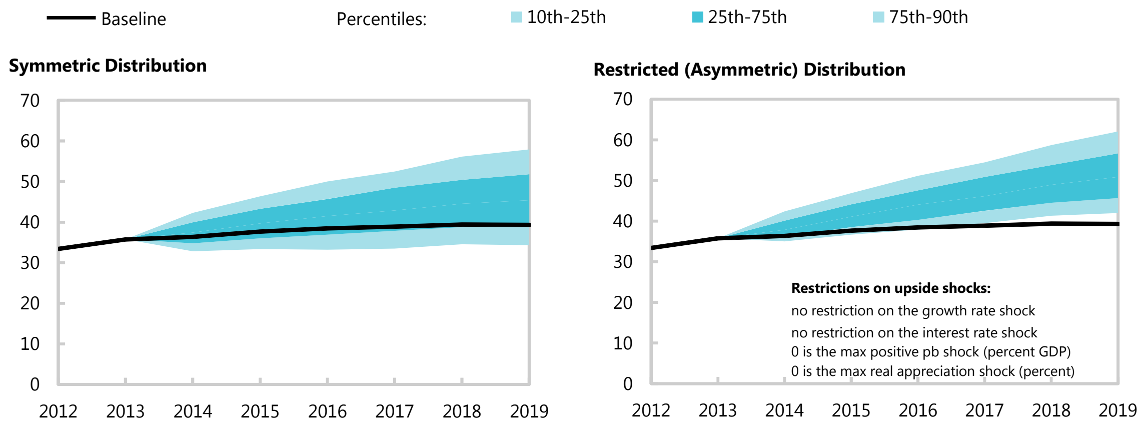
FYR Macedonia—Public DSA Risk Assessment

Heat Map

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

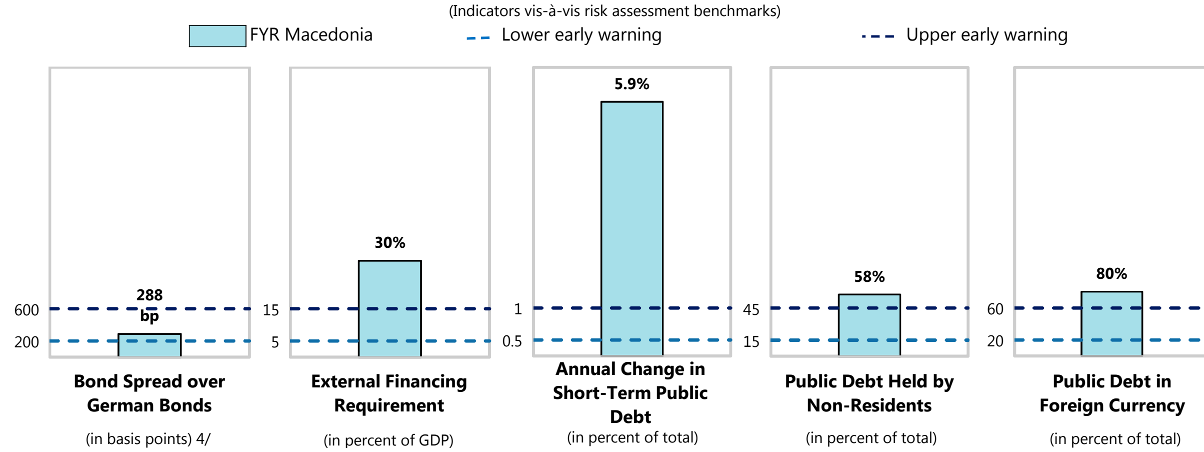
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



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, 14-Feb-14 through 15-May-14.

Appendix II. Risk Assessment Matrix[1]

Source of Risks	Likelihood	Expected Impact of Risk
Surges in global financial market volatility (related to UMP exit)	**High**	**Low** **Financial channels for transmission are relatively limited**. Public sector external financing requirements for 2014 are expected to be fully met with official financing. Cross-border lending is relatively unimportant. The scope for portfolio investment flows is constrained by the limited availability of equity and debt instruments. **Policy response**: Careful management of the rollover of the 2015 eurobond; re-establish medium term debt management strategy.
Protracted period of slower growth in advanced and emerging economies	**High** (Europe) **Medium** (elsewhere)	**Medium/High** **Real exposure to European economies is very high.** • **Setbacks in the implementation of FDI plans** would lead to weaker than expected investment, reducing medium term potential growth. Debt dynamics would worsen. • **Lower import demand from European markets** could dampen the contribution of exports to growth. • **Lower private transfers** would weigh on consumption. **Policy response:** Continue with structural reforms to enhance competitiveness and potential growth. Fiscal impulse from public sector infrastructure operations is currently supporting both the recovery and medium term growth.
Financial stress in the Euro-area re-emerges triggered by stalled or incomplete delivery of national and euro area policy commitments	**Medium**	**Medium** **Further stress in euro-area parent banks of two systemic local subsidiaries** could lead to renewed tightening of credit conditions, with attendant effects on growth. The standalone strength of these subsidiaries and their limited dependence on parent bank funding are important mitigating factors. **Policy response**: Relieve structural bottlenecks to more efficient intermediation of savings; seek a suitable framework to continue cooperation with home country supervisors.
Increasing geopolitical tensions surrounding Ukraine lead to disruptions in financial, trade and commodity markets	**Medium**	**Low/Medium** **Trade exposure is low, except for gas**. Russia is the sole supplier of natural gas, and storage capacity is very limited. Steel industry was hit during the 2009 gas crisis. **Commodity price shocks** in cereals would have a limited negative effect on the trade balance. An oil price shock would have a more pronounced impact on the current account.

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

INTERNATIONAL MONETARY FUND

FORMER YUGOSLAV REPUBLIC OF MACEDONIA

June 17, 2014

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION AND THIRD POST-PROGRAM MONITORING DISCUSSIONS—INFORMATIONAL ANNEX

Prepared By European Department

CONTENTS

FUND RELATIONS

(As of June 9, 2014)

Missions. Article IV and third Post–Program Monitoring mission, Skopje, May 6–19th, 2014. Concluding statement is available at: http://www.imf.org/external/np/ms/2014/051914a.htm

Staff team. Ivanna Vladkova Hollar (head), Marc Gerard, Marzie Taheri Sanjani, Gregorio Impavido (all EUR), Patrick Gitton (Resident Representative), and Gjorgji Nacevski (local economist).

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

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

Membership Status: Joined 12/14/92; Article VIII

General Resources Account:	SDR Million	Percent of Quota
Quota	68.90	100.00
Fund holdings of currency	265.90	385.92
Reserve position	0.00	0.00

SDR Department:	SDR Million	Percent of Allocation
Net cumulative allocation	65.62	100.00
Holdings	3.44	5.25

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

[1/] Formerly Precautionary Credit Line (PCL)

Latest Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
PLL [1/]	01/19/2011	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				
	2014	2015	2016	2017	2018
Principal	73.88	98.50	24.63		
Charges/Interest	1.01	1.19	0.22	0.06	0.06
Total	74.89	99.69	24.84	0.06	0.06

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

At end-May 2014, the official exchange rate was 45.3 denars per U.S. dollar and 61.65 denars per euro. The FYR of Macedonia has accepted the obligations of Article VIII, Sections 2, 3, and 4 with effect from June 19, 1998.

Article IV Consultations:
The first consultation with the FYR of Macedonia was concluded in August 1993. The last consultation was concluded on June 26, 2013 (IMF Country Report 13/178). The FYR Macedonia is on the standard 12-month Article IV consultation cycle, while Post-Program Monitoring is expected to take place every 6 months.

[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
FX Reserves Modeling	RES/MCM		February 2012, February 2013
Public Financial Management	FAD		November 2012
Provisioning Regulation	MCM		November 2012
STA TA Evaluation	STA		September 2012
National Accounts	STA		June 2009, August 2011, September 2012, October 2013
Assessing the Budgeting Framework and Investigation of Payment Arrears	FAD		March 2012
Macroeconomic Modeling at NBRM	MCM		March, November 2009; September and November 2010; May and November 2011; February and November 2012, March 2013, May 2014
Domestic Debt Market Development	MCM		October 2011
Tax Administration	FAD		June 2011, September 2013, November 2013, March 2013
Medium-Term Budgeting	FAD		May 2011
Safeguards Assessment	FIN		February 2011
Stress Testing	MCM		February 2011
SDDS Subscription	STA		December 2010
Tax Administration	FAD		April 2010
Public Financial Management	FAD		September 2009
Tax Administration	FAD		July 2009

Contingency Planning and Crisis Preparedness	MCM		February 2009
Government Finance Statistics	STA		October 2008
Balance of Payments Statistics	STA		October 2008
National Accounts Statistics	STA		April 2007; January, May, September, and December 2008
Export and Import Deflators	STA		December 2007
GFS 2001	STA		December 2007
Expenditure Rationalization	STA		November 2007
Central Bank Law	FAD		July 2007
Tax Policy	MCM		July 2007
National Accounts Statistics	FAD		June 2007
Liquidity, Cash and Debt Management	STA		April 2007
Tax Administration	MCM		April 2007
Balance of Payments Statistics	FAD		October 2006
Tax Policy	FAD		September 2006
Government Finance Statistics	STA		June 2006
Banking Law	LEG, MCM		June 2006
Resident Experts			
Tax Administration	FAD		October 2006–August 2011
Banking Supervision	MCM		May 2006–May 2008
FSAP Participation and ROSCs (since 2003)			

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

Resident Representative The Fund has had a resident representative in Skopje since 1995. Mr. Patrick Gitton has held this position since August 2013.

IMF–WORLD BANK COLLABORATION

Background

The Bank and the Fund country teams on the Former Yugoslav Republic of Macedonia maintained close collaboration, seeking synergies and harmonizing policy recommendations. Close coordination has resulted in largely shared views of the economic situation in the country, particularly in the context of the latest Public Expenditure Policy Based Guarantee (PEPBG), for which the Fund provided an Assessment Letter in November 2012. The area of public financial management has been at the center of discussions over the last year, and the measures supported by the PEPBG on public finance management have benefited from the findings and recommendations of the recent IMF TA mission.

Key Areas of World Bank Involvement

- The World Bank program in FYR Macedonia focuses on three pillars: (i) faster growth by improving competitiveness; (ii) more inclusive growth by strengthening employability and social protection, and continued improvement of social programs; and (iii) more sustainable resource use and an analysis of options for "greener" economic growth. Because FYR Macedonia's future growth and development depends fundamentally on the pace of EU accession, virtually every intervention in the program is designed to help it prepare for the EU membership.
- A series of two budget support operations (Competitiveness DPL) has been made available to the Government with the aim to improve the competitiveness of the economy to develop a stronger export-oriented enterprise sector. The first of these has been closed, while the second one has been approved, and disbursement is expected until the end of June, 2014.
- The World Bank also provided recently two Policy Based Guarantees for two loans the Government contracted with commercial Banks, together in the amount of €255 million. The Policy Based Guarantees supported critical reforms needed to strengthened robustness of public financial management and help mitigate the impact of the euro zone turmoil.
- The Real Estate Cadastre and Registration Project (US$26 million) is supporting the digitalization of cadastral maps and securing land and real estate titles. The Regional and Local Roads Program Support Project (US$105 million) is helping with the rehabilitation of the regional and local roads and provides institutional support to improve the management of roads. The World Bank finances the energy sector through the Electric Power Development Energy Community of South East Europe Project APL3 (US$44 million) to improve the

transmission grid, including an interconnection with Serbia. Local development is assisted through the Municipal Services Improvement Project (US$75 million), which is helping to improve transparency, financial sustainability and delivery of targeted municipal services in selected municipalities. The World Bank is also active in the human development sector through the Conditional Cash Transfer Project (US$25 million), and the new Skills Development and Innovation Support Project (US$24).

Macedonia–Bank and Fund Planned Activities in Macrocritical Structural Reform Areas, June 2014–May 2015			
Title	**Products**	**Provisional Timing of Missions**	**Expected Delivery Date**
1. Fund work	4th Post-Program Monitoring Report	October 2014	December 2014
	Article IV Report	Spring 2015	June 2015
	Technical assistance on compliance and risk management in revenue administration	Short-term expert visit in Spring 2015 (tentative)	TA report after the mission
	Technical Assistance on National Account statistics	Ongoing through a resident advisor (based in Sarajevo)	TA report after the mission
	Technical assistance on Financial Stability Indicators	October 2014 (tentative)	TA report after the mission
	Technical assistance on medium-term budget process	December 2014 (tentative)	TA report after the mission
2. Bank work program	Public Finance Review	Ongoing, most recent mission May 2014	Report scheduled for September 2014
	Southeastern Europe Regular Economic Update	Continuous and periodic missions	June and December
	Real Estate Cadastre and Registration project supervision	Continuous	Project closing December 2014
	Municipal Services Improvement project supervision	Continuous	Project closing November 2017
	Regional and Local Roads Program Support project supervision	Continuous	Project closing December 2015
	CCT project supervision	Continuous	Project closing December 2015
	Energy Community South East Europe Adaptable Program Loan (ECSEE APL) 3 supervision	Continuous	Project closing November 2015
	Balkan Financial Sector Technical Assistance Facility (TA to NBRM and MoF on bank resolution; LoLR, etc.)	TBD	
	Skills Development and Innovation Support Project	Continuous	Project closing May 2019

STATISTICAL ISSUES

(As of June 9, 2014)

I. Assessment of Data Adequacy for Surveillance	
General: Data provision has some shortcomings but is broadly adequate for surveillance. Areas that would benefit most from further improvement are national accounts and government finance statistics.	
National accounts: Quality of national account measurement need to be improved. In 2013, by Decision of the Government of the Republic of Macedonia, amendments were made to the National Classification of Activities—NKD Rev.2 and entailed significant changes in the decomposition of historical data. The primary objective of the Classification of Activities is to provide a basis for comparing statistical data of the Republic of Macedonia on European and world level, i.e. in its content and structure is completely harmonized with the European Classification of Activities NACE Rev.2. Currently the State Statistical Office (SSO) is working on a new revision that will be effective around the second half of 2014. **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* (GFSMY) or the *International Financial Statistics* (*IFS*).	
Monetary sector: EUR receives a monthly electronic report of monetary statistics, covering the balance sheet of the central bank, the commercial banks and other depository corporations.	
External sector: External sector statistics meet international standards. In additional to monthly balance of payments data, the authorities compile and disseminate international investment position (IIP) data, reserve assets and foreign currency liquidity data, and external debt statistics.	
II. Data Standards and Quality	
FYR Macedonia participates in the General Data Dissemination System (GDDS), and, since November 2011, in the Special Data Dissemination Standard (SDDS).	Data ROSC published on September 29, 2004.

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

(As of June 9, 2014)

	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]	Data Quality – Accuracy and Reliability[9]
Exchange Rates	5/30/14	5/30/14	D	W	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	5/23/14	5/30/14	D	W	Q		
Reserve/Base Money	5/29/14	5/30/14	W	W	M		
Broad Money	Apr. 14	5/21/14	M	M	M	O, LO, LO, O	O, LO, O, O, O
Central Bank Balance Sheet	Apr. 14	5/21/14	M	M	M		
Consolidated Balance Sheet of the Banking System	Apr. 14	5/21/14	M	M	M		
Interest Rates[2]	Apr. 14	5/30/14	M	M	M		
Consumer Price Index	Apr. 14	5/9/14	M	M	M	O, O, O, LO	LO, O, LNO, O, LO
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Apr.14	5/28/14	A	A	A		
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	Apr.14	5/28/14	M	M	M	LO, LNO, LO, O	LO, LO, LO, LO, LNO
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Apr.14	5/13/14	A	A	A		
External Current Account Balance	Mar. 14	5/30/14	M	M	M		
Exports and Imports of Goods and Services	Mar 14	5/5/14	M	M	M	O, LO, O, LO	LO, O, LO, O, LO
GDP/GNP	Dec. 13	3/17/14	Q	Q	Q	O, LO, O, LO	LO, O, LNO, O, O
Gross External Debt	12/31/13	3/30/14	Q	Q	Q		
International Investment Position[6]	12/13	3/30/14	Q	Q	Q		

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

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

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

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

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

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

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

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

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

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International Monetary Fund
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IMF Executive Board Concludes 2014 Article IV Consultation and Third Post-Program Monitoring Review with the Former Yugoslav Republic of Macedonia

On July 1, 2014, the Executive Board of the International Monetary Fund (IMF) concluded the 2014 Article IV Consultation and Third Post-Program Monitoring with Macedonia.[1]

Growth accelerated to 3.1 percent in 2013 and has been more job-friendly than in the past. After a good performance at 3.9 percent year-on-year in the first quarter, baseline growth is expected to gather pace—to about 3.5 percent this year—and to broaden further. Domestic demand will be supported by private consumption and large public infrastructure projects, while the contribution of exports will be offset by higher investment-related imports. Inflation is weakening, led by lower food and commodity prices, but a pickup in the second half of the year is projected, bringing average inflation to about 1 percent in 2014. The decline in foreign exchange reserves observed since end-2012 has been mostly due to valuation effects and is expected to halt and partially reverse in the second half of 2014, preserving reserve adequacy. A pickup in foreign direct investment (FDI) and significant financial inflows to the public sector from multilateral and bilateral external creditors will offset a widening current account deficit and slightly declining private transfers.

[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.

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

The nominal cash budget deficit target for 2013 was met, but resulted in a higher-than-targeted 4.1 percent of GDP deficit. For the first four months of 2014, growth in expenditures has outpaced that of revenues, resulting in a cumulative budget deficit of 2.5 percent of GDP, against a targeted deficit of 3.5 percent of GDP for the year. As in 2013, subsidies and other transfers were frontloaded, with almost 50 percent of the budgeted amount spent in the first four months.. Central government debt rose to 35.8 percent of GDP at end-2013 and is expected to rise by about half a percent of GDP in 2014. Debt of state-owned-enterprises is increasing at a faster pace and is expected to bring public sector debt at about 43.5 percent of GDP at the end of the year.

The financial sector has been resilient. Banks' overall capital adequacy ratio stands at around 17 percent and liquidity ratios at around 30 percent; while the share of non-performing loans to non-financial entities (11.1 percent in March 2014) is gradually declining. Monetary conditions remain accommodative, with the main policy rate reduced by 75 basis points to 3.25 percent in several steps since mid-2012, the successive relaxation of reserve requirements for specific categories of liabilities, and additional credit support measures in July 2013. As a result, credit growth has been gathering pace since the second half of 2013, bouncing back to 7.5 percent year-on-year in March 2014. However, dynamic household lending growth contrasts with still weak lending growth to the corporate sector.

Executive Board Assessment[2]

Executive Directors welcomed the economic recovery underway, the decline in unemployment, and the broadly favorable economic outlook. Directors noted, however, that securing a lasting expansion and durable reductions in unemployment requires continued efforts to preserve macroeconomic stability and promote a dynamic financial sector, as well as a more supportive business environment.

Directors encouraged the authorities to meet their 2014 deficit target for the central government, as a first step toward securing the consolidation needed to safeguard a sustainable trajectory for the public debt. More broadly, they agreed that the overall policy framework would benefit from greater fiscal transparency and a well-articulated debt management strategy that takes into consideration both domestic and external sources of financing while maintaining macroeconomic stability and supporting growth. Directors advised the authorities to specify the measures underpinning fiscal adjustment to reduce implementation risks and noted that greater efforts to prioritize and monitor public investment projects would also strengthen public financial management.

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

Directors concurred that monetary policy should continue to refrain from providing additional accommodation in the period ahead, barring an unforeseen deterioration of the macroeconomic environment. The primary focus of policy should instead shift to supporting the adequacy of international reserves and an exchange rate regime that has served the country well.

Directors agreed that Macedonia’s financial system remains liquid and adequately capitalized. They noted, nonetheless, that structural weaknesses in the sector, if unaddressed, would continue to hamper intermediation and the flow of credit. Directors agreed that in light of the systemic importance of euro-area subsidiaries to the domestic banking system, preserving cooperation between home and host country authorities will be critical, as the European Union’s Single Supervisory Mechanism comes into force.

Directors commended the authorities’ efforts to advance their structural reform agenda. In particular, they noted important progress in implementing labor market policies to mitigate skill mismatches. Directors also underscored the importance of further alleviating long-standing impediments to private sector activity, including by better enforcing payment discipline in public and private sector contracts. They also welcomed efforts to strengthen supply chain linkages between foreign enterprises and domestic firms.

FYR Macedonia: Selected Economic Indicators

	2009	2010	2011	2012	2013	2014
	Annual percentage change, unless otherwise specified					
Real GDP	-0.9	2.9	2.8	-0.4	3.1	3.4
Real domestic demand	-3.1	-0.3	3.9	2.0	-0.6	4.1
Private consumption	-4.7	2.1	2.9	-3.0	4.3	3.5
					-	
Gross investment	-0.4	-6.7	9.6	20.0	11.5	7.0
Net exports 1/	2.9	3.0	-1.9	-2.8	3.5	-0.5
CPI inflation (annual average)	-0.8	1.5	3.9	3.3	2.8	1.0
Unemployment rate (annual average)	32.2	32.0	31.4	31.0	29.0	29.0
	In percent of GDP					
Current account balance	-6.8	-2.0	-2.5	-3.0	-1.8	-4.5
				-	-	
Trade balance	-23.0	-20.0	-20.8	22.9	19.5	-22.1
Exports of goods	38.0	45.5	53.6	52.7	52.9	55.3
Imports of goods	61.1	65.5	74.4	75.6	72.5	77.4
Private transfers	16.4	18.9	19.0	21.1	19.4	19.2
External debt (percent of GDP)	56.4	58.2	64.8	69.4	63.0	60.3
Gross investment	25.9	25.5	26.2	29.4	24.4	25.6
Domestic saving	19.1	23.5	23.7	26.4	22.6	21.1
Public	0.6	1.1	1.4	0.2	-0.6	0.5
Private	18.5	22.4	22.3	26.2	23.2	20.6
Foreign saving	6.8	2.0	2.5	3.0	1.8	4.5
Central Government Gross Debt	24.1	24.4	27.9	33.4	35.8	36.4
Public Sector Gross Debt 2/	27.1	28.0	32.1	28.3	42.1	44.8
Central Government Balance	-2.7	-2.4	-2.5	-3.9	-4.1	-3.5
Memorandum items:						
Nominal GDP (billions of denars)	411	434	460	459	474	491
Nominal GDP (billions of euros)	6.7	7.1	7.5	7.5	7.7	8.0
GDP per capita (EUR)	3265	3430	3629	3615	…	…

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

1/ Contribution to growth.

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

Statement by Mr. Menno Snel, Executive Director for Former Yugoslav Republic of Macedonia and Mr. Metodij Hadzi-Vaskov, Advisor to Executive Director
July 1, 2014

The Macedonian authorities would like to thank the IMF team for the candid and constructive exchange of views during the mission. They broadly agree with staff's assessment and main policy recommendations. Building on positive experience in the past, the authorities continue to make use of Fund advice in formulating economic policies. In this context, they have intensified efforts aimed at strengthening supply chain linkages between FDIs and domestic companies, while making further progress with the development of the domestic debt market. The authorities look forward to continued cooperation and Fund support aimed at strengthening the capacity for medium-term budget planning. The achievement of higher economic growth, employment, and standard of living constitute a key strategic priority of the new Government Program for the period 2014-2018.

Economic developments

Following a strong and robust recovery in economic activity in 2013, economic growth has accelerated faster than expected, to 3.9 percent in the first quarter of 2014, placing Macedonia among the top growth-performers in Europe. After a slight deceleration in 2013 to 2.8 percent, the average inflation rate in the first four months of 2014 dropped close to zero, largely reflecting the receding pressures from food prices. Industrial production continued to increase steadily, recording a growth rate of 3.1 percent over the period January-April 2014. Over the same time period, expanding activity of existing and new FDIs contributed to a strong export growth of 15.1 percent, and an increase in the import coverage by exports from 62.4 percent to 65.2 percent. After subdued performance in the first half of 2013, credit growth started to strengthen in the second half of 2013, reaching 7.6 percent at end-May 2014.

On the basis of favorable growth prospects, prudent macroeconomic policies, and a stable financial sector, Fitch has affirmed Macedonia's credit rating at BB+ with stable outlook in March, and Standard & Poor's has affirmed credit rating at BB- with stable outlook in May 2014. Net FDI inflows accelerated to 3.3 percent of GDP in 2013 and to over 1 percent of GDP in the first quarter of 2014, while the pipeline of current and forthcoming FDI projects has further expanded. Against the backdrop of stronger economic activity, largely reflecting a dynamic FDI sector, unemployment has continued to decline. The latest figures indicate that the unemployment rate in Macedonia has dropped to the lowest level over the last twenty years. The continued reduction of the unemployment rate on a sustainable basis remains the authorities' key priority.

Fiscal policy

The authorities are committed to meeting the fiscal deficit target of 3.5 percent of GDP in 2014. Going forward, they aim to formulate fiscal policy in line with the medium-term fiscal strategy, which envisions a decrease in the fiscal deficit to 2.6 percent of GDP by 2016, and aims at stabilizing central government debt without jeopardizing the path of economic recovery.

Investment in capital infrastructure projects remains a key priority for the authorities over the medium term. Beyond their near- to medium-term positive impact on economic activity and employment, these projects are essential for reducing costs, enhancing competitiveness, and boosting the economy's potential growth. The authorities envisage ensuring fiscal space for capital expenditures by containing current expenditures, continuing to base revenues on prudent macroeconomic assumptions, and further enhancing the efficiency and the effectiveness of the revenue administration, including through the implementation of GPRS on all cash registers that will provide real-time transaction information.

The public debt management policy, which constitutes a part of the medium-term fiscal strategy, aims at meeting the public sector financing needs at the lowest possible cost consistent with a prudent level of risk, and at ensuring the long-term sustainability of public finances. The authorities underline that they retain full control over the indebtedness of all public enterprises, given the legal obligation of these enterprises to pass the same scrutiny as all other budget users. Moreover, their borrowing capacity will continue to be assessed through a rigorous long-term sustainability analysis.

In order to further strengthen budget discipline and enhance predictability of fiscal policy in the future, the new Government Program stipulates introduction of fiscal rules, which will place limits on budget deficit and debt level, as well as strengthen the fiscal accountability mechanisms. The regulatory framework on fiscal rules is expected to be prepared by September 2014.

Monetary and financial sector policy

The NBRM authorities remain vigilant to possible further pressures on the balance of payments, and stand ready to adjust monetary policy if needed to ensure the sustainability of the exchange rate peg. They point out that the deterioration of the balance of payments in the first quarter of 2014 was in line with the expectations, and mainly reflects the seasonal pattern of some of the components. The expected private transfers and capital account inflows in the second half of 2014 are expected to partly mitigate the depletion of reserves in the first half of the year. Notwithstanding the recent decline in reserves, mainly due to valuation effects, several key metrics indicate that the level of reserves remains adequate.

The NBRM authorities see significant upside risks to the balance of payments baseline related to the recently-announced FDI projects.

The authorities reiterate their commitment to maintaining their prudent bank supervision framework in the context of the changing supervisory landscape in Europe. In particular, they emphasize the importance of further extending the current cross-border cooperation in banking supervision through supervisory colleges to the supervisors of other foreign parent banks. At the same time, the NBRM authorities express concern that the ongoing move toward centralized European supervision may terminate bilateral arrangements with Macedonia, which may not be replaced by establishing effective supervisory cooperation in the context of the SSM. In light of recent credit market developments, the NBRM authorities highlight that their macroprudential measures had a visible effect on accelerating credit growth.

Business environment and reforms agenda

Recognizing the continued and comprehensive improvement of the business environment, the latest World Bank Doing Business report ranked Macedonia among the top 10 reformers in the world for the fourth time in the last seven years. Macedonia has made substantial progress in several other international rankings, including the Index of Economic Freedom, the Global Competitiveness Index, and the Forbes list of best countries for business, which have consistently placed Macedonia on top among regional peers in recent years. The authorities believe that the decision by several large foreign investors to expand their production capacity and open new factories a short period after their initial investments in the country provides key evidence about the tangible improvement of the business climate.

In line with Fund advice, the authorities have intensified their efforts to strengthen the interconnectedness between FDIs and the domestic private sector. In particular, a special committee has been established with the task of enhancing linkages between FDIs and local companies, thereby supporting the steady progress on the value-added ladder and facilitating knowledge spillovers. Key challenges in this respect include achievement of high quality standards, further development of entrepreneurial spirit and skills, and comprehensive improvements in organizational structures.

The law on financial discipline, which came into effect on May 1, is expected to enforce payment discipline and improve liquidity of the private sector through an effective regulation of the payment period for the public as well as the private sector. Access to finance for domestic SMEs is expected to be further improved through the operationalization of the fourth credit line from the European Investment Bank starting in June 2014. Strong emphasis will continue to be put on improving educational curricula, further reducing skills mismatches, and implementation of active labor market measures with a particular focus on youth. Innovations will be promoted within a newly-developed policy framework, given their key role in enhancing competitiveness of the private sector and facilitating the transition toward a knowledge-based economy.

Concluding remarks

The Macedonian authorities remain fully committed to safeguarding Macedonia's sound economic fundamentals, extending the track record of prudent economic policies, and maintaining macroeconomic and financial stability. Complementing comprehensive regulatory reforms with an ambitious infrastructure investment agenda is expected to enhance competitiveness and provide a boost to job creation. At the same time, the authorities acknowledge that Macedonia's economic prospects critically depend on developments in the European economies given the high level of interconnectedness. The Macedonian authorities remain vigilant, closely monitor external sources of vulnerability, and stand ready to undertake measures aimed at alleviating possible adverse effects on the domestic economy and preserving stability.