INTERNATIONAL MONETARY FUND

IMF Country Report No. 12/133

FORMER YUGOSLAV REPUBLIC OF MACEDONIA

2011 ARTICLE IV CONSULTATION

June 2012

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2011 Article IV consultation with Macedonia, the following documents have been released and are included in this package:

- **Staff Report** for the 2011 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on December 13, 2011, with the officials of Macedonia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 16, 2012. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- **Informational Annex** prepared by the IMF.
- **Public Information Notice** (PIN)summarizing the views of the Executive Board as expressed during its June 1, 2012 discussion of the staff report that concluded the Article IV consultation.
- **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 policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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FORMER YUGOSLAV REPUBLIC OF MACEDONIA

STAFF REPORT FOR THE 2011 ARTICLE IV CONSULTATION

May 16, 2012

KEY ISSUES

Context: The economic recovery is losing steam due to adverse external developments. Nonetheless, Macedonia is poised to achieve low but positive growth under the baseline scenario of a shallow recession in the euro area, and BoP pressures appear contained. Under a downside scenario, growth would be weaker and external financing pressures could arise.

Fiscal Policy. In the near term, the government will need to reduce expenditure growth to meet the 2012 deficit target, even beyond adjustments already made in the supplementary budget. A key longer-term challenge will be to reconcile the competing objectives of higher public investment and increases in pensions and public wages, while preserving low public debt and low taxes. Strengthening of fiscal institutions is needed to improve medium-term expenditure prioritization and budget execution practices.

Public Finance. Macedonia has secured an external bank loan that will meet its financing needs into 2013. Over the medium term, public debt management reform and development of domestic debt markets are called for to reduce dependence on potentially volatile external debt markets.

Monetary Policy. The central bank has eased slightly after keeping on hold for over a year, in the context of a slowing economy, low inflation, and muted credit growth. While this stance is justified by the circumstances, the central bank's overriding objective should remain stability of the de facto exchange rate peg.

Financial Sector. Financial stresses in the euro area and the large size of local subsidiaries of euro area banks call for vigilance. The authorities have appropriately intensified their financial sector monitoring and contingency planning in response.

Growth. Raising potential growth will be necessary to reduce high unemployment and improve living standards. The authorities' strategy appropriately focuses on investment in infrastructure and education, preserving low taxes, and attracting FDI.

Approved By
Ajai Chopra and Jan Kees Martijn

Discussions were held in Skopje, November 30–December 13, and continued from headquarters. A team comprised of Mr. McGrew (head), Ms. Shamloo, Messrs. Arregui and Tereanu (all EUR), Ms. Bi (SPR), and Mr. Tieman (Resident Representative) met with Prime Minister Gruevski, Finance Minister and Deputy Prime Minister Stavreski, Deputy Prime Minister Peshevski, NBRM Governor Bogov, other officials; the private sector; media representatives; and others. At the conclusion of the visit a joint press conference was held with the finance minister and NBRM governor.

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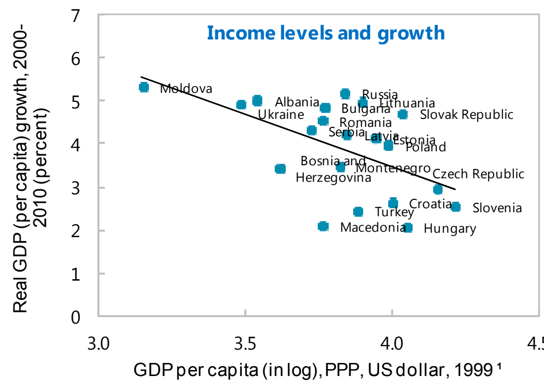
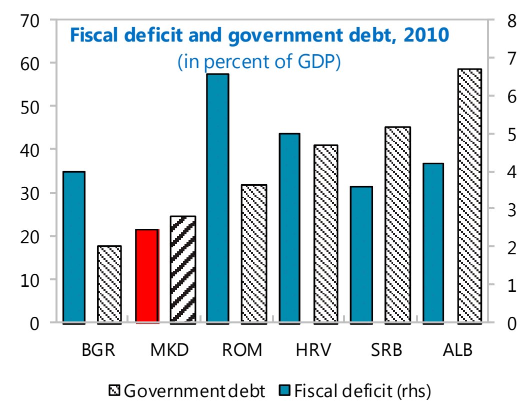
CONTEXT

1. Macedonia is a middle income country with a good record on macroeconomic stability but lower growth than its peers. The peg to the euro has anchored monetary policy and helped achieve a long record of low inflation, while low fiscal deficits have kept public debt ratios moderate[1]. Despite sound macroeconomic policies, growth has fallen short of other countries in the region, while high unemployment rates, which predate independence, persist.



Source: IMF WEO. Data for Montenegro and Malta are for 2000.



Source: IMF WEO

2. The euro area crisis is affecting Macedonian exports and growth, and could also lead to pressures on external finances. About 50 percent of exports go to the euro area, and as in 2008–09, a sharp slowdown in exports would have a significant impact on growth. Banks have limited reliance on external financing, which provides a degree of insulation from external financial developments. Nevertheless, pressures on external finances could arise in a downside scenario.

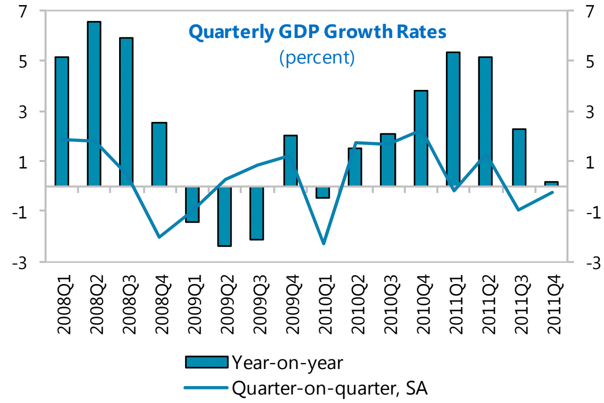
3. Staff held discussions with the authorities during the December mission and into April 2012 on the second review of the two-year Precautionary and Liquidity Line (PLL) arrangement approved in January 2011. The discussions focused on public financial management issues, including government payment arrears, and the government's fiscal financing plan for 2012. In April the government announced it had reached agreement on a foreign bank loan that would meet its fiscal financing needs for 2012 and into 2013, and it therefore would not need to draw upon PLL resources. The authorities informed staff that they would not pursue completion of the review and would allow the arrangement to expire in January 2013.

[1] The exchange rate regime is referred to as a peg to the euro in this report. Formally, the de jure exchange rate classification is "floating," while the de facto classification is "stabilized." 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.

RECENT DEVELOPMENTS, PROSPECTS, AND RISKS

A. Growth and Inflation

4. The recovery slowed in 2011, due largely to worsening external conditions. The 2010–11 recovery was led by a surge in exports, with domestic demand picking up in 2011 on the back of lower interest rates, a moderate resumption of credit growth, and modest employment gains. In the second half of the year a slowdown was visible in softening exports, sales, production, and credit. Average growth for 2011 was 3 percent, but year-on-year growth in the fourth quarter was only 0.2 percent.

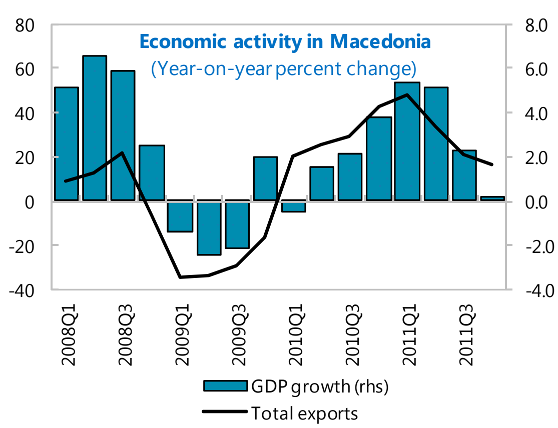


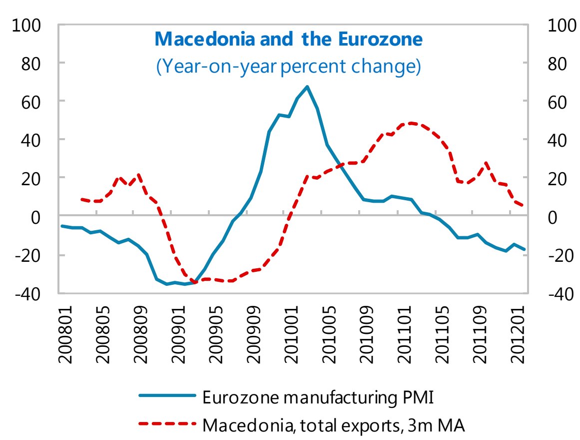
Source: SSO and IMF staff estimates

5. Staff expects 2012 growth to decline to 2 percent, with significant downside risks. This projection is based on a scenario with a shallow euro area recession in 2012.

- Economic weakness and financial strains in the euro area are expected to feed through directly to lower demand for Macedonian exports and to some reduction in remittances and FDI, with indirect effects on domestic demand. Bank credit is expected to grow slowly due to external uncertainties and to deleveraging and reduced risk tolerance on the part of foreign parents. The relatively mild impact of the euro area crisis on growth under the baseline projection reflects Macedonia's modest external financial linkages, the absence of significant financial sector or external imbalances, and a strong pipeline of FDI projects.

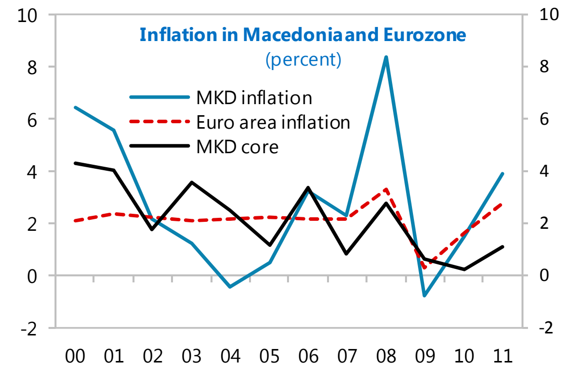
- However, a deeper than expected downturn and intensified financial pressures in the euro area could have a sizable impact on exports, remittances and FDI, pushing the economy toward recession and putting pressures on international reserves. This could damage domestic confidence in the viability of exchange rate peg and prompt an outflow of bank deposits, adding to reserve pressures. In this scenario, the central bank would likely need to raise interest rates to protect reserves and the exchange rate peg, further dampening growth.





Sources: Haver Analytics, NBRM, SSO

6. Inflation is expected to decline from 3.9 percent in 2011 to 2 percent in 2012. The jump in headline inflation in 2011 was due to increases in food and fuel prices, with core inflation a more contained 1.1 percent. In 2012 the impact of food and fuel price developments is expected to fade, and with growth remaining below potential, this will support a fall in inflation. Over the longer term, average inflation has broadly tracked the euro area, though with greater volatility due in large part to the greater weights of food and energy in the Macedonian basket.



Sources: Haver, SSO and IMF staff calculations.

7. The authorities' views on the growth outlook were similar to those of staff. The NBRM recently reduced its 2012 projection from 2.4 to 2 percent, on the back of lower growth expectations of main trading partners. But overall the authorities believed that the lack of imbalances in the economy, in particular the moderate current account deficit and contained credit growth, would limit the impact of adverse external developments. This was in contrast to the run-up to the 2008–09 crisis, when a large current account deficit and rapid credit growth needed to be reined in quickly. The government's official projection for 2012 growth was initially 4.5 percent, but it reduced this to 2.5 percent in April 2012 in the face of mounting evidence of slowing growth.

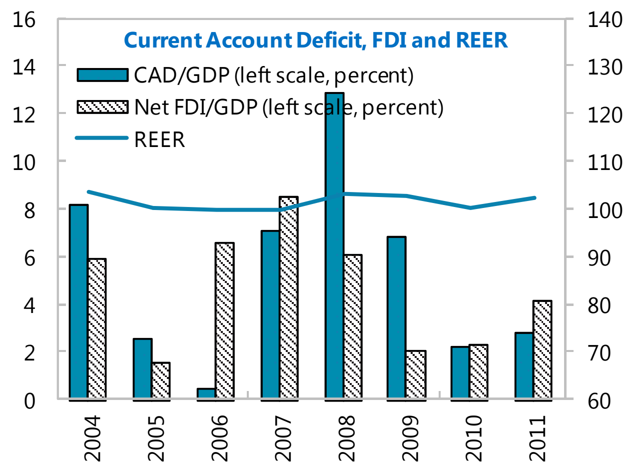
B. External sector

8. The current account deficit was 2.8 percent of GDP in 2011. The current account deficit widened modestly from 2010 to 2011, reflecting a pick-up in domestic demand and higher fuel prices. However, these were largely offset by the strong performance of private transfers as residents converted their euro-denominated assets into denars following the intensification of the euro area crisis in late 2011. Main sources of external financing included FDI of some €300 million (4.1 percent of GDP), the €221 million PLL purchase in March, and a €130 million commercial bank loan backed by a World Bank Policy-Based Guarantee (PBG) in December 2011.

9. International reserves increased significantly and are at broadly adequate levels. Gross international reserves rose by €355 million over the course of 2011 (€135 million excluding the PLL purchase), ending the year at 114 percent of short-term debt by residual maturity and over 4 months of prospective imports. End-2011 reserves were 119 percent of the new Fund measure of reserve adequacy based on risk-weighted liabilities, which is in the range considered adequate[2].

[2] See Assessing Reserve Adequacy, IMF Policy Paper, February 2011. The new metric is a weighted average of exports, short-term debt at residual maturity, other portfolio liabilities, and broad money. Reserve coverage of 100-150 percent of the new metric is considered adequate.

10. The current account deficit is expected to widen and then level off at around 5 percent of GDP in the medium term and to be financed largely by FDI. Export growth is expected to be robust over the medium term, underpinned by FDI in the tradable sector (notably auto parts, see Box 1), low wage levels relative to neighboring countries, and improvements in the business climate. Meanwhile, restrained growth of private credit will help contain imports. The trade deficit is thus expected to widen only modestly in the next few years before narrowing in the medium-term. Private transfers are expected to normalize from their peak of 19½ percent of GDP in 2011, as euro area stress subsides. The behavior of private transfers is the main contributor to the projected increase in the current account deficit in 2012. The real exchange rate appears to be fairly valued, based on measures such as CGER estimates and relative wage levels.



Sources: Authorities' data; and IMF staff estimates.

Box 1. Greenfield FDI in Macedonia

Macedonia has been successful recently in attracting greenfield FDI. Investments have branched out of the traditional export-oriented industries such as food and metal processing into new and higher value-added industries. In particular, with the entrance of two large car-parts manufacturers in 2007, automotive components have become one of Macedonia's main exports. This rapid structural shift in greenfield FDI reflects Macedonia's low labor costs and tax rates, its geographical proximity to assembly plants in Central and Western Europe and Turkey, duty-free access to the European market, and investment incentives such as tax holidays.

Pipeline Greenfield FDI Projects by Industry, 2012-15
(in million euros)

Industry	Total Planned Investment, 2012-15
Automotive components	204
Cement	140
Glass	65
Residential construction	60
Services	25
Food processing	15
Other 1/	9
Total	**518**

1/ Includes pharmacy and textile.
Source: Invest in Macedonia; IMF staff calculations.

A large pipeline of greenfield FDI projects is planned for the next two to three years, concentrating on the automotive components industry. This includes both expansion plans in incumbents and investments from new entrants. Other sectors attracting FDI include construction materials, residential construction, glass (e.g., for packaging of agricultural products and wine), and food processing.

Given the financial stress in Europe, some of the projects may be postponed or implemented more slowly. The pipeline consists mainly of confirmed projects for which contracts have been signed, and in some cases construction is underway. While adverse financial conditions and weaker demand in destination markets may delay some of these projects, they are expected to materialize in the medium term.

C. Fiscal Policy

11. The fiscal deficit was 2.6 percent of GDP in 2011 on a cash basis, as spending was reduced in line with revenue shortfalls to meet the government's deficit target. Revenues rose 3.5 percent compared to 2010, below the 12.6 percent assumed in the budget. The shortfall was due largely to over-optimistic estimates of non-tax revenues. To meet its deficit target, the government under-executed budgeted spending, in particular on investment and goods and services. Nonetheless, capital spending rose 15.5 percent relative to 2010, consistent with the authorities' goal of boosting infrastructure development. Wages and salaries were held down by a second year of government wage freezes. The PLL purchase and loan backed by the PBG provided the main sources of fiscal financing (¶25).

	2011 Budget 1/		2011 Actual	
	Percent of GDP	Annual growth	Percent of GDP	Annual growth
Total revenue and grants	32.2	12.6	29.6	3.5
Tax revenue	26.4	8.8	25.6	5.4
Non tax revenue 2/	5.7	33.8	3.9	-7.7
Total expenditure	34.7	12.4	32.1	3.9
Current expenditure	30.2	9.2	28.3	2.6
o/w wages and salaries	5.2	3.0	5.1	2.2
o/w transfers	20.5	10.0	19.3	3.8
Capital expenditure	4.7	36.9	3.9	15.5

Note:
1/ Budget figures following the expenditure reallocation of Sep 2011
2/ Including capital revenues and grants.
Source: MoF

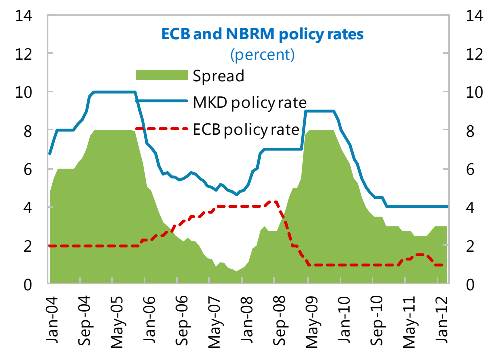
12. The deficit was somewhat larger on an accrual basis due to arrears. The government failed to make payments totaling €7.6 million due to an external supplier of medical equipment in the second half of 2011 and eventually reached agreement to make the overdue payments (plus interest) in January 2012. It also reported €8 million in arrears on VAT refunds. These two items add up to 0.2 percent of GDP. There are also widespread reports by businesses of late payments by the government to its suppliers, suggesting the actual amount of arrears may be higher. Moreover, the government renegotiated some contracts to extend payments to future years for goods or services received in 2011.

13. The 2012 budget calls for a fiscal deficit of 2½ percent of GDP, but is based on highly optimistic revenue assumptions. The budget is based on a 4.5 percent real growth rate and assumes total revenue growth of 14.8 percent compared to the outcome for 2011. Similar to 2011, the budget prioritizes investment spending. It calls for a 52 percent increase in capital expenditure compared to the 2011 outcome, and a 9 percent increase in current expenditure. Staff project that revenues will grow 6 percent, significantly below the budget assumption, with the difference reflecting in part staff's lower growth projections. Based on staff's lower nominal GDP forecast, the authorities' deficit target translates to 2.6 percent of GDP.

14. The government submitted a supplementary budget to parliament in April 2012 that would reduce annual expenditure by 4½ percent (1½ percent of GDP) relative to the budget while keeping the deficit target unchanged. The proposed cuts focus on capital expenditures (which would still grow 21 percent compared to the 2011 outcome). The revised budget assumes revenue growth of 9 percent, still above staff projections (by 1 percent of GDP).

D. Monetary and Financial Policies

15. The NBRM left interest rates unchanged from December 2010 to early April 2012, while modestly relaxing prudential requirements. The NBRM kept the benchmark rate at 4 percent, while issuing some 2½ percent of GDP in CB-bills (its sterilization instrument) over this period. Meanwhile it sought to ease credit conditions through a relaxation of prudential requirements by: (1) abolishing separate denar and foreign exchange liquidity requirements in favor of a unified requirement regardless of currency denomination; (2) reducing from 100 to 80 percent the share of term deposits counted as short-term liabilities; and (3) eliminating the reserve requirement on household term deposits with maturity over two years and repo transactions.



Sources: NBRM, Haver analytics.

16. In April 2012 the NBRM announced a new set of measures aimed at easing credit conditions and furthering money market development.

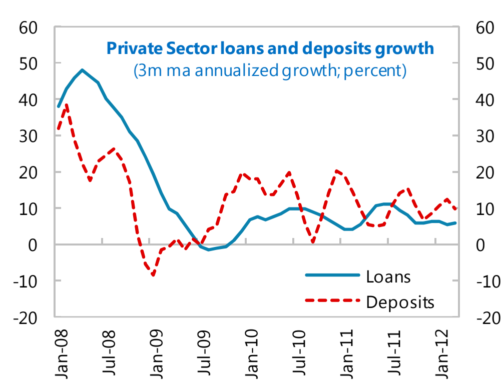
- First, it announced it would gradually decrease the amount of outstanding central bank bills by limiting the volume offered at its auctions and reducing the frequency of auctions to once a month, which would be expected to lead to lower interest rates. The maximum interest rate would be 4 percent (the same as the previous benchmark rate) while quantities would be adjusted to ensure interest rate declines were gradual and consistent with exchange rate stability. As of early May, after four auctions under the new system, the average interest rate had declined only to 3.93 percent, despite a significant decrease in outstanding central bank bills. In early May the NBRM reduced the maximum interest rate to 3.75 percent.

- Second, it introduced a 7-day and overnight deposit facility at an interest rate of 2 percent and 1 percent, respectively, which banks could use to place excess liquidity between the monthly bill auctions.

- Third, it initiated a weekly repurchase operation to provide liquidity to banks against their holdings of treasury and central bank securities and reduced the rate on the overnight lending facility from 150 bps to 50 bps over the central bank bill rate.

E. Financial sector

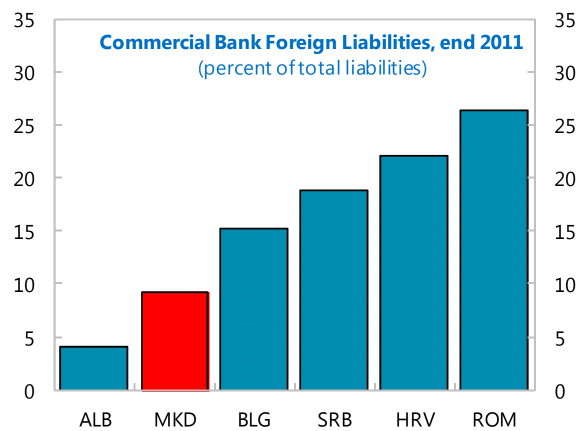
17. Banking sector indicators suggest the system is in overall sound shape, and credit growth has been moderate. As of December 2011, the capital adequacy ratio was close to 17 percent (with tier 1 capital at 14 percent). Deposits provided the main source of funding (loans totaled 86 percent of deposits) and reliance on foreign funding was low. The NPL ratio was 9.5 percent, up somewhat from the



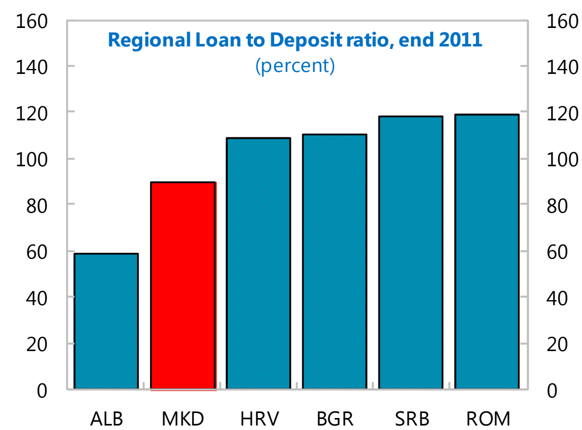
Sources: NBRM.

previous quarter but down from its 2010 peak of over 10 percent, and provisions exceeded NPLs. Profitability was low but positive. Loan growth through December was 8.5 percent (year-over-year), compared to 9.2 percent deposit growth. Euroization of deposits, while high, had declined to pre-crisis levels (see Selected Issues Paper).

18. Banks have limited direct exposure to euro area financial turbulence. Two of the three large banks (who together account for some 40 percent of system assets) have parents from the euro area, namely Greece and Slovenia. With the exception of modest amounts of long-term subordinated debt instruments, they do not depend on their parents for funding, and nor do they hold significant claims against their parents (which are restricted by related-party limits). Nonetheless, in the event of an adverse scenario in Greece or the broader euro area, bank-specific or even system-wide deposit outflows could not be excluded.



Sources: Respective Central Banks and IFS.



Sources: IFS, Haver and IMF staff estimates.

19. Credit growth is expected to be subdued in 2012. On the supply side, banks are likely to be conservative in light of financial turmoil in the euro area, weakening growth prospects, and low profitability. Foreign parents of the large banks are likely to reinforce a risk-averse stance as they seek to strengthen their capital ratios at the consolidated level. The deterioration of the economic outlook will also weigh on the demand side.

F. Medium-term outlook, risks, and data quality

20. The medium-term outlook is broadly favorable, as Macedonia builds on its advantages of low wages and taxes and implements structural reforms to boost potential growth and employment. The authorities' pro-growth policies include preserving a low tax environment (including flat 10 percent corporate and personal income tax rates), investing in infrastructure and education, and promoting FDI. They are also pursuing structural reforms to improve the business climate, and adopted a new Energy Law to strengthen the long-term prospects of the energy sector. These policies have started to pay off, with several foreign investment projects underway. Reflecting these reforms, Macedonia's global ranking in the World Bank's Doing Business report improved from 34th in 2011 to 22nd in 2012. Other competitiveness indicators paint a more mixed but still generally favorable picture compared to neighboring countries (Box 3). Key areas to unlock faster growth and lower unemployment include improved property rights, judicial reform, and education, where Macedonia scores low on international indices.

21. The principal risks arise from developments in the euro area (Annex I).

- A deeper recession in the euro area would affect Macedonia through lower exports and remittances and a slowdown in FDI, which would reduce growth and could lead to a loss of foreign reserves.
- In the event of significant intensification of the euro area crisis, pressures on Macedonia's exchange rate peg could emerge, potentially leading to outflows of bank deposits and pressures on foreign reserves.
- An adverse scenario in Greece could damage confidence in Greek bank subsidiaries in Macedonia and also prompt deposit outflows.

22. Economic and financial statistics continue to be broadly adequate, and the authorities have subscribed to SDDS. The authorities improved the timeliness and periodicity of their data provision, leading to SDDS subscription in November 2011. Some remaining data shortcomings include quality of quarterly real GDP time series and incomplete fiscal data on public enterprises. The authorities are drawing on EU and IMF technical assistance to further improve national account statistics.

Box 2. Macedonia's Response to Past Policy Advice from the Fund

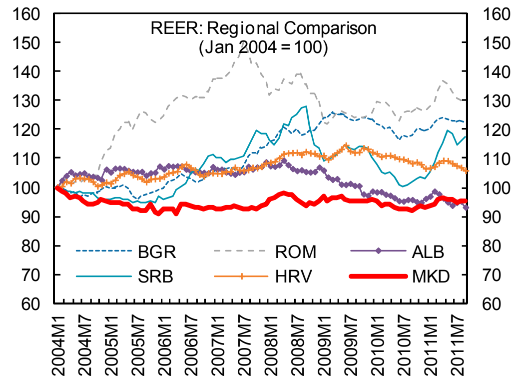
During the 2010 Article IV consultations (concluded in January 2011), Directors commended Macedonia for its sound macroeconomic and financial policies, while identifying sizeable downside risks from potential international spillovers.

On fiscal policy Directors agreed that the 2011 deficit target of 2.5 percent of GDP struck an appropriate balance between debt sustainability and the need to support growth. They advised that the authorities should consolidate the deficit once a robust recovery is underway. They also stressed the importance of developing the domestic public debt market. On monetary policy, Directors believed that interest rates were at appropriate levels and saw limited scope for further reductions. Directors praised the authorities' commitment to improve data quality and subscribe to Special Data Dissemination Standards (SDDS).

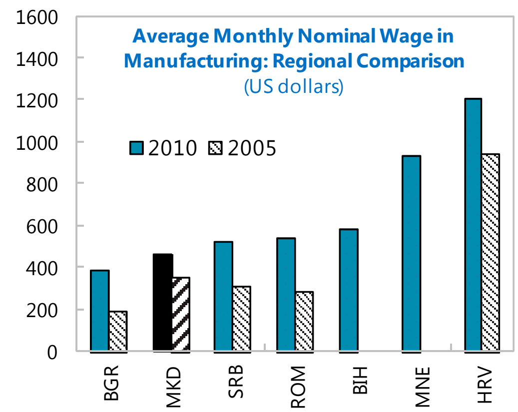
The authorities' policies over the past year have been broadly consistent with the advice of Directors. The government met its 2011 fiscal deficit target on a cash basis, after containing expenditures in response to revenue underperformance. The 2012 fiscal deficit target of 2.5 percent of GDP is appropriate in light of slowing growth. The government took initial steps towards deepening the domestic bond market with two issuances of 5-year treasury bonds. The NBRM kept interest rates unchanged through April 2012, when it initiated a limited easing, in the context of a contained current account deficit and increasing international reserves. The authorities have subscribed to SDDS.

Box 3. Competitiveness and Growth in Macedonia

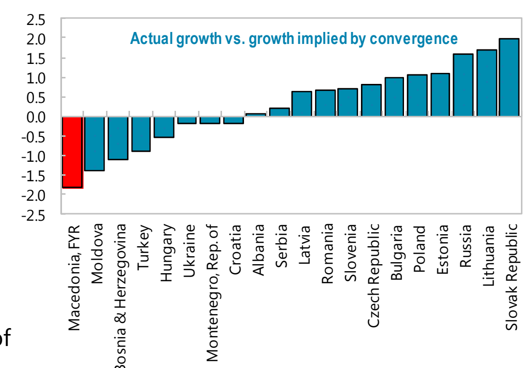
Macedonia's growth over the past decade has fallen short of its peers and unemployment has remained high. Despite recent progress, further reforms will be needed to raise potential growth and employment.



Source: INS data and IMF staff calculation.



Sources: ILO data; and IMF staff calculation.



Sources: IMF, World Economic Outlook database; and IMF staff calculations.
[1] Difference between each country's actual growth rate and the growth rate that could be expected given initial income levels.

Macedonia fares relatively well on standard measures of cost competitiveness.

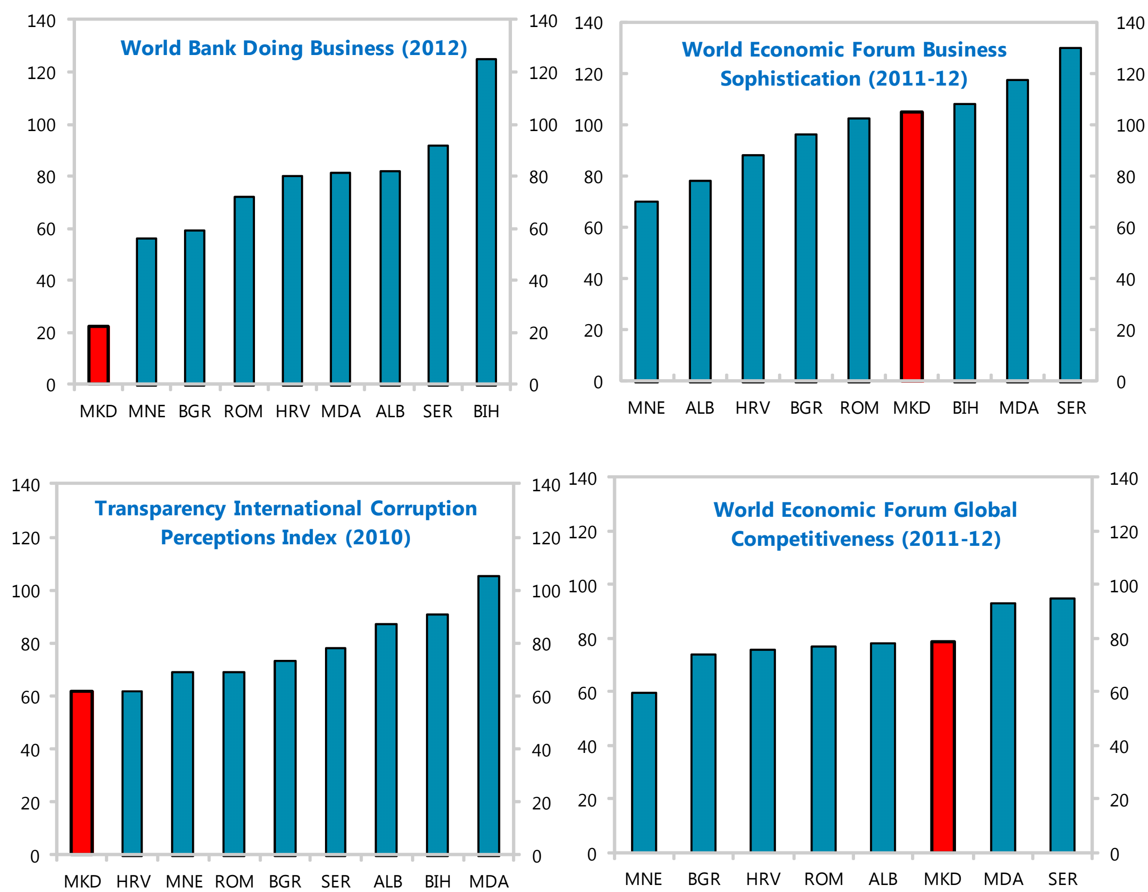
- The standard CGER analysis suggests no significant misalignment of Macedonia's REER.
- Wages in Macedonia are lower than in other countries in the region except Bulgaria. This contrasts to 2005, when wages in Macedonia were higher than those in Serbia and Romania.
- Tax rates are low: both personal and corporate income tax rates are a flat 10 percent.

However, growth has been disappointing, averaging 3¼ percent over the past decade, and unemployment remains a chronic problem. Growth is significantly lower than what would be expected given Macedonia's per capita GDP (poorer countries grow faster). Relatively low education levels explain part, though not all, of the underperformance. The remainder could be due to other factors such as inadequate infrastructure and institutional shortcomings. It could also reflect the legacy of economic and political shocks in the years after independence, including border closures with Greece, the Serbia trade embargo, and the ethnic conflict in Macedonia in 2001. High unemployment remains a chronic problem: while it has decreased from 37 to 32 percent over the past decade, it remains stubbornly high and is a drag on growth.

Further reforms will be needed to achieve significantly faster growth. Recent improvements in the business environment (as indicated by the World Bank's Doing Business indicator), success in attracting FDI to non-traditional areas, and a more stable political climate in Macedonia and the region, should combine to raise potential growth to above 4 percent. However, additional efforts will be needed to boost potential growth further and speed convergence. Policies directed at the interrelated goals of improving education outcomes and reducing unemployment should be an important part of the strategy to strengthen long-term growth. Macedonia scores low on international measures of education quality, and unemployment is much higher among those who have not completed secondary schooling. Moreover, there is anecdotal evidence that employers have difficulty finding qualified workers, despite high unemployment.

The authorities' strategy to reduce unemployment focuses on two fronts. First, it seeks to promote increased growth through improving infrastructure and attracting investment. Second, it is pursuing initiatives to improve education and training to better match skills with employer needs. The unemployment agency has designed active labor market polices, including vocational training and internships. The government also recently passed legislation making school enrollment compulsory through the secondary level.

Regional Rankings for Competitiveness and Business Environment 2010–12



Source: World Bank; World Economic Forum; and Transparency International.
Note: in all charts, a lower figure indicates a better ranking

POLICY DISCUSSIONS

A. Fiscal Policy and Financing

23. **Staff views the planned 2012 fiscal stance as broadly appropriate based on cyclical and debt sustainability grounds, but consolidation will be needed over the medium term to stabilize debt ratios at safe levels**. In staff's view, debt sustainability should provide the long-term anchor for fiscal policy, with cyclical considerations also playing a role, subject to availability of financing.

- The government debt ratio was 28.6 percent of GDP at end-2011, which is moderate and consistent with debt sustainability. Staff recommended reducing the fiscal deficit to below 1.5 percent of GDP over the medium term, which will be required to stabilize public debt at 30 percent of GDP, consistent with previous staff advice. Low deficits would also provide space for counter-cyclical policies during future downturns. Consolidation must be undertaken in a medium-term budget framework and will require the government to prioritize among competing expenditure goals (¶28).

- The 2012 deficit target of 2½ percent of GDP is roughly neutral on a cyclically adjusted basis. A more expansionary stance is not advisable in light of financing constraints, even if growth falls short of the staff baseline.

FYR Macedonia: Cyclically-adjusted Fiscal Balances

	2011	2012	2013
Primary fiscal balance	-1.8	-1.9	-1.2
Overall fiscal balance	-2.6	-2.6	-2.5
Cyclically-adjusted primary balance	-1.0	-1.0	-0.5
Cyclically-adjusted overall balace	-1.7	-1.8	-1.7
Fiscal impulse (primary balance)	-0.4	0.0	-0.6
Fiscal impulse (overall balance)	-0.4	0.0	-0.1
Memo:			
Output gap 1/	-0.6	-1.8	-2.0
Absorption gap 2/	-5.0	-4.1	-3.2

Source: IMF staff estimates.
Note: The fiscal impulse is the difference in the cyclically-adjusted balance between the previous and the current year (a negative fiscal impulse means a cyclically-adjusted contraction). Cyclical adjustment of fiscal balances is done with respect to both output and absorption gaps.
1/ Percent of potential GDP
2/ Percent of potential absorption

24. Given the optimistic revenue forecasts in the 2012 budget, expenditures will need to be reduced significantly below budgeted amounts to meet the deficit target. The amount of needed adjustment relative to the budget is estimated at 2½ percent of GDP. Reductions will need to be focused largely on investment spending, since there is limited discretionary spending elsewhere in the budget. In a scenario with the revenue shortfall projected by staff, and taking into account the limited room for reducing other expenditure, staff expects that investment spending will rise by just 3½ percent in 2012. The supplemental budget submitted to parliament in April, which reduces expenditure by 1½ percent of GDP (see paragraph 14), goes a considerable way towards addressing the expected revenue shortfall.

	2012 Budget 1/		2012 Staff projections 1/	
	Percent of GDP	Annual growth	Percent of GDP 1/	Annual growth
Total revenue and grants	32.4	14.8	30.0	6.0
Tax revenue	26.6	8.8	25.5	4.0
Non tax revenue 2/	5.8	53.8	4.5	19.0
Total expenditure	35.1	14.3	32.6	6.2
Current expenditure	29.5	8.7	28.8	6.4
o/w wages and salaries	4.8	-2.0	4.8	-2.0
o/w transfers	20.2	9.2	20.1	8.8
Capital expenditure	5.7	52.5	3.9	3.3

Note:
1/ Staff projections for 2012 NGDP
2/ Including capital revenues and grants.
Source: MoF and IMF staff estimates

25. Foreign borrowing will provide the main source of budget financing in 2012. In December 2011 the government concluded an external bank loan of €130 million (backed by a World Bank guarantee). In April 2012 it announced that it had agreed on terms for a €250 million five-year loan from a foreign bank (which requires approval by parliament before it can be finalized). Finally, the authorities expect to borrow US$100 million from the World Bank through two DPLs in late 2012. These sources, together with €60 million in planned domestic Treasury debt issuance, will cover the 2012 fiscal deficit, pre-finance repayment of a €175 million Eurobond maturing in January 2013, and provide a significant buffer for 2013.

Central government financing 1/

	2011		2012	
	mn. EUR	percent of GDP	mn. EUR	percent of GDP
Total Financing Requirement	**318**	**4.3**	**289**	**3.8**
Deficit	187	2.6	202	2.6
Gross Amortizations	131	1.8	86	1.1
Domestic structural bonds	80	1.1	30	0.4
External	51	0.7	56	0.7
Total Financing Sources	**318**	**4.3**	**289**	**3.8**
Government deposits at the NBRM	-112	-1.5	-165	-2.2
Domestic Treasury securities (net)	44	0.6	60	0.8
External	386	5.3	393	5.1
o/w private	126	1.7 2/	250	3.3 3/
o/w official	260	3.6	143	1.9 4/
o/w IMF PLL	221	3.0	0	0.0
Memo:				
Nominal GDP (mn EUR)	7,309		7,644	

Note:

1/ Projections of financing sources include MOF data and Fund staff estimates.

2/ The EUR 130 million private loan backed by the World Bank Policy Based Guarantee of covered remaining 2011 needs and will finance roughly half of the 2012 deficit. The amount useable for financing, after fees, is EUR 126 mn.

3/ The private external issuance of 2012 (EUR 250 mn) covers the remaining deficit financing of 2012 and pre-financing of the Eurobond falling due in January 2013.

4/ The official financing projection includes two World Bank Development Policy Loans totalling EUR 76 mn (USD 100 mn), assumed to become available at end 2012.

Source: MoF and IMF staff estimates

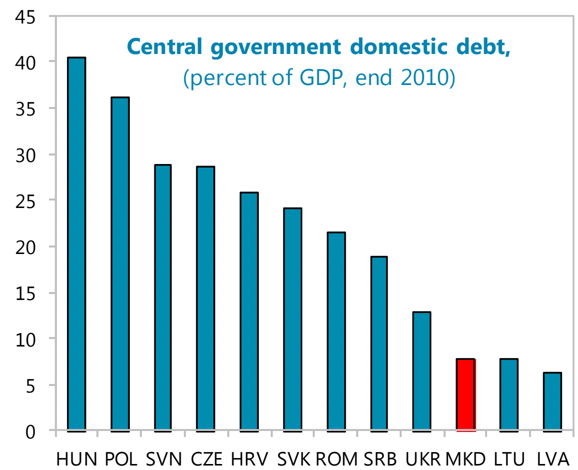
26. **Debt financing remains a significant medium-term challenge**. Although the authorities have met their financing needs for the next year, they remain dependent on access to external markets to finance their deficits and repay some €750 million (10 percent of GDP) in private external debt and IMF loans maturing in 2014-17. Such reliance on external financing poses significant risks in light of uncertainties and volatility in external capital markets. This vulnerability was evident in 2010 and 2011, when the authorities drew on official sources (the SDR allocation in 2010 and the PLL in 2011) in response to unfavorable conditions on private external markets.

27. **Public debt management reform to deepen domestic markets and improve access to external sources should be a key policy priority.** The domestic debt market is small, with outstanding debt equal to only 5 percent of GDP (excluding 2 percent of GDP in structural bonds issued in compensation for transition-related expenses). Deeper domestic debt markets will diversify funding sources and help insulate public finances from disruptions in access to external markets. Compared to other countries in the region and elsewhere, the domestic public debt market is small and dominated by short-term securities, suggesting there is significant room for growth (see Selected Issues Paper). Moreover, the ample liquidity of the domestic banking system, including significant holdings of central bank debt instruments, points to room for increased domestic public debt without crowding out lending to the private sector (¶35). A deeper domestic debt market, with

longer maturities (which will require higher interest rates than those on short-term T-bills), will also help to build a domestic yield curve and support development of private debt markets. In this context, the auction of a five-year treasury bond in September 2011 was a welcome development, although a similar auction in December 2011 raised a smaller amount because the government failed to offer higher interest rates in response to changed market conditions. The authorities should also continue to access private external debt markets at an early stage to pre-finance their borrowing needs, as they are doing in 2012, to guard against the risk that market conditions turn unfavorable.

Box 4. Debt Market Development in Macedonia

The public debt market in Macedonia is very small and is dominated by short-term Treasury bills. This has required the authorities to rely on external markets for public financing, exposing the country to volatility of market access. Development of domestic debt markets and a more strategic approach to external debt issuance will help strengthen the stability of public finances. Issuance of longer-term debt will entail somewhat higher interest rates, but will reduce rollover risk and help establish a reference yield curve for private debt markets. The experience of other countries in the region suggests there is considerable scope for deepening domestic debt markets, although this will take time.



Source: Haver Analytics and country authorities

An IMF technical assistance mission in October 2011 and an Article IV Selected Issues Paper identified a number of key recommendations, including:

- Lengthen domestic maturities, and be prepared to pay higher interest rates;
- Enhance liquidity through fungibility of debt instruments and attention to secondary market development;
- Measure risks explicitly and benchmark them against a chosen debt profile;
- Reduce refinancing risk through pre-financing and avoiding bunching of maturities;
- Develop institutions and market practices to help achieve the above objectives.

28. Staff recommended public financial management reforms in the areas of revenue forecasting, commitment control systems, and medium-term budgeting, in order to improve budgeting practices and avoid arrears.

- The revenue assumptions in the 2012 budget are optimistic (even after the revisions in the supplementary budget), implying the need for further expenditure reductions. The authorities have a strong track of reducing expenditure to meet their fiscal targets. However, more realistic revenue forecasts would allow earlier and better planning and prioritization to match expenditures with available resources. Moreover, larger contingency buffers in the budget would help to accommodate revenue shortfalls.

- Commitment control systems should be strengthened and budget laws and procedures should be strictly enforced to prevent budget users from making commitments that are not matched by budget appropriations. The government should also ensure that annual budgets provide funding for multiyear contracts signed in previous years. Progress in these areas will help to prevent government payment arrears such as those that arose in 2011. The government should make public the amount of any arrears and commit to reduce them over time. The practice of seeking to reschedule amounts due to private suppliers should be discontinued because suppliers may feel they have little choice if they want continued access to government contracts, and on grounds of transparency.

- A greater focus on medium-term budgeting would allow the government to set its priorities based on a realistic assessment of available fiscal space and required trade-offs. In this context, the government's intentions over the medium term to increase investment spending, raise pensions and public sector wages, and reduce the labor tax wedge—without raising taxes—will be difficult to achieve without increased deficits or cuts in other spending. To accommodate higher investment spending the authorities should avoid discretionary pension increases and continue current policies of public wage restraint. It should also move forward with plans for public administration reform to improve efficiency and contain the wage bill over the medium term, which would help to create fiscal space.

29. The authorities confirmed their commitment to reduce spending in the event of revenue shortfalls, so as to meet their fiscal deficit target. They explained that the 2012 budget assumptions on growth and revenue performance had been set in the third quarter of 2011, before the deterioration in euro areas growth prospects had become apparent to them. The authorities recognized that revenue growth was likely to fall well short of budget assumptions, which motivated the spending cuts in the proposed supplementary budget. They were committed to further expenditure restraint if needed to meet their deficit target.

30. The authorities' medium-term fiscal plans call for continued moderate deficits to provide room to build infrastructure, while keeping public debt at sustainable levels. The authorities believed that infrastructure investment—including roads, railroads, and natural gas networks—is a critical priority for growth, and that this justified maintaining moderate deficits on the order of 2–2½ percent of GDP over the medium term. They indicated that their target ceiling for government debt was 30 to 35 percent of GDP (a de facto increase from the previous ceiling of 30 percent), which provided the medium-term anchor for fiscal policy. The authorities indicated that pension increases and social contribution reductions would be undertaken only if they could be accommodated without increasing the deficit beyond the targeted range.

31. The authorities agreed on the need to improve public financial management systems. In particular, they indicated that they would upgrade Treasury IT systems in line with recommendations by a recent Fund TA mission so that all budget users would be required to enter detailed information on annual and multiyear spending commitments into the Treasury information system. They believed that in addition to providing for better control over spending commitments, this would support the medium-term budget process by improving baseline spending estimates. The government acknowledged only nominal amounts of arrears outside the delayed payments to external medical suppliers and VAT refund delays. However, the government believed that the spending reductions in the supplemental budget and the action to secure full financing for the 2012 budget early in the year would help to prevent payment delays from arising in the future.

32. The authorities agreed on the importance of public debt management and development of domestic debt markets. They welcomed many of the recommendations of the recent Fund technical assistance mission in this area. However, the authorities were less certain than staff about the room for expanding the domestic debt market without crowding out private investment, and they were concerned that offering higher interest rates in order to place more debt would lead to higher bank loan rates.

B. Monetary Policy and International Reserves

33. The exchange rate peg against the euro has served Macedonia well, delivering low inflation, a stable real exchange rate, and moderate volatility of output. CGER estimates do not indicate significant misalignment, and the medium-term balance of payments appears sustainable. Staff continues to view the peg as appropriate for Macedonia, provided supportive macroeconomic policies remain in place.

Macedonia: Estimated REER Misalignment

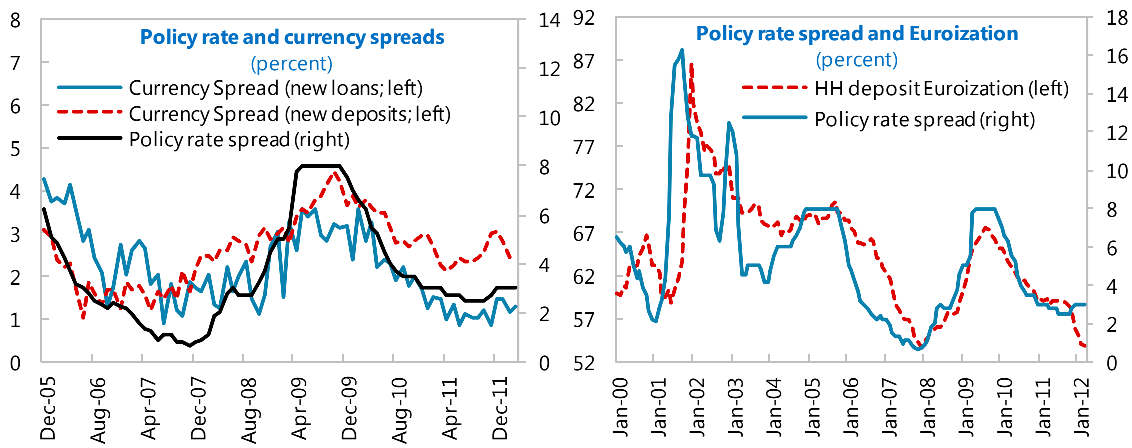
Approach	Magnitude of Misalignment
Macroeconomic Balance	-5.1
Equilibrium REER	5.4
External Stability	-0.1
Overall Assessment	No Significant Misalignment

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

34. The authorities believed the recent changes to the monetary policy framework were consistent with the exchange rate peg and affirmed their readiness to raise interest rates if necessary to respond to potential exchange rate pressures. They explained that the changes had been introduced against the background of a significant increase in foreign exchange reserves, favorable BoP developments and prospects, low core inflation, a negative output gap, and subdued credit growth. In this context they believed the new policies would improve credit conditions in the economy, boost money market development and would bring a side benefit of improving the central bank balance sheet position by reducing interest expenses on central bank bills. The NBRM expected that the new framework could lead to some increase in banks' holdings of foreign assets in lieu of central bank bills and a corresponding lower accumulation of NBRM reserves. However, they believed that bank foreign assets provided a useful buffer to support the exchange rate peg.

35. Staff broadly shared the authorities' assessment on monetary policy. Staff agreed that economic developments provided a supportive context for the recent modest relaxation of prudential requirements and changes to the monetary policy framework. They emphasized that reductions in the benchmark interest rate should be pursued cautiously and that the NBRM should remain ready to respond to any BoP pressures that might arise. Staff did not expect the modest easing would have a significant impact on bank lending, in light of the already ample levels of bank liquidity. Slow credit growth primarily reflected low demand by borrowers and a more cautious approach to risk by banks. Staff also underscored that the overriding objective of monetary policy should be to protect the exchange rate peg and that credit growth and central bank balance sheet considerations should be subordinate. While the interest rate spread between the central bank benchmark rate and the ECB policy rate remained above levels of 2006–08—suggesting potential room for easing—the latitude for maneuver appears limited, given that the policy rate spread over Euro area rates has historically tracked measures of risk premium (see Selected Issues Paper).

36. The authorities had also considered the tail risk event that euro area stress could intensify. In such an event they believed the best course would be to continue to peg. They believed that the pegged regime had provided a valuable framework for disciplined macroeconomic policies and had helped to preserve competitiveness.



Sources: NBRM, ECB.

C. Financial Sector

37. Staff encouraged the authorities to be prepared for adverse scenarios. Specifically:

- The authorities should make progress on closing remaining gaps in the NBRM's regulatory toolkit by expanding its ability to provide emergency liquidity assistance (ELA) and passing legislation to ensure adequate powers to impose fit and proper requirements on bank owners and managers and to intervene insolvent banks without being subject to court challenge. These gaps had been identified in the most recent (2008) FSAA and in the 2011 PLL arrangement and should be given greater priority in light of external risks.

- Staff advised the NBRM to undertake daily monitoring of deposits to ensure early warning of any negative trends, to engage in contingency planning, and to review its bank resolution powers.

38. **The authorities agreed with the need for heightened contingency planning and a full set of central bank powers to respond to adverse developments.** They noted that the recently established Financial Stability Committee was now meeting quarterly and was focused on closing the gaps in the regulatory toolkit that had been identified in the FSAA. Although the NBRM still lacked powers to provide ELA against private loans, it had made progress in expanding the class of acceptable collateral. The NBRM had also put in place procedures to monitor deposits on a daily basis and believed that its bank resolution framework was adequate.

39. **The authorities and staff agreed it was important to strike the right balance between stability-oriented policies and supporting credit growth to the economy.** The NBRM acknowledged the need to preserve adequate liquidity buffers and had reviewed its liquidity requirement framework and determined that it was consistent with the Basel III framework. The NBRM also conducted liquidity stress tests on a regular basis, and believed that banks had adequate liquidity to withstand a severe scenario. The authorities shared staff's concern that deleveraging by parent banks could result in tighter credit conditions.

D. Risks

40. **The authorities broadly shared staff's views on risks.** They pointed to the domestically-financed banking system, low public debt, a contained current account deficit and adequate foreign reserves as important buffers against risks. Nonetheless, they agreed that growth would suffer in the event of adverse conditions in the euro area, and that in a case of extreme financial turbulence the exchange rate peg could come under pressure. With respect to spillovers from the euro area through the banking system, they did not believe Macedonian banks were directly exposed to their parents but were mindful of possible confidence effects and were monitoring deposit trends closely.

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41. **Macedonia is well-positioned to avoid an economic downturn in the baseline scenario of a shallow recession in the euro area.** Growth should be supported by a solid pipeline of FDI, a banking sector that is predominantly funded by domestic deposits, underlying improvements in the export base, and a contained current account deficit. However, a more adverse scenario in the euro area could put growth at risk and lead to external financing pressures.

42. **The policy mix appears to be appropriate.** The fiscal policy stance is close to neutral and consistent with debt sustainability, while monetary policy reflects an appropriate balance between stability and growth. In the event of an adverse external scenario and slower growth, policies would likely need to become more pro-cyclical. Monetary tightening could be needed to protect the exchange rate peg, while financing constraints would constrain the use of automatic stabilizers in

fiscal policy. Over the medium term, the fiscal deficit should be contained to below 1.5 percent of GDP to stabilize debt ratios at below 30 percent of GDP.

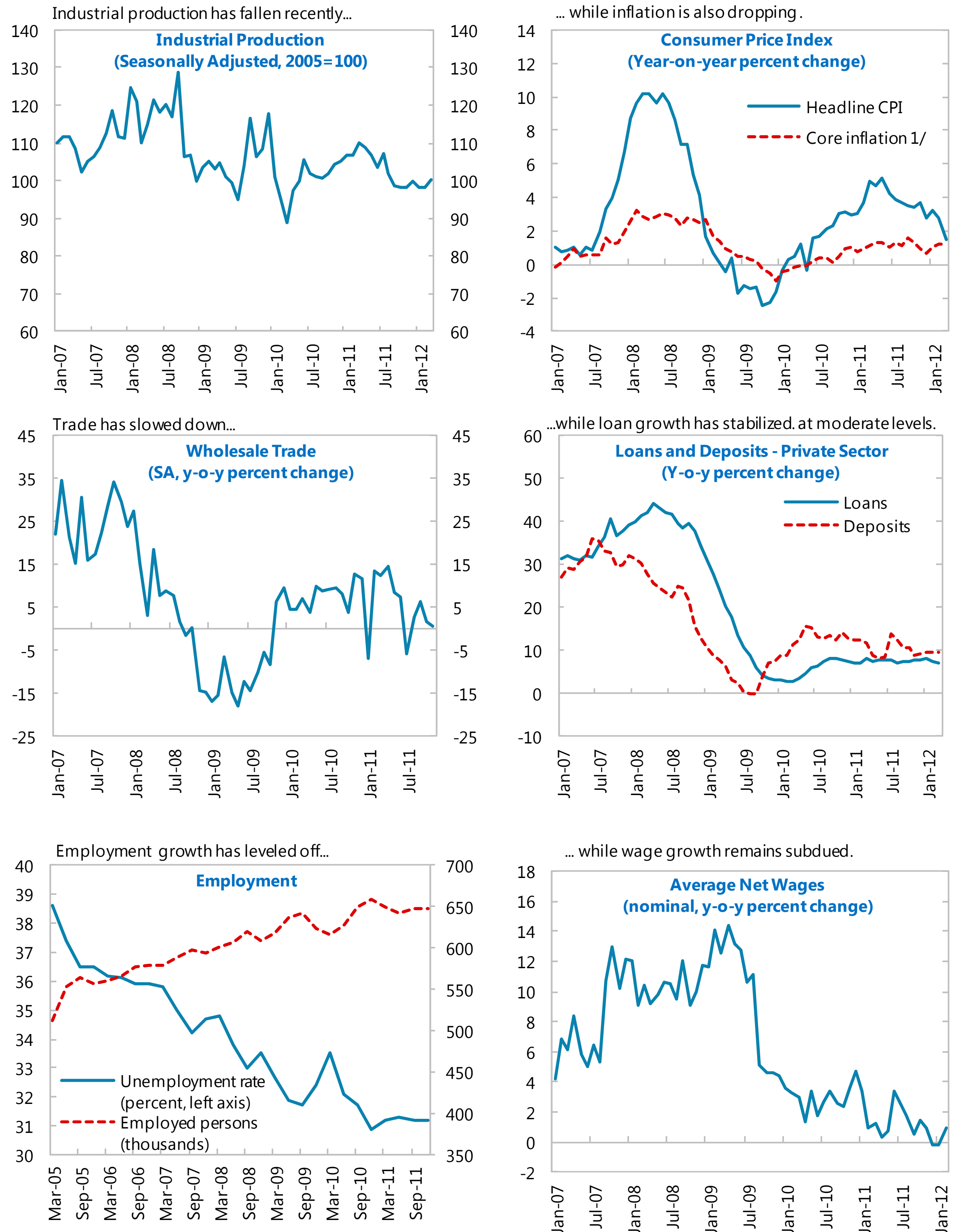
43. Reliance on external borrowing from private markets to meet fiscal financing needs is a vulnerability, which calls for greater focus on public debt management and deepening of domestic debt markets. The authorities' decision to access external debt markets early in 2012 to pre-finance the January 2013 Eurobond repayment was welcome in light of the potential volatility of external market conditions. Nonetheless, looking forward Macedonia remains exposed to disruptions in access to external debt markets, which are its main source of fiscal financing. Development of deeper domestic debt markets is needed to diversify funding sources and reduce risks. The authorities must be prepared to offer higher interest rates, especially on longer-term instruments, to expand the domestic market.

44. The authorities should focus on improving public financial management, including revenue forecasting, commitment control, and medium-term budgeting. This will help to reduce the risk of arrears and allow a more considered evaluation of medium-term spending priorities within the available budget envelope. In the event that arrears arise, transparency about their amount and a firm commitment to repay them over time would be desirable.

45. Macedonia faces good medium-term growth prospects. To achieve higher growth potential it will be important for Macedonia to continue to focus on improving the business environment, infrastructure, and education, and to preserve its track record of sound macroeconomic management.

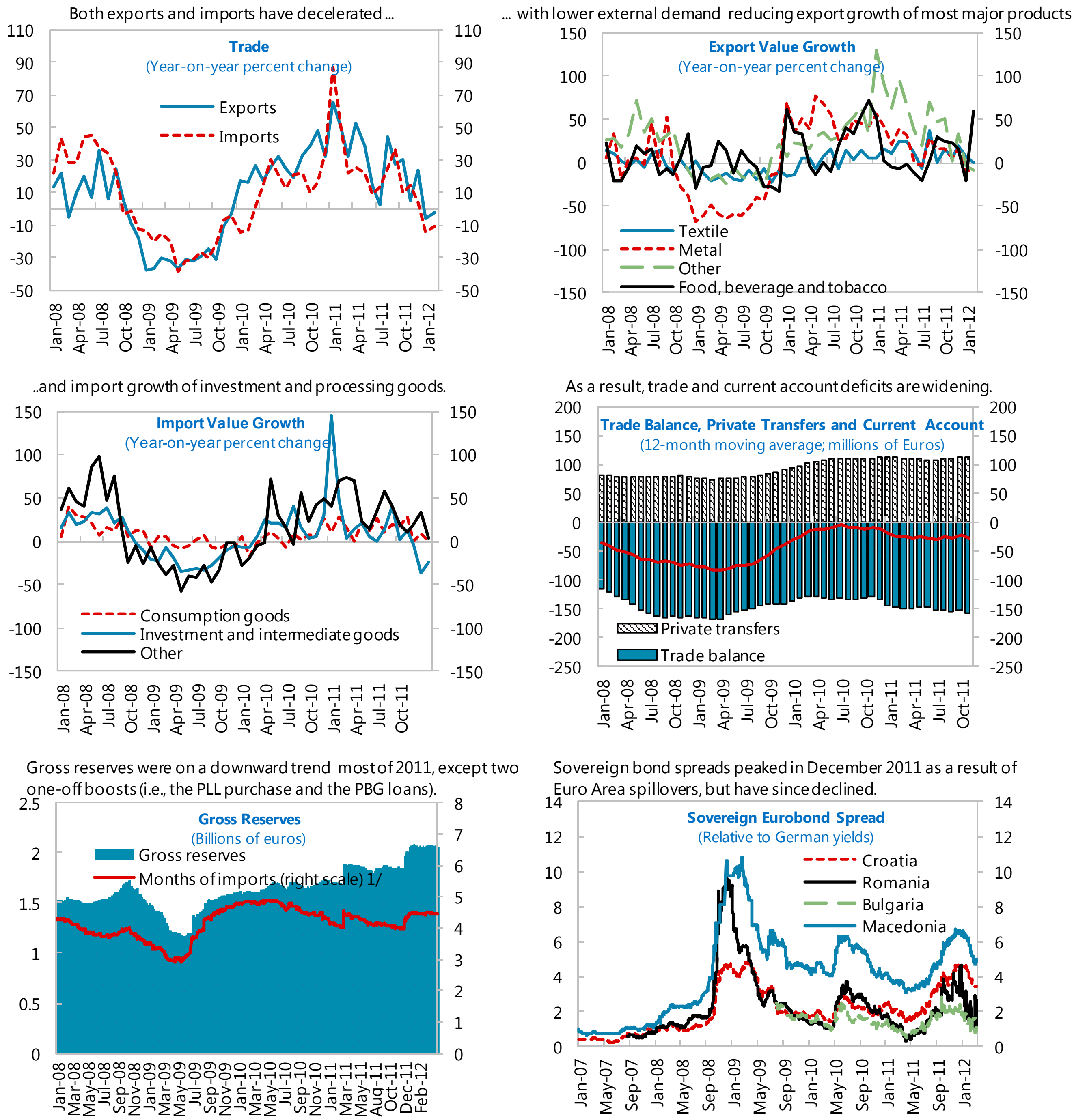
46. It is expected that the next Article IV consultation will be held on the standard 12-month cycle.

Figure 1. FYR Macedonia: Recent Economic Developments



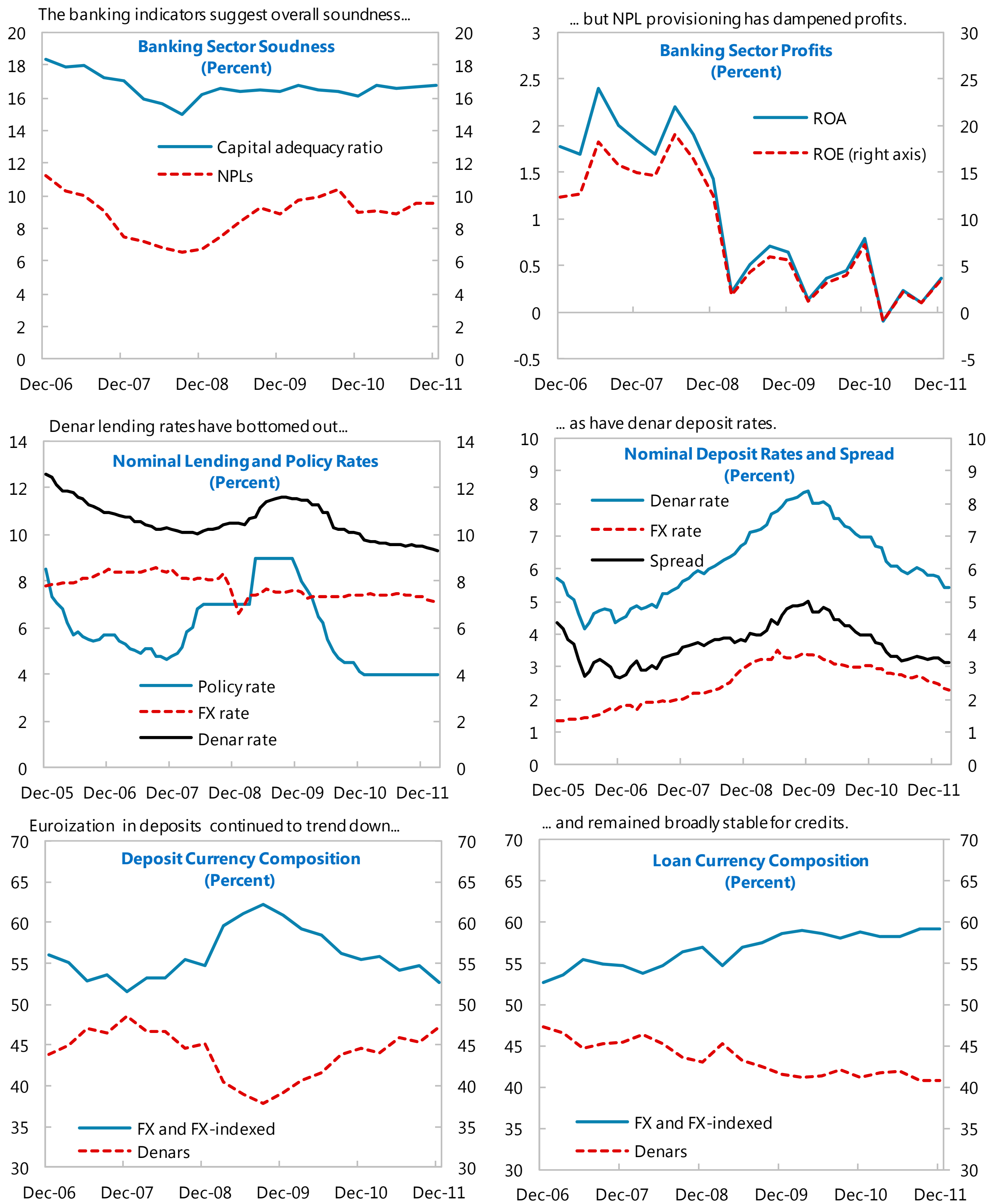
Sources: Haver, SSO, NBRM and IMF Staff estimates.
1/ Excluding food, tobacco, fuels and heating.

Figure 2. FYR Macedonia: External Sector Developments



Sources: Bloomberg; Authorities' data; and IMF staff estimates.
1/ 12-month moving average of imports.

Figure 3. FYR Macedonia: Banking Sector Developments



Sources: NBRM and IMF staff estimates.

Table 1. FYR Macedonia: Macroeconomic Framework, 2007–17
(Year-on-year percentage change, unless otherwise indicated)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
						Proj.					
Real GDP	6.1	5.0	-0.9	1.8	3.0	2.0	3.2	4.2	4.0	4.0	4.0
Real domestic demand	9.2	6.7	-3.3	-0.1	5.7	2.3	3.8	3.9	3.5	3.6	3.5
Consumption	7.7	6.9	-4.9	0.5	3.8	1.3	3.4	3.6	3.5	3.5	3.4
Private	7.7	6.9	-4.9	0.5	3.8	1.3	3.4	3.6	3.5	3.5	3.4
Public	0.2	8.1	0.6	-0.4	-5.5	2.5	3.9	3.4	2.2	3.2	3.2
Gross investment	23.2	4.7	-0.6	-2.1	21.2	5.0	5.0	5.0	4.0	4.0	4.0
Exports (volume)	12.0	-7.0	-16.0	24.1	10.5	7.2	10.7	9.8	8.5	7.0	6.2
Imports (volume)	16.3	0.0	-15.3	11.4	13.8	6.0	9.4	7.5	6.3	5.5	4.9
Contributions to growth											
Domestic demand	10.8	8.1	-4.1	-0.1	6.7	2.7	4.6	4.7	4.2	4.3	4.3
Net exports	-4.6	-3.1	3.2	1.9	-3.7	-0.7	-1.4	-0.5	-0.2	-0.3	-0.3
Central government operations (percent of GDP)											
Revenues	32.2	32.5	30.5	30.2	29.6	30.0	30.0	30.1	30.2	30.2	30.2
Expenditures	31.6	33.4	33.2	32.7	32.1	32.6	32.5	32.3	32.2	31.7	31.7
Of which: capital	3.8	4.9	3.3	3.6	3.9	3.9	4.0	4.0	4.0	4.0	4.0
Balance	0.6	-0.9	-2.7	-2.5	-2.6	-2.6	-2.5	-2.2	-2.0	-1.5	-1.5
Savings and investment (percent of GDP)											
Domestic saving	17.6	14.0	19.1	21.5	22.7	21.8	21.3	21.6	22.0	22.0	21.6
Public	4.4	3.9	0.6	1.1	1.4	1.2	1.5	1.8	2.0	2.5	2.5
Private	13.2	10.0	18.5	20.4	21.3	20.5	19.8	19.8	20.0	19.5	19.1
Foreign saving	7.1	12.8	6.8	2.2	2.8	5.0	6.2	5.9	5.4	5.0	5.0
Gross investment	24.6	26.8	25.9	23.7	25.4	26.8	27.5	27.5	27.4	27.0	26.7
Consumer prices											
Period average	2.3	8.4	-0.8	1.5	3.9	2.0	2.0	2.0	2.0	2.0	2.0
End-period	6.7	4.1	-1.6	3.0	2.8	2.0	2.0	2.0	2.0	2.0	2.0
Memorandum items:											
Current account balance (percent of GDP)	-7.1	-12.8	-6.8	-2.2	-2.8	-5.0	-6.2	-5.9	-5.4	-5.0	-5.0
Gross official reserves (millions of euros)	1,524	1,495	1,598	1,715	2,069	2,402	2,293	2,557	2,856	2,980	3,108
in percent of ST debt	117	110	105	103	114	115	109	105	116	125	125
in months of prospective imports	3.6	4.4	4.2	3.7	4.3	4.5	4.0	4.2	4.4	4.3	4.0
Gross Central Government Debt (percent of GDP)	24.0	20.6	23.8	24.8	28.6	32.3	30.2	30.7	30.9	30.6	30.4
Foreign direct investment (percent of GDP)	8.5	6.1	2.0	2.3	4.1	2.6	4.5	5.0	5.0	5.0	5.0
External debt (percent of GDP)	47.6	49.2	56.4	59.9	66.7	69.9	66.9	67.7	67.6	64.9	61.3
Nominal GDP (billions of denars)	365	412	411	425	450	470	498	528	562	596	632
Nominal GDP (millions of euros)	5,965	6,720	6,703	6,905	7,309	7,644	8,101	8,582	9,142	9,687	10,269

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

Table 2. FYR Macedonia: Central Government Operations, 2006–12

	2006	2007	2008	2009	2010	2011	2012	
							Budget	Proj.
	(Billions of denars)							
Total revenue	102.3	117.5	133.7	125.3	128.5	132.9	152.5	140.9
Tax revenue	89.2	101.3	112.6	106.9	109.3	115.2	125.3	119.8
Personal income tax	8.4	8.9	8.7	8.7	8.9	9.5	10.7	9.9
Corporate income tax	4.7	5.9	8.6	4.4	3.7	3.9	3.9	3.9
VAT	27.2	33.0	36.2	35.2	37.7	42.2	44.7	44.3
Excises	12.2	13.3	14.3	14.5	14.9	15.5	17.2	16.1
Custom duties	5.4	6.2	6.3	5.2	4.7	3.8	5.8	3.9
Other taxes	1.8	2.5	2.9	2.9	3.9	4.0	4.0	4.0
Social contributions (total)	29.4	31.6	35.8	35.9	35.5	36.3	39.0	37.7
Pension contributions	18.6	20.1	23.1	23.4	23.0	23.4	24.7	24.3
Unemployment contributions	1.4	1.5	1.8	1.8	1.7	1.7	1.9	1.8
Health contributions	9.4	10.0	10.9	10.7	10.9	11.2	12.4	11.6
Non tax revenue	9.9	10.4	12.9	12.6	12.1	12.7	15.9	13.9
Capital revenue	1.8	4.9	6.9	5.0	5.6	3.9	7.2	4.3
Of which: Telecom dividend	0.0	2.9	3.8	2.4	2.5	2.3	2.7	2.7
Grants	1.4	0.9	1.3	0.8	1.5	1.1	4.1	2.9
Total expenditure	104.0	115.4	137.5	136.2	139.0	144.4	165.0	153.3
Current expenditure	94.8	101.8	117.7	123.0	124.2	127.5	138.6	135.6
Wages and salaries	23.4	23.6	20.8	22.7	22.6	23.1	22.7	22.7
Goods and services	12.9	14.8	18.7	16.2	14.7	13.9	17.4	14.8
Transfers	55.3	60.5	75.5	81.7	83.7	86.9	94.9	94.6
Pensions	25.4	26.3	30.9	33.5	34.4	35.8	33.4	37.0
Health	15.8	16.1	19.1	18.7	19.3	20.5	22.1	21.7
Local governments	2.1	3.7	10.5	12.8	13.3	14.1	15.4	15.4
Other	12.0	14.4	15.0	16.7	16.6	16.6	24.0	20.4
Interest	3.1	2.9	2.6	2.4	3.2	3.5	3.6	3.6
Capital expenditure	9.3	13.7	20.1	13.4	15.3	17.7	27.0	18.3
Lending minus repayment	0.0	-0.2	-0.2	-0.2	-0.5	-0.8	-0.6	-0.6
Overall fiscal balance	-1.7	2.2	-3.8	-10.9	-10.5	-11.5	-12.4	-12.4
Financing	1.1	-3.6	2.4	10.9	10.5	11.5	12.4	12.4
Domestic	-9.8	7.6	-0.1	0.1	5.9	-9.4	-2.0	-8.5
Central Bank	-7.2	12.7	3.2	-0.3	4.0	-7.3	0.0	-10.3
Other domestic financing	-2.6	-5.1	-3.3	0.4	1.9	-2.1	-2.0	1.9
Privatization receipts	20.3	-0.7	1.7	0.1	0.0	0.3	0.2	0.2
Foreign	-9.4	-10.5	0.8	10.7	4.6	20.6	14.2	20.7
Official	...	...	...	0.0	4.6	13.1	0.7	5.3
Private	...	...	...	10.7	0.0	7.6	13.5	15.4
Memo items:								
Contributions to second pillar pensions	1.3	1.9	2.5	2.9	3.2	3.5	3.6	3.6
Gross debt (as share of GDP)	32.0	24.0	20.6	23.8	24.8	28.6	31.3	32.3
Nominal GDP (billions of denars)	320	365	412	411	425	450	485	470

Sources: IMF Staff and MoF estimates.

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

Table 2. FYR Macedonia: Central Government Operations, 2006–12 (continued)

	2006	2007	2008	2009	2010	2011	2012	
							Budget	Proj.
	(Percent of GDP)							
Total revenue	32.0	32.2	32.5	30.5	30.2	29.6	31.4	30.0
Tax revenue	27.9	27.8	27.4	26.0	25.7	25.6	25.8	25.5
Personal income tax	2.6	2.4	2.1	2.1	2.1	2.1	2.2	2.1
Corporate income tax	1.5	1.6	2.1	1.1	0.9	0.9	0.8	0.8
VAT	8.5	9.0	8.8	8.6	8.9	9.4	9.2	9.4
Excises	3.8	3.6	3.5	3.5	3.5	3.5	3.6	3.4
Custom duties	1.7	1.7	1.5	1.3	1.1	0.8	1.2	0.8
Other taxes	0.6	0.7	0.7	0.7	0.9	0.9	0.8	0.8
Social contributions (total)	9.2	8.7	8.7	8.7	8.4	8.1	8.0	8.0
Pension contributions	5.8	5.5	5.6	5.7	5.4	5.2	5.1	5.2
Unemployment contributions	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Health contributions	3.0	2.7	2.6	2.6	2.6	2.5	2.6	2.5
Non tax revenue	3.1	2.8	3.1	3.1	2.8	2.8	3.3	2.9
Capital revenue	0.6	1.4	1.7	1.2	1.3	0.9	1.5	0.9
Of which: Telecom dividend	0.0	0.8	0.9	0.6	0.6	0.5	0.6	0.6
Grants	0.4	0.2	0.3	0.2	0.3	0.2	0.8	0.6
Total expenditure	32.5	31.6	33.4	33.2	32.7	32.1	34.0	32.6
Current expenditure	29.6	27.9	28.6	30.0	29.2	28.3	28.6	28.8
Wages and salaries	7.3	6.5	5.1	5.5	5.3	5.1	4.7	4.8
Goods and services	4.0	4.1	4.6	3.9	3.5	3.1	3.6	3.1
Transfers	17.3	16.6	18.3	19.9	19.7	19.3	19.6	20.1
Pensions	7.9	7.2	7.5	8.2	8.1	8.0	6.9	7.9
Health	4.9	4.4	4.6	4.6	4.5	4.6	4.6	4.6
Local governments	0.7	1.0	2.5	3.1	3.1	3.1	3.2	3.3
Other	3.7	4.0	3.6	4.1	3.9	3.7	5.0	4.3
Interest	1.0	0.8	0.6	0.6	0.7	0.8	0.7	0.8
Capital expenditure	2.9	3.8	4.9	3.3	3.6	3.9	5.6	3.9
Lending minus repayment	0.0	-0.1	0.0	-0.1	-0.1	-0.2	-0.1	-0.1
Overall fiscal balance	-0.5	0.6	-0.9	-2.7	-2.5	-2.6	-2.6	-2.6
Financing	0.4	-1.0	0.6	2.7	2.5	2.6	2.6	2.6
Domestic	-3.1	2.1	0.0	0.0	1.4	-2.1	-0.4	-1.8
Central Bank	-2.2	3.5	0.8	-0.1	0.9	-1.6	0.0	-2.2
Other domestic financing	-0.8	-1.4	-0.8	0.1	0.4	-0.5	-0.4	0.4
Privatization receipts	6.3	-0.2	0.4	0.0	0.0	0.1	0.0	0.0
Foreign	-2.9	-2.9	0.2	2.6	1.1	4.6	2.9	4.4
Official	…	…	…	0.0	1.1	2.9	0.1	1.1
Private	…	…	…	2.6	0.0	1.7	2.8	3.3
Memo items:								
Contributions to second pillar pensions	0.4	0.5	0.6	0.7	0.7	0.8	0.7	0.8
Gross debt (as share of GDP)	32.0	24.0	20.6	23.8	24.8	28.6	31.3	32.3
Nominal GDP (bill. Denars)	320	365	412	411	425	450	485	470

Sources: IMF Staff and MoF estimates.

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

Table 3. FYR Macedonia: Balance of Payments, 2008−17
(Millions of euros, unless otherwise indicated)

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
							Projection			
Current account	-862	-457	-150	-201	-385	-500	-507	-489	-487	-517
Trade balance	-1763	-1560	-1468	-1682	-1784	-1915	-2016	-2073	-2140	-2197
Exports	2693	1933	2493	3179	3318	3622	3945	4292	4662	5028
Imports	-4455	-3492	-3961	-4861	-5102	-5537	-5961	-6365	-6802	-7225
Services (net)	9	16	49	97	98	111	131	160	190	221
Income (net)	-94	-47	-99	-109	-142	-157	-164	-173	-181	-217
Transfers (net)	985	1133	1367	1493	1443	1461	1542	1596	1644	1676
Of which										
Official	49	35	32	76	48	52	59	53	55	55
Private	936	1098	1335	1416	1395	1409	1484	1543	1589	1621
Of which: Cash exchange	774	928	1153	1236	1266	1311	1369	1426	1484	1542
Capital and financial account	795	444	192	540	718	391	770	789	611	644
Capital account (net)	-12	20	13	21	0	0	0	0	0	0
Financial account	807	424	179	519	718	391	770	789	611	644
Direct investment (net)	409	137	158	302	200	365	429	457	484	513
Portfolio investment (net)	-51	104	-62	-42	202	-208	-23	34	-11	-8
Of which: Eurobond (net)	-16	152	-37	-29	250	-175	0	50	0	0
Other investment	448	183	83	260	316	235	365	298	138	139
Trade credits (net)	-4	169	64	8	115	8	94	73	-48	31
MLT loans (net)	281	34	66	460	259	220	273	245	260	292
Public sector	36	7	38	367	84	90	128	60	58	64
Disbursements	69	47	97	456	143	155	289	238	283	404
of which : IMF credit	0	0	0	221	0	0	0	0	0	0
Amortization	-32	-40	-59	-89	-59	-65	-161	-178	-225	-340
of which : Repayment to the IMF	0	0	0	0	0	0	83	111	28	0
Banks (net)	-1	16	94	52	128	80	92	113	123	142
Non-Banks (net)	246	12	-66	41	47	49	53	72	79	87
ST loans (net)	-44	16	62	-27	31	32	34	37	39	41
Currency and deposits (net)	207	-62	-171	-234	-88	-25	-38	-56	-113	-225
Of which: Commercial banks	251	-60	-81	-98	-48	0	0	0	0	0
Other (net)	8	25	62	53	0	0	0	0	0	0
Errors and omissions	-24	27	20	-7	0	0	0	0	0	0
Overall Balance	-91	14	61	332	333	-109	263	300	124	128
					(Percent of GDP)					
Current account	-12.8	-6.8	-2.2	-2.8	-5.0	-6.2	-5.9	-5.4	-5.0	-5.0
Of which										
Trade balance	-26.2	-23.3	-21.3	-23.0	-23.3	-23.6	-23.5	-22.7	-22.1	-21.4
Private transfers	13.9	16.4	19.3	19.4	18.2	17.4	17.3	16.9	16.4	15.8
FDI (net)	6.1	2.0	2.3	4.1	2.6	4.5	5.0	5.0	5.0	5.0
					(Year-on-year percent change)					
Exports of G&S (Value)	10.3	-24.7	25.0	24.9	4.4	9.2	8.9	8.8	8.6	7.9
Volume	-7.0	-16.0	24.1	10.5	7.2	10.7	9.8	8.5	7.0	6.2
Price	18.6	-10.3	0.7	13.0	-2.7	-1.4	-0.8	0.3	1.5	1.5
Imports of G&S (Value)	21.7	-20.3	12.5	20.8	5.0	8.5	7.7	6.8	6.9	6.2
Volume	0.0	-15.3	11.4	13.8	6.0	9.4	7.5	6.3	5.5	4.9
Price	21.7	-6.0	1.0	6.1	-1.0	-0.8	0.1	0.5	1.3	1.2
Terms of trade (2008=100)	100.0	95.4	95.1	101.2	99.6	98.9	98.0	97.9	98.0	98.3
Memorandum Items:										
Nominal GDP	6720	6703	6905	7309	7644	8101	8582	9142	9687	10269
ST debt at residual maturity (year-end)	1353	1516	1667	1812	2085	2107	2430	2461	2380	2482
Gross foreign exchange reserves	1495	1598	1715	2069	2402	2293	2557	2856	2980	3108
Months of prospective imports of G&S	4.4	4.2	3.7	4.3	4.5	4.0	4.2	4.4	4.3	4.0
Percent of short term debt (residual maturity)	110.5	105.4	102.9	114.2	115.2	108.8	105.2	116.1	125.2	125.2
External debt (percent of GDP)	49.2	56.4	59.9	66.7	69.9	66.9	67.7	67.6	64.9	61.3
Medium and long term	31.9	37.9	40.6	44.1	46.4	44.3	44.8	44.9	43.6	40.5
Short term	17.3	18.5	19.2	22.6	23.5	22.7	22.9	22.7	21.3	20.8
External debt service	1397	1427	1614	1796	1967	2250	2284	2619	2655	2571
Percent of exports of G&S	41.3	56.0	50.6	45.1	47.4	49.6	46.3	48.8	45.5	40.8
Percent of exports of G&S and private transfers	32.0	38.7	35.4	32.8	35.2	37.5	35.2	37.6	35.5	32.3

Source: NBRM, IMF Staff Estimates.

Table 4. FYR: Macedonia - Central Bank Survey 2007-2012
(Local Currency Billions unless specified otherwise)

	2007	2008	2009	2010				2011				2012
				1Q-10	2Q-10	3Q-10	4Q-10	1Q-11	2Q-11	3Q-11	4Q-11	1Q-12
NFA	94.4	91.0	93.2	94.2	100.3	99.3	100.6	112.2	108.2	109.1	122.5	122.5
Assets	95.0	91.9	97.8	98.9	105.2	104.2	105.5	116.9	120.2	119.1	141.6	145.5
Liabilities	-0.6	-1.0	-4.6	-4.7	-4.9	-4.8	-4.9	-4.8	-12.0	-10.1	-19.1	-22.9
NDA	-56.6	-50.1	-47.3	-50.2	-52.9	-53.6	-51.6	-64.8	-59.8	-62.5	-68.9	-73.7
Banks (net)	-21.0	-19.0	-16.8	-23.2	-23.6	-27.6	-26.9	-28.5	-30.0	-31.6	-32.2	-40.4
of which:												
NBRM Bills and 6MD	-21.0	-19.0	-16.0	-23.0	-23.5	-26.6	-25.9	-28.5	-30.0	-31.6	-32.2	-40.4
Central Government (net)	-19.6	-11.0	-11.4	-6.9	-5.4	-5.0	-3.5	-15.2	-8.1	-7.3	-13.4	-9.9
of which:												
Deposits at Central Bank	-20.8	-12.3	-12.7	-8.2	-6.8	-10.4	-9.0	-20.6	-13.4	-12.7	-19.1	-15.4
Denar	-15.3	-9.2	-2.8	-4.2	-2.2	-3.5	-5.9	-2.9	-2.6	-5.0	-7.0	-4.4
FX	-5.5	-3.1	-9.9	-4.0	-4.6	-6.9	-3.1	-17.7	-10.8	-7.7	-12.1	-11.0
State and Local Governments (net)	-1.6	-2.8	-2.4	-2.6	-3.2	-3.4	-2.5	-3.5	-3.6	-3.5	-2.3	-2.7
Other items (net)	-14.4	-17.2	-16.7	-17.5	-20.7	-17.6	-18.7	-17.7	-18.0	-20.2	-20.9	-20.6
Reserve Money	37.9	40.9	46.0	44.0	47.5	45.7	49.0	47.3	48.5	46.5	53.6	48.8
Currency in Circulation	17.9	17.6	16.3	14.8	15.7	15.9	17.0	15.9	17.0	17.2	19.3	17.9
Other	20.0	23.3	29.7	29.2	31.8	29.8	32.0	31.4	31.4	29.3	34.3	30.9
Cash in Vaults	2.0	3.2	3.2	3.2	2.8	2.9	3.2	2.8	3.1	3.2	3.5	3.2
Total Reserves	18.0	20.1	26.5	26.0	29.0	26.8	28.8	28.6	28.3	26.2	30.9	27.7
on Denar Deposits	10.7	10.3	14.2	13.8	16.3	13.8	15.7	15.1	14.4	12.0	16.7	14.7
on FX Deposits	7.3	9.8	12.2	12.2	12.7	13.0	13.2	13.5	13.9	14.2	14.1	13.0
(Contribution to annual growth in reserve money)												
NFA	30.4	-9.2	5.6	46.2	72.8	24.8	16.0	40.8	16.6	21.2	44.7	21.9
NDA	-10.2	17.2	6.8	-26.4	-45.7	-15.3	-9.4	-33.2	-14.5	-19.5	-35.2	-18.9
Reserve Money	20.2	8.0	12.4	19.8	27.1	9.5	6.6	7.6	2.1	1.8	9.5	3.1
Memorandum Items:												
NBRM Bills (percent of GDP)	5.8	4.2	3.9	5.6	5.7	6.4	6.1	4.6	4.4	4.6	7.2	9.0
Govt Deposits at Central Bank (Percent of GDP)	5.7	3.0	3.1	2.0	1.6	2.5	2.1	4.8	3.0	2.9	4.2	3.4

Source: NBRM, Staff Estimates

Table 5. FYR: Macedonia - Monetary Survey 2007-2012
(Local Currency Billions unless specified otherwise)

	2007	2008	2009	2010				2011				2012
				1Q-10	2Q-10	3Q-10	4Q-10	1Q-11	2Q-11	3Q-11	4Q-11	1Q-12
NFA	109.1	91.0	94.8	92.9	100.0	97.1	99.9	110.8	104.8	111.0	124.7	121.7
Central Bank	94.4	91.0	93.2	94.2	100.3	99.3	100.6	112.2	108.2	109.1	122.5	122.5
Commercial Banks	14.6	0.0	1.5	-1.3	-0.4	-2.2	-0.7	-1.3	-3.5	1.9	2.2	-0.9
NDA	66.7	104.5	112.5	117.8	120.4	124.8	132.7	123.9	134.7	134.1	130.3	136.0
Credit to Government (net)	-10.5	-8.4	-4.8	-0.4	1.9	2.3	9.0	-3.7	2.0	2.2	-1.8	1.9
From Banks (net)	10.6	5.5	9.0	9.0	10.4	10.8	15.0	14.9	13.7	13.0	14.0	14.6
of which: Credit (Tbills)	13.0	9.4	13.1	13.1	14.3	13.6	18.1	17.8	16.4	15.9	16.7	17.3
From Central Bank (net)	-21.2	-13.9	-13.7	-9.5	-8.6	-8.5	-6.0	-18.7	-11.7	-10.8	-15.8	-12.7
of which: Deposits	-20.8	-12.3	-12.7	-8.2	-6.8	-10.4	-9.0	-20.6	-13.4	-12.7	-19.1	-15.4
Credit to Private Sector (Gross)	130.4	174.8	180.2	182.8	187.6	191.2	193.4	197.6	202.3	205.1	208.2	211.8
From Banks	129.0	173.3	178.7	181.4	186.2	189.7	191.9	196.1	202.2	205.1	208.1	211.7
Denars	97.9	134.5	139.8	141.1	143.0	145.8	143.6	145.9	149.8	149.5	150.6	153.6
FX	31.0	38.8	38.9	40.3	43.2	44.0	48.3	50.3	52.4	55.6	57.6	58.1
From Central Bank	1.4	1.5	1.5	1.5	1.4	1.5	1.5	1.4	0.1	0.1	0.1	0.1
Other Items (net)	-53.1	-61.9	-62.9	-64.6	-69.1	-68.7	-69.7	-69.9	-69.6	-73.2	-76.0	-77.7
Broad Money (M3)	175.8	195.5	207.3	210.7	220.4	221.9	232.6	234.7	239.4	245.1	255.0	257.6
Currency in Circulation	17.9	17.6	16.3	14.8	15.7	15.9	17.0	15.9	17.0	17.2	19.3	17.9
Total Deposits	157.9	177.9	191.0	195.9	204.7	205.9	215.6	218.8	222.4	227.9	235.7	239.8
Denars	89.6	94.1	90.5	93.4	99.7	100.0	106.8	107.9	110.2	113.3	122.3	128.0
FX	68.3	83.8	100.5	102.5	105.0	105.9	108.8	110.8	112.2	114.6	113.5	111.8
				(Year-on-year percent change)								
Private Sector Credit	39.0	34.1	3.1	2.8	6.1	8.1	7.3	8.0	7.8	7.3	7.7	7.2
Broad Money	29.3	11.2	6.0	10.7	14.8	13.4	12.2	11.4	8.6	10.5	9.7	9.8
Private Sector Deposits	31.9	12.7	7.3	11.5	15.2	13.6	12.9	11.7	8.6	10.7	9.3	9.6
				(Contribution to annual growth in broad money)								
NFA	1.1	-10.3	1.9	6.3	11.7	2.5	2.5	8.5	2.2	6.3	10.7	4.6
NDA	28.2	21.5	4.1	4.4	3.1	10.8	9.7	2.9	6.5	4.2	-1.0	5.1
Broad Money	29.3	11.2	6.0	10.7	14.8	13.4	12.2	11.4	8.6	10.5	9.7	9.8
				(Percent of GDP)								
Private Sector Credit	35.7	42.5	43.9	44.6	45.4	45.7	45.5	45.7	45.8	46.0	46.3	47.1
Broad Money	48.2	47.5	50.5	51.4	53.3	53.0	54.8	54.3	54.3	54.9	56.7	57.3
Private Sector Deposits	43.3	43.2	46.5	47.7	49.5	49.2	50.8	50.6	50.4	51.1	52.4	53.3
Memorandum Items:												
Money Multiplier	4.6	4.8	4.5	4.8	4.6	4.9	4.7	5.0	4.9	5.3	4.8	5.3
Reserve Requirement Ratio (% of deposits)												
Denars	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0
FX Indexed	10.0	10.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0
FX	10.0	10.0	13.0	13.0	13.0	13.0	13.0	13.0	13.0	13.0	13.0	13.0
Velocity	2.1	2.1	2.0	1.9	1.9	1.9	1.8	1.8	1.8	1.8	1.8	1.7

Source: NBRM, Staff Estimates

Table 6. FYR Macedonia: Financial Soundness Indicators of the Macedonian Banking System, 2005-11

	2005	2006	2007	2008	2009	2010	2011			
							2011Q1	2011Q2	2011Q3	2011Q4
Capital adequacy										
Regulatory capital/risk weighted assets	21.3	18.3	17.0	16.2	16.4	16.1	16.8	16.5	16.7	16.8
Tier I capital/risk weighted assets 1/	21.6	17.4	15.7	14.0	13.8	13.4	14.1	14.0	14.0	14.1
Equity and reserves to Assets	15.8	13.3	11.4	11.5	11.4	10.6	11.0	11.0	11.1	11.0
Asset composition										
Structure of loans										
Enterprises (loans to enterprises/total loans)	61.7	59.0	54.9	54.2	58.7	58.9	59.0	58.6	58.4	58.2
Households (loans to households/total loans)	30.6	33.4	37.7	38.5	37.9	37.1	36.6	36.5	36.9	36.5
Lending with foreign currency component to private sector	49.2	52.7	54.7	57.0	58.5	58.8	58.3	58.2	59.2	59.2
Foreign currency lending/total credit to private sector	25.4	26.3	24.6	22.9	22.6	25.8	26.2	26.5	27.7	28.2
Foreign currency indexed lending/total credit to private sector	23.8	26.4	30.1	34.1	35.9	33.0	32.1	31.7	31.5	31.0
NPLs 2/										
NPLs / gross loans	14.9	11.2	7.5	6.7	8.9	9.0	9.1	8.9	9.5	9.5
NPLs net of provision / own funds	2.9	0.7	-5.0	-6.2	-0.6	-0.3	-1.5	-2.1	-1.7	-0.9
Provisions to Non-Performing Loans	94.2	98.3	114.3	118.1	101.4	100.7	103.3	104.5	103.6	101.9
Large exposures/own funds	189.7	194.7	181.4	118.0	213.3	200.4	182.1	199.6	186.1	189.6
Connected lending										
Banking system exposure to subsidiaries and shareholders / own funds	4.3	5.2	5.6	3.1	4.6	6.3	3.0	4.4	4.2	4.6
Banking system equity investments/own funds	7.0	6.3	4.9	3.9	1.5	1.5	1.4	1.5	1.5	1.6
Earning and profitability										
ROAA 3/	1.2	1.8	1.8	1.4	0.6	0.8	-0.1	0.2	0.1	0.4
ROAE 3/	7.5	12.3	15.0	12.5	5.6	7.3	-1.0	2.1	1.0	3.4
Interest margin/gross income 4/	53.8	57.1	57.0	58.9	62.6	61.8	63.5	62.7	62.5	60.0
Noninterest expenses/gross income 5/	68.1	63.6	60.3	64.0	64.5	68.2	73.7	70.8	70.7	69.7
Personnel expenses/noninterest expenses	42.1	41.1	38.4	36.5	36.9	36.1	34.5	34.9	34.7	34.1
Interest Rates										
Local currency spreads	6.5	6.3	4.5	3.2	2.8	2.3	3.0	3.0	3.0	3.2
Foreign currency spreads	6.5	6.7	6.5	4.2	4.2	4.4	4.6	4.6	4.7	4.8
Interbank market interest rate	8.7	4.9	3.1	5.3	6.2	2.7	2.2	2.2	2.2	2.2
Liquidity										
Highly liquid assets/total assets 6/	15.0	18.0	20.9	16.9	20.6	25.3	24.2	24.7	23.3	25.3
Highly liquid assets/total short-term liabilities 7/	21.7	25.2	28.2	24.0	30.1	38.5	37.4	38.4	36.3	39.6
Liquid assets/total assets	38.0	37.7	34.7	22.9	25.6	30.9	30.2	29.7	29.9	31.2
Liquid assets/total short-term liabilities	55.0	52.8	46.8	32.4	37.4	46.9	46.7	46.1	46.6	48.9
Customer deposits/total (noninterbank) loans	142.3	137.1	128.4	107.7	108.2	114.3	113.4	112.0	113.3	115.7
Foreign currency deposits/total deposits	55.7	51.8	44.5	48.1	56.2	53.5	53.8	53.3	53.0	50.8
Including foreign exchange-indexed 8/	58.5	56.1	51.5	54.8	60.9	55.5	55.9	54.2	54.7	52.7
Central bank credit to banks/bank liabilities	0.2	0.1	0.1	0.01	0.01	0.01	0.01	0.01	0.01	0.01
Sensitivity to market risk										
Net open foreign exchange position / own funds	51.6	47.0	38.2	25.1	13.0	18.9	11.9	10.0	17.9	21.3

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 31.03.2009 these items have been adjusted for unrecognized impairment.

4/ Interest margin is 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

8/ FX indexed deposits include deposits and other FX indexed liabilities. However FX indexed deposits comprise the majority of these items. Since 31.03.2009, the figure refers only to FX indexed deposits.

Table 7. FYR Macedonia: Fiscal Debt Sustainability Framework, 2007-2017
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Debt-stabilizing primary balance 9/
Baseline: Public sector debt 1/	24.0	20.7	23.8	24.8	28.6	**32.3**	**30.2**	**30.8**	**30.9**	**30.6**	**30.4**	**-0.5**
o/w foreign-currency denominated	14.7	13.7	16.5	17.0	21.6	25.1	22.6	22.9	22.7	22.0	21.4	
Change in public sector debt	-8.0	-3.3	3.1	1.0	3.8	3.7	-2.0	0.5	0.1	-0.2	-0.2	
Identified debt-creating flows (4+7+12)	-3.8	-1.3	3.1	1.8	1.1	1.4	0.7	0.5	0.1	-0.2	-0.2	
Primary deficit	-1.4	0.3	2.1	1.7	1.8	1.9	1.2	1.1	0.8	0.3	0.3	
Revenue and grants	32.2	32.5	30.5	30.2	29.6	30.0	30.0	30.1	30.2	30.2	30.2	
Primary (noninterest) expenditure	30.8	32.8	32.6	32.0	31.3	31.8	31.2	31.1	31.1	30.5	30.5	
Automatic debt dynamics 2/	-3.1	-2.0	0.6	0.1	-0.6	-0.5	-0.5	-0.6	-0.7	-0.5	-0.5	
Contribution from interest rate/growth differential 3/	-3.1	-2.1	0.6	0.0	-0.6	-0.5	-0.5	-0.6	-0.7	-0.5	-0.5	
Of which contribution from real interest rate	-1.4	-1.0	0.5	0.4	0.1	0.1	0.5	0.6	0.4	0.7	0.6	
Of which contribution from real GDP growth	-1.7	-1.1	0.2	-0.4	-0.7	-0.5	-1.0	-1.2	-1.1	-1.2	-1.2	
Contribution from exchange rate depreciation 4/	0.0	0.0	-0.1	0.1	0.0	...	...	...	...	...	...	
Other identified debt-creating flows	0.8	0.5	0.4	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	0.2	-0.4	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.6	0.9	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 5/	-4.2	-2.0	0.0	-0.8	2.7	2.3	-2.7	0.0	0.0	0.0	0.0	
Public sector debt-to-revenue ratio 1/	74.5	63.7	77.9	81.9	96.7	107.7	100.8	102.3	102.2	101.4	100.6	
Gross financing need 6/	6.9	4.1	6.1	7.3	8.6	8.2	10.2	9.4	11.3	10.1	12.0	
in billions of Euros	0.4	0.3	0.4	0.5	0.6	0.6	0.8	0.8	1.0	1.0	1.2	
Scenario with key variables at their historical averages 7/						**32.3**	**28.9**	**28.3**	**27.7**	**27.2**	**26.6**	**-1.0**
Scenario with no policy change (constant primary balance) in 2012-2017						**32.3**	**30.9**	**32.2**	**33.4**	**34.7**	**36.0**	**-0.6**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	6.1	5.0	-0.9	1.8	3.0	2.0	3.2	4.2	4.0	4.0	4.0	
Average nominal interest rate on public debt (in percent) 8/	2.8	3.0	2.9	3.2	3.3	2.8	4.3	4.0	4.0	4.2	4.2	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-4.6	-4.4	2.2	1.7	0.6	0.3	1.6	2.3	1.6	2.4	2.3	
Nominal appreciation (increase in US dollar value of local currency, in percent)	0.0	-0.3	0.4	-0.5	0.0	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	7.4	7.4	0.7	1.6	2.7	2.5	2.7	1.6	2.5	1.9	1.9	
Growth of real primary spending (deflated by GDP deflator, in percent)	3.8	11.6	-1.5	-0.1	1.0	3.6	1.2	4.0	3.7	2.1	4.1	
Primary deficit	-1.4	0.3	2.1	1.7	1.8	1.9	1.2	1.1	0.8	0.3	0.3	

1/ Consolidated general government gross debt.

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

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

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

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

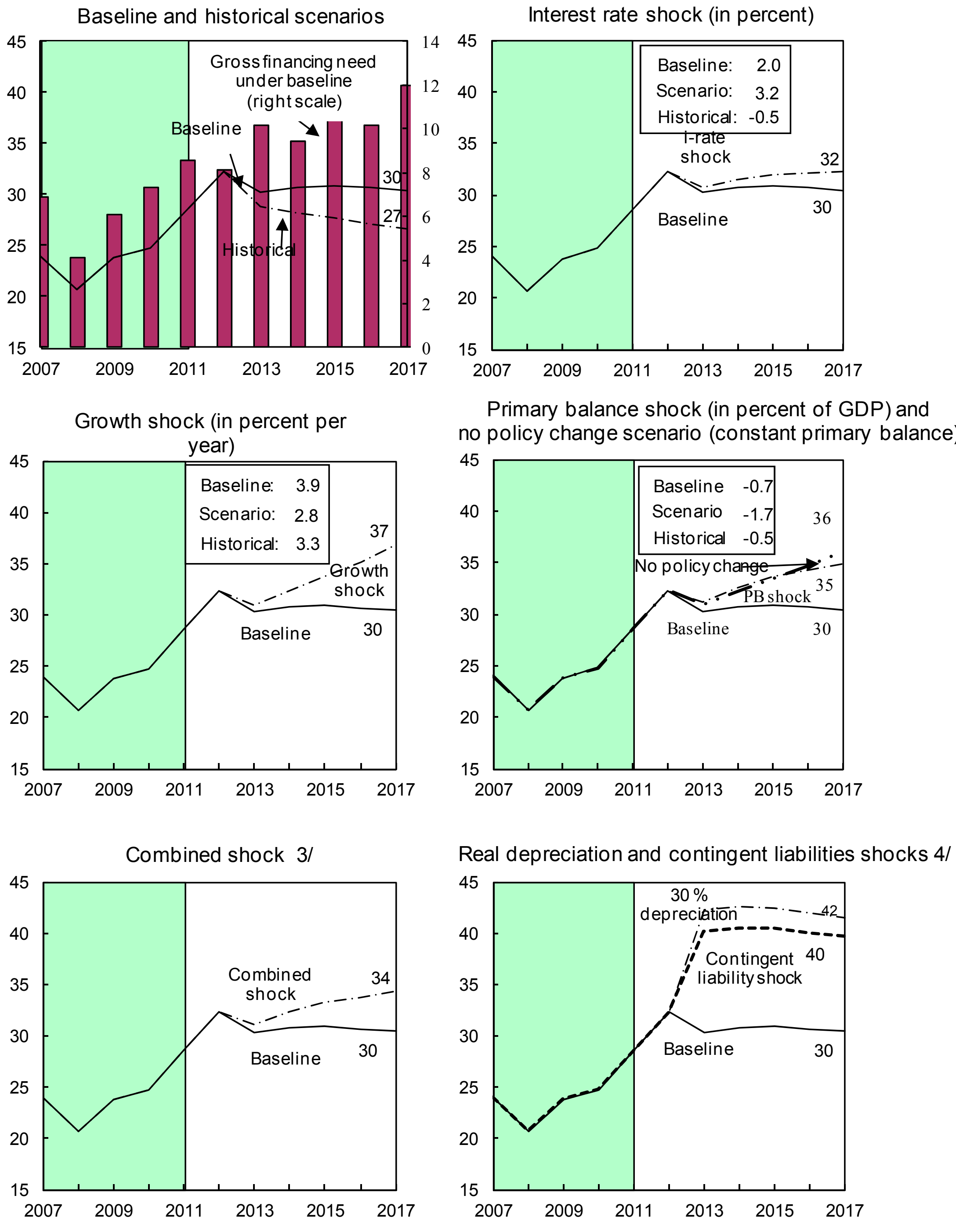
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

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

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

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

Figure 4. FYR Macedonia: Public Debt Sustainability: Bound Tests 1/ 2/
(Public debt in percent of GDP)



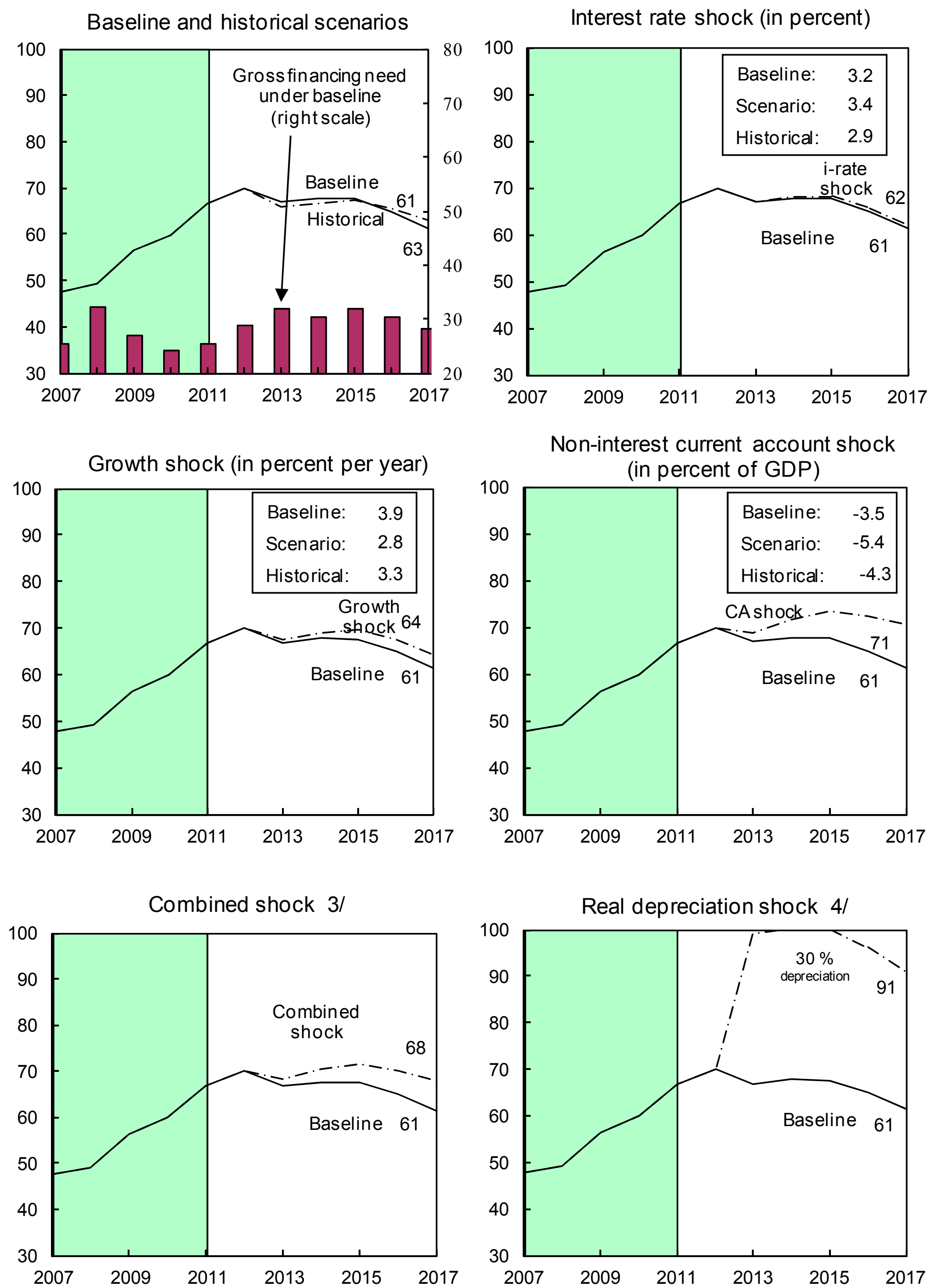
Sources: International Monetary Fund, country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
4/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2010, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Table 8. FYR Macedonia: External Debt Sustainability Framework, 2007-2017
(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2007	2008	2009	2010	2011	10-Year Historical Average	10-Year Standard Deviation	2012	2013	2014	2015	2016	2017	Debt-stabiliz non-interes current accou
aseline: External debt	47.6	49.2	56.4	59.9	66.7			**69.9**	**66.9**	**67.7**	**67.6**	**64.9**	**61.3**	**-5.6**
hange in external debt	-0.2	1.5	7.2	3.5	6.8			3.2	-3.0	0.8	-0.1	-2.7	-3.6	
entified external debt-creating flows (4+8+9)	-7.1	4.5	6.9	-1.4	-5.7			2.3	0.9	-0.5	-1.0	-1.4	-1.3	
Current account deficit, excluding interest payments	5.5	11.5	5.7	0.8	1.0			3.0	4.1	3.8	3.3	3.0	3.2	
Deficit in balance of goods and services	19.3	26.1	23.0	20.5	21.7			22.1	22.3	22.0	20.9	20.1	19.2	
Exports	51.5	50.4	38.0	46.1	54.4			54.3	56.0	57.5	58.8	60.2	61.3	
Imports	70.8	76.5	61.1	66.7	76.1			76.4	78.2	79.5	79.7	80.4	80.5	
Net non-debt creating capital inflows (negative)	-8.3	-3.0	-0.1	-1.9	-5.2			-1.5	-3.2	-3.7	-3.8	-3.9	-3.9	
Automatic debt dynamics 1/	-4.3	-4.0	1.2	-0.2	-1.5			0.8	-0.1	-0.6	-0.5	-0.6	-0.6	
Contribution from nominal interest rate	1.6	1.4	1.1	1.4	1.8			2.0	2.0	2.1	2.1	2.0	1.9	
Contribution from real GDP growth	-2.6	-2.1	0.4	-1.0	-1.7			-1.3	-2.1	-2.7	-2.5	-2.6	-2.4	
Contribution from price and exchange rate changes 2/	-3.3	-3.2	-0.3	-0.7	-1.6			...	...	...	...	...	...	
esidual, incl. change in gross foreign assets (2-3) 3/	6.9	-3.0	0.4	4.8	12.5			0.9	-3.9	1.3	0.9	-1.2	-2.3	
xternal debt-to-exports ratio (in percent)	92.6	97.6	148.2	129.7	122.5			128.7	119.6	117.7	115.0	107.7	100.0	
ross external financing need (in billions of US dollars) 4/	1.5	2.2	1.8	1.7	1.9			2.2	2.6	2.6	2.9	2.9	2.9	
in percent of GDP	25.5	32.2	27.0	24.1	25.6			28.7	31.9	30.5	31.9	30.4	28.2	
cenario with key variables at their historical averages 5/								**69.9**	**66.0**	**66.7**	**67.4**	**65.6**	**62.9**	**-5.9**
ey Macroeconomic Assumptions Underlying Baseline														
eal GDP growth (in percent)	6.1	5.0	-0.9	1.8	3.0	3.3	2.2	2.0	3.2	4.2	4.0	4.0	4.0	
DP deflator in US dollars (change in percent)	7.4	7.3	0.6	1.2	2.7	3.3	2.4	2.5	2.7	1.6	2.5	1.9	1.9	
ominal external interest rate (in percent)	3.8	3.2	2.2	2.6	3.1	2.9	0.5	3.2	3.1	3.3	3.2	3.1	3.0	
rowth of exports (US dollar terms, in percent)	28.3	10.3	-24.7	25.0	24.9	11.0	16.5	4.4	9.2	8.9	8.8	8.6	7.9	
rowth of imports (US dollar terms, in percent)	25.0	21.7	-20.3	12.5	20.8	10.6	13.3	5.0	8.5	7.7	6.8	6.9	6.2	
urrent account balance, excluding interest payments	-5.5	-11.5	-5.7	-0.8	-1.0	-4.3	3.9	-3.0	-4.1	-3.8	-3.3	-3.0	-3.2	
et non-debt creating capital inflows	8.3	3.0	0.1	1.9	5.2	3.7	2.5	1.5	3.2	3.7	3.8	3.9	3.9	

Derived as [r - g - ρ(1+g) + εα(1+r)]/(1+g+ρ+gρ) times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate,
= nominal appreciation (increase in dollar value of domestic currency), and α = share of domestic-currency denominated debt in total external debt.
The contribution from price and exchange rate changes is defined as [-ρ(1+g) + εα(1+r)]/(1+g+ρ+gρ) times previous period debt stock. ρ increases with an appreciating domestic currency (ε > 0) and rising inflation (based on GDP deflator).
For projection, line includes the impact of price and exchange rate changes.
Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.
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.
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
the last projection year.

Figure 5. FYR Macedonia: External Debt Sustainability: Bound Tests 1/ 2/
(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2013.

Table 9. FYR Macedonia: Composition of Central Government Debt

	2010		2011	
	(share of GDP)	(share of debt)	(share of GDP)	(share of debt)
External	17.0	68.6	21.6	75.7
Private	4.7	19.1	6.7	23.4
Official	12.3	49.6	14.9	52.3
Domestic	7.8	31.4	6.9	24.3
Structural Bonds	3.3	13.2	2.1	7.3
Government Securities	4.5	18.2	4.9	17.0
Gross Debt	24.8	100.0	28.6	100.0
NBRM Deposits	2.1		4.2	
Net Debt	22.7		24.4	
Memo Items:				
Foreign currency debt 1/	23.1		26.1	
Short-term debt	4.5		4.6	

Source: MoF and Staff estimates.

Note:

1/ Includes foreign currency indexed debt issued on the domestic market.

Table 10. FYR Macedonia: External Debt Decomposition, 2011

	Millions of euros	Percent of GDP
Total External Debt	4,875	66.7
Total External MLT Debt	3,225	44.1
Private	1,695	23.2
Intecompany Loans	569	7.8
Loans	1,076	14.7
Other	50	0.7
Public 1/	1,531	20.9
Official Creditors	1,326	18.1
Private Creditors	205	2.8
Total External ST Debt	1,649	22.6
Private	1,406	19.2
Intercompany Debt	321	4.4
Trade Credits	817	11.2
Arrears	161	2.2
Other	106	1.5

Sources: NBRM and IMF Staff Estimates
1/ Public includes general government and monetary authorities.

Annex. Former Yugoslav Republic of Macedonia: Risk Assessment Matrix

Nature/Source of Main Threats	Overall Level of Concern	
	Likelihood of Realization of Threat in the Next 1–2 years (high, medium or low)	**Expected Impact if Threat is Realized** (high, medium, or low)
A deeper or more prolonged recession in the euro area	**Medium** The euro area remains exposed to significant downside growth risks.	**Medium** This could result in negative spillovers to Macedonia through reduced exports, remittances, and FDI. The result would be lower growth, and BoP pressures could emerge that would require pro-cyclical interest rate hikes and fiscal cuts.
Significant intensification of the euro area crisis	**Low** While the probability is low, persistent volatility in euro area financial markets suggests risks exist.	**High** This could lead to pressures on the denar exchange rate due to its peg to the euro, leading to outflows of bank deposits and pressures on foreign reserves. Given the high degree of euroization, the exchange rate peg is crucial for the stability of the financial system.
Intensified stress and threat of insolvencies in the Greek banking system.	**Medium** Prospects for the Greek economy and banking system remain subject to considerable risks.	**Medium** With a quarter of the system's total assets, the share of Greek-owned banks is among the largest in the region. While there is minimal reliance on funding from Greek parents, a confidence shock and destabilizing deposit outflows cannot be excluded.

FORMER YUGOSLAV REPUBLIC OF MACEDONIA

STAFF REPORT FOR THE 2011 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

May 16, 2012

Prepared By

European Department
(In consultation with other departments)

CONTENTS

STATISTICAL ISSUES

(As of April 30, 2012)

I. Assessment of Data Adequacy for Surveillance
General: Data provision has some shortcomings, but is broadly adequate for surveillance and monitoring purposes. Areas that would benefit most from further improvement are national accounts and government finance statistics.
National accounts: Quarterly GDP data in constant pricesfrom the production approach have been published since September 2011.. Employment data from the company survey continue to be unreliable. **Price statistics:** The CPI series are rebased every year and this has caused small discrepancies in historical data.
Government finance statistics: Data coverage on government below-the-line financing from National Bank deposits is inadequate, as a result of different coverage of accounts between the Ministry of Finance and the National Bank – the government does not regularly report Treasury Single Account and budgetary FX account balances. In addition, data on arrears, including those on public hospitals, as well as data on state enterprises, which are not part of the central government, are limited. 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: Balance of payment data are compiled on monthly basis. The compilation and coverage have improved in recent years, and most of the recommendations from the 2004 ROSC mission and the late 2006 STA mission were implemented

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

III. Reporting to STA (Optional)
No data are being reported for publication in the *Government Finance Statistics Yearbook* or in the *IFS*.

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

(as of April 30, 2012)

	Date of Latest Observation	Date Received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]	Memo Items: Data Quality – Methodological Soundness[8]	Memo Items: Data Quality – Accuracy and Reliability[9]
Exchange Rates	4/27/12	4/30/12	D	W	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	4/27/12	5/2/12	D	W	Q		
Reserve/Base Money	4/16/12	4/18/12	W	W	M	O, LO, LO, O	O, LO, O, O, O
Broad Money	Mar. 12	4/20/12	M	M	M		
Central Bank Balance Sheet	Mar. 12	4/20/12	M	M	M		
Consolidated Balance Sheet of the Banking System	Mar. 12	4/20/12	M	M	M		
Interest Rates[2]	Mar. 12	4/30/12	M	M	M		
Consumer Price Index	Apr. 12	5/3/12	M	M	M	O, O, O, LO	LO, O, LNO, O, LO
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Oct. 11	12/26/11	A	A	A	LO, LNO, LO, O	LO, LO, LO, LO, LNO
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	Mar. 12	4/25/12	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Mar. 12	Apr. 12	M	M	M		
External Current Account Balance	Jan. 12	4/12/12	M	M	M	O, LO, O, LO	LO, O, LO, O, LO
Exports and Imports of Goods and Services	Feb. 12	4/06/12	M	M	M		
GDP/GNP	Dec. 11	3/23/12	Q	Q	Q	O, LO, O, LO	LO, O, LNO, O, O
Gross External Debt	12/31/11	3/30/12	Q	Q	Q		
International Investment Position[6]	2010	Dec 11	A	A	A		

[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 validation of intermediate data and statistical outputs, and revision studies.

FUND RELATIONS

(As of April 30, 2012)

Missions. Article IV and PLL review mission, Skopje, November 30–December 13, 2011. Concluding statement is available at: http://www.imf.org/external/np/ms/2011/121311.htm.

Staff team. Wes McGrew (head), Nicolas Arregui, Maral Shamloo, Eugen Tereanu, (all EUR), Ran Bi (SPR), and Alexander Tieman (Resident Representative).

Discussions. The staff team met Prime Minister Gruevski, Deputy Prime Minister and Minister of Finance Stavreski, National Bank of the Republic of Macedonia Governor Bogov, Deputy Prime Minister Peshevski, 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.

I.	**Membership Status:**	Joined 12/14/92; Article VIII	
II.	**General Resources Account:**	SDR Million	Percent of Quota
	Quota	68.90	10.00
	Fund holdings of currency	265.90	385.92
	Reserve position	0.00	0.00
III.	**SDR Department:**	SDR Million	Percent of Allocation
	Net cumulative allocation	65.62	100.00
	Holdings	1.55	2.36
IV	**Outstanding Purchases and Loans:**	SDR Million	Percent of Allocation
	Precautionary and Liquidity Line [1/]	197.00	285.92

[1/] formerly Precautionary Credit Line (PCL)

V. **Latest Financial Arrangements:**

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
PLL [1/]	01/19/2011	10/18/2013	413.40	197.00
Stand-By	08/31/2005	08/30/2008	51.68	10.50
Stand-By	04/30/2003	08/15/2004	20.00	20.00

[1/] formerly PCL

VI. **Projected Payments to the Fund (Expectation Basis)**
(SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2012	2013	2014	2015	2016
Principal			73.88	98.50	24.63
Charges/Interest	1.77	2.35	2.23	1.27	0.25
Total	1.77	2.35	76.11	99.77	24.88

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

At end-December 2011, the official exchange rate was 47.7 denars per U.S. dollar and 61.5 denars per euro. The FYR Macedonia has accepted the obligations of Article VIII, Sections 2, 3, and 4 with effect from June 19, 1998.

VIII. **Article IV Consultations:**
The first consultation with the FYR Macedonia was concluded in August 1993. The last consultation was concluded on January 19, 2011 (IMF Country Report 11/42). The FYR Macedonia is on the standard 12-month consultation cycle.

IX. Technical Assistance (since 2006):

Purpose	**Department**	**Date**
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 2012
Domestic Debt Market Development	MCM	October 2011
National Accounts	STA	August 2011
Tax Administration	FAD	June 2011
Medium-Term Budgeting	FAD	May 2011
Safeguards Assessment	FIN	February 2011
Stress Testing	MCM	February 2011
SDDS Subscription	STA	December 2010
Tax Administration	FAD	April 2010
Public Financial Management	FAD	September 2009
Tax Administration	FAD	July 2009
National Accounts	STA	June 2009
Contingency Planning and Crisis Preparedness	MCM	February 2009
Government Finance Statistics	STA	October 2008
Balance of Payments Statistics	STA	October 2008
National Accounts Statistics	STA	April 2007; January, May, September, and December 2008

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

X. **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

XI. **Resident Representative**

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

COORDINATION OF IMF AND WORLD BANK WORK PLANS

1. At discussion in May 2011, IMF and World Bank country teams for FYR Macedonia agreed that growth is returning to Macedonia, but that the country continues to face challenges that include the need to raise potential growth and tackle high unemployment. Coming out of the 2009 recession, growth in 2010 reached just 1.8 percent, but has been gradually accelerating since mid-2010 and is projected to rise to 3 percent in 2011 with domestic demand adding to the sound export performance. In keeping with returning growth, fiscal revenues are broadly in line with the budget. Financing for this year's deficit has been secured by drawing € 220 million from the IMF precautionary credit line. The banking sector remains broadly in good shape, with the quality of its loan portfolio starting to recover from the 2009-10 deterioration. Balance of payments pressures remain subdued, as the current account deficit remains moderate and official foreign exchange reserves are above pre-crisis levels and broadly adequate by most standard metrics. The exchange rate peg to the Euro, while beneficial for stability, will continue to require disciplined economic policies. While external financing needs appear manageable, a slowdown in main economic partners or further pressures on oil and food prices may renew pressures on the balance of payments. Against this background Macedonia's main macroeconomic challenges are to avoid procyclical fiscal policies and maintain fiscal sustainability by meeting the government's deficit targets; pursue monetary and fiscal policies that are supportive of the exchange rate regime, price stability and of economic growth; and safeguard the stability of the financial system, including through continued sound supervision and regulation as well as contingency planning. Beyond the current year, maintaining fiscal sustainability while securing adequate budget financing remain important challenges. In the medium-run, raising potential growth by pursuing structural reform remains essential.

2. Based on this shared assessment, the teams identified six areas of structural reform as macrocritical in light of their importance for stimulating private sector activity, and ensuring fiscal and external sustainability and financial sector stability.

- **Public expenditure management and public finance.** Improving budget planning and the structure of public spending are key areas for improvement. Accurate revenue and expenditure forecasts, based on prudent growth assumptions, are needed to ensure realistic budgets and avoid supplementary budgets that result from revenue underperformance or underestimation of spending. Moreover, further expanding the medium-term elements of the fiscal framework would help to anchor fiscal policy around the goal of public debt sustainability. The domestic public debt market needs to be developed over the medium term to provide a larger and more reliable domestic source of fiscal financing and reduce reliance on external funding.

- **Tax administration.** Continued reforms in this area will help to improve compliance and reduce informality, contributing to a broader and more stable tax base that allows lower tax rates and adequate fiscal financing. Macedonia has already achieved major gains by unifying the collection of social contributions (pension, health and unemployment) and integrating them with personal income tax collection, resulting in significant improvement in compliance.

- **Social sector spending. Pension reform.** Considerable reforms have been implemented to put the system on a sustainable financial basis. Still, with the recent reduction in contribution rates and changes to the pension indexation formula, the budgetary transfers made to the Pension and Disability Insurance Fund (PDIF) increased. Social safety net. The social safety net is complex, with a large number of overlapping programs that are not well-targeted and fail to reach some of most vulnerable people in society. Efforts are needed to ensure that an increasing share of transfers reach the poor. Health Sector. Pressures recently re-emerged in the health sector as the contribution rate was lowered while the basic benefits package remained underfunded and costs increased. The authorities recognize the need to improve the long-run sustainability of the basic benefits package and several options for its redefinition are being considered based on a actuarial analysis supported by the World Bank.

- **Improving competitiveness.** The business climate improved in Macedonia in recent years, but a number of challenges remain which will require strong, concerted medium-term efforts. Areas where further efforts can pay off include streamlining administrative procedures, improving contract enforcement, and facilitating foreign trade, particularly further simplifying procedures and promoting their usage. Advances are needed in safeguarding property rights and the rule of law, and facilitating competition through improved market entry and exit. Though the burden of excessive regulations has been reduced it still impedes economic activity in certain areas and there is some evidence that policy uncertainty has increased.

- **Financial sector.** Continued strong financial sector supervision and planned improvements in contingency planning will help to ensure the authorities are able to monitor the health of the system carefully and respond appropriately to problems that emerge. This includes powers of the banking regulator to impose fit and proper requirements on bank owners and to intervene in banks that are not viable. Full implementation in practice of the MoU on crisis coordination and cooperation between the NBRM, the Finance Ministry (MoF), and other agencies, remains important to provide a quick response to threats. Increased attention should be put to non-banking financial sector institutions over the upcoming period to ensure that risks remain manageable.

- **Electricity sector.** The new Energy Law goes a long way towards full compliance with the country's obligations under the Energy Community Treaty. The adoption of secondary legislation and full implementation of the Law will create a more transparent regulatory framework and ensure a tariff structure that reflects the costs of service delivery. This will help eliminate hidden and cross-subsidies that are poorly targeted, encourage inefficient patterns of consumption, damage incentives for investment, and impose fiscal or quasi-fiscal costs. New investment in generation capacity is also needed in light of inadequate domestic supplies. In view of financial and environmental considerations, end-use energy efficiency improvement, use of PPPs and renewable energy sources should be promoted.

3. The teams agreed on the following division of labor:

- **The Bank recently began an assessment of the FYR Macedonia's competitiveness**. In particular, the assessment will try to identify policy measures to: (i) facilitate the expansion of exports, as well as expand the range of products and service exported; (ii) upgrade the quality and value added of export; and (iii) support sectors that have the potential to generate jobs. The findings of this assessment will feed into the upcoming Macedonia Competitiveness Development Policy Loan series.

- **The Bank also started the preparation of the new Country Economic Memorandum** which should help define an overall growth strategy for Macedonia by integrating sustainability and green growth into the main objectives of stronger growth, job creation and attracting FDI and EU accession. The objective is to support the Government in: (i) assessing the economic costs and benefits of a shift to greener growth taking into account projected climate change; and with this knowledge, (ii) prioritizing actions for implementation.

- **The Fund will retain the lead in tax administration reform.** It has a full-time resident advisor in place (until August 2011, funded by the Dutch government) as well as a full program of technical assistance missions. Priorities for the coming year include reviewing the progress in modernizing revenue administration, addressing compliance problems that have emerged with the economic slowdown, increasing training for Public Revenue Office staff, and coordinating technical assistance with other donors.

- **The Bank will continue the dialogue with the Government** in order to reassure the sustainability of the pension system and prevent a drain on general tax revenues.

- **An Institutional Development Fund (IDF) will also support institutional development** in of the Ministry of Health in setting up a modern accreditation system to help monitor and evaluate the quality of care provided by health sector institutions with standards, procedures and capacity to meet international standards. The accreditation of health facilities will be used as a tool for continuous quality improvement and ensuring the protection of patients' rights.

- **Social safety net.** The Bank will continue to advise the government on measures to improve the functioning of the social safety net through its Conditional Cash Transfers (CCT) operation and the Programmatic Poverty Assessment analytical work. Immediate priorities include introduction of a cash benefit management information system and continued implementation of a conditional cash transfer program to ensure compliance with requirements for mandatory secondary school enrollment. Streamlining and consolidation of cash benefits and their improved administration and targeting are expected over the medium-term.

- **Both the Fund and the Bank will encourage the authorities to implement realistic, predictable, and transparent budget procedures.** The Fund will also encourage the authorities to anchor fiscal policies in a credible medium-term fiscal framework and is prepared to offer technical assistance for that purpose. In addition, the Fund will provide technical assistance on domestic debt market development.

- **A considerable part of the World Bank's portfolio is providing support to improve the business environment**. Infrastructure improvements are supported under the Regional and Local Roads Project, Municipal Services Improvement Project and the Second Trade and Transport Facilitation Project. At the same time, the Real Estate Cadastre and Registration Project, the Legal and Judicial Implementation Project and the Agriculture Strengthening and Accession Project support development and reform of institutions to support growth. The ongoing Technical Assistance for Higher Education aims to assist the authorities in building skills, while a planned regional report will also evaluate Research & Development practices in the country. An innovative regional Disaster Management will provide financial protection from losses caused by climate change and geo-hazards.

- **The Fund and Bank have both been involved in financial sector reform,** including through the November 2008 joint FSAA update as well as the extensive dialogue during the preparation of the 2009 World Bank First Development Policy Loan (DPL1). The Fund has also provided technical assistance in the area of contingency planning, stress testing of the banking system, and macro modeling. The Bank, through the Policy-based Guarantee (PBG) and the Balkan Financial Sector Technical Assistance Facility will: i) (with input from IMF staff) assist the authorities in reviewing the bank resolution framework and the operational capacity of the Deposit Insurance Fund and ii) provide advice on the operational rules for the Financial Stability Committee and the design of a solvency test in case of Lender of Last Resort request. The Bank will also work with the authorities to improve the framework for Motor Third Party Liability (MTPL) insurance

- **The Bank has the lead on electricity sector reform.** It will continue to encourage the adoption over time of realistic prices of electricity and elimination of subsidized rates. As part of the dialogue, the Bank is advising the government on promoting use of alternative ways of financing energy sector investments (PPPs, including by having IFC as a transaction advisor in a large hydropower concession project) as well as diversifying energy sources (use of gas, renewables, wind etc.). The Bank is also providing assistance to strengthen the Energy Regulatory Commission. The Bank's Energy Community of South East Europe Adaptable Programmatic Loan 3 (ECSEE APL3) and the Lukovo Pole Renewable Energy Project support improvements of interconnectivity and the transmission grid and reliability of production. Finally, the recently restructured Global Environment Facility project promotes energy efficiency in the public sector.

Appendix 1. Macedonia: Bank and Fund Planned Activities in Macrocritical Structural Reform Areas, June 2011–May 2012

Title	Products	Provisional Timing of Missions	Expected Delivery Date
1. Fund work program	Article IV consultation	November 2011	January 2012
	Technical assistance on domestic debt market development	Fall 2011	TA report by end 2011
	Technical assistance to MoF on medium term budgeting	Fall 2011 and Spring 2012 (tentative)	TA reports after the missions
	Technical assistance to the Public Revenue Office on modernizing revenue administration	Ongoing. Resident advisor (until August 2011), TA mission from HQ in June 2011	TA review report summer 2011
	Technical Assistance to help the SSO improve its National Account statistics and move towards SDDS subscription	Aug 2011 mission on National Account statistics	TA report after the mission
2. Bank work program	Supervision of CCT project	Continuous	
	Additional Financing for ECSEE APL 3 (Macedonia)	Continuous	December 2011
	Supervision of energy sector activities	Continuous	
	PBG preparation (fiscal framework; pensions; social safety net; health spending; financial sector stability and supervision)	September 2011	December 2011
	Balkan Financial Sector Technical Assistance Facility (TA to NBRM and MoF on bank resolution; LoLR etc.)	September 2011	June 2012

Title	Products	Provisional Timing of Missions	Expected Delivery Date
	Competitiveness Assessment	TBD	September 2011
	Green Growth and Climate Change Analytic and Advisory Services (CEM)	TBD	December 2012

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 12/58
FOR IMMEDIATE RELEASE
June 8, 2012

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

IMF Executive Board Concludes 2011 Article IV Consultation with Former Yugoslav Republic of Macedonia

On June 1, 2012, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Macedonia.[1]

Background

The economic recovery is losing steam due to adverse external developments. Growth was 3 percent in 2011, but was slowing in the second half of the year, which was visible in softening exports, sales, production, and credit. Growth is expected to slow to 2 percent in 2012. The absence of significant imbalances in the Macedonian economy and limited external financial linkages will help to contain the impact on Macedonia of weak growth and financial stress in the euro area. Meanwhile, inflation peaked at 3.9 percent on average in 2011 on the back of sharp rises in food and fuel prices, but core inflation was lower at 1.1 percent. Inflation is expected to decline to 2 percent in 2012. The current account deficit was contained in 2011, at 2.8 percent of GDP, as a pick-up in domestic demand and higher fuel prices were largely offset by private transfers. The current account deficit is expected to widen and then level off at around 5 percent of GDP in the medium term, largely matching the inflow of foreign direct investment. Meanwhile, international reserves increased significantly to over €2 billion at end-2011, which is a broadly adequate level, and have been stable in 2012.

In the financial sector, non-performing loans (NPLs) remained at elevated levels at just below 10 percent. Still, provisions exceed NPLs, and the system remained free of pressures on liquidity or solvency. Moreover, the banking system remained profitable after provisioning, capital adequacy ratios remained close to 17 percent, well-above

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

their regulatory minimum, and bank liquidity was ample. Reliance on domestic deposits as the primary funding source, combined with minimal reliance on external funding and the lack of exposure to risky external assets, have helped shield the banking system from euro area developments. Both deposits and loans have continued to increase modestly.

On fiscal policy, the authorities achieved their 2011 deficit target on a cash basis, by reducing spending in line with revenue shortfalls, although the deficit would have been somewhat larger if arrears on government payments and VAT refunds were included. The 2012 budget called for a deficit of 2½ percent of GDP, but was based on highly optimistic growth and revenue assumptions. The supplementary budget submitted to parliament in April 2012 reduced projected revenues and also reduced expenditures, preserving the original deficit target. The revised revenue assumptions are still somewhat optimistic—by about 1 percent of GDP according to staff projections—but the government has committed to adjust expenditures further if necessary to achieve its deficit target. In this context, Macedonia has a track record of meeting its cash deficit targets, cutting expenditure when needed to achieve its target.

The authorities announced that they have secured a foreign bank loan that will meet remaining 2012 fiscal financing needs and provide resources to repay a Eurobond maturing in January 2013. The loan is expected to be disbursed in the first half of 2012.

The National Bank left interest rates unchanged from December 2010 until April 2012, while modestly relaxing prudential requirements that had been tightened as a crisis response in 2008–09. In April, it introduced a set of measures aimed at easing credit conditions and furthering money market development, including a gradual reduction in the amount of outstanding 28-day central bank bills, the introduction of a 7 day and overnight deposit facility and a weekly repo auction. In early May 2012, it lowered the maximum rate on central bank bills by 25 bps to 3.75 percent. These gradual easing measures were taken against a background of favorable balance of payments conditions, slowing growth, subdued inflation, and modest credit growth.

Executive Board Assessment

Executive Directors noted that, while economic growth has slowed, Macedonia's medium-term outlook remains generally favorable. To address challenges posed by possible adverse spillovers from the euro area, Directors encouraged the authorities to persevere in their pursuit of macroeconomic and financial stability, building on advances made thus far.

Directors considered the current fiscal stance appropriate. They noted that continued fiscal consolidation will be important to stabilize the debt-to-GDP ratio at prudent levels. In this context, Directors were reassured by the authorities' intention to meet the 2012 deficit target but noted that further expenditure restraint might be needed. They underscored that a sound medium-term fiscal framework would help prioritize needed social spending.

Directors agreed that measures to improve public debt management and deepen the domestic debt markets should remain policy priorities. Progress on these fronts would reduce dependence on external financing, which could be volatile. Directors also emphasized the need for stronger public financial management that would improve budget planning and prevent arrears.

Directors agreed that the current exchange rate arrangement has served Macedonia well. They encouraged the central bank to stand ready to increase policy rates in the event that external risks materialize and exchange rate pressures emerge.

Directors concurred that the banking sector remains stable and well capitalized. They noted its limited reliance on external financing and ample liquidity. Nonetheless, Directors recommended continued vigilance and encouraged the authorities to make further progress on addressing regulatory gaps and strengthening their crisis response capacity.

Directors agreed that well-designed infrastructure investments and further labor market reforms are essential to raise potential growth and durably reduce unemployment. Steps in these directions would also cement Macedonia's success in attracting foreign direct investment.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The staff report (use the free Adobe Acrobat Reader to view this pdf file) for the 2011 Article IV Consultation with Former Yugoslav Republic of Macedonia is also available.

Former Yugoslav Republic of Macedonia: Selected Economic Indicators

	2007	2008	2009	2010	2011
	Annual percentage change, unless otherwise specified				
Real GDP	6.1	5.0	-0.9	1.8	3.0
Real domestic demand	9.2	6.7	-3.3	-0.1	5.7
Consumption	7.7	6.9	-4.9	0.5	3.8
Gross investment	23.2	4.7	-0.6	-2.1	21.2
Net exports 1/	-4.6	-3.1	3.2	1.9	-3.7
CPI inflation (annual average)	2.3	8.4	-0.8	1.5	3.9
Unemployment rate (annual average)	34.9	33.8	32.2	32.1	31.4
	In percent of GDP				
Current account balance	-7.1	-12.8	-6.8	-2.2	-2.8
Trade balance	-19.8	-26.2	-23.3	-21.3	-23.0
Exports of goods	41.4	40.1	28.8	36.1	43.5
Imports of goods	-61.2	-66.3	-52.1	-57.4	-66.5
External debt	47.6	49.2	56.4	59.9	66.7
Gross investment	24.6	26.8	25.9	23.7	25.4
Domestic saving	17.6	14.0	19.1	21.5	22.7
Public	4.4	3.9	0.6	1.1	1.4
Private	13.2	10.0	18.5	20.4	21.3
Foreign saving	7.1	12.8	6.8	2.2	2.8
Central Government Gross Debt	24.0	20.6	23.8	24.8	28.6
Central Government Balance	0.6	-0.9	-2.7	-2.5	-2.6
Memorandum items:					
Nominal GDP (billions of denars)	365	412	411	425	450
Nominal GDP (billions of euros)	6.0	6.7	6.7	6.9	7.3
GDP per capita (EUR)	2917	3280	3265	3356	…

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

1/ Contribution to growth

Statement by Mr. Snel and Mr. Hadzi-Vaskov on Former Yugoslav Republic of Macedonia
June 1, 2012

The Macedonian authorities would like to thank the IMF team for the useful analysis and recommendations included in the staff report. The authorities consider that staff's analysis adequately represents the current macroeconomic situation in Macedonia, with a broadly balanced assessment of the strengths and risks, in particular those related to the challenges stemming from the euro zone. As demonstrated with past practice, the authorities' policies over the past year have been consistent with the advice of Directors during the last Article IV consultations.

Economic Developments

Macedonia has sound economic fundamentals and maintains a strong track record of solid macroeconomic and financial policies. After growing by 5.2 percent in the first half of 2011, economic activity significantly slowed in the second half of the year mainly due to worsening conditions in trading partners, achieving average growth in 2011 of 3 percent. Against the background of the unfavorable projections for Macedonia's main trading partners, the authorities' view on the growth outlook in 2012 is similar to staff's, with prospects for intensification of economic activity in the second half of the year, after a slowdown in the first half.

Headline inflation accelerated moderately to an average of 3.9 percent in 2011, mainly as a result of higher food and energy prices, while core inflation remained low and stable at 1.1 percent. Capital inflows contributed to further accumulation of foreign exchange reserves to the historically highest level of EUR 2,069 million at year-end.

The pursuit of sound macroeconomic policies in Macedonia has been further acknowledged by the credit rating agencies. In May 2012 Standard and Poor's affirmed its BB credit rating assessment with stable outlook for the Republic of Macedonia on foreign and local currency. This rating agency based the confirmation of the credit rating on favorable fiscal and external debt stock positions and on the prospect of eventual accession to the European Union, which acts as a policy anchor. In November 2011 Fitch also affirmed its BB+ credit rating with stable outlook on the Republic of Macedonia for foreign and local currency, based on stable macroeconomic policies, low debt stock and a stable banking system.

The government, having reached an agreement on a five-year foreign bank loan that will secure its financing needs in 2012 and into 2013, would not need to draw upon the precautionary and liquidity line (PLL). Therefore, the authorities would not pursue completion of the review, allowing it to expire in January 2013.

Fiscal Policy

Macedonia has maintained fiscal discipline and a track record of prudent fiscal policy in favorable as well as in challenging times. The Government met its deficit target of 2.55 percent of GDP in 2011 and remains strongly committed to achieve its target of 2.5 percent of GDP in 2012. Faced with deteriorating external conditions, in April the Government prepared and submitted to Parliament a supplementary budget with reductions on the expenditure side by 4.5 percent compared to the initial budget, but without change in the deficit target. Macedonia's government debt-to-GDP ratio at 26.8 percent by the end of Q1 in 2012 is among the lowest in Europe, having decreased significantly over the last decade.

The authorities are committed to improve the public financial management systems, including by upgrading the Treasury IT systems, in line with recommendations by a recent IMF TA mission. The authorities also share staff's view about the importance of further development of the domestic debt market and have undertaken steps in this direction with the issuance of 5-year treasury bonds starting in September 2011.

Monetary and Exchange Rate Policies

Despite increased risks stemming from the external environment in 2011, the National Bank of the Republic of Macedonia (NBRM) managed to extend its strong track record, successfully maintaining its objectives of stable inflation and a stable denar/euro nominal exchange rate.

In light of the last changes in the operational monetary policy framework, the NBRM authorities would like to emphasize that they aim at its expansion and enhanced flexibility, while simultaneously supporting the further development of the financial markets, particularly the money markets. Compared to the old framework, where the banks' borrowing from the central bank was available only by an overnight lending facility at a relatively high interest rate, the regular weekly repo operations introduced by the NBRM within the new framework will create an alternative source of bank funding at the policy rate. This instrument, together with the introduction of the 7-day and overnight deposit facility will support greater flexibility in liquidity management of the banking system. In order to promote the use of repo operations and to amplify interbank activity, the NBRM reduced the frequency of CB-bills auctions from once a week to once within the period of reserve requirement, and limited the offered amount of CB-bills. The maximum interest rate of CB-bills was set at the level of 4 percent (the same as the previous benchmark rate), while quantities offered are adjusted according to liquidity conditions in the banking system. This ensures that the interest rate is close to the targeted maximum interest rate, consistent with the exchange rate peg policy. In addition to the above mentioned goals, the latest changes in the operational monetary framework, in particular the regular repo operations, are in line with the recommendation of the Fund TA mission for domestic debt market deepening.

In early May, 2012, the monetary stance was eased slightly, with the policy rate being reduced by 25 basis points from 4 percent to 3.75 percent. The change in the policy stance was pursued against the backdrop of a weaker growth outlook and contained inflationary pressures, expectations for maintenance of a moderate current account deficit, and financial inflows abundant enough to allow for further accumulation of international reserves. The NBRM authorities are committed to basing monetary policy on the overriding objective of protecting the exchange rate peg and ensuring price stability, while balance sheet considerations are subordinated to the primary goal, as has always been evidenced.

The NBRM authorities agree that an adverse scenario in Greece and increased uncertainty in the euro area could put additional downward pressure on exports and FDI inflows, but at the same time they expect some counterbalancing effect from the adjustment of imports. Additionally, recent developments from Q4 of 2011 and Q1 of 2012 have shown increased preferences of the private sector for domestic currency savings and strong private transfers inflows (cash exchange inflows). Thus instead of increased pressure on the foreign exchange reserves, actually a de-euroization process in the domestic economy was seen.

Financial Sector

The banking system remains stable, maintaining high liquidity and solvency despite challenges from the external environment. In contrast to the evidence of deleveraging/disintermediation in other European countries, the banks expanded their activities, raising the level of financial intermediation. After increasing by 8.5 percent in 2011, mainly supported by a 9.8 percent growth in deposits from non-financial entities, banks' assets continued to grow in the first three months of 2012 at a rate of 8.7 percent year-on-year.

Denar-denominated deposits increased even faster at 16.7 percent in 2011, especially in December when almost half of the increase took place, indicating a shift in savings preferences toward domestic currency. Growth of denar deposits continued in the first months of 2012, at the rate of 21.6 percent (March 2012 relative to March 2011). Credit growth was somewhat slower at 8.5 percent in 2011, and 8.3 percent in Q1 of 2012.

Banks maintain ample liquidity and the share of liquid assets in total assets increased from 31.2 percent at end-2011 to 31.5 percent at end of March 2012. While nonperforming loans (NPL) as share of total loans increased from 9.5 percent at end-2011 to 9.9 percent at end of March 2012, they remain more than fully covered by provisions. The banking system enjoys a stable and high level of solvency, with the capital adequacy ratio increasing from 16.8 percent at end-2011 to 17.5 percent at end of March 2012, more than double the prescribed minimum of 8 percent.

The Macedonian banking system is not exposed to foreign funding, as it is mostly financed by domestic deposits. At the same time, it does not have debt holdings of the periphery euro zone countries. Moreover, recent stress test simulations indicated that the banking sector is resilient to shocks, including transmission of adverse shocks from Greece, with the capital adequacy for each bank staying above the prescribed 8 percent minimum.

Reforms Agenda

Besides maintaining macroeconomic and financial stability, the authorities' efforts are also focused on implementation of structural reforms aimed at acceleration of growth, continuous improvement of the business environment, competitiveness enhancements, creation of new jobs and a sustained decrease in unemployment.

Regulatory reforms aimed at improving the business environment have been recognized by respected international rankings. The World Bank's Doing Business 2012 report placed Macedonia as the 3rd best reformer among 183 countries in the world. Moreover, Macedonia is ranked 1st in the region, 22nd in the world (in front of many advanced economies), having improved by 70 positions on the global rankings in the last five years.

The European Commission and the Republic of Macedonia launched the High-Level Accession Dialogue (HLAD) on March 15, which provides a platform for strengthened cooperation, policy discussion and debate. Focusing on key reform priorities and challenges, the HLAD aims at ensuring better preparation for EU membership and acceleration of the EU integration process of the Republic of Macedonia. Strengthening of the market economy, one of the five main themes within the HLAD, focuses on a range of actions, aimed at ensuring better functioning of markets, including active measures to achieve an inclusive and effective labor market and address the underlying causes of unemployment.

According to the Government program for the period 2011-2015, attracting foreign direct investment (FDI) remains the key objective towards achieving the Government's strategic priority of higher economic growth and decrease in unemployment on a sustainable basis. Macedonia has been successful in attracting Greenfield FDI, especially in the automotive components sector. FDI amounted to EUR 304 million or 4.1 percent of GDP in 2011, higher than the sum for 2009 and 2010. It is also encouraging to see that growth in FDI was solely due to higher equity capital and reinvested earnings. Based on improvements in the business climate, a large pipeline of ongoing and planned projects, and implementation of further (structural) reforms, the authorities expect a continuous increase in FDI matching the levels of the most favorable pre-crisis years.

Concluding Remarks

The authorities consistently value and make use of Fund advice on fiscal, monetary, financial and other issues. They remain strongly committed to maintain the set of strong macroeconomic policies and continue with the consistent implementation of structural reforms aimed at improving the business environment, accelerating economic growth and enhancing competitiveness. Recognizing that the main risks to the macroeconomic scenario are related to the duration and depth of turbulence in the euro zone, the authorities closely monitor developments in different sectors of the domestic economy, stay vigilant to the sources of uncertainties stemming from the euro zone, and remain ready to undertake necessary measures.