INTERNATIONAL MONETARY FUND

IMF Country Report No. 16/356

FORMER YUGOSLAV REPUBLIC OF MACEDONIA

2016 ARTICLE IV CONSULTATION—PRESS RELEASE; AND STAFF REPORT

November 2016

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 2016 Article IV consultation with Former Yugoslav Republic of Macedonia, the following documents have been released and are included in this package:

- A **Press Release**.

  The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on a lapse of time basis, following discussions that ended on September 29, 2016 with the officials of the Former Yugoslav Republic of Macedonia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on October 26, 2016.

- An **Informational Annex** prepared by the IMF staff.

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

Selected Issues

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Press Release No. 16/513
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November 21, 2016

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

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

On November 9, 2016, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Former Yugoslav Republic of Macedonia, and considered and endorsed the staff appraisal without a meeting on a lapse of time basis.[2]

The economy has been growing at a solid pace on the back of strong domestic demand and exports with real GDP now 16 percent above its pre-crisis level. In 2015, GDP growth picked up to 3.8 percent from 3.6 percent in 2014. In 2016H2, growth slowed to 2.2 percent due to investment contraction and weaker credit growth reflecting political uncertainties. Unemployment rate continues to decline. Headline inflation has hovered around zero for the last two years while core inflation turned positive at end-2015. Reflecting exports from the technological and investment zones (TIDZ) and lower oil prices, the trade deficit has narrowed in recent years.

Overall fiscal deficit improved in 2015 to 3½ percent of GDP from 4.2 percent in 2014. Higher profit tax revenues, including one-off collections, and under-execution of capital spending helped achieve the fiscal consolidation. Large under-execution of capital spending continued in 2016H1. The government adopted two supplementary budgets during July-August which together raised the 2016 overall fiscal deficit target to 4 percent of GDP compared to 3.2 percent in the original budget. Public debt is projected to reach almost 48 percent of GDP in 2016.

Credit growth remains robust particularly to households. Some slowdown was experienced reflecting both policy measures and political uncertainties. In May, the NBRM increased the policy rate by 75 bps to 4 percent, and took macro-prudential measures to stem deposit outflow and euroization pressures. These policies combined with FX interventions

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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.

[2] The Executive Board takes decisions under its lapse-of-time procedure when the Board agrees that a proposal can be considered without convening formal discussions.

successfully stabilized the exchange rate, although lost household deposits have not fully returned to the system. Lending rates continued to decline despite increase in the policy rate. The official reserve coverage has improved due to the recent issuance of external sovereign bond, and is projected to strengthen further over the medium term on the back of improving trade balances, strong FDI and other financial inflows.

Executive Board Assessment

The economy has endured a number of shocks in the last two years, including a prolonged political crisis. Growth has so far shown resilience benefiting from accommodative policies, low commodity prices, sustained foreign investment and improving labor market conditions. However, the prolonged domestic political crisis is beginning to take a toll on confidence and the country's EU accession prospects.

GDP growth is projected to soften in 2016 but pick up in the medium term contingent on return of political stability. Assuming elections in December followed by stability, growth is expected to pick up to 3.2 percent in 2017 and further in the medium term benefiting from infrastructure and foreign direct investment, continued improvement in labor market and some strengthening of credit growth. In addition to political uncertainties, the outlook faces a number of other downside risks, notably a slowdown in external demand and renewed financial turmoil in Greece.

Fiscal policy space has largely been depleted amidst rising risks. The fast rise in debt since 2008 is mostly due to rising primary deficits which, in turn, reflect a combination of low tax rates and low collection efficiency on the revenue side, and inefficiencies in social spending and subsidies on the expenditure side. For 2016, staff projects a widening in the overall fiscal deficit to 4 percent of GDP. In the medium term, without measures, overall fiscal deficit is projected to stay around 3½ percent of GDP with public debt reaching almost 55 percent of GDP. Meanwhile, rising borrowing costs, high fiscal financing needs and recent sovereign downgrading by Fitch have raised near-term fiscal risks. Public finances also face long-term challenges from population ageing.

Fiscal consolidation should start without delay. To counter risks and create fiscal policy space, consolidation should start now to stabilize public debt-to-GDP ratio below 50 percent. For 2016, given caretaker government and little time left in the year, a small consolidation of 0.4 percent of GDP is recommended relying on scaling back of goods and services spending and collection of VAT arrears. For 2017–18, a consolidation of 1¼ percent of GDP in the cyclically-adjusted structural primary balance is recommended.

Medium-term fiscal consolidation should rely on high-quality measures. In the last two years, improvement in the cyclically-adjusted fiscal balance has mostly relied on under-execution of capital spending. To produce durable results and enhance confidence, particularly in light of the authorities' intention to introduce a fiscal rule, consolidation should be based on durable measures. On the revenue side, this entails raising collections, particularly that of VAT, by strengthening coverage, targeting compliance risks, improving the operation of large tax payer office, and establishing a Risk Management Unit. On the expenditure side, a reduction of subsidies and transfers together with greater efficiency in health and education spending would yield the required savings.

Ensuring sustainability of the pension system is an important medium-term goal. Despite earlier parametric reforms and introduction of a multi-pillar system, the PAYG (pay-as-you-go) system faces significant financial imbalances due to population ageing and cuts in the contribution rate. The pension deficit, which is sizable at 4½ percent of GDP, is projected to more than double by 2030 without further reforms. To ensure sustainability, the authorities are encouraged to consider raising statutory retirement age given the sizable gap with the EU average, revising indexation to mostly link to the CPI in line with many countries in the EU, implementing policies to increase labor force participation, and increasing contribution rates.

Current monetary policy stance is appropriate. Historically low interest rates have helped sustain robust private sector credit growth and domestic demand without jeopardizing external stability. Given still-negative output gap, low core inflation and moderate real exchange rate undervaluation, low policy rate is appropriate. However, in case of pressures on the exchange rate or risks of deposit outflows, the monetary policy stance may need to be tightened by raising the policy rate along with stricter macro-prudential policies. Official reserves are deemed adequate and projected to improve in the medium term on the back of strong exports, continued FDI and other financial inflows.

Continued vigilance is required for an otherwise healthy and profitable banking sector. Banks are well-capitalized and profitable. Structural liquidity in the banking system is ample and, according to NBRM's latest stress tests, provides strong buffers to withstand severe deposit outflow shocks. Macro prudential policies have been successful in maintaining banking system stability through recent episodes of deposit and exchange rate pressures. Continued vigilance is needed to preserve this record.

Efforts to reduce high structural unemployment should continue. Benefitting from active labor market policies and broad-based growth, overall unemployment rate has declined by 10 percentage points since 2008. However, at 24 percent, unemployment is still high and mostly structural reflecting a shortage of skilled labor. Active labor market policies targeting on-the-job training are bearing fruit and should be continued mindful of fiscal costs.

Policies to attract FDI have contributed to net exports and growth. Competitive wages, reduced regulations and financial benefits have attracted sizable FDI in recent years. While these flows have contributed to investment and exports, spillover into domestic economy is considered limited. To ensure broad-based benefits and sustainability of the FDI-led growth strategy, complementary reforms to remove impediments faced by the domestic private sector, such as constrained access to finance and unpredictability of business environment, are recommended.

FYR Macedonia: Selected Economic Indicators

	2010	2011	2012	2013	2014	2015	2016
	Year-on-year change, unless otherwise specified						
Real GDP	3.4	2.3	-0.5	2.9	3.6	3.8	2.2
Real domestic demand 1/	1.2	0.5	4.0	1.6	5.5	3.0	1.3
Consumption 1/	2.2	-3.8	1.3	1.4	1.7	3.0	1.3
Gross investment 1/	-1.0	4.2	2.8	0.1	3.9	0.0	0.0
Net exports 1/	2.1	1.7	-3.9	1.3	-1.7	0.7	0.4
CPI inflation (annual average)	1.7	3.9	3.3	2.8	-0.1	-0.2	0.0
Unemployment rate (annual average)	32.1	31.4	31.0	29.0	28.0	26.1	25.4
	In percent of GDP						
Current account balance	-2.0	-2.5	-3.2	-1.6	-0.5	-2.1	-1.9
Goods and services balance	-19.7	-20.5	-22.4	-18.3	-17.2	-16.4	-16.1
Exports of goods and services	38.4	45.6	44.5	43.3	47.7	48.7	50.1
Imports of goods and services	58.1	66.1	66.9	61.6	64.9	65.1	66.2
Private transfers	18.6	18.7	20.6	18.1	17.3	16.9	16.4
External debt	57.8	64.2	68.2	64.0	70.0	69.4	71.2
Gross investment	24.5	26.9	28.9	28.8	30.3	31.1	33.7
Domestic saving	22.4	24.4	25.8	27.2	29.8	29.0	31.8
Public	1.1	1.3	0.2	-0.5	-0.9	-0.1	-1.2
Private	21.3	23.1	25.6	27.7	30.6	29.2	33.1
Foreign saving	2.0	2.5	3.2	1.6	0.5	2.1	1.9
General government gross debt	24.7	28.0	33.7	34.0	38.0	38.2	40.3
Public sector gross debt 2/	27.0	30.4	36.4	38.0	43.4	44.2	47.9
Central government balance	-2.4	-2.5	-3.8	-3.8	-4.2	-3.5	-4.0
Memorandum items:							
Nominal GDP (billions of denars)	437	464	467	501.9	527.6	558.2	578.8
Nominal GDP (billions of euros)	7.1	7.5	7.6	8.1	8.6	9.1	9.4
GDP per capita (euros)	3459	3665	3680	3930	4126	4375	...

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

1/ Contribution to growth. The inconsistency between real GDP growth and contributions to growth results from discrepancies in the official data on GDP and its components.

2/ Includes general government and public sector non-financial enterprises.

INTERNATIONAL MONETARY FUND

FORMER YUGOSLAV REPUBLIC OF MACEDONIA

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION

October 26, 2016

KEY ISSUES

Context: The post-crisis economic recovery has been solid and broad-based due to accommodative policies, low commodity prices and large infrastructure and foreign investment. However, a prolonged period of domestic political uncertainties is beginning to impact confidence and the country's EU accession prospects. Growth should pick up in the medium term contingent on the return of political stability following parliamentary elections in December.

Key policy recommendations

Fiscal Policy. A rapid rise in public debt since 2008 has largely depleted fiscal policy space. To restore confidence and create policy space, fiscal consolidation should start without delay to stem the rise in borrowing costs and contain public debt below 50 percent of GDP in the medium term. Consolidation should rely on high-quality measures such as improving tax efficiency and rationalization of social spending rather than under-execution of public investment. A broader set of policy measures, encompassing the labor market and pensions, are required to rein in the large pension deficit set to worsen in the long run due to population ageing.

Monetary and Financial Policy. The low policy rate is appropriate in light of deflation, the still-negative output gap and external stability. However, significant downside risks call for maintaining strengthened surveillance over a healthy and profitable banking system. The financial sector has withstood two deposit runs in the last eighteen months thanks to the authorities' swift and strong policy actions. A tightening of the monetary policy stance through higher policy rates and targeted macro-prudential measures may be needed if deposit outflows and currency conversion pressures resurface.

Structural Policy. Active labor market policies have helped reduce unemployment and should be continued mindful of fiscal costs. Priorities are to upgrade labor skills to address high structural unemployment. Tackling systemic weaknesses in governance, the judiciary and public administration has become critical not only to end the ongoing political crisis but also to improve the business environment and ensure greater integration with the European Union.

Approved By
Mahmood Pradhan (EUR) and Zeine Zeidane (SPR)

Discussions were held in Skopje, September 21–29, 2016. The mission met with Vice Prime Minister Pesevski, Finance Minister Minoski, NBRM Governor Bogov, other senior officials, private sector representatives, parliamentarians, trade unions, and envoys representing the international community.

The staff team comprised Ms. Rahman (head), Ms. Jirasavetakul, Messrs. Omoev and Na, and Mr. Nacevski (Local economist). Mr. Shimbov (World Bank) attended some meetings. Mr. Gordon (EUR senior reviewer) and Mr. Clicq (OED) attended the policy meetings. A part of the background work was prepared by outgoing desk economists Ms. Sodsriwiboon and Mr. Chai. Ms. Mahadewa and Ms. Chen assisted in the preparation of the staff report.

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TABLES

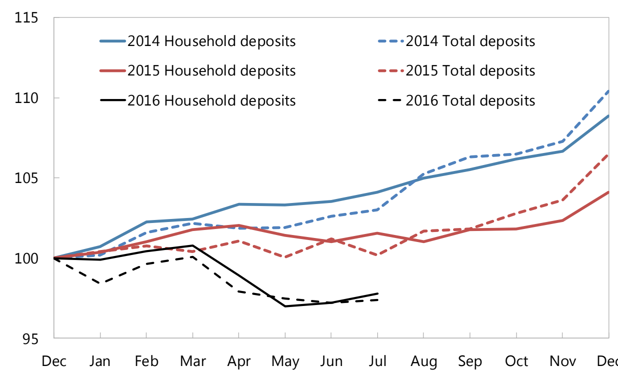
ANNEXES

CONTEXT

1. **The economy has endured a deep and prolonged political crisis**. The crisis started in January 2015 with the main opposition party (SDSM-social democrat) releasing tape recordings implicating state officials of the ruling coalition (led by VMRO-DPMNE-nationalist) in vote rigging and large-scale government abuse of power. It subsequently led to the resignation of the Prime Minister and gave way to an interim technical government. Despite active mediation from the European Union (EU) and the U.S., parliamentary elections are yet to take place. On July 20, 2016, the four main political parties signed a new agreement on steps to promote the rule of law, ensure media freedom, and clean up the voter list with parliamentary elections set for December 11. While this agreement removes the long political impasse, there are lingering risks of further postponement of elections and post-election instability.

2. **The crisis has begun to affect confidence and prospects.** The banking sector has seen a drastic slowdown in deposit growth. FDI inflows have also moderated. Meanwhile, in November 2015, nine years after granting the candidate status, the EU decided to keep the recommendation conditional on progress on political and governance fronts. A failure to make meaningful progress in these areas is likely to negatively affect FYR Macedonia's EU accession aspirations and dent FDI inflows, much of which are sourced from EU countries.

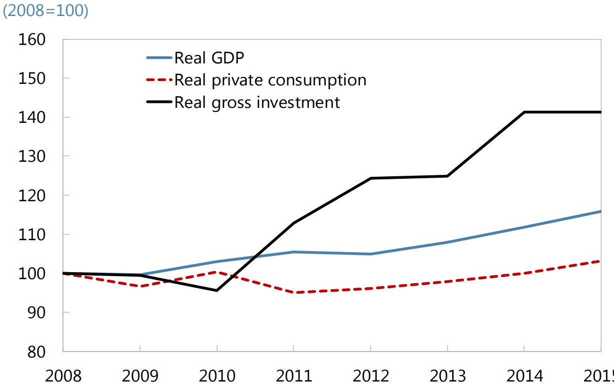
FYR Macedonia: Monthly Deposits
(Stock of deposits, December data of previous year =100)



Sources: NBRM, IMF Staff Calculations.

3. **Recovery from the global financial crisis has been solid, but growth has slowed.** Real GDP growth averaged around 2½ percent during 2010–15 compared to 4 percent during 2003–09, mostly reflecting a slowdown in potential growth, an experience shared by other countries in the region (Box 1). Although contributions from capital have held up, benefitting from large infrastructure and foreign direct investment, lower contributions from labor and negative productivity growth are estimated to have nearly halved FYR Macedonia's potential output growth in post-crisis years. High structural unemployment, low labor force participation and an ageing population cast a lasting shadow on the longer-term economic outlook. As policy support and stimulus from infrastructure investment taper off, growth may lose steam unless reforms to improve productivity and labor's contribution are put in place.

FYR Macedonia: Real GDP and Components
(2008=100)

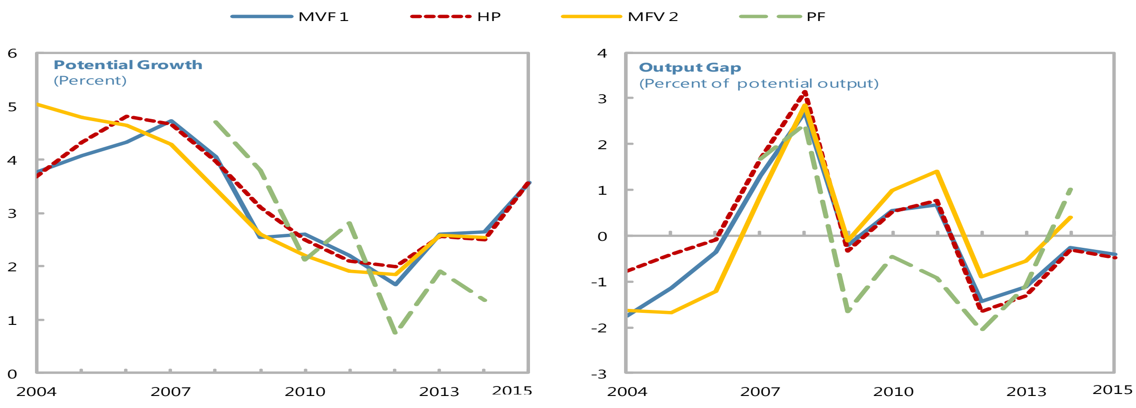


Sources: Republic of Macedonia State Statistical Office (SSO); and IMF staff calculations.

Box 1. Estimates of Potential Output Growth

Various model-based estimates show that FYR Macedonia's potential output growth has decelerated after the global financial crisis. Potential output growth, measured by the three filter-based approaches, averaged at 2.3 percent during 2009–12 compared to 4.3 percent during 2004–8.[1] The estimates are very similar across different methodologies although the production function approach tends to produce a somewhat lower growth after 2011.

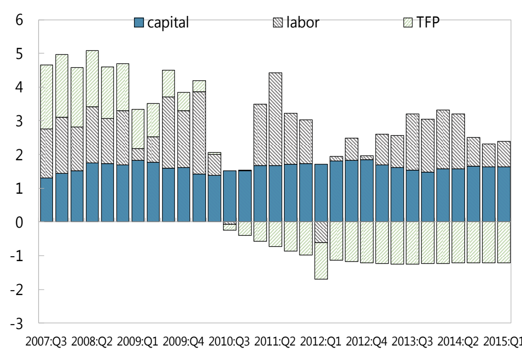
FYR Macedonia: Potential Growth and Output Gap Estimates



Source: IMF staff calculations.

Lower contributions from TFP and labor seem to be the main explanation behind the deceleration in potential growth. While TFP contributed strongly to pre-crisis growth, its contribution has turned negative since 2010. The labor's contribution has decreased in recent years. In contrast, the contribution of capital has been relatively stable at little over 1 percentage point – reflecting significant public and private investment in recent years.

Contributions to Potential Growth: Production Function Approach
(Percentage points)



Source: IMF staff calculations.

The slowdown is in line with developments in the Central, Eastern and South-eastern (CESEE) European region. The Spring 2016 *Regional Economic Issues* report shows that, on average, potential growth in the CESEE region has halved compared to the pre-crisis potential growth rate, largely reflecting productivity slowdown which in turn is a result of lower potential growth in trading partners, slower technical progress in frontier economies, and weaker post-crisis global trade.

1/ Four different methods were used to estimate potential output growth: Hodrick-Prescott (HP) filter, multivariate filter (MVF1), multivariate filter with financial frictions (MVF2), and production function (PF) methods. This Box is based on analysis in Podpiera et al, "*A Fresh Look at Potential Output and Output Gaps in Central, Eastern, and Southeastern Europe*", forthcoming IMF Working Paper.

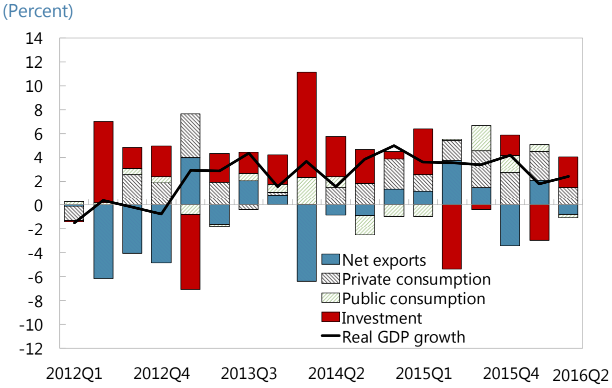
Text Box. Relations with the Fund and Past Policy Advice

A two-year Precautionary and Liquidity Line (PLL) was approved on January 19, 2011. In March 2011, the authorities drew 286 percent of quota (about US$ 305 million). Following the expiration of the PLL in January 2013, the authorities engaged in post-program monitoring which terminated in January 2015. All outstanding Fund credit (about US$174 million) was repaid in advance in February 2015. The Fund decided to not renew the resident representative position in Skopje after the term of the last representative ended in August 2016 but kept the local office open. In the absence of an IMF program, a larger field presence has proved less necessary.

The authorities' course of action in the areas of fiscal policy and public finance management have not always been aligned with the IMF recommendations in recent years. The authorities are yet to implement key recommendations of the last two Article IV consultations: adopt a fiscal policy anchored in a medium-term strategy to ensure stabilization of public debt, improve budget planning and medium-term budgetary framework, and adopt durable revenue and expenditure measures to support fiscal consolidation. Since the last Article IV, the engagement with the tax administration has been constructive. In the area of monetary and financial policies, implementation has been in line with IMF recommendations.

RECENT ECONOMIC AND FINANCIAL DEVELOPMENTS

Contribution to Real GDP Growth
(Percent)

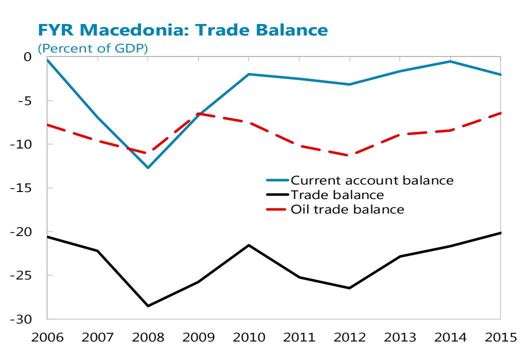


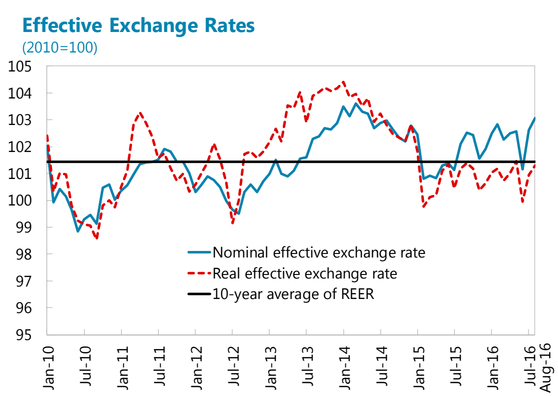
Sources: SSO; and IMF staff calculations.

4. **After strengthening in 2015, GDP growth slowed in 2016H1**. Growth picked up in 2015 to 3.8 percent benefiting from strong household credit growth, improving labor market conditions and robust demand from trading partners, particularly Germany. Subsequently, growth slowed to 2.1 percent y-o-y in 2016H1 reflecting a temporary sharp drop in investment in 2016Q1 and some softening of private consumption in 2016Q2 reflecting base effects from 2015 and slowing credit growth. Overall economic activity has been resilient (Figure 1). In August, FYR Macedonia also experienced strong floods affecting municipalities around Skopje and Tetovo. Despite initial fears, preliminary assessments by the World Bank suggest limited economic impact from the floods. Headline inflation has remained around zero for more than two years reflecting low imported food and energy prices. This has helped support private consumption and reduce the trade deficit (Figure 1). Core inflation has been positive since end-2015.

5. Large under-execution of capital spending helped contain the fiscal deficit in 2015 and 2016H1. The cyclically-adjusted primary fiscal deficit, excluding one-off profit tax collections[1], improved to 2.6 percent of GDP from 3.1 percent in 2014 mostly on account of under-execution of capital spending (Table 2). During 2016H1, capital expenditure was about 24 percent of the amount originally budgeted. However, the government adopted two supplementary budgets during July-August which together raised the overall fiscal deficit target to 4 percent of GDP compared to 3.2 percent in the original budget. Relative to the original budget, these two budget revisions incorporate higher current spending of 0.7 percent of GDP (0.4 percent of GDP budgeted for flood victims) and lower revenues (0.5 percent of GDP), which are partly countered by lower capital spending (0.5 percent of GDP). The authorities issued a 7-year eurobond of €450 million in July at 5.6 percent yield.

6. External stability has been supported by an improving trade balance and sizable private transfers. The trade deficit has narrowed in recent years benefiting from a better oil trade balance and exports from the technological and investment zones (TIDZ) (Table 3, Figure 3). Developments in 2016H1 show strong export growth led by machinery, transport and chemical products, but a widening of the current account deficit reflecting lower secondary income. The real effective exchange rate has been relatively stable in recent months and below its 10-year average. Staff's stability assessment shows the external position to be broadly in line with fundamentals (Annex 1). Gross international reserves are adequate, including by the IMF's ARA metric.



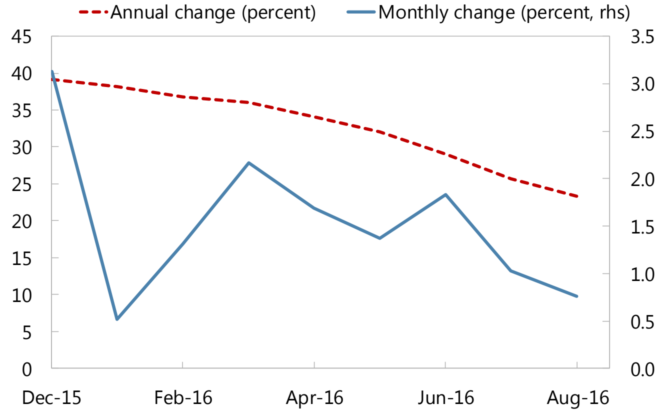


Sources: IMF INS database; and IMF staff calculations.

[1] Collection of the profit tax increased by 1.1 percent of GDP in 2015 (of which 0.4 percent estimated to be one-off) reflecting a policy change in January 2015 that widened the tax base to include both distributed and reinvested profits, with a refund of the latter to be processed in the following year.

7. Credit growth has been solid despite some slowdown in both household and corporate credit (Figure 4). Household credit growth has been buoyant with some slowdown in long-term consumer lending. This partly reflects policy measures taken in December 2015 that increased the risk weight on newly approved long-term consumer loans with maturity equal to or longer than eight years from 75 percent to up to 150 percent. Reflecting uncertainties, credit growth to non-financial corporates (NFCs) continued to slow despite declining lending rates.

Consumer Loans with Original Maturity Equal or Longer than 8 Years



Sources: NBRM and IMF staff calculations.

OUTLOOK AND RISKS

8. GDP growth is projected to soften in 2016 but pick up in the medium term. In 2016, GDP growth is projected to slow down to 2.2 percent mostly reflecting stalled investment and some moderation in credit growth. Assuming elections in December followed by stable government, growth is projected to increase to 3.2 percent in 2017 with some pick-up in outer years benefiting from infrastructure investment, continued improvement in labor market and some strengthening of credit growth (Table 1). Staff's analysis shows that the authorities' planned infrastructure investment during 2014-18 is likely to contribute to growth by ½ percentage points annually in the medium term including by improving productivity.[2] Headline inflation turned positive in September 2016 and is projected to gradually reach 2 percent by end-2018. Staff projects a widening of the current account deficit in the medium term to around 3 percent of GDP reflecting higher interest and dividend payments and lower transfers (Tables 1 and 3). A modest strengthening of FDI inflows is anticipated based on expectations of political stability. Despite strong growth, external debt-to-GDP ratio is projected to rise above 70 percent of GDP in the medium term reflecting large financing needs of the public sector.

9. This positive outlook is highly contingent on return of political stability. A derailment of the agreement among main political parties and further postponement of elections could significantly affect near-term growth with related negative impacts on the financial sector and the fiscal balance. In 2017, real GDP growth could drop to below 2 percent through further confidence loss and weaker credit growth that would impact private consumption and investment. The banking sector could see renewed pressures of deposit outflows and currency conversion with a decline in

[2] It is important to note that public infrastructure investment is mostly carried out by a non-financial public enterprise, and therefore, financed outside of the general government budget. See Selected Issues Paper "Public Infrastructure Investment and Economic Growth in FYR Macedonia" for details.

foreign exchange reserves. The fiscal deficit is likely to be notably higher than envisaged in the baseline due to lower revenue collections, particularly from VAT, unless offsetting expenditure cuts are made. A further rise in the sovereign risk premium could pose financing constraints. The impact on the current account balance would depend on the degree of currency conversion pressures. The trade balance may improve in 2017 through lower imports as long as activities in the TIDZ continue (the political crisis has so far not impacted exports from the zone) and external conditions, such as demand in key partner countries and commodity prices, remain favorable. This may, however, be countered by deterioration in the secondary income account if currency conversion pressures are strong. A prolonged political crisis may also impact FYR Macedonia's image as an FDI destination slowing investment inflows for several years. In addition to domestic political crisis, other downside risks include slower-than-projected global or euro area growth, spillover from possible financial volatility in Greece and intensification of the refugee crisis (Box 2). The flow of migrants has drastically slowed since the border closures in early March. But uncertainties linger regarding implementation of the EU-Turkey agreement which could reignite refugee inflows.

10. The authorities broadly agreed with staff's economic outlook and risks. They considered domestic political crisis as the most significant risk and stressed its negative impact on activities. They viewed continued FDI inflows, solid growth and improving employment as testament to the economy's resilience to shocks. Benefiting from foreign investment, exports have undergone a transformation in favor of automobile and chemical products establishing links with global supply chains which are expected to sustain strong growth in the medium term. Their estimates show that net exports from TIDZ averaged around 2.6 percent of GDP during 2014–15 which are expected to increase as these companies reach full capacity. They viewed risks of spillovers from Greece and the refugee crisis to be contained and noted no impact of Brexit yet. The authorities see little risks from a prolonged period of low inflation given it is driven by external factors and also in light of the modest level of private sector indebtedness.

Box 2. Risk Assessment Matrix[1]
(Scale—high, medium, or low)

Source of Risks	Relative Likelihood	Impact if Realized	Recommended Policy Response
Deepening domestic political crisis	High	High • Widespread deterioration of consumer and investor confidence • Large deposit outflows particularly deposits in local currency, weakening international reserve position, risks to financial and external stability • Delayed FDI inflows; growth slowdown via lower consumption and investment • Further fiscal widening and higher sovereign borrowing costs • Postponement of recommendation to open accession negotiations.	• Tighten monetary policy and adopt targeted macro-prudential measures to counter financial sector stress. • Follow through political agreement and hold elections in December. • More ambitious fiscal consolidation within a credible medium-term budget framework.
Spillovers from renewed financial volatility in Greece	Medium	Medium/Low This could re-ignite deposit outflows as in summer 2015 and pose risks to financial stability.	Keep existing prudential measures in place and monitor developments closely.
Sharper-than-expected global growth slowdown due to structurally weak growth in key advanced and emerging economies	High	Medium Weaker exports and FDI, given significant direct trade and FDI linkages with the euro area.	• Lower policy rate • Slower fiscal consolidation depending on the size of the shock
Heightened risk of fragmentation/security dislocation in Europe	High	Medium/Low Border controls could restrict movement of goods, services and labor in the single market affecting trade.	• Seeking understanding with the EU on common border and asylum policy. • Seek EU financial support to cover fiscal costs.

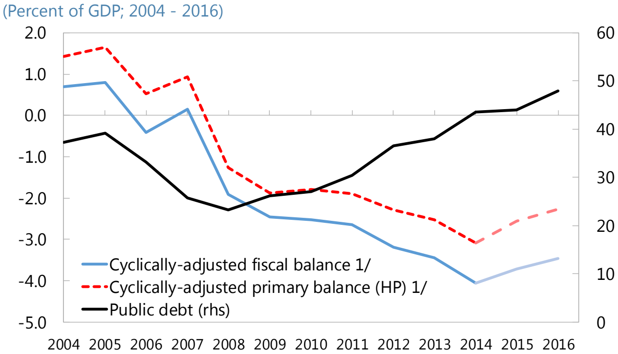
[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate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

POLICY DISCUSSIONS

A. Fiscal Policy: Ensuring a Strong Fiscal Foundation

Background

Cyclically-adjusted Fiscal Balance and Public Debt
(Percent of GDP; 2004 - 2016)



Sources: Macedonia Ministry of Finance; and IMF staff calculations.
Note: 1/ excludes one-off profit tax revenue in 2015, and flood-related spending in 2016.

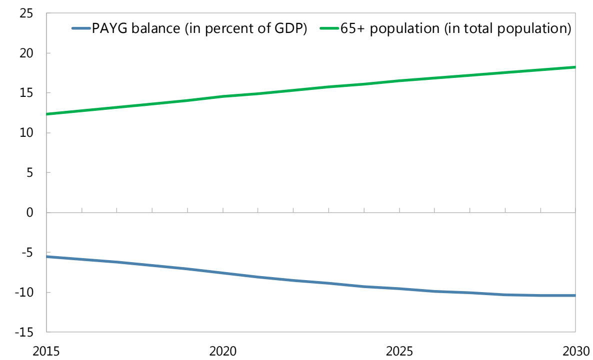
11. Fiscal policy has been accommodative for quite some time. The cyclically-adjusted overall and primary deficits have widened considerably with some recent improvements largely reflecting under-execution of capital spending (see paragraph 6). A combination of low rates and low collection efficiency has resulted in a sustained decline in tax revenues while expenditures, two-thirds of which are social transfers and subsidies, have been relatively stable in proportion to GDP (Figure 2). For 2016, staff projects the overall fiscal deficit to widen to 4 percent of GDP taking into account spending increases in the two supplementary budgets. Gross fiscal financing needs for 2016 are substantial—around 15 percent of GDP, but are more than covered by the proceedings of the recent bond issuance.

12. Fiscal risks are on the rise. Public debt has been on an upward trajectory since 2008 and is projected to reach 48 percent of GDP at end-2016. The rapid and sustained increase in public debt has been accompanied by rising borrowing costs. In addition, fiscal slippages have become a persistent feature with supplementary budgets issued almost every year during the last decade. In August, Fitch downgraded FYR Macedonia's sovereign rating by one notch to BB with negative outlook citing the long-running political crisis and weak governance. On a positive note, the structure of domestic public debt has shown significant improvements in recent years with longer maturity, a higher share of fixed-rate debt, and a declining share of FX debt (Table 2, Figure 2). However, at about 75 percent of the total public debt, FX debt still poses significant risks (Annex IV).

13. Without measures, the overall fiscal deficit is likely to stay around 3½ percent of GDP in the medium term. The authorities' 2017 budget projects the fiscal deficit to decline to 3 percent of GDP mainly relying on optimistic revenue projections. While the medium-term fiscal strategy is currently under preparation, the authorities indicated their objective to bring the overall deficit to around 2.6 percent of GDP in 2018. Nonetheless, no concrete policy measures have been identified. Taking into account historical revenue performance and the baseline macroeconomic scenario, staff projects the overall deficit to stay around 3½ percent of GDP and the primary deficit around 2 percent of GDP in the medium term, exceeding the debt-stabilizing level (Annex IV). Public debt is projected to reach almost 55 percent of GDP in the medium term.

14. In addition, public finances face long-term challenges from population ageing. At 4½ percent of GDP, FYR Macedonia's pension deficit is sizable. This reflects generous benefits, relatively low contribution rates and low labor force participation rates (Annex II). The pension deficit is projected to reach 10½ percent of GDP by 2030, reflecting declining working age population. Afterwards, the deficit is projected to improve benefitting from earlier parametric reforms although would still stay sizable at above 5 percent of GDP. Population ageing is also likely to put pressures on public health spending.

FYR Macedonia: Pension Balance and Share of 65+ Population
(Percent of GDP, %)



Sources: World bank, UN and IMF staff calculations.

Discussion

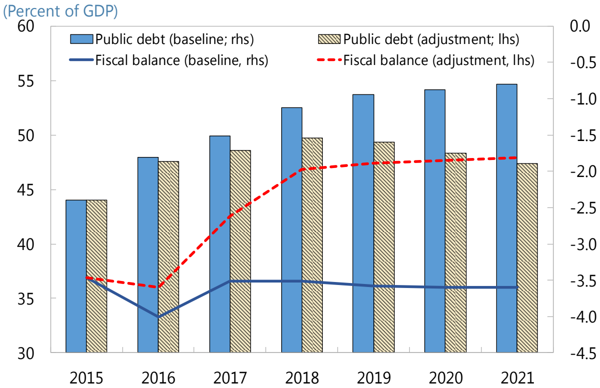
15. Staff recommended fiscal consolidation to start without delay. Rising fiscal risks and limited policy space call for strong and upfront consolidation to instill confidence. For 2016, given the interim government and limited time left in the year, staff recommends a modest consolidation of around 0.4 percent of GDP relying on temporary measures, such as scaling back goods and services spending and collection of VAT arrears. For 2017 and 2018, assuming December parliamentary election and stable government thereafter, staff recommends a reduction in the overall fiscal deficit to 2½ percent and 2 percent of GDP respectively to stabilize public debt below 50 percent of GDP. This implies an adjustment in the cyclically-adjusted structural balance of 1¼ percent of GDP over the next two years. Any negative impact of the recommended consolidation on private sector is expected to be mitigated by continued monetary accommodation and structural reforms to ensure labor market improvement and steady FDI inflows.

16. Medium term consolidation should rely on high-quality measures. Instead of relying on one-off measures or under-execution of capital spending, staff reiterated the need to identify revenue and expenditure measures to ensure durability.

a. **Revenue measures.** Given the authorities' choice to maintain low tax rates, improving efficiency, particularly that of VAT, needs to be a key component of fiscal consolidation. Significant revenue gains can be expected from implementation of priority measures identified by the recent TADAT assessment: strengthening coverage and targeting of compliance risks, improving the operation of large tax payer office, and establishing a Risk Management Unit with comprehensive and structured process to identify compliance risks. `

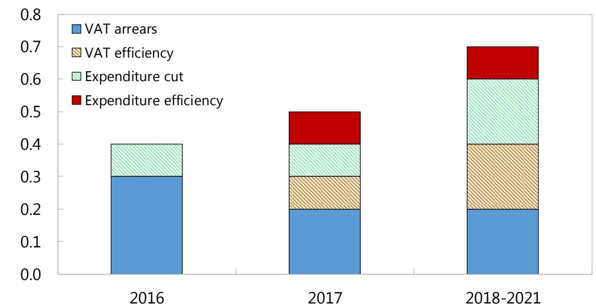
b. **Expenditure measures.** In light of their large shares in total expenditure, staff recommended rationalization and better-targeting of subsidies and transfers.[3] The World Bank's (WB) 2015 Public Expenditure Review highlights room for such savings, in particular through rationalization of agricultural subsidies and transfers to local government which are not well-targeted, as well as refraining from ad-hoc pension increases and generous indexation. In addition, there is scope for efficiency gains in health and education spending where same results can be achieved with lower spending.

Fiscal Balance and Public Debt
(Percent of GDP)



Source: IMF staff estimates.

Possible Measures Underlying Fiscal Consolidation
(Percent of GDP)



Source: IMF staff estimates.
Note: Non-policy adjustments (not shown in the chart) are expenditure reductions in 2017 due to one-off flood-related spending in 2016, and in 2018-2021 due to lower interest expense associated with lower debt levels.

17. The recommended fiscal adjustment is projected to stabilize public debt below 50 percent of GDP. In line with 2015 Article IV consultation, staff recommended keeping public debt below 50 percent of GDP for the following reasons.

a. Recent analysis by IMF staff (*Modernizing the Framework for Fiscal Policy and Public Debt Sustainability Analysis)* that looks at long-run debt thresholds for emerging market economies points to 49-58 percent of GDP as the safe threshold. For FYR Macedonia, which is a small open economy with limited policy space and significant vulnerabilities, a prudent public debt ratio is likely to be at the lower bound of this range rather than the upper bound. A growing body of empirical literature also shows lesser effectiveness of fiscal policy when debt-to-GDP ratio is high.[4] More specifically, for a group of European countries, studies show responses of real GDP and private investment to fiscal stimulus becoming negative when public debt level exceeds 50-60 percent of GDP (Nickel and Tudyka, 2014).

b. FYR Macedonia faces significant future spending pressures not just from ageing population (paragraph 15), but also from infrastructure investment needs beyond what is planned in the medium term. For a land-locked economy, improving connectivity is key to competitiveness

[3] Social transfers and subsidies account for about 62 percent of FYR Macedonia's total spending, compared to the emerging markets Europe's average of 47¼ percent in 2015.

[4] See for example, Sutherland (1997); Perotti (1999); Chung and Leeper (2007); Faverro and Giavazzi (2007); and Corsetti et al (2012).

and growth. Choosing a prudent debt limit in the medium term will enhance its ability to accommodate longer-term spending pressures.

18. Reforms to rein in the sizable pension deficit are warranted. Staff highlighted several options: (i) raise statutory retirement age given the sizable gap of 3 years for men and 5 years for women with the EU average; (ii) consider revising indexation (currently indexed as 50/50 to CPI/wage) to mostly CPI in line with many countries in the EU; (iii) implement reforms to increase labor force participation, particularly that of women (one of the lowest in Europe), and (iv) consider increasing contribution rates if sustainability is not secured through other measures.

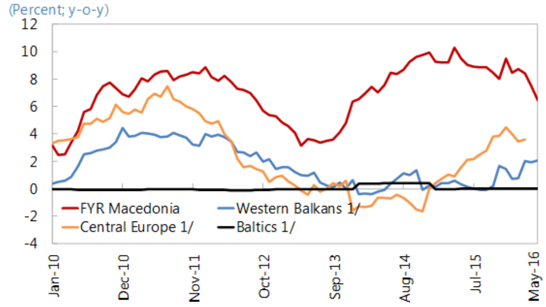
19. The authorities agreed with staff on the need to rebuild fiscal policy space. They drew attention to the importance of fiscal policy in supporting the economy during the global financial crisis. Going forward, they envisaged the role of the government as largely that of an enabler to maximize private sector's contributions to the economy. They acknowledged the rapid rise in public debt, and reiterated the commitment to consolidate their fiscal positions to contain risks and rebuild buffers. The authorities see fiscal consolidation rely on (i) a broadening of the tax base from stronger growth and enhanced revenue mobilization through modernization of the tax system, and (ii) higher expenditure efficiency, including through strengthening the link between expenditure planning and execution. On revenue measures, the authorities appreciated FAD's advice and technical assistance and noted that they are in the process of reviewing action plans following the recent TADAT assessment.

20. Preparations for the introduction of the fiscal rule, originally planned for January 2017, are on hold. The authorities explained that this will need to wait until after a stable government. Institutional readiness needs improvement given limited linkages between the medium-term budget framework and the annual budget process, persistent over-projection of revenues and the periodic build-up of public sector payment arrears. The legal framework for the fiscal rule should include independent monitoring and oversight, as well as other enforcement mechanisms, such as corrective measures to restore deviations over a certain period of time.

B. Monetary and Financial Policies: Maintaining Stability

Background

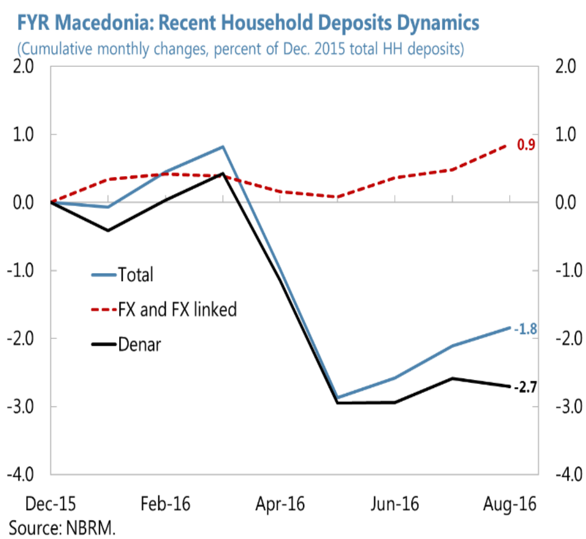
Private Sector Credit Growth, 2010–16
(Percent; y-o-y)

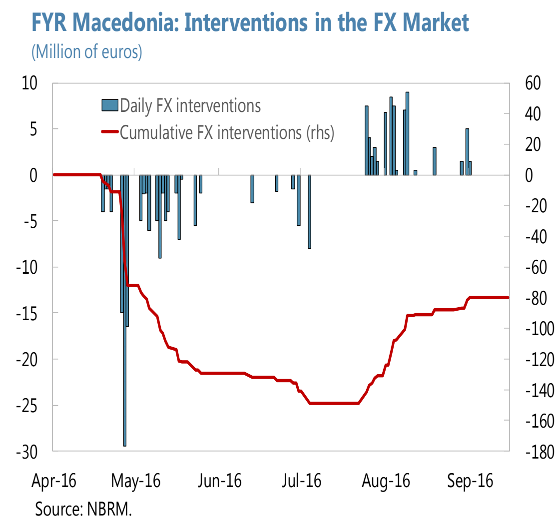


Sources: National Authorities; EBRD; and IMF staff calculations.
Note: 1/ Simple average. Baltics: Estonia, Latvia, and Lithuania. Central Europe includes Czech Republic, Poland, Slovakia, and Slovenia. Western Balkans: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Macedonia, Montenegro, and Serbia.

21. Robust household credit growth has sustained financial deepening. Given that pre-crisis credit boom was mostly financed by domestic deposits, post-crisis resumption of credit growth has been more resilient compared to many others in emerging Europe facing prolonged deleveraging by parent institutions. Risks from household credit growth appear low based on overall debt stock (21 percent of GDP) and debt service relative to income (8 percent). Most mortgage holders are also first-time house buyers.

22. Banking sector is healthy and profitable. Banks are well-capitalized, with the capital adequacy level twice the regulatory requirement of 8 percent. The NPL ratio fell to 7 percent in July reflecting the recent measures to write off NPLs that are fully provisioned for more than two years (Figure 4). Banks' profitability continued to improve in light of strong growth in net interest income. Structural liquidity in the banking system is ample and, according to NBRM's latest stress tests, provides strong buffers to withstand severe deposit outflow shocks. Liquid assets count for one third of total assets in the banking system covering around 60 percent of household deposits and over 70 percent of liabilities with residual contractual maturity of up to 30 days.

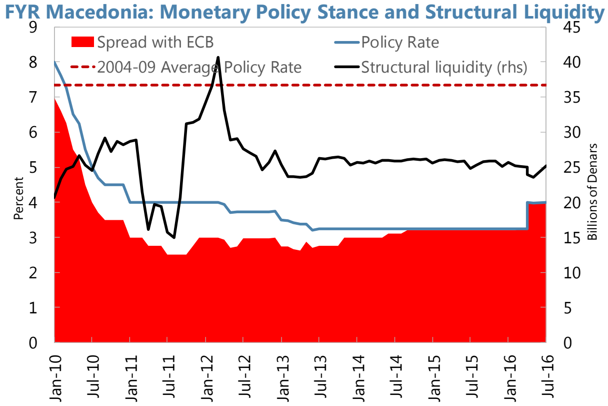




23. However, the banking sector remains susceptible to deposit outflows. In April, an intensification of the political crisis led to deposit outflow and currency conversion pressures prompting the NBRM to increase the policy rate by 75 bps to 4 percent. The NBRM also sold a total of 141 million euros (about 6 percent of its end-March stock of reserves of 2.26 billion) during April-June and took the following macro-prudential measures (i) increased reserve requirement on FX-linked deposits to 50 percent from 20 percent, and (ii) resumed FX deposit auctions offering banks an interest rate higher than the current euro negative rate. These measures successfully stabilized the exchange rate although lost household deposits have not fully returned to the system. This was the second deposit run in the last eighteen months following an earlier episode in summer 2015 at the height of the financial crisis in Greece. A repeat of such episodes cannot be ruled out as long as political uncertainties persist.

Discussion

FYR Macedonia: Monetary Policy Stance and Structural Liquidity



Source: NBRM.

24. Staff and the authorities agreed that the current monetary policy stance is appropriate. Limited capital mobility allows FYR Macedonia to have some control over monetary policy despite a fixed exchange rate regime (officially classified as *stabilized arrangement*). The weaker growth in 2016 does not call for policy relaxation given that broader economic indicators are robust (Figure 1). At the same time, with no major misalignment in the exchange rate (Annex 1), continued deflation and still-negative output gap, staff does not see reasons to increase the policy rate. However, in case of pressures on the exchange rate or risk of deposit outflows, staff and the authorities agreed that the monetary policy stance may need to be tightened by raising the policy rate along with stricter macro-prudential policies, such as raising the reserve requirement on FX- or FX-linked deposits. In staff's views this could also include offering higher interest rate on FX deposit auctions.

25. The authorities viewed the current pace of credit growth as satisfactory but expressed concerns regarding slow deposit growth. Overall, a high single-digit growth rate for private sector credit augurs well for financial deepening. There are risks of weakening of credit growth if household deposits continue to stagnate. The authorities viewed current NFC credit growth to be solid given political uncertainties and the very low post-crisis NFC credit growth in the rest of region reflecting weak balance sheets and high credit standards. Staff highlighted structural impediments that may also be weighing down NFC credit demand. A predominantly collateral-based lending system together with very high collateral requirements (on average 180 percent of the loan value) deters access to finance for the domestic private sector together with other regulatory hurdles (see paragraph 30).

26. The authorities expressed their intention to maintain the prudential measures that were put in place to monitor the Greek-owned subsidiaries. In May 2016, the smaller Greek-owned subsidiary Alpha Bank was sold to Switzerland-based Silk Road Investment Fund. The remaining Greek-owned subsidiary Stopanska Bank is systemic (holds about a fifth of the system's assets), profitable, and fully domestic deposit-funded. Although contagion pressures are no longer present, staff agreed with authorities' decision to maintain current prudential measures for enhanced surveillance (e.g., limits on intra-group exposure, daily deposit monitoring, ex-post notification for parent-sub transaction, see SM/15/214 for details) given uncertainties in Greece. The temporary and targeted capital flow measures adopted in June 2015 to prevent possible outflows to Greece expired in December as planned.

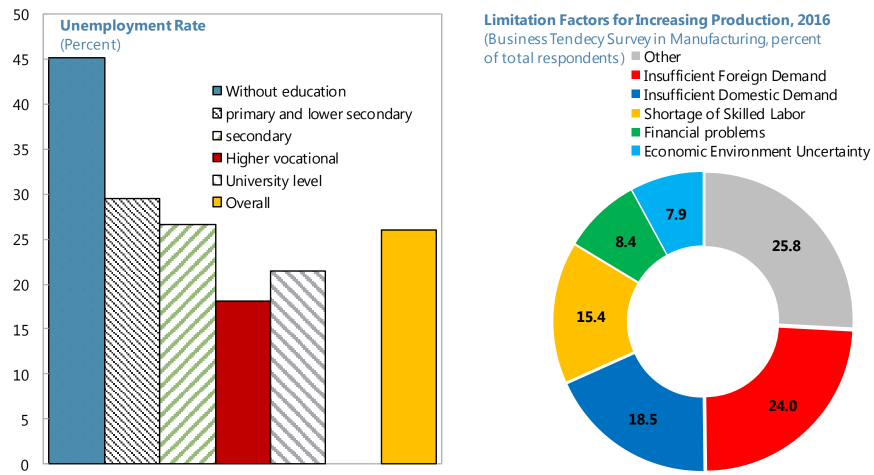
27. Cooperation between the NBRM and the European Single Supervisory Mechanism (SSM) is satisfactory. In October 2015, FYR Macedonia, together with four other southeastern European non-EU countries, signed a memorandum of understanding with the European Banking

Authority (EBA) to establish a framework for cooperation and information exchange. The authorities are waiting for EBA to start the process of assessing the equivalence of the supervisory and regulatory framework relative to that applied to EU countries. The 2008 FSAP update found the NBRM's regulation and supervision to be reasonably comprehensive and financial safety net arrangements broadly adequate. Since then, particularly in the context of spillovers from the financial crisis in Greece, the authorities have significantly enhanced their stress-testing and contingency planning capacity. These actions, together with pro-active use of macro-prudential tools and an effective communication strategy, have served FYR Macedonia well in navigating recent crises. The authorities have requested participation in the FSAP to identify the financial system's strengths, risks and weaknesses in light of enhancements in the supervisory framework and macro-prudential instruments since the global financial crisis.

C. Structural Policy: Improving the Economy's Potential

Background

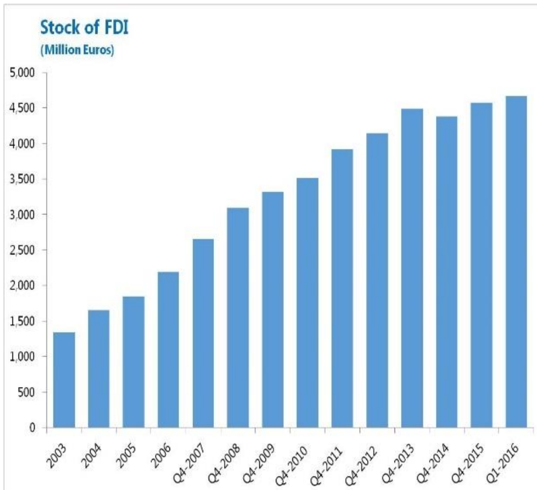
28. FYR Macedonia has seen significant reduction in unemployment benefitting from robust growth and active labor market policies. The overall unemployment rate has declined by 10 percentage points since 2008 along with improving employment (Figure 1). However, at 24 percent, the unemployment rate is one of the highest in emerging Europe. While the presence of a significant informal economy suggests possible overestimation, the rate is likely to be high. Staff's earlier analyses show that high unemployment is largely structural, mostly reflecting skills shortage and mismatch resulting from emigration of skilled workers and low level of education. Disaggregated data point to lower unemployment rates for workers with vocational training and tertiary education. Skills shortage is also highlighted in business surveys as a key constraint to possible expansion.

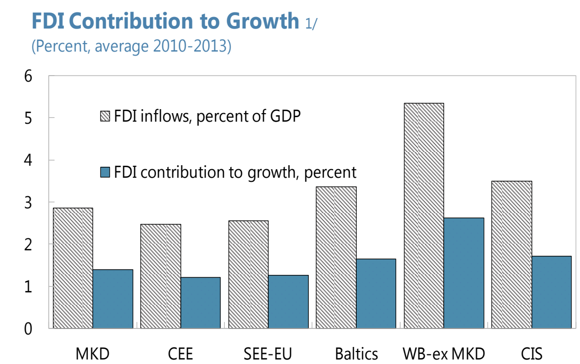


Sources: Business Tendency Survey; Eurostat; and Republic of Macedonia State Statistical Office.
Note: The sample for the Business Tendency Survey in Manufacturing industry includes 250 business entities classified in the division No 15 to 36 of the National Classification of Activities (NACE)."

29. Notable FDI inflows in the last decade have helped investment and exports although spillovers into the domestic economy is considered to be limited. Competitive wage, structural reforms and generous financial benefits, including tax breaks, have attracted sizable manufacturing FDI into FYR Macedonia since late 2000s, although less so than in emerging European peers. Staff's analysis shows that FDI inflows have contributed to real per capita growth annually by about

1.3 percent in recent years.[5] A lack of data precludes a thorough analysis of contributions to value added and employment, but estimates and anecdotal evidence point to limited contributions. Examples of successful FDI- and export-led growth in Central European countries highlight the importance of generating higher domestic value added over time to sustain the interest of foreign investors and contain the costs from financial incentives. In case of FYR Macedonia, emigration of skilled labor, particularly in technical and engineering occupations, could pose some constraints to such upward movement.





Sources: UNCTAD, IMF Staff Estimates

1/ The FDI contribution to growth is calculated from the estimated elasticity of real per capita GDP growth to FDI inflows. However, it needs to be interpreted with caution as it may not capture other factors influencing the overall growth during the periods and does not differentiate the type nor industry of FDI inflows in the host country.

30. Despite improvement in business environment, domestic firms continue to experience impediments. FYR Macedonia currently ranks as number one in emerging Europe in the World Bank's Doing Business index. However, domestic firms continue to report difficulties in accessing credit and collecting payments, and are burdened with various forms of unpredictable and ad-hoc inspections that impose both financial and non-financial costs. A recent poll of 800 companies carried out by the Economic Chamber of Macedonia shows that most respondents face considerable delays in VAT refunds relative to that provisioned by the VAT law and debtor companies frequently fail to meet their financial obligations set under the Financial Discipline Law.

31. Weak governance negatively impacts confidence and indirectly contributes to emigration of skilled workers. The European Commission's most recent assessment highlights concerns about excessive political interference in public administration and judicial system (Box 3). The World Economic Forum's 2015-16 Global Competitiveness Index also ranks FYR Macedonia unfavorably in the areas of judicial independence (ranked 98 out of 140). Weak governance holds back trust in domestic institutions and policy making, and may indirectly contribute to emigration of

[5] See Selected Issues Paper FYR Macedonia: FDI Spillovers on Growth and Employment.

skilled labor. The effective implementation of the AML framework can complement anti-corruption efforts.

Box 3. European Commission's 2015 Assessment of FYR Macedonia [1/]

The European Commission's 2015 assessment report gives FYR Macedonia good marks for maintaining macroeconomic stability but highlights significant weaknesses in business environment, public administration, judiciary, and media freedom, which are elaborated below.

The EC sees scope for further improvement in business environment. Frequent legal changes, uneven implementation of laws and difficult contract enforcement burden business operations. The large informal economy continues to hamper competition. Government arrears still affect companies' liquidity. To improve access to finance for SMEs, which provide the bulk of jobs, the EC recommends developing alternatives to bank lending and reduction in NPLs. The country is moderately prepared to take on the obligations of the EU membership in the areas of public procurement, statistics and financial control.

The EC notes some political interference with State institutions and the work of the judiciary. There are serious concerns about the politicization of public service which needs a renewed strategy, including more merit-based recruitment, enhanced public financial management, and greater fiscal transparency. The situation of the judicial system has been deteriorating since 2014 against the background of political interference in certain high profile or politically sensitive cases. This casts a shadow over an otherwise functioning judiciary. A track record of effective prosecution, especially on high level corruption, still needs to be established. As a result, public trust in the functioning of the institutions has further eroded.

Freedom of media needs improvement. The EC data shows the country continued to regress in terms of media freedom during last year. Political interference in the editorial policies of the media, in particular mainstream nationwide broadcasters, is a concern.

[1/] This Box was based on European Commission Staff Working Document SWD (2015) 212 final; http://ec.europa.eu/enlargement/pdf/key_documents/2015/20151110_report_the_former_yugoslav_republic_of_macedonia.pdf.

Discussion

32. Staff highlighted the importance of labor market reforms in light of still high unemployment and low labor force participation. Policies to improve vocational training and on-the-job training are bearing fruit and should continue although being mindful of fiscal costs. The authorities mentioned that reducing unemployment is one of the highest priority of the government supported by policies to stimulate demand, improve skills match and activate people at risks. The active labor market policies are designed to meet employers' needs and are continuously monitored and evaluated. Staff emphasized the need to increase labor force participation, particularly that of young and female labor force, in order to support long-term growth against the background of ageing population. The authorities mentioned family responsibilities being at the core of low female participation, particularly in light of large emigration of male population, as well as low educational attainment rather than policy disincentives. They expect positive results from implementation of several EU-funded projects targeting both youth and female employment. Improving governance and easing regulatory environment for the domestic private sector would enhance productivity along with authorities' planned infrastructure upgrading.

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33. The economy has endured a number of shocks in the last two years, including a prolonged political crisis. Growth has so far shown resilience benefiting from accommodative policies, low commodity prices, sustained foreign investment and improving labor market conditions. However, the prolonged domestic political crisis is beginning to take a toll on confidence and the country's EU accession prospects. An extended period of accommodative fiscal policy has helped support domestic demand, but has also depleted policy space to counter further shocks.

34. GDP growth is projected to soften in 2016 but pick up in the medium term contingent on return of political stability. Real GDP growth is projected to slow down to 2.2 percent in 2016 reflecting stalled investment and some moderation in credit growth partly impacted by political uncertainties. Assuming elections in December followed by stability, growth is expected to pick up to 3.2 percent in 2017 and further in the medium term benefiting from infrastructure and foreign direct investment, continued improvement in the labor market and some strengthening of credit growth. In addition to political uncertainties, the outlook faces a number of other downside risks, notably a slowdown in external demand and renewed financial turmoil in Greece.

35. Fiscal policy space has largely been depleted amidst rising risks. Public debt has more than doubled since 2008 and is projected to reach 48 percent of GDP this year. The fast rise in debt is mostly due to rising primary deficits which, in turn, reflect a combination of low tax rates and low collection efficiency on the revenue side, and inefficiencies in social spending and subsidies on the expenditure side. For 2016, staff projects a widening in the overall fiscal deficit to 4 percent of GDP. In the medium term, without measures, overall fiscal deficit is projected to stay around 3½ percent of GDP with public debt reaching almost 55 percent of GDP. Meanwhile, rising borrowing costs, high fiscal financing needs and recent sovereign downgrading by Fitch have raised near-term fiscal risks. Public finances also face long-term challenges from population ageing.

36. Fiscal consolidation should start without delay. To counter risks and create fiscal policy space, consolidation should start now to stabilize public debt-to-GDP ratio below 50 percent. For 2016, given the caretaker government and little time left in the year, a small consolidation of 0.4 percent of GDP is recommended relying on scaling back of goods and services spending and collection of VAT arrears. For 2017-18, a consolidation of 1¼ percent of GDP in the cyclically-adjusted structural primary balance is recommended.

37. Medium-term fiscal consolidation should rely on high-quality measures. In the last two years, improvement in the cyclically-adjusted fiscal balance has mostly relied on under-execution of capital spending. To produce durable results and enhance confidence, particularly in light of the authorities' intention to introduce a fiscal rule, consolidation should be based on durable measures. On the revenue side, this entails raising collections, particularly that of VAT, by strengthening coverage, targeting compliance risks, improving the operation of large tax payer office, and establishing a Risk Management Unit. On the expenditure side, a reduction of subsidies and transfers together with greater efficiency in health and education spending would yield the required savings.

38. Ensuring sustainability of the pension system is an important medium-term goal. Despite earlier parametric reforms and introduction of a multi-pillar system, the PAYG (pay-as-you-go) system faces significant financial imbalances due to population ageing and cuts in the contribution rate. The pension deficit, which is sizable at 4½ percent of GDP, is projected to more than double by 2030 without further reforms. To ensure sustainability, the authorities are encouraged to consider raising statutory retirement age given the sizable gap with the EU average, revising indexation to mostly link to the CPI in line with many countries in the EU, implementing policies to increase labor force participation, and increasing contribution rates.

39. Current monetary policy stance is appropriate. Historically low interest rates have helped sustain robust private sector credit growth and domestic demand without jeopardizing external stability. Given still-negative output gap, low core inflation and moderate real exchange rate undervaluation, low policy rate is appropriate. However, in case of pressures on the exchange rate or risks of deposit outflows, the monetary policy stance may need to be tightened by raising the policy rate along with stricter macro-prudential policies. Official reserves are deemed adequate and projected to improve in the medium term on the back of strong exports, continued FDI and other financial inflows.

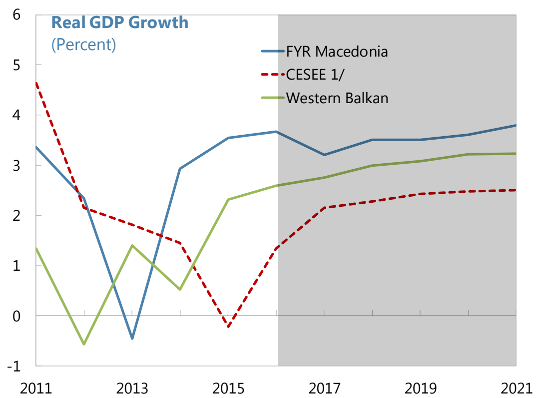
40. Continued vigilance is required for an otherwise healthy and profitable banking sector. Banks are well-capitalized and profitable. Structural liquidity in the banking system is ample and, according to NBRM's latest stress tests, provides strong buffers to withstand severe deposit outflow shocks. Macro prudential policies have been successful in maintaining banking system stability through recent episodes of deposit and exchange rate pressures. Continued vigilance is needed to preserve this record.

41. Efforts to reduce high structural unemployment should continue. Benefitting from active labor market policies and broad-based growth, overall unemployment rate has declined by 10 percentage points since 2008. However, at 24 percent, unemployment is still high and mostly structural reflecting a shortage of skilled labor. Active labor market policies targeting on-the-job training are bearing fruit and should be continued mindful of fiscal costs.

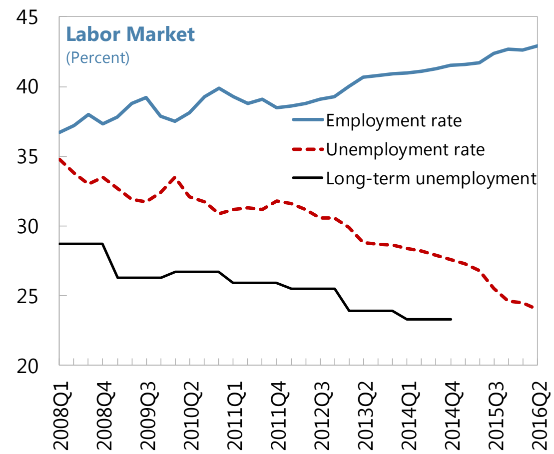
42. Policies to attract FDI have contributed to net exports and growth. Competitive wages, reduced regulations and financial benefits have attracted sizable FDI in recent years. While these flows have contributed to investment and exports, spillover into domestic economy is considered limited. To ensure broad-based benefits and sustainability of the FDI-led growth strategy, complementary reforms to remove impediments faced by the domestic private sector, such as constrained access to finance and unpredictability of business environment, are recommended.

Figure 1. FYR Macedonia: Real Sector Developments

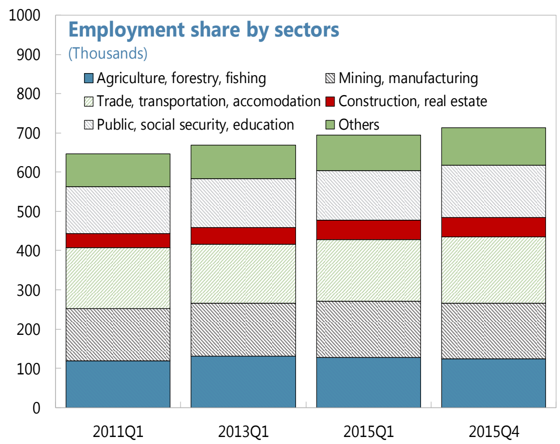
Robust growth is projected to continue in the medium term.



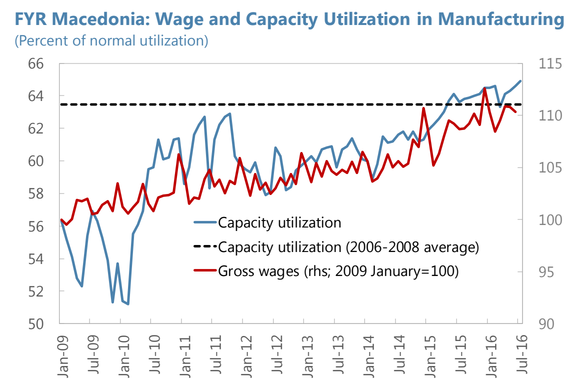
Labor market has seen continued improvement and



broad-based employment growth.

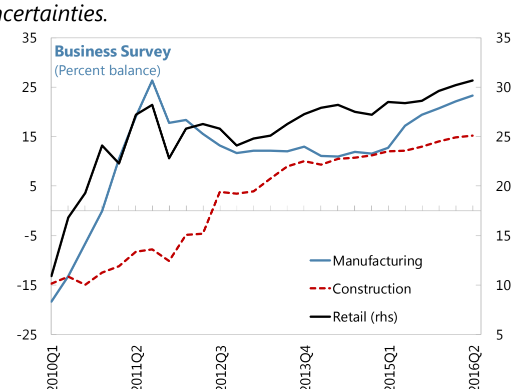


High frequency indicators show resilience.

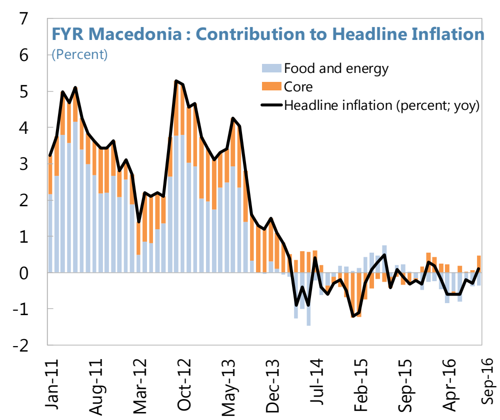


Sources: Republic of Macedonia State Statistical Office; and IMF staff calculations.

Business sentiment has not diminished despite uncertainties.



Low prices have supported private consumption.

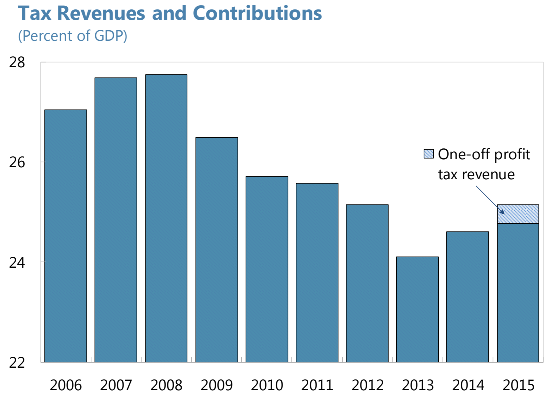


Sources: National authorities; and IMF staff calculations.

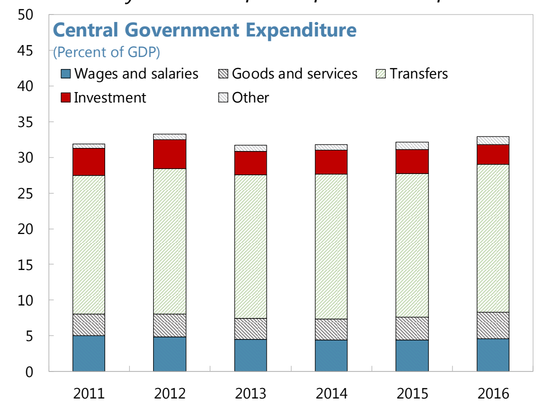
Note: 1/ CESEE: Albania, Belarus, Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Macedonia, Moldova, Poland, Romania, Russia, Serbia, Slovakia, Slovenia, Ukraine, and Turkey. Western Balkan includes Albania, Bosnia, Bulgaria, Croatia, Kosovo, Macedonia, Montenegro and Serbia.

Figure 2. FYR Macedonia: Fiscal Sector Developments

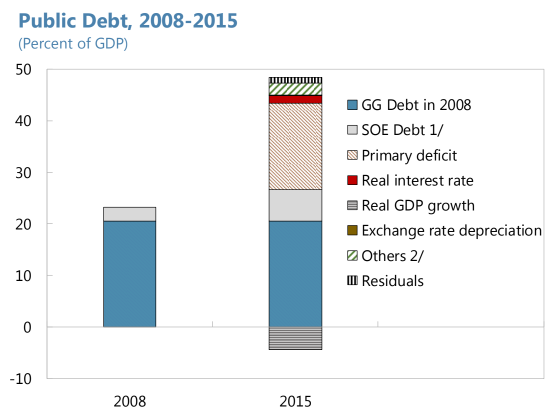
Low rates and inefficiencies have reduced tax revenues…



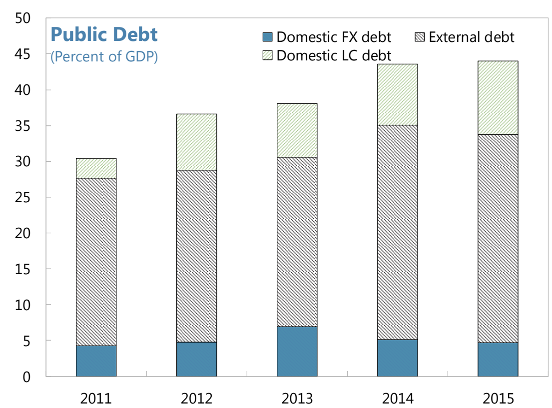
… while expenditures remained relatively stable and heavily skewed in favor of social transfers.



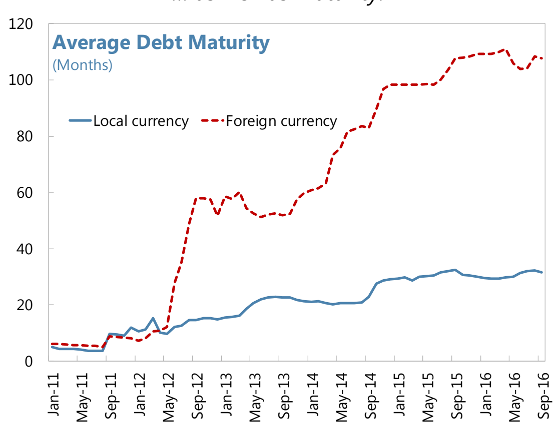
Public debt rose fast mainly due to the primary deficit.



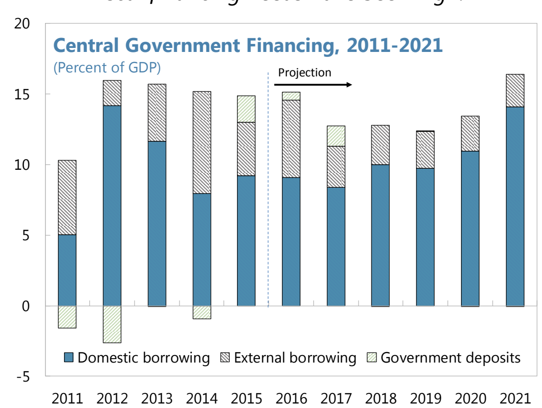
Currency composition of public debt is improving…



… as well as maturity.



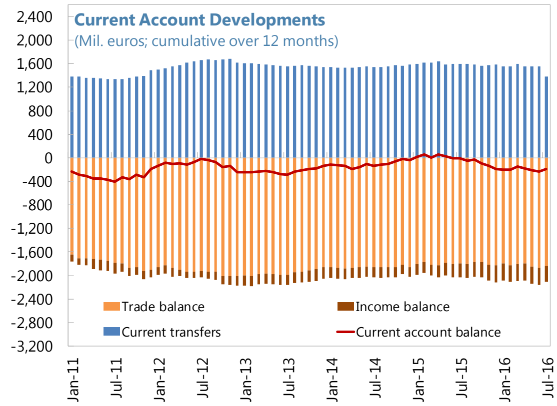
Fiscal financing needs have been high.



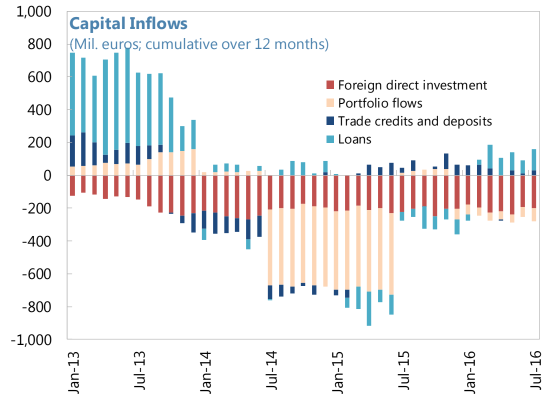
Sources: National authorities; and IMF staff calculations.
Notes: 1/ SOE debt presented here includes only non-financial public enterprises.
2/ Other debt creating flows include, for instance, privatization receipts, changes in cash deposits or securities held for liquidity purposes, etc.

Figure 3. FYR Macedonia: External Sector Developments

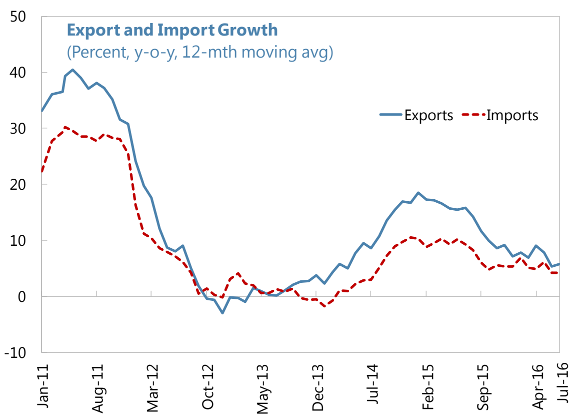
The current account deficit increased in 2015….



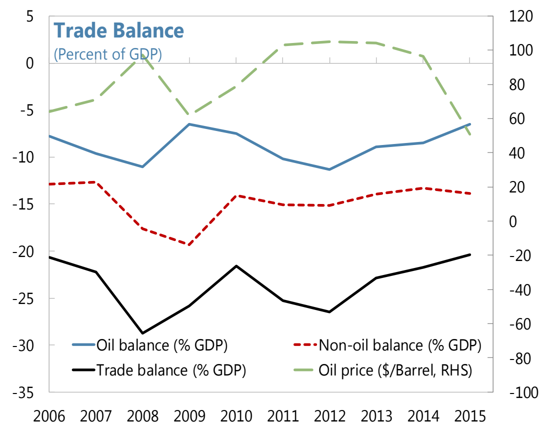
.. but remained fully financed by FDI.



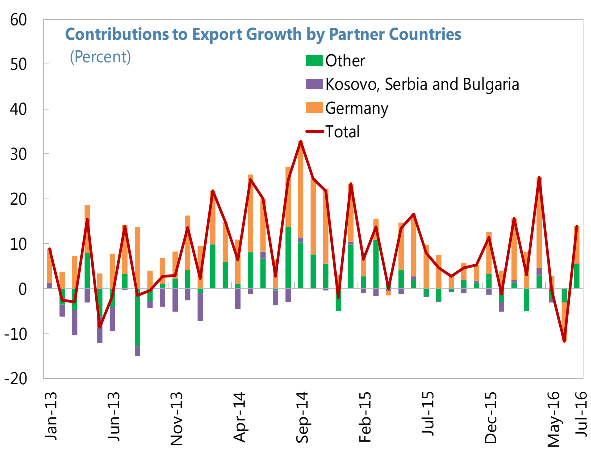
Exports growth has slowed in recent months…



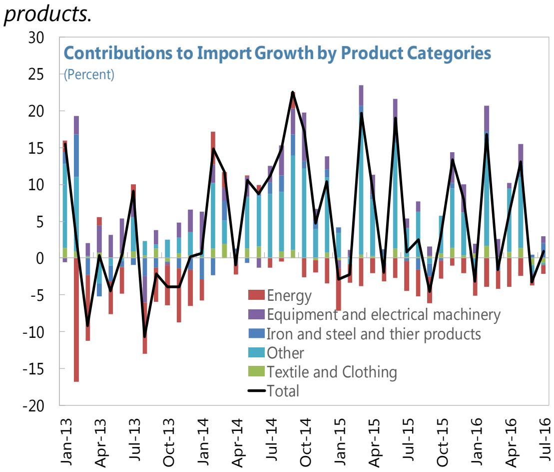
..but trade deficit improved due to oil trade deficit.



Exports benefit from strong demand from Germany…



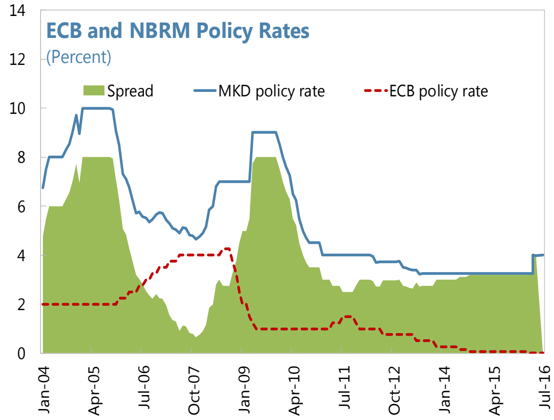
..while imports growth is largely driven by non-energy products.



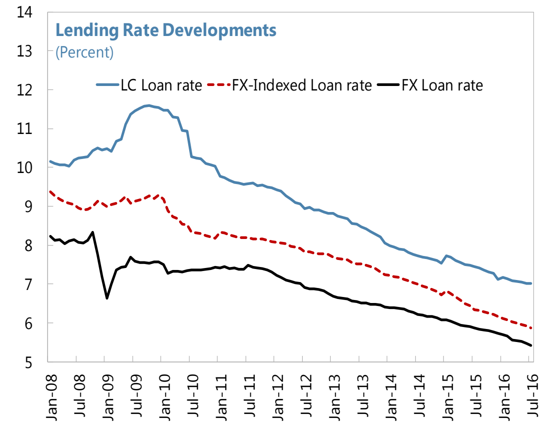
Sources: National authorities; and IMF staff calculations.

Figure 4. FYR Macedonia: Monetary Sector Development

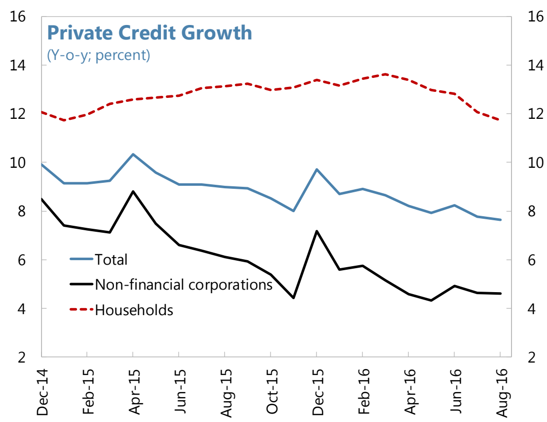
The policy rate was raised recently….



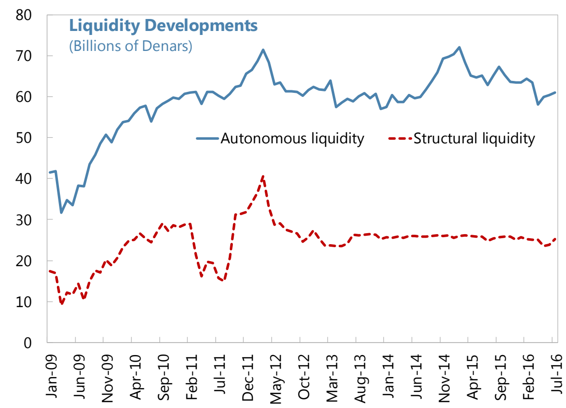
.. but lending rates continue to decline.



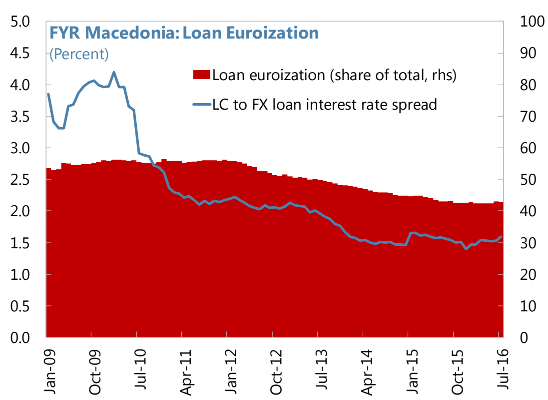
Credit growth is robust with some slowdown..



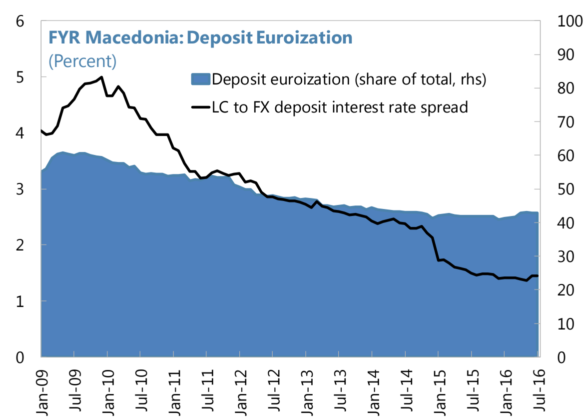
.. amidst strong liquidity.



Euroization has stalled on both asset…



.. and the liability sides.

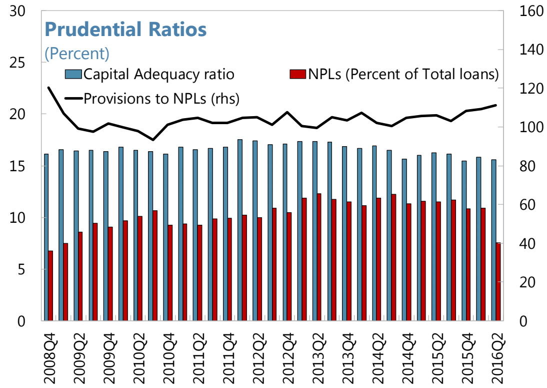


Sources: NBRM; and IMF staff calculations.

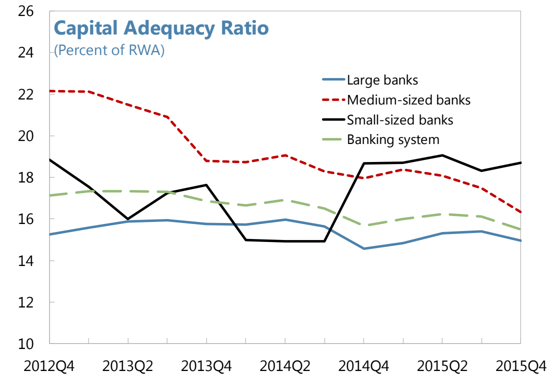
Note: Autonomous liquidity is computed as the sum of net foreign assets, net public sector assets, net bank assets,other items net, minus currency in circulation. Structural liquidity is calculated as autonomous liquidity minus reserves held by banks at the central bank.

Figure 5. FYR Macedonia: Banking Sector Development 20082016

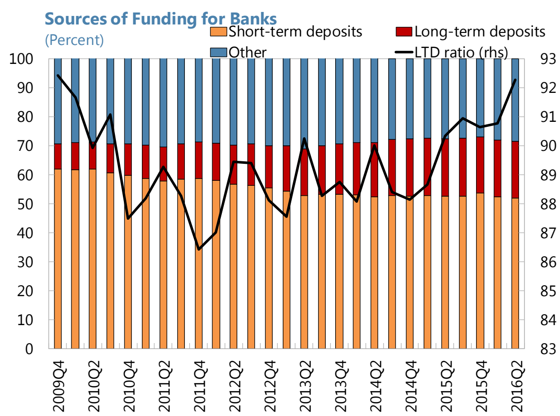
Banking sector continues to be resilient...



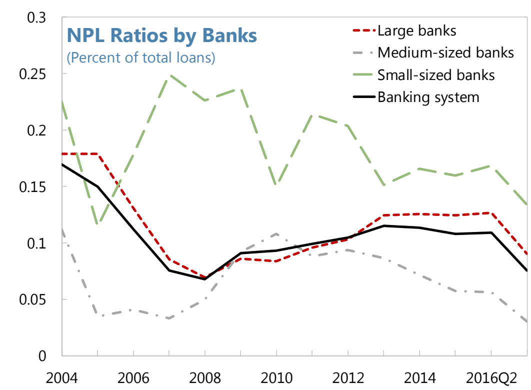
...with high capitalization



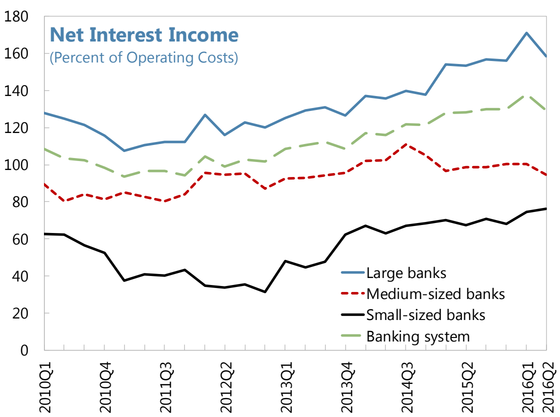
..and a funding structure reliant on deposits.



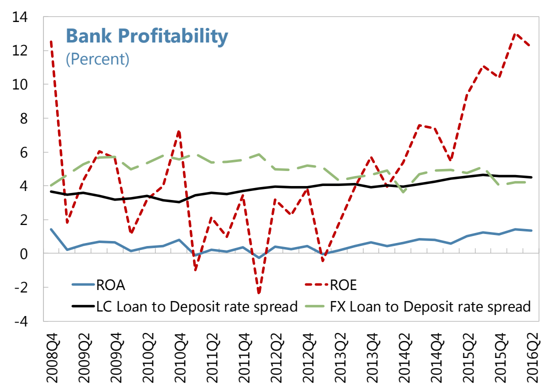
NPLs continue to decline.



Rising net interest incomes and fees...



..., have contributed to strong profitability in recent years.



Sources: NBRM; and IMF staff calculations.

Table 1. FYR Macedonia: Macroeconomic Framework, 2012–2021

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

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
				Est.			Proj.			
Real GDP	-0.5	2.9	3.6	3.8	2.2	3.2	3.4	3.6	3.8	3.8
Real domestic demand	3.5	1.3	4.7	2.1	1.6	2.6	2.7	2.9	3.2	3.1
Consumption	1.4	1.6	1.9	3.5	1.6	2.3	2.4	2.6	3.0	2.7
Private consumption	1.2	1.9	2.1	3.2	2.4	2.5	2.6	2.8	3.0	3.0
Gross investment	10.2	0.5	13.1	0.1	0.0	3.2	3.5	3.7	3.7	4.3
Exports (volume)	2.0	6.1	18.2	4.6	6.1	6.3	7.0	7.5	7.9	8.0
Imports (volume)	8.2	2.2	16.0	2.4	4.0	4.5	5.1	5.6	6.1	6.2
Contributions to growth 1/										
Domestic demand	4.0	1.6	5.5	2.5	1.8	3.0	3.1	3.3	3.6	3.5
Net exports	-3.9	1.3	-1.7	0.7	0.4	0.2	0.3	0.3	0.2	0.3
Output gap (percent of potential GDP)	-1.9	-1.3	-0.5	-0.4	-0.6	-0.4	-0.3	-0.2	-0.1	0.0
General government operations (percent of GDP)										
Revenues	29.4	27.8	27.5	28.8	28.9	29.5	29.5	29.5	29.5	29.5
Expenditures	33.3	31.7	31.7	32.3	32.9	33.0	33.1	33.1	33.1	33.1
Of which: capital	4.0	3.3	3.3	3.3	2.8	3.5	3.5	3.5	3.5	3.5
Balance	-3.8	-3.8	-4.2	-3.5	-4.0	-3.5	-3.5	-3.6	-3.6	-3.6
Savings and investment (percent of GDP)										
Domestic saving	25.8	27.2	29.8	29.0	31.8	33.3	33.8	34.1	34.5	35.1
Public	0.2	-0.5	-0.9	-0.1	-1.2	0.0	0.0	-0.1	-0.1	-0.1
Private	25.6	27.7	30.6	29.2	33.1	33.4	33.9	34.2	34.6	35.2
Foreign saving	3.2	1.6	0.5	2.1	1.9	1.6	1.8	2.1	2.4	2.8
Gross investment	28.9	28.8	30.3	31.1	33.7	34.9	35.6	36.2	36.9	38.0
Consumer prices										
Period average	3.3	2.8	-0.1	-0.2	0.0	0.8	1.6	2.0	2.0	2.0
End-period	4.7	1.5	-0.5	-0.3	0.4	1.1	2.0	2.0	2.0	2.0
Private sector credit growth	5.2	6.3	9.8	9.5	4.5	6.9	6.6	6.7	7.2	7.3
Memorandum items:										
Current account balance (percent of GDP)	-3.2	-1.6	-0.5	-2.1	-1.9	-1.6	-1.8	-2.1	-2.4	-2.8
Gross official reserves (millions of euros)	2,193	1,993	2,437	2,262	2,347	2,422	2,577	2,856	3,094	3,285
in percent of ST debt	92.1	96.1	105.2	101.2	104.9	106.2	119.1	131.2	143.2	153.0
in months of prospective imports	5.2	4.3	5.0	4.4	4.1	3.9	3.8	3.8	3.8	3.8
Gross general government debt (percent of GDP)	33.7	34.0	38.0	38.2	40.3	40.7	42.2	43.6	44.7	45.8
Public and publicly guaranteed debt (percent of GDP)	36.4	38.0	43.4	44.2	47.9	49.9	52.5	53.7	54.2	54.7
Foreign direct investment (percent of GDP)	1.7	2.8	2.3	2.2	1.7	2.0	2.4	2.6	2.8	2.7
External debt (percent of GDP)	68.2	64.0	70.0	69.4	71.2	71.5	71.4	72.2	72.3	72.1
Nominal GDP (billions of denars)	467	502	528	558	579	605	636	671	712	755
Nominal GDP (millions of euros)	7,585	8,150	8,562	9,061	9,394	9,821	10,317	10,892	11,554	12,257
GDP per capita (PPP, constant USD 2005)	9,323	...	...	...	...	...	...	...	...	...
Gini coefficient	...	...	...	...	...	...	...	...	...	...

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

Note: 1/ The inconsistency between Real GDP growth and contributions to growth results from discrepancies in the official data on GDP and its components.

Note: 2/ Including general government and public sector non-financial enterprises.

Table 2A. FYR Macedonia: Central Government Operations, 2012–2021

(Billions of denars)

	2012	2013	2014	2015	2016			2017		2018	2019	2020	2021
					Budget	Revised budget	Proj.	Budget	Proj.	Proj.	Proj.	Proj.	Proj.
Total Revenues	137.4	139.7	145.2	160.7	176.5	173.5	167.2	187.2	178.6	187.8	198.3	210.3	223.1
Tax Revenues and Contributions	117.4	121.0	129.3	140.8	150.7	149.6	147.8	160.7	155.4	163.5	172.6	183.1	194.2
PIT	9.6	10.3	12.3	12.9	14.0	14.0	13.9	15.3	14.7	15.5	16.4	17.3	18.4
CIT	3.7	4.4	5.1	12.0	11.0	10.0	10.0	11.6	10.4	10.9	11.6	12.3	13.0
VAT (net)	38.5	39.8	43.9	41.7	47.6	47.3	46.9	52.1	49.0	51.5	54.3	57.6	61.1
Excises	16.6	16.0	17.4	19.8	20.2	20.0	20.0	22.6	21.2	22.3	23.6	25.0	26.5
Custom Duties	4.1	4.3	4.2	4.3	5.1	4.9	4.8	5.0	5.3	5.7	6.1	6.4	6.8
Other Taxes	4.3	3.8	2.3	2.2	2.6	3.2	2.1	2.3	2.3	2.4	2.6	2.7	2.9
Social Contributions	40.8	42.5	44.2	47.9	49.2	50.1	50.1	51.9	52.4	55.1	58.1	61.7	65.4
Pensions	27.5	28.7	29.7	32.2	33.2	33.8	33.8	35.0	35.3	37.1	39.2	41.5	44.1
Unemployment	1.7	1.8	1.9	2.0	2.1	2.1	2.1	2.2	2.2	2.3	2.4	2.5	2.7
Health	11.5	12.0	12.6	13.6	13.9	14.3	14.3	14.8	15.0	15.7	16.6	17.6	18.7
Non-Tax Revenues	12.4	11.6	10.4	12.1	18.4	16.6	12.9	17.5	14.3	15.0	15.8	16.8	17.8
Capital Revenues	4.6	3.7	2.1	3.0	3.2	2.3	1.4	2.6	2.6	2.7	2.9	3.1	3.3
Grants	3.0	3.5	3.4	4.7	4.2	5.0	5.0	6.3	6.3	6.6	7.0	7.4	7.8
Expenditures	155.2	159.0	167.3	180.1	195.5	196.6	190.4	205.8	199.8	210.1	222.3	235.9	250.3
Current Expenditures	137.1	142.9	150.4	162.0	170.7	175.1	175.1	179.3	179.3	188.5	199.5	211.7	224.6
Wages and salaries	22.7	22.6	23.1	24.7	25.9	26.5	26.5	26.8	26.8	28.1	29.7	31.5	33.4
Goods and services	14.7	14.9	15.5	18.1	19.8	21.7	21.7	19.6	19.6	20.6	21.7	23.1	24.5
Transfers	95.5	100.8	106.8	112.7	119.2	119.9	119.9	124.6	124.7	131.0	138.3	146.7	155.6
Pensions	40.9	44.9	48.1	50.3	48.7	48.4	48.7	51.2	51.2	53.8	56.8	60.3	63.9
Health	20.9	21.4	22.1	23.6	25.0	25.6	25.0	26.4	26.4	27.7	29.3	31.0	32.9
Other	33.7	34.5	36.6	38.8	45.5	46.0	46.3	47.1	47.1	49.5	52.2	55.4	58.8
Interest	4.2	4.6	5.1	6.5	5.8	6.9	6.9	8.2	8.2	8.8	9.7	10.5	11.1
Capital Expenditures	18.8	16.6	17.6	18.7	25.6	22.3	16.1	27.0	21.0	22.1	23.3	24.7	26.2
Lending minus repayment 1/	-0.6	-0.6	-0.7	-0.5	-0.8	-0.8	-0.8	-0.5	-0.5	-0.5	-0.5	-0.5	-0.6
Overall fiscal balance	-17.8	-19.3	-22.1	-19.4	-19.0	-23.1	-23.2	-18.6	-21.3	-22.3	-24.0	-25.6	-27.2
Financing	17.7	19.3	22.1	19.5	19.0	23.1	23.2	18.6	21.3	22.3	24.0	25.6	27.2
Domestic	13.3	13.1	-6.1	21.7	8.5	3.7	3.7	10.2	12.9	14.8	12.6	28.2	43.5
Central Bank deposits	-12.3	-0.3	-5.4	10.3	-1.2	4.4	3.2	1.7	8.6	-0.1	0.2	-0.2	-0.2
Other domestic financing	25.6	13.4	-0.8	11.4	9.7	-0.7	0.5	8.5	4.2	15.0	12.5	28.5	43.7
Privatization receipts	0.1	0.6	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	4.3	5.6	27.8	-2.2	10.5	19.4	19.4	8.4	8.4	7.5	11.4	-2.7	-16.3
Memo items:													
Gross general government debt (in percent of GDP)	33.7	34.0	38.1	38.2			40.4		40.7	42.3	43.6	44.7	45.8
Nominal GDP (billions of denars)	467	502	528	558			578.8		605.1	635.6	671.0	711.9	755.2
Stock of government deposits at the NBRM (EUR mln eop)	316.5	305.0	370.0	202.4			150.0		9.9	12.2	9.5	13.0	16.8
Public and publicly guaranteed debt (in percent of GDP) 2/	36.4	38.0	43.4	44.2			47.9		49.9	52.5	53.7	54.2	54.7
Cyclically-adjusted primary balance 3/	-8.4	-9.5	-16.2	-14.3			-13.1		-12.3	-12.9	-13.8	-14.9	-16.1

Sources: IMF Staff and MoF estimates.

Notes:

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

2/ Including general government and non-financial SOEs.

3/ Includes 0.4% of GDP one-off profit tax revenue in 2015.

Table 2B. FYR Macedonia: Central Government Operations, 2012–2021 (concluded)

(Percent of GDP)

	2012	2013	2014	2015	2016			2017		2018	2019	2020	2021
					Budget	Revised budget	Proj.	Budget	Proj.	Proj.	Proj.	Proj.	Proj.
Total Revenues	29.4	27.8	27.5	28.8	30.5	29.8	28.9	30.7	29.5	29.5	29.5	29.5	29.5
Tax Revenues and Contributions	25.2	24.1	24.5	25.2	26.0	25.7	25.5	26.3	25.7	25.7	25.7	25.7	25.7
PIT	2.0	2.0	2.3	2.3	2.4	2.4	2.4	2.5	2.4	2.4	2.4	2.4	2.4
CIT	0.8	0.9	1.0	2.2	1.9	1.7	1.7	1.9	1.7	1.7	1.7	1.7	1.7
VAT (net)	8.2	7.9	8.3	7.5	8.2	8.1	8.1	8.5	8.1	8.1	8.1	8.1	8.1
Excises	3.6	3.2	3.3	3.5	3.5	3.4	3.5	3.7	3.5	3.5	3.5	3.5	3.5
Custom Duties	0.9	0.8	0.8	0.8	0.9	0.8	0.8	0.8	0.9	0.9	0.9	0.9	0.9
Other Taxes	0.9	0.8	0.4	0.4	0.4	0.6	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Social Contributions	8.7	8.5	8.4	8.6	8.5	8.6	8.7	8.5	8.7	8.7	8.7	8.7	8.7
Non-Tax Revenues	2.7	2.3	2.0	2.2	3.2	2.8	2.2	2.9	2.4	2.4	2.4	2.4	2.4
Capital Revenues	1.0	0.7	0.4	0.5	0.5	0.4	0.2	0.4	0.4	0.4	0.4	0.4	0.4
Grants	0.7	0.7	0.6	0.8	0.7	0.9	0.9	1.0	1.0	1.0	1.0	1.0	1.0
Expenditures	33.3	31.7	31.7	32.3	33.8	33.8	32.9	33.7	33.0	33.1	33.1	33.1	33.1
Current Expenditures	29.4	28.5	28.5	29.0	29.5	30.1	30.2	29.4	29.6	29.7	29.7	29.7	29.7
Wages and salaries	4.9	4.5	4.4	4.4	4.5	4.6	4.6	4.4	4.4	4.4	4.4	4.4	4.4
Goods and services	3.1	3.0	2.9	3.2	3.4	3.7	3.8	3.2	3.2	3.2	3.2	3.2	3.2
Transfers	20.5	20.1	20.2	20.2	20.6	20.6	20.7	20.4	20.6	20.6	20.6	20.6	20.6
Pensions	8.8	9.0	9.1	9.0	8.4	8.3	8.4	8.4	8.5	8.5	8.5	8.5	8.5
Health	4.5	4.3	4.2	4.2	4.3	4.4	4.3	4.3	4.4	4.4	4.4	4.4	4.4
Other	7.2	6.9	6.9	7.0	7.9	7.9	8.0	7.7	7.8	7.8	7.8	7.8	7.8
Interest	0.9	0.9	1.0	1.2	1.0	1.2	1.2	1.3	1.4	1.4	1.5	1.5	1.5
Capital Expenditures	4.0	3.3	3.3	3.3	4.4	3.8	2.8	4.4	3.5	3.5	3.5	3.5	3.5
Lending minus repayment 1/	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Overall fiscal balance	-3.8	-3.8	-4.2	-3.5	-3.3	-4.0	-4.0	-3.0	-3.5	-3.5	-3.6	-3.6	-3.6
Financing	3.8	3.8	4.2	3.5	3.3	4.0	4.0	3.0	3.5	3.5	3.6	3.6	3.6
Domestic	2.8	2.6	-1.2	3.9	1.5	0.6	0.6	1.7	2.1	2.3	1.9	4.0	5.8
Central Bank deposits	-2.6	-0.1	-1.0	1.8	-0.2	0.8	0.6	0.3	1.4	0.0	0.0	0.0	0.0
Other domestic financing	5.5	2.7	-0.1	2.0	1.7	-0.1	0.1	1.4	0.7	2.4	1.9	4.0	5.8
Privatization receipts	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	0.9	1.1	5.3	-0.4	1.8	3.3	3.4	1.4	1.4	1.2	1.7	-0.4	-2.2
Memo items:													
Gross general government debt (in percent of GDP)	33.7	34.0	38.1	38.2			40.4		40.7	42.3	43.6	44.7	45.8
Nominal GDP (billions of denars)	466.7	501.9	527.6	558.2			578.8		605.1	635.6	671.0	711.9	755.2
Stock of government deposits at the NBRM (EUR mln eop)	316.5	305.0	370.0	202.4			150.0		9.9	12.2	9.5	13.0	16.8
Public and publicly guaranteed debt (in percent of GDP) 2/	36.4	38.0	43.4	44.2			47.9		49.9	52.5	53.7	54.2	54.7
Cyclically-adjusted primary balance 3/	-1.8	-1.9	-3.1	-2.6			-2.3		-2.0	-2.0	-2.1	-2.1	-2.1

Sources: IMF Staff and MoF estimates.

Notes:

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

2/ Including general government and non-financial SOEs.

3/ Includes 0.4% of GDP one-off profit tax revenue in 2015.

Table 3a. FYR Macedonia: Balance of Payments, 2012–2021
(Millions of euros, unless otherwise indicated)

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
					Projections					
Current account	-240	-134	-43	-187	-177	-157	-181	-230	-277	-347
Trade balance	-2008	-1863	-1856	-1827	-1875	-1956	-2040	-2146	-2262	-2406
Exports	2307	2375	2784	3041	3276	3710	4178	4749	5459	6067
Imports	4315	4238	4640	4867	5151	5666	6218	6895	7721	8473
Services (net)	309	375	384	342	361	372	396	424	455	489
Primary Income (net)	-164	-193	-161	-286	-286	-295	-320	-349	-381	-404
Secondary Income (transfers, net)	1622	1547	1589	1584	1623	1721	1783	1841	1912	1974
Of which										
Official	60	74	110	54	78	79	69	75	75	73
Private	1562	1473	1479	1529	1545	1641	1714	1766	1837	1901
Of which: Cash exchange	1189	1092	1046	1092	1103	1172	1224	1260	1312	1357
Capital account (net)	9	15	3	7	6	8	8	6	7	7
Net lending (+) / Net borrowing (-)	-231	-119	-40	-180	-171	-149	-173	-223	-270	-341
Financial account	-354	-63	-436	-38	-256	-225	-328	-502	-508	-532
Direct investment (net)	-131	-229	-197	-203	-160	-196	-252	-288	-318	-337
Portfolio investment (net)	-77	159	-482	-66	-287	-93	-44	-110	-150	-140
Of which: Eurobonds amortizations	0	175	0	151	130	75	95	60	60	60
Of which: Eurobonds disbursements	0	0	491	266	450	191	155	150	150	150
Other investment	-146	8	244	231	190	64	-33	-105	-40	-55
Trade credits (net)	-158	88	-32	-73	-19	-20	-21	-22	-24	-25
MLT loans (net)	-43	-341	-63	20	-81	-196	-250	-329	-274	-280
Public sector	-57	-282	36	106	4	-21	-62	-95	-73	-76
Disbursements	161	379	126	78	65	94	136	136	136	136
of which : IMF credit	0	0	0	0	0	0	0	0	0	0
Amortization	-99	-102	-154	-219	-69	-74	-74	-41	-63	-59
Banks	26	-26	-19	24	-108	-34	-41	-76	-72	-59
Other sectors	-13	-33	-80	-110	23	-142	-147	-158	-129	-145
ST loans (net)	-48	16	-4	-4	19	20	21	22	23	25
Currency and deposits (net)	104	245	342	287	272	260	218	225	235	226
Of which: Commercial banks	-124	28	81	-17	31	32	15	26	24	22
Other (net)	0	0	0	0	0	0	0	0	0	0
Errors and omissions	19	13	13	-4	0	0	0	0	0	0
Overall Balance	142	-44	409	-145	85	76	155	279	238	191
Memorandum Items:										
ST debt at residual maturity (year-end)	2382	2073	2315	2236	2237	2280	2163	2176	2160	2147
Gross foreign exchange reserves	2193	1993	2437	2262	2347	2422	2577	2856	3094	3285
Months of prospective imports of G&S	5.2	4.3	5.0	4.4	4.1	3.9	3.8	3.8	3.8	3.8
Percent of short-term debt (residual maturity)	92.1	96.1	105.2	101.2	104.9	106.2	119.1	131.2	143.2	153.0
External debt (percent of GDP)	68.2	64.0	70.0	69.4	71.2	71.5	71.4	72.2	72.3	72.1
Medium and long-term	48.5	49.1	54.4	54.6	57.1	58.1	58.8	60.4	61.2	61.8
Short-term	19.7	14.9	15.6	14.8	14.1	13.4	12.6	11.8	11.0	10.3
External debt service	1786	2032	1598	1949	1733	1660	1707	1597	1615	1605
Percent of exports of G&S	52.9	57.6	39.1	44.2	36.8	31.9	29.6	24.8	22.3	20.1
Percent of exports of G&S and transfers	36.2	40.6	28.7	32.8	27.7	24.3	22.8	19.5	17.8	16.2

Sources: NBRM; and IMF staff estimates.

Table 3b. FYR Macedonia: Balance of Payments, 2012–2021 (concluded)

(Percent of GDP, unless otherwise indicated)

	Avg 2003-11	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
						Projections					
Current account	-5.1	-3.2	-1.6	-0.5	-2.1	-1.9	-1.6	-1.8	-2.1	-2.4	-2.8
Trade balance	-23.0	-26.5	-22.9	-21.7	-20.2	-20.0	-19.9	-19.8	-19.7	-19.6	-19.6
Exports	24.7	30.4	29.1	32.5	33.6	34.9	37.8	40.5	43.6	47.2	49.5
Imports	47.7	56.9	52.0	54.2	53.7	54.8	57.7	60.3	63.3	66.8	69.1
Services (net)	2.9	4.1	4.6	4.5	3.8	3.8	3.8	3.8	3.9	3.9	4.0
Primary Income (net)	-1.5	-2.2	-2.4	-1.9	-3.2	-3.0	-3.0	-3.1	-3.2	-3.3	-3.3
Secondary Income (transfers, net)	16.6	21.4	19.0	18.6	17.5	17.3	17.5	17.3	16.9	16.5	16.1
Of which											
Official	0.9	0.8	0.9	1.3	0.6	0.8	0.8	0.7	0.7	0.6	0.6
Private	15.6	20.6	18.1	17.3	16.9	16.4	16.7	16.6	16.2	15.9	15.5
Of which: Cash exchange	10.9	15.7	13.4	12.2	12.1	11.7	11.9	11.9	11.6	11.4	11.1
Capital account (net)	0.0	0.1	0.2	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Net lending (+) / Net borrowing (-)	-5.1	-3.0	-1.5	-0.5	-2.0	-1.8	-1.5	-1.7	-2.1	-2.3	-2.8
Financial account	-7.5	-4.7	-0.8	-5.1	-0.4	-2.7	-2.3	-3.2	-4.6	-4.4	-4.3
Direct investment (net)	-4.3	-1.7	-2.8	-2.3	-2.2	-1.7	-2.0	-2.4	-2.6	-2.8	-2.7
Portfolio investment (net)	-0.7	-1.0	2.0	-5.6	-0.7	-3.1	-0.9	-0.4	-1.0	-1.3	-1.1
Of which: Eurobonds amortizations	0.0	0.0	2.1	0.0	1.7	1.4	0.8	0.9	0.6	0.5	0.5
Of which: Eurobonds disbursements	0.6	0.0	0.0	5.7	2.9	4.8	1.9	1.5	1.4	1.3	1.2
Other investment	-2.5	-1.9	0.1	2.8	2.5	2.0	0.6	-0.3	-1.0	-0.3	-0.4
Trade credits (net)	-0.8	-2.1	1.1	-0.4	-0.8	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
MLT loans (net)	-1.7	-0.6	-4.2	-0.7	0.2	-0.9	-2.0	-2.4	-3.0	-2.4	-2.3
Public sector	-0.4	-0.7	-3.5	0.4	1.2	0.0	-0.2	-0.6	-0.9	-0.6	-0.6
Disbursements	1.9	2.1	4.6	1.5	0.9	0.7	1.0	1.3	1.2	1.2	1.1
of which : IMF credit	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortization	-1.5	-1.3	-1.2	-1.8	-2.4	-0.7	-0.7	-0.7	-0.4	-0.5	-0.5
Banks	-0.5	0.3	-0.3	-0.2	0.3	-1.2	-0.3	-0.4	-0.7	-0.6	-0.5
Other sectors	-0.9	-0.2	-0.4	-0.9	-1.2	0.2	-1.4	-1.4	-1.5	-1.1	-1.2
ST loans (net)	-0.1	-0.6	0.2	0.0	0.0	0.2	0.2	0.2	0.2	0.2	0.2
Currency and deposits (net)	0.5	1.4	3.0	4.0	3.2	2.9	2.7	2.1	2.1	2.0	1.8
Of which: Commercial banks	0.1	-1.6	0.3	0.9	-0.2	0.3	0.3	0.1	0.2	0.2	0.2
Other (net)	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	-0.1	0.2	0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall Balance	2.4	1.9	-0.5	4.8	-1.6	0.9	0.8	1.5	2.6	2.1	1.6
	(Percentage change, year-on-year)										
Exports of G&S (Value)	12.2	-2.0	4.6	15.8	7.9	6.7	10.6	10.6	11.6	12.8	10.1
Volume	9.2	2.0	6.1	18.2	4.6	6.1	6.3	7.0	7.5	7.9	8.0
Price	2.2	-3.8	-1.4	-2.0	3.1	0.5	4.1	3.4	3.9	4.6	1.9
Imports of G&S (Value)	10.3	1.7	-1.1	10.8	6.0	5.5	9.1	9.0	10.1	11.1	9.3
Volume	6.7	8.2	2.2	16.0	2.4	4.0	4.5	5.1	5.6	6.1	6.2
Price	2.9	-6.0	-3.2	-4.5	3.6	1.4	4.4	3.8	4.3	4.8	2.9
Terms of trade (2008=100)	96.4	95.9	97.7	100.2	99.8	98.9	98.5	98.2	97.8	97.6	96.7

Sources: NBRM; and IMF staff estimates.

Table 4. FYR Macedonia: Monetary Survey, 2010–2020

(Billions of denars, unless specified otherwise)

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
					Projections					
NFA	126.1	114.8	146.4	137.4	141.4	144.1	151.6	166.8	179.4	189.1
Central Bank	128.9	118.2	145.0	134.2	138.2	140.9	148.4	163.5	176.2	185.9
Commercial Banks	-2.8	-3.4	1.3	3.2	3.2	3.2	3.2	3.2	3.2	3.2
NDA	140.2	165.6	163.5	193.6	199.8	211.9	226.2	235.3	249.8	270.2
Credit to Government (net)	1.9	10.8	-2.6	13.2	15.0	33.8	43.8	55.8	67.5	79.1
From Banks (net)	29.1	37.0	31.4	36.5	44.6	54.7	64.9	76.8	88.6	100.5
of which: Credit (Tbills)	31.7	38.8	33.3	38.0	46.4	56.6	66.8	78.6	90.5	102.3
From Central Bank (net)	-27.2	-26.2	-33.9	-23.3	-29.6	-20.9	-21.1	-20.9	-21.1	-21.4
of which: Deposits	-30.4	-29.5	-37.1	-26.3	-33.0	-24.4	-24.5	-24.4	-24.6	-24.8
Credit to Private Sector (Gross)	218.9	232.7	255.5	279.8	292.4	312.6	333.2	355.7	381.3	409.1
From Banks	218.8	232.7	255.4	279.7	292.3	312.5	333.1	355.5	381.1	409.0
Denars	164.4	178.4	199.2	223.1	233.1	249.2	265.7	283.6	304.0	326.2
FX	54.4	54.3	56.2	56.6	59.1	63.2	67.4	71.9	77.1	82.7
From Central Bank	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other Items (net)	-80.6	-78.0	-89.4	-99.5	-77.6	-105.5	-121.9	-146.2	-167.5	-186.1
Broad Money (M3)	266.3	280.4	309.9	331.0	341.3	356.0	377.8	402.1	429.2	459.3
Currency in Circulation	20.1	20.7	23.2	26.3	27.3	28.5	29.9	31.6	33.5	35.6
Total Deposits	246.2	259.7	286.7	304.7	314.0	327.5	347.8	370.4	395.6	423.7
Denars	135.1	147.9	171.1	182.1	185.4	193.3	205.3	218.7	233.6	250.1
FX	111.1	111.7	115.5	122.7	128.6	134.2	142.5	151.8	162.1	173.6
				(Percentage change, year-on-year)						
Private Sector Credit	5.2	6.3	9.8	9.5	4.5	6.9	6.6	6.7	7.2	7.3
Broad Money	4.4	5.3	10.5	6.8	3.1	4.3	6.1	6.4	6.7	7.0
Private Sector Deposits	4.4	5.5	10.4	6.3	3.1	4.3	6.2	6.5	6.8	7.1
				(Contribution to annual growth in broad money)						
NFA	0.5	-4.2	11.3	-2.9	1.2	0.8	2.1	4.0	3.1	2.3
NDA	3.9	9.5	-0.7	9.7	1.9	3.5	4.0	2.4	3.6	4.7
				(Percent of GDP)						
Private Sector Credit	46.9	46.4	48.6	49.9	50.5	51.7	52.4	53.0	53.6	54.2
Broad Money	57.0	55.9	58.9	59.1	59.0	58.8	59.4	59.9	60.3	60.8
Private Sector Deposits	52.7	51.7	54.5	54.4	54.3	54.1	54.7	55.2	55.6	56.1
Memorandum Items:										
Money Multiplier	4.8	5.2	5.1	5.4	5.1	5.1	5.1	5.1	5.2	5.2
Reserve Requirement Ratio (% of deposits)										
Denars	10.0	8.0	8.0	8.0	0.0	0.0	0.0	0.0	0.0	0.0
FX Indexed	20.0	20.0	20.0	20.0	50.0	50.0	50.0	50.0	50.0	50.0
FX	13.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0
Velocity	1.8	1.8	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.6

Sources: NBRM; and IMF staff estimates.

Table 5. FYR Macedonia: Central Bank Survey, 2012–2021
(Billions of denars, unless specified otherwise)

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
					Projections					
NFA	128.9	118.2	145.0	134.2	138.2	140.9	148.4	163.5	176.2	185.9
Assets	143.3	122.7	149.9	139.4	144.4	149.0	158.5	175.7	190.3	202.1
Liabilities	-14.4	-4.5	-4.8	-5.1	-6.1	-8.1	-10.1	-12.1	-14.1	-16.1
NDA	-73.0	-64.7	-84.2	-73.0	-71.0	-70.8	-74.4	-85.3	-93.0	-97.5
Banks (net)	-26.1	-28.2	-35.6	-34.0	-25.2	-33.6	-37.1	-48.1	-55.7	-59.9
of which:										
NBRM Bills and short-term facilities	-27.1	-28.3	-35.6	-34.0	-30.0	-29.0	-29.0	-30.0	-31.5	-32.0
Central Government (net)	-24.9	-24.1	-31.4	-20.2	-27.0	-18.4	-18.5	-18.3	-18.5	-18.8
of which:										
Deposits at Central Bank	-30.4	-29.5	-37.1	-26.3	-33.0	-24.4	-24.5	-24.4	-24.6	-24.8
Denar	-19.5	-16.3	-8.2	-8.9	-12.4	-8.5	-8.6	-8.5	-8.6	-8.7
FX	-10.9	-13.1	-28.9	-17.4	-20.6	-15.9	-15.9	-15.8	-16.0	-16.1
State and Local Governments (net)	-2.3	-2.1	-2.6	-3.1	-3.1	-3.1	-3.1	-3.1	-3.1	-3.1
Other items (net)	-19.7	-10.2	-14.6	-15.8	-15.8	-15.8	-15.8	-15.8	-15.8	-15.8
Reserve Money	55.9	53.5	60.9	61.2	67.2	70.1	73.9	78.3	83.1	88.4
Currency in Circulation	20.1	20.7	23.2	26.3	27.3	28.5	29.9	31.6	33.5	35.6
Other	35.8	32.8	37.6	34.9	39.9	41.6	44.0	46.7	49.6	52.8
Cash in Vaults	3.9	4.3	4.9	5.7	5.9	6.1	6.3	6.5	6.7	6.9
Total Reserves	32.0	28.4	32.8	29.3	34.1	35.5	37.7	40.2	42.9	46.0
on Denar Deposits	18.9	16.2	20.2	16.0	20.0	20.9	22.2	23.7	25.3	27.1
on FX Deposits	13.0	12.2	12.6	13.3	14.0	14.6	15.5	16.6	17.7	18.9
	(Contribution to annual growth in reserve money)									
NFA	11.9	-19.2	50.3	-17.8	6.5	4.0	10.7	20.5	16.1	11.7
NDA	-7.7	14.8	-36.5	18.4	3.2	0.4	-5.2	-14.6	-9.9	-5.4
	(Percentage change, year-on-year)									
Reserve Money	4.3	-4.4	13.8	0.6	9.8	4.3	5.5	5.8	6.2	6.4
Memorandum Items:	(Percent of GDP)									
NBRM Bills	5.6	5.1	4.8	4.5	3.5	3.3	3.1	3.1	3.2	3.1
Government Deposits at Central Bank	6.5	5.9	7.0	4.7	5.7	4.0	3.9	3.6	3.5	3.3

Sources: NBRM; and IMF staff estimates.

Table 6. FYR Macedonia: Financial Soundness Indicators of the Macedonian Banking System, 2011-2016

(Percent)

	2011	2012	2013	2014	2015				2016		
					2015Q1	2015Q2	2015Q3	2015Q4	2016Q1	2016Q2	Aug.
Capital adequacy											
Regulatory capital/risk weighted assets	16.8	17.1	16.8	15.7	16.0	16.2	16.1	15.5	15.8	15.6	n.a.
Tier I capital/risk weighted assets 1/	14.1	14.5	14.4	13.7	13.9	14.6	14.5	13.9	14.3	14.1	n.a.
Equity and reserves to Assets	11.0	11.2	11.3	10.8	10.9	11.0	11.3	10.8	11.1	11.5	11.3
Asset composition											
Structure of loans											
Enterprises (loans to enterprises/total loans)	58.2	56.9	55.4	55.2	54.7	54.2	53.4	53.9	53.0	51.6	n.a.
Households (loans to households/total loans)	36.5	36.4	37.7	38.7	39.3	39.9	40.9	40.0	41.2	42.3	n.a.
Lending with foreign currency component to private sector	59.2	55.4	52.7	49.4	49.2	47.7	47.5	46.5	46.2	46.0	n.a.
Foreign currency lending/total credit to private sector	28.2	25.5	23.8	22.4	22.6	21.5	20.9	20.5	20.0	19.3	n.a.
Foreign currency indexed lending/total credit to private sector	31.0	29.8	28.9	27.0	26.6	26.3	26.6	25.9	26.3	26.7	n.a.
NPLs 2/											
NPLs/gross loans	9.5	10.1	10.9	10.8	11.1	11.0	11.2	10.3	10.4	7.2	n.a.
NPLs net of provision/own funds	-0.9	-3.7	-1.8	-3.0	-3.6	-3.8	-2.0	-5.3	-5.8	-4.8	n.a.
Provisions to Non-Performing Loans	101.9	107.1	103.1	104.6	105.5	106.0	103.1	108.4	109.2	111.3	111.0
Large exposures/own funds	189.6	205.1	188.5	233.1	211.6	202.9	193.5	212.4	201.1	175.5	n.a.
Connected lending											
Banking system exposure to subsidiaries and shareholders/own funds	4.6	3.5	4.2	4.3	5.0	4.5	3.4	3.4	3.4	4.1	n.a.
Banking system equity investments/own funds	1.6	1.8	1.7	2.6	3.4	2.6	2.6	2.6	2.6	2.6	n.a.
Earning and profitability											
ROAA 3/	0.4	0.4	0.6	0.8	0.6	1.0	1.2	1.1	1.4	1.4	1.5
ROAE 3/	3.4	3.8	5.7	7.4	5.5	9.4	11.1	10.4	13.0	12.2	13.5
Interest margin/gross income 4/	60.0	60.7	62.2	63.5	61.2	62.5	62.8	62.8	64.9	62.6	63.7
Noninterest expenses/gross income 5/	69.7	65.3	62.8	58.1	53.6	54.8	54.6	54.7	53.2	54.8	54.5
Personnel expenses/noninterest expenses	34.1	33.1	35.0	35.5	37.3	37.0	36.3	35.8	37.5	34.7	35.0
Interest Rates											
Local currency spreads	3.2	3.5	3.6	4.0	4.1	4.1	4.3	4.2	4.2	4.1	n.a.
Foreign currency spreads	4.8	4.6	4.8	4.9	4.5	4.5	4.6	4.6	4.5	4.4	n.a.
Interbank market interest rate	2.2	2.1	2.2	1.5	1.1	1.0	1.1	1.2	1.2	1.2	n.a.
Liquidity											
Highly liquid assets/total assets 6/	25.3	29.4	27.3	25.5	24.5	23.6	24.5	24.3	24.8	22.8	24.7
Highly liquid assets/total short-term liabilities 7/	39.6	48.2	47.6	45.5	44.0	42.2	43.9	42.4	43.7	40.5	n.a.
Liquid assets/total assets	31.2	32.4	31.2	29.8	29.2	27.9	28.3	28.2	28.7	26.0	27.4
Liquid assets/total short-term liabilities	48.9	53.0	54.5	53.2	52.4	49.9	50.8	49.2	50.5	46.3	48.7
Customer deposits/total (noninterbank) loans	115.7	113.5	112.7	113.4	112.8	110.7	110.0	110.3	110.2	108.4	111.6
Foreign currency deposits/total deposits	50.8	47.3	44.9	42.3	43.3	42.9	43.0	42.1	42.5	43.7	43.9
Including foreign exchange-indexed 8/	52.7	48.3	45.5	42.8	44.0	43.1	43.4	42.4	42.9	44.1	n.a.
Central bank credit to banks/bank liabilities	0.01	0.4	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Sensitivity to market risk											
Net open foreign exchange position/own funds	21.3	11.4	15.6	17.5	10.3	8.5	7.7	11.1	10.3	10.1	n.a.

Sources: NBRM's Financial Stability Unit.

Notes:

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

2/ Includes loans to financial and nonfinancial sector.

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

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

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

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

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

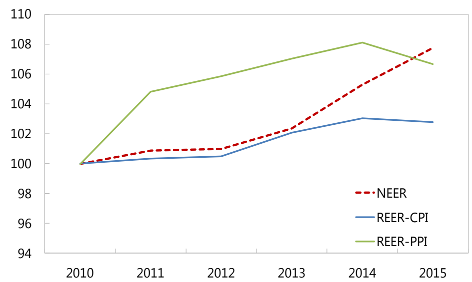
8/ FX indexed deposits include deposits and other FX indexed liabilities. However FX indexed deposits comprise the majority of these items. Since 2009Q1, the figure refers only to FX indexed deposits.

Annex I. An Assessment of External Stability and Competitiveness

Current account based estimates show the exchange rate to be broadly in line with fundamentals. FYR Macedonia's current account (CA) deficit has narrowed significantly in recent years, from the historical average of around 4¼ percent of GDP during 2003–2014 to 2.1 percent of GDP in 2015. The decline in oil prices and the expansion of export capacities contributed to this improvement. Estimates using the Fund's recently developed EBA-lite tools[1] show a norm of -3.9 percent of the cyclically-adjusted CA, in which the norm incorporates the policy gap of -1.6 percent resulting from fiscal policy (-0.2 percent), private sector credit (0.3 percent) and reserves (-1.7 percent) vis-à-vis medium-term objectives. This implies a CA gap of 1.4 percent of GDP. An alternative measure based on external sustainability concept to stabilize the current level of IIP suggests a norm of -3.2 percent of GDP.

FYR Macedonia: Real Effective Exchange Rate

(2010=100)



Sources: NBRM

1/ Increase in REER indicates appreciation

FYR Macedonia's net international investment position (IIP) deteriorated slightly to -54.6 percent of GDP in 2015, compared to -53.1 percent of GDP in 2014. The decline was mainly due to the issuance of a government bond and FDI-related debt. Over the medium-term, the net IIP is likely to stay at the same level in percent of GDP despite strong economic growth due to rising public debt and current account deficits.

FYR Macedonia: Estimated Current Account Gap and Real Exchange Rate Misalignment

(Percent of GDP, otherwise indicated)

EBA-lite CA Method	
Cyclically-adjusted CA	-2.5
Cyclically-adjusted CA norm	-3.9
CA gap	1.4
REER gap (Percent)	-4.7
EBA-lite REER Index Model	
REER Gap (Percent)	-2.0
EBA-lite External Sustainability Model	
Underlying CA	-2.8
CA norm	-3.2
CA gap	0.4
REER gap (Percent)	-1.4

Source: IMF Staff Estimates

1/ Negative value implies undervaluation

[1] The External Balance Assessment (EBA) methodology has been developed by the IMF as a successor to the former CGER exercise. There are two important differences. First, EBA makes a sharper distinction between positive (descriptive) understanding of current accounts and real exchange rates and making normative evaluations. Second, EBA takes into account a much broader set of factors—including policies, cyclical factors, and global capital market conditions—that may influence the current account and real exchange rate. For more details, see "The External Balance Assessment (EBA) methodology," IMF Working Paper No.13/272. EBA-lite model has been developed using the same methodology for countries not included in EBA. For more details, see "Methodological Note on EBA-Lite" at http://www.imf.org/external/np/pp/eng/2016/020516.pdf.

The real effective exchange rate was relatively stable in 2015. Estimated real exchange rate gap based on the EBA-lite CA model implies slight undervaluation of about 4.7 percent. Meanwhile, the EBA-lite REER and External Sustainability approach suggest the real exchange rate to be close to the equilibrium level. Overall, these estimates suggest that there are no significant real exchange rate misalignments.

Reserve coverage in FYR Macedonia is broadly adequate according to various reserve adequacy metrics. Gross international reserves accounted for 2.26 billion euros at end-2015. The reserve level was above the standard rules of thumb (three months of prospective imports and 20 percent of broad money). It also stayed in line with the Fund's ARA metric. By debt metrics, in 2015 reserves fell slightly fell short of 100 percent of short-term debt at remaining maturity benchmark, but is projected to strengthen in the medium term. In light of large downside domestic and external risks and significant eurorization of the financial sector, a prudent stance with moderate reserve accumulation would be appropriate.

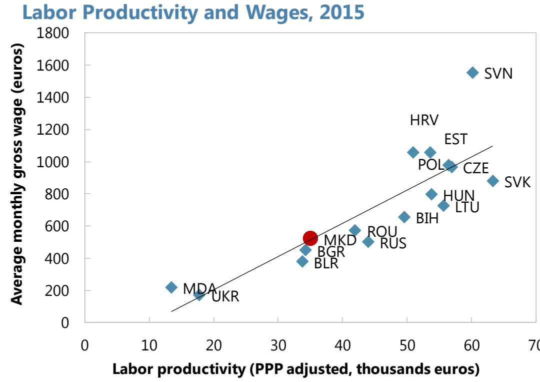
Reserve Adequacy Ratios for Macedonia 2014–2021

	2014	2015	2016	2017	2018	2019	2020	2021
Reserve/STD (percent)[1/]	105.2	101.2	104.9	106.2	119.1	131.2	143.2	153.0
Reserve/Months of prospective import goods [2/]	6.0	5.3	5.0	4.7	4.5	4.4	4.4	4.4
Reserve/Broad money (percent) [3/]	48.3	42.1	42.3	41.9	42.0	43.7	44.4	44.0
Expanded 'Greenspan-Guidotti' metric: Reserves/(STD + CA deficit)	103.3	93.3	97.2	99.4	109.9	118.7	127.0	131.7
Reserves/ARA metric (percent) [4/]	131.7	118.4	117.6	116.2	119.5	126.0	129.4	130.8

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

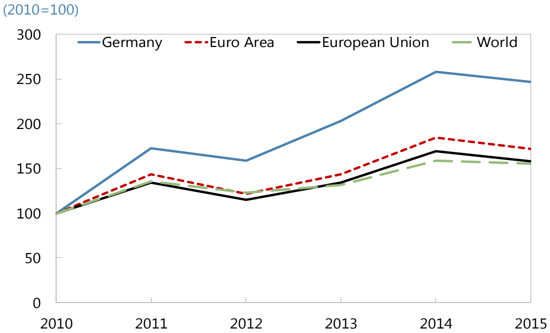
Other competitiveness indicators also point to soundness. Labor costs have been in line with productivity developments. FYR Macedonia's share in foreign markets have seen strong growth in recent years reflecting foreign investment and expansion of export capacity in the free trade zone with some moderation in 2015.

Labor Productivity and Wages, 2015



Sources: National authorities and IMF staff calculations.

FYR Macedonia: Exports Share Evolution
(2010=100)



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

Annex II. Sustainability of the Pension System

FYR Macedonia's public pension system currently suffers from significant financial imbalances. The pension system comprises three pillars: the first PAYG (pay- as-you-go) pillar, the second mandatory fully-funded pension pillar where new labor market entrants after 2003 are obliged to join and the third voluntary fully-funded pension pillar. The pension deficit, defined as pension revenues net of pension expenditure, has increased from nearly 3 percent of GDP in 2007 to 4½ percent of GDP in 2014 contributing significantly to the overall fiscal deficit. The deterioration reflects the following developments.

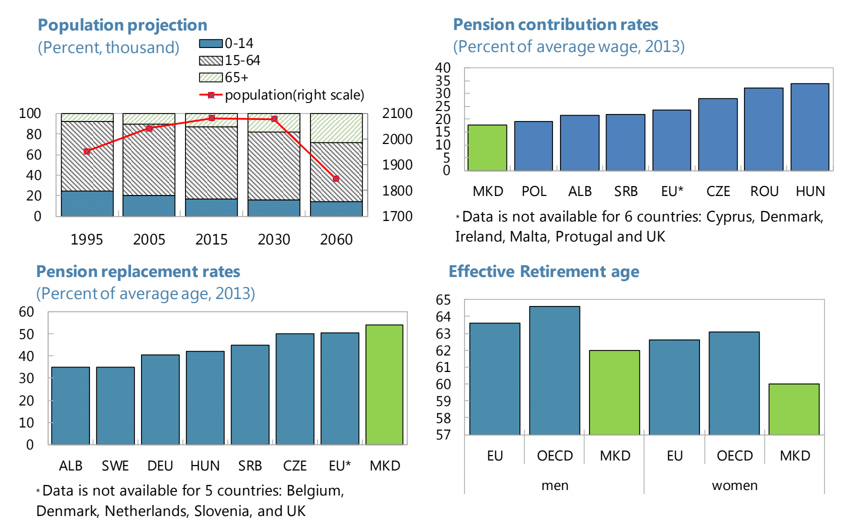
Rapid ageing of population: The share of population aged over 65 in the total population has increased to 12.7 percent in 2015 from 8 percent in 1995. This trend is projected to continue, with the share of population aged over 65 reaching 28.6 percent in 2060. At the same time, overall population is projected to decline drastically after 2030.

Low contribution rates: The authorities have lowered the contribution rate several times to improve labor cost competitiveness, putting FYR Macedonia among countries with the lowest pension contribution rates in Europe.

Relatively generous pension benefits: The pension replacement rate, which stood at 56 percent in 2014, was the most generous among transition economies, and even higher than in several high-income EU member states such as Germany, Sweden, Norway, and Finland.

Low effective retirement age: The authorities have increased the statutory retirement age (to 64 for men and 62 for women), abolished general early retirement and tightened eligibility criteria for disability pension. However, effective retirement age in FYR Macedonia around 61 years is lower than in most countries in the region.

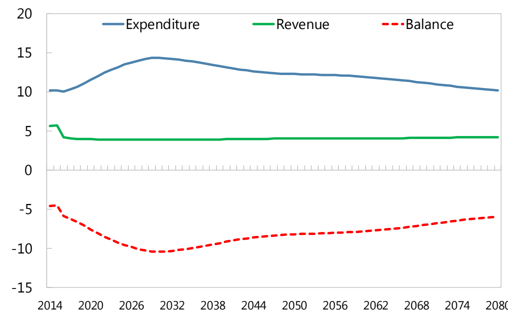
Background for Pension Imbalances



Sources:UN, World bank, OECD, Euro statistics, and PIOM.

Without further reforms, rising pension deficit is projected to pose significant pressures on the overall fiscal deficit. The number of pensioners, which had increased by 23 percent between 2000 and 2014, would exceed the number of contributors by 2037. According to the World Bank's calculations, PAYG pension deficit is projected to rise to 10.5 percent of GDP by 2030.[1] The PAYG deficit is projected to add to fiscal deficit by 3.7 percent of GDP in 2017 from the current 3 percent of GDP. In addition, the replacement rate is also projected to fall to below 40 percent by 2050 without further reforms due to the increase of second pillar pensioners with lower accrual rates.

Pension Projection
(Percent of GDP)



Sources: World bank and IMF staff calculations

[1]/ The analysis is based on the Public Expenditure Review of FYR Macedonia, The World Bank.

Table 1. FYR Macedonia : External Debt Sustainability Framework, 2011-2021
(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2011	2012	2013	2014	2015			2016	2017	2018	2019	2020	2021	**Debt-stabilizing non-interest current account 6/**
Baseline: External debt	64.2	68.2	64.0	70.0	69.4			**71.2**	**71.5**	**71.4**	**72.2**	**72.3**	**72.1**	**-6.1**
Change in external debt	6.5	3.9	-4.1	5.9	-0.6			1.8	0.3	-0.1	0.8	0.1	-0.2	
Identified external debt-creating flows (4+8+9)	-5.3	1.2	-5.9	-4.6	-4.4			-1.2	-2.5	-3.0	-2.9	-2.9	-2.5	
Current account deficit, excluding interest payments	1.8	2.6	1.1	0.0	1.4			1.2	0.9	1.1	1.4	1.7	2.1	
Deficit in balance of goods and services	20.5	22.4	18.3	17.2	16.4			16.1	16.1	15.9	15.8	15.6	15.6	
Exports	45.6	44.5	43.3	47.7	48.7			50.1	53.0	55.8	59.0	62.8	65.1	
Imports	66.1	66.9	61.6	64.9	65.1			66.2	69.1	71.7	74.8	78.4	80.8	
Net non-debt creating capital inflows (negative)	-4.5	-1.7	-2.8	-2.3	-2.1			-1.7	-2.0	-2.4	-2.6	-2.7	-2.7	
Automatic debt dynamics 1/	-2.6	0.3	-4.2	-2.3	-3.7			-0.8	-1.5	-1.6	-1.7	-1.9	-1.9	
Contribution from nominal interest rate	0.7	0.6	0.5	0.5	0.6			0.7	0.7	0.7	0.7	0.7	0.7	
Contribution from real GDP growth	-1.3	0.3	-1.9	-2.2	-2.4			-1.5	-2.2	-2.3	-2.4	-2.6	-2.6	
Contribution from price and exchange rate changes 2/	-2.1	-0.6	-2.9	-0.7	-1.9			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	11.8	2.8	1.8	10.6	3.9			3.0	2.8	2.9	3.7	3.0	2.3	
External debt-to-exports ratio (in percent)	140.8	153.3	147.9	146.6	142.6			142.2	134.9	127.9	122.3	115.1	110.7	
Gross external financing need (billions of Euros) 4/	1643.7	1979.6	2124.6	1595.1	2079.2			1848.0	1751.7	1818.3	1750.2	1810.4	1864.8	
in percent of GDP	21.8	26.1	26.1	18.6	22.9	10-Year	10-Year	19.7	17.9	17.7	16.1	15.7	15.3	
Scenario with key variables at their historical averages 5/								**71.2**	**70.6**	**70.3**	**71.0**	**71.2**	**70.7**	**-7.7**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Real GDP growth (in percent)	2.3	-0.5	2.9	3.5	3.7	3.2	2.3	2.2	3.2	3.4	3.6	3.8	3.8	
GDP deflator in US dollars (change in percent)	3.7	1.0	4.4	1.1	2.8	2.8	1.7	1.1	1.3	1.6	1.9	2.2	2.2	
Nominal external interest rate (in percent)	1.3	1.0	0.8	0.9	1.0	0.7	0.4	1.0	1.0	1.0	1.0	1.0	1.0	
Growth of exports (Euro terms, in percent)	26.1	-2.0	4.6	15.8	7.9	11.4	16.7	6.7	10.6	10.6	11.6	12.8	10.1	
Growth of imports (Euro terms, in percent)	20.8	1.7	-1.1	10.8	6.0	9.5	13.8	5.5	9.1	9.0	10.1	11.1	9.3	
Current account balance, excluding interest payments	-1.8	-2.6	-1.1	0.0	-1.4	-3.5	4.0	-1.2	-0.9	-1.1	-1.4	-1.7	-2.1	
Net non-debt creating capital inflows	4.5	1.7	2.8	2.3	2.1	4.1	2.9	1.7	2.0	2.4	2.6	2.7	2.7	

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

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

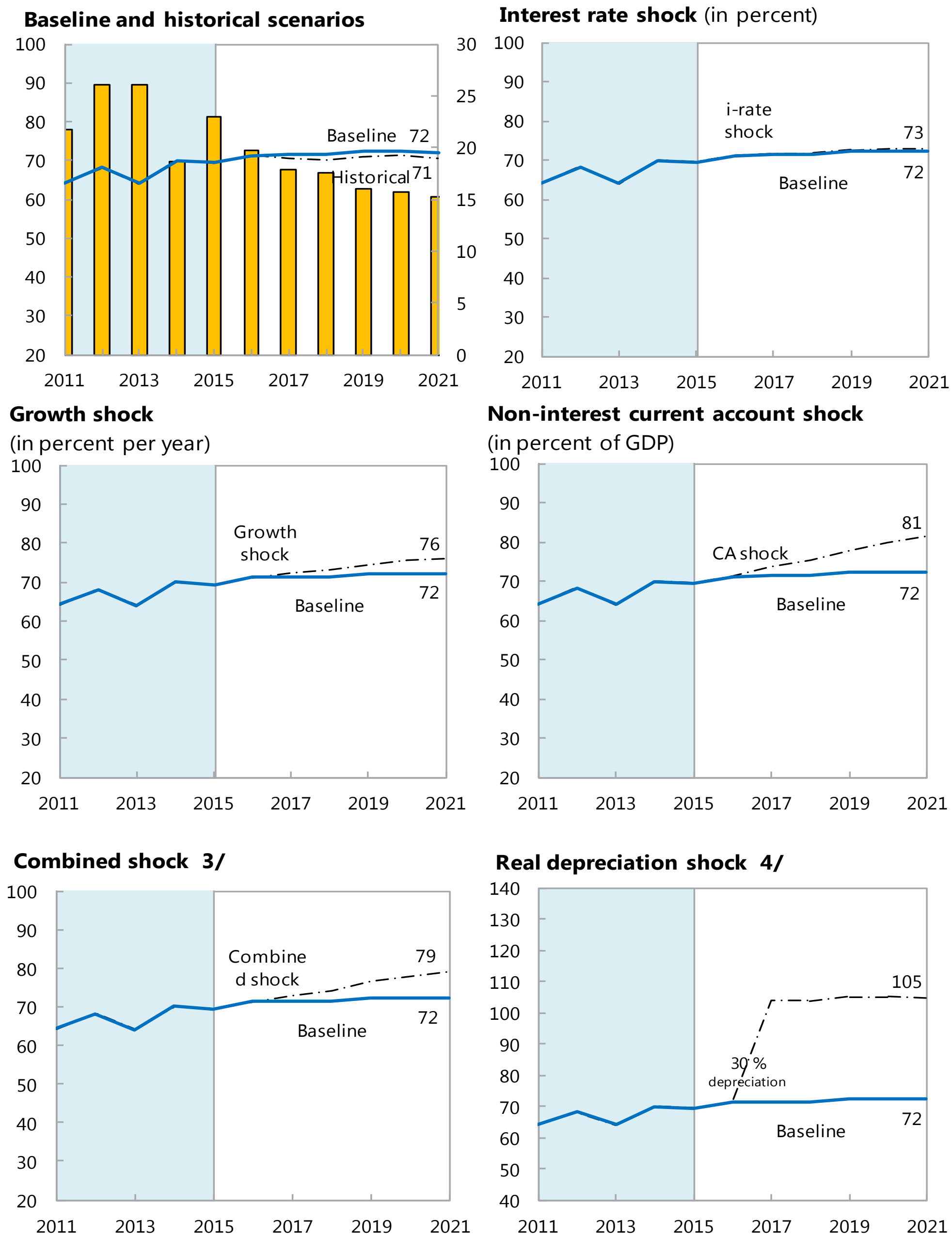
3/ For projection, line includes the impact of price and exchange rate changes.

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

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

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

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 2016.

Annex IV. Public Debt Sustainability Analysis

General government and public debt is projected to increase, driven by primary deficits and external financing for public investments. High gross financing needs and potential shocks to growth constitute major risks. Stronger fiscal consolidation is therefore needed to stabilize debt and rebuild fiscal space. Improvement in public debt management is visible and should be continued.

1. **General government debt is expected to rise by 7¾ percent of GDP over the forecast horizon, to about 45¾ percent at end-2021.** An increase in the general government debt level in 2016 is driven by widening fiscal deficit—partially due to flood-related spending—which is expected to be mainly financed by domestic T-bills and Eurobond issuance (of €450 million at 5.625% yield) in July 2016. Debt accumulation over the medium term is mainly driven by primary deficit and partially offset by favorable growth prospects.

2. **Public sector debt, including that of non-financial public sector, is expected to rise to nearly 55 percent of GDP by end-2021, up from 44 percent of GDP in 2015.** Publicly guaranteed debt of public non-financial enterprises, including that of the Public Enterprise for State Roads (PESR) – the main implementer of public transport infrastructure projects, is expected to grow by nearly 4 percent of GDP during the next few years, reflecting continued borrowing to finance public infrastructure investments. Publicly guaranteed debt of public non-financial enterprises is projected to gradually decline after 2018 due to scheduled debt repayments.

3. **Stronger fiscal consolidation is needed to stabilize debt and rebuild fiscal space.** While the level of public debt is not alarmingly high, the speed of debt accumulation since the global financial crisis raises caution. Baseline gross financing needs are above the benchmark, and adverse shocks, particularly in GDP growth could result in general government and public debt well above 50 and at 60 percent of GDP, respectively, by 2021. Space for fiscal policy, the main countercyclical stabilization policy tool in FYR Macedonia, is limited. The general government primary deficit is expected to be around 2.1 percent of GDP by 2021, 0.6 percentage points higher than the debt-stabilizing primary balance, revealing a pressing need for stronger fiscal consolidation.

4. **The improvement in public debt management is welcome and should be continued.** These improvements are most significant in the domestic government securities market. The average maturity of outstanding government securities has increased significantly from less than 12 months in 2011 to more than 4 years by 2015, reflecting increasing reliance on long-term borrowing. In the meantime, the share of foreign currency denominated domestic government securities has declined from 90 percent in 2009 to around 30 percent in 2015. Interest rates on all types of securities have decreased noticeably. However, overall a large share of public debt is still denominated in foreign currencies and improvements in public debt management should continue.

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

(in percent of GDP unless otherwise indicated)

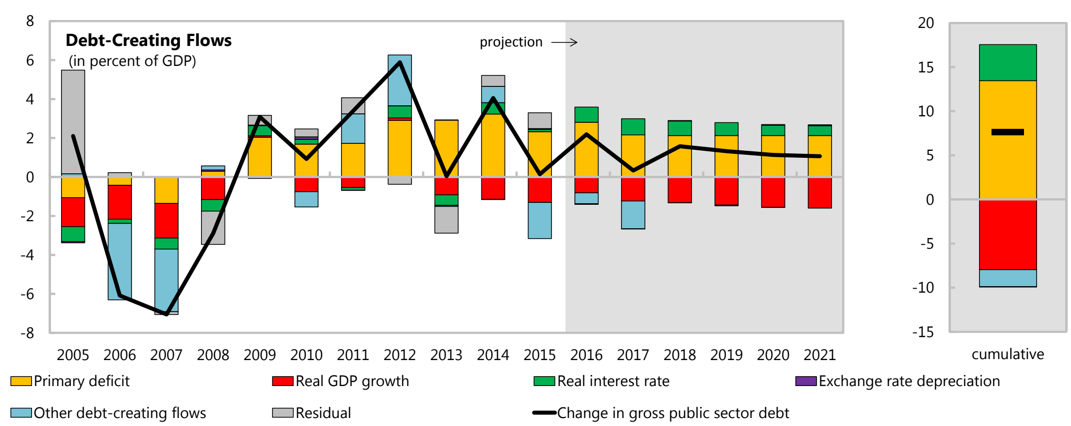
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2005-2013 [2/]	2014	2015	2016	2017	2018	2019	2020	2021
Nominal gross public debt	28.4	38.0	38.2	40.3	40.7	42.3	43.6	44.7	45.8
Public gross financing needs	11.0	14.2	14.9	15.1	12.7	12.8	12.4	13.4	16.4
Real GDP growth (in percent)	3.3	3.5	3.7	2.2	3.2	3.4	3.6	3.8	3.8
Inflation (GDP deflator, in percent)	3.3	1.1	2.8	1.1	1.3	1.6	1.9	2.2	2.2
Nominal GDP growth (in percent)	6.7	5.1	5.8	3.7	4.5	5.1	5.6	6.1	6.1
Effective interest rate (in percent) [4/]	3.0	3.0	3.2	3.2	3.5	3.6	3.6	3.6	3.5

As of September 23, 2016		
Sovereign Spreads		
EMBIG (bp) 3/		387
5Y CDS (bp)		409
Ratings	Foreign	Local
Moody's	n.a.	n.a.
S&Ps	BB-	BB-
Fitch	BB	BB

Contribution to Changes in Public Debt

	Actual			Projections							
	2005-2013	2014	2015	2016	2017	2018	2019	2020	2021	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	-0.1	4.0	0.1	2.2	0.3	1.6	1.3	1.1	1.1	7.6	
Identified debt-creating flows	-0.5	3.5	-0.7	2.2	0.3	1.6	1.3	1.1	1.1	7.6	
Primary deficit	1.0	3.2	2.3	2.8	2.2	2.1	2.1	2.1	2.1	13.5	-1.1
Primary (noninterest) revenue and grants	30.7	27.5	28.8	28.9	29.5	29.5	29.5	29.5	29.5	176.6	
Primary (noninterest) expenditure	31.7	30.7	31.1	31.7	31.7	31.7	31.7	31.7	31.7	190.1	
Automatic debt dynamics [5/]	-1.1	-0.6	-1.1	0.0	-0.4	-0.6	-0.8	-1.0	-1.1	-3.9	
Interest rate/growth differential [6/]	-1.1	-0.6	-1.2	0.0	-0.4	-0.6	-0.8	-1.0	-1.1	-3.9	
Of which: real interest rate	-0.2	0.6	0.1	0.8	0.8	0.7	0.7	0.5	0.5	4.1	
Of which: real GDP growth	-0.9	-1.1	-1.3	-0.8	-1.2	-1.3	-1.4	-1.6	-1.6	-8.0	
Exchange rate depreciation [7/]	0.0	0.0	0.1	…	…	…	…	…	…	…	
Other identified debt-creating flows	-0.4	0.8	-1.9	-0.6	-1.4	0.0	0.0	0.0	0.0	-1.9	
Privatization receipts (negative)	-0.8	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Changes in cash, deposits, and securities	0.4	0.9	-1.9	-0.6	-1.4	0.0	0.0	0.0	0.0	-1.9	
Residual, including asset changes [8/]	0.4	0.6	0.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

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

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

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

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

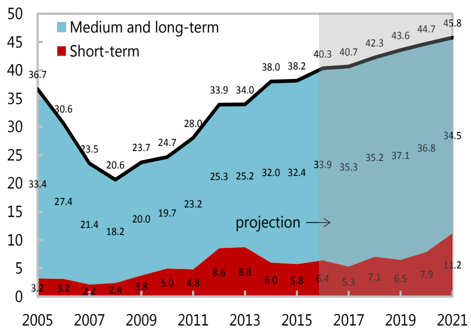
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

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

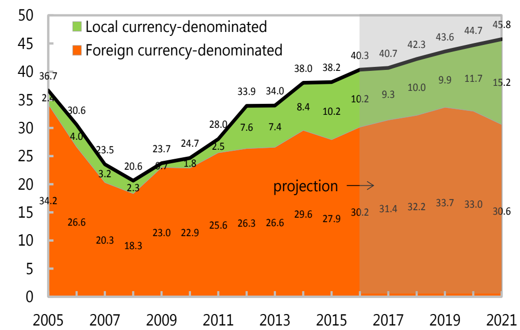
FYR Macedonia General Government DSA - Composition of General Government Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



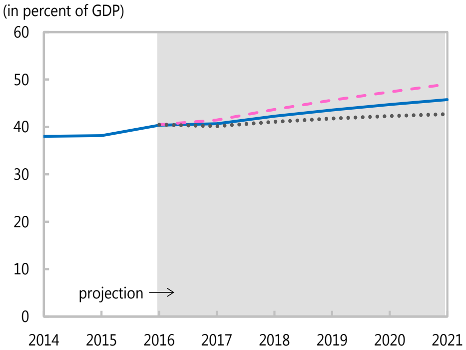
By Currency
(in percent of GDP)



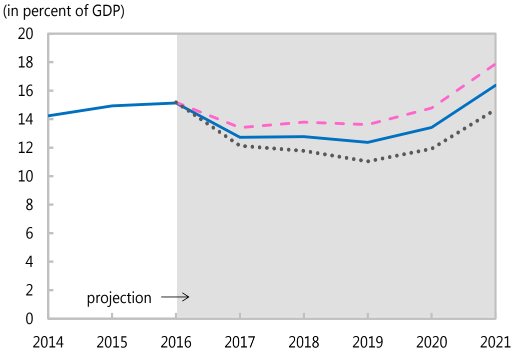
Alternative Scenarios

Baseline   Historical   Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

Baseline Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	2.2	3.2	3.4	3.6	3.8	3.8
Inflation	1.1	1.3	1.6	1.9	2.2	2.2
Primary Balance	-2.8	-2.2	-2.1	-2.1	-2.1	-2.1
Effective interest rate	3.2	3.5	3.6	3.6	3.6	3.5
Constant Primary Balance Scenario						
Real GDP growth	2.2	3.2	3.4	3.6	3.8	3.8
Inflation	1.1	1.3	1.6	1.9	2.2	2.2
Primary Balance	-2.8	-2.8	-2.8	-2.8	-2.8	-2.8
Effective interest rate	3.2	3.5	3.6	3.6	3.5	3.4

Historical Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	2.2	3.2	3.2	3.2	3.2	3.2
Inflation	1.1	1.3	1.6	1.9	2.2	2.2
Primary Balance	-2.8	-1.5	-1.5	-1.5	-1.5	-1.5
Effective interest rate	3.2	3.5	3.2	3.1	2.9	2.6

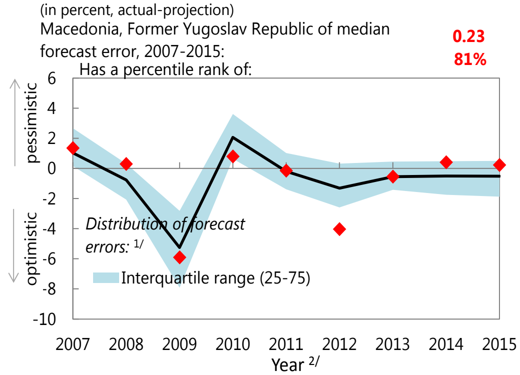
Source: IMF staff.

FYR Macedonia General Government DSA - Realism of Baseline Assumptions

Forecast Track Record, versus all countries

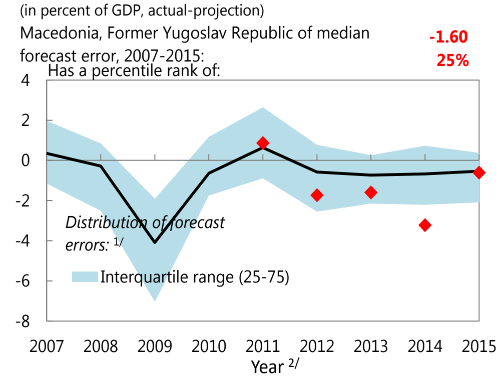
Real GDP Growth

(in percent, actual-projection)



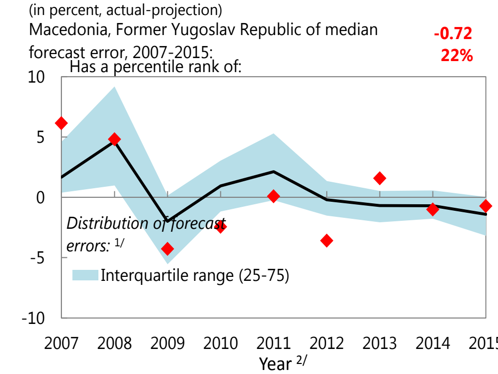
Primary Balance

(in percent of GDP, actual-projection)



Inflation (Deflator)

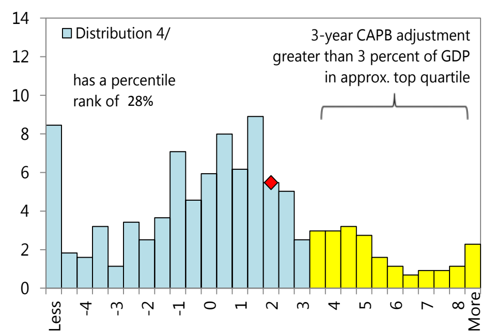
(in percent, actual-projection)



Assessing the Realism of Projected Fiscal Adjustment

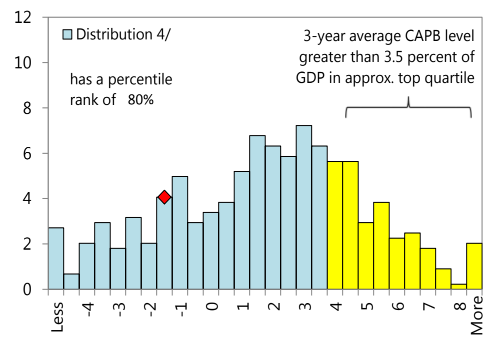
3-Year Adjustment in Cyclically-Adjusted Primary Balance (CAPB)

(Percent of GDP)



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

(Percent of GDP)



Source : IMF Staff.

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

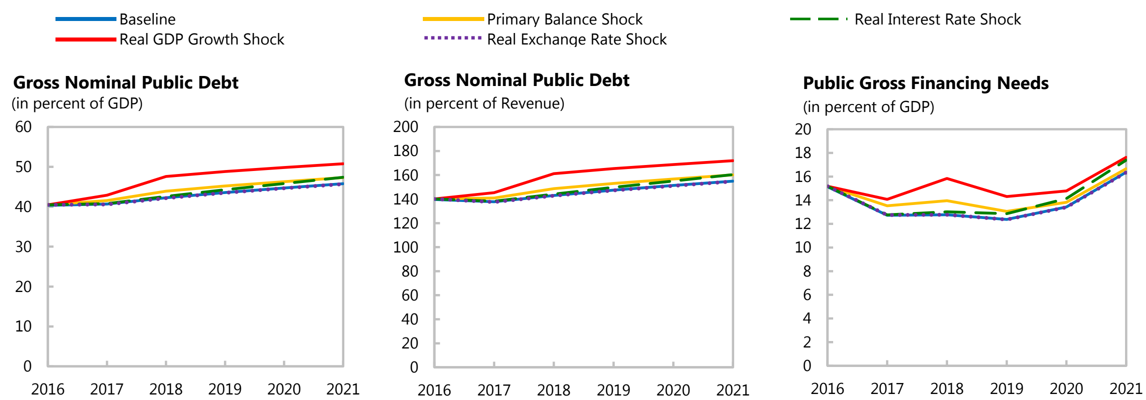
2/ Projections made in the spring WEO vintage of the preceding year.

3/ Not applicable for Macedonia, Former Yugoslav Republic of, as it meets neither the positive output gap criterion nor the private credit growth criterion.

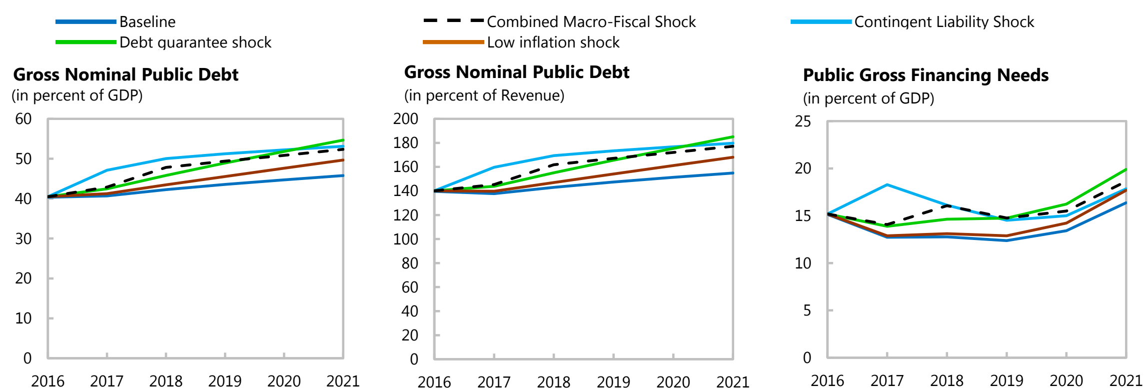
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

FYR Macedonia General Government DSA - Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

Primary Balance Shock	2016	2017	2018	2019	2020	2021
Real GDP growth	2.2	3.2	3.4	3.6	3.8	3.8
Inflation	1.1	1.3	1.6	1.9	2.2	2.2
Primary balance	-2.8	-2.9	-2.9	-2.1	-2.1	-2.1
Effective interest rate	3.2	3.5	3.6	3.6	3.6	3.5
Real Interest Rate Shock						
Real GDP growth	2.2	3.2	3.4	3.6	3.8	3.8
Inflation	1.1	1.3	1.6	1.9	2.2	2.2
Primary balance	-2.8	-2.2	-2.1	-2.1	-2.1	-2.1
Effective interest rate	3.2	3.5	4.1	4.5	4.6	4.8
Combined Shock						
Real GDP growth	2.2	0.9	1.1	3.6	3.8	3.8
Inflation	1.1	0.7	1.0	1.9	2.2	2.2
Primary balance	-2.8	-3.2	-4.1	-2.1	-2.1	-2.1
Effective interest rate	3.2	3.5	4.1	4.4	4.6	4.7
Debt guarantee shock						
Real GDP growth	2.2	1.2	1.4	1.6	1.8	1.8
Inflation	1.1	1.3	1.6	1.9	2.2	2.2
Primary balance	-2.8	-3.1	-3.0	-3.0	-2.9	-2.9
Effective interest rate	3.2	3.5	3.8	3.9	4.0	3.9

Real GDP Growth Shock	2016	2017	2018	2019	2020	2021
Real GDP growth	2.2	0.9	1.1	3.6	3.8	3.8
Inflation	1.1	0.7	1.0	1.9	2.2	2.2
Primary balance	-2.8	-3.2	-4.1	-2.1	-2.1	-2.1
Effective interest rate	3.2	3.5	3.6	3.7	3.6	3.5
Real Exchange Rate Shock						
Real GDP growth	2.2	3.2	3.4	3.6	3.8	3.8
Inflation	1.1	1.0	1.6	1.9	2.2	2.2
Primary balance	-2.8	-2.2	-2.1	-2.1	-2.1	-2.1
Effective interest rate	3.2	3.5	3.6	3.6	3.6	3.5
Contingent Liability Shock						
Real GDP growth	2.2	0.9	1.1	3.6	3.8	3.8
Inflation	1.1	0.7	1.0	1.9	2.2	2.2
Primary balance	-2.8	-7.2	-2.1	-2.1	-2.1	-2.1
Effective interest rate	3.2	3.9	3.9	3.6	3.6	3.5
Low inflation shock						
Real GDP growth	2.2	2.2	2.4	2.6	2.8	2.8
Inflation	1.1	1.1	1.1	1.1	1.1	1.1
Primary balance	-2.8	-2.2	-2.1	-2.1	-2.1	-2.1
Effective interest rate	3.2	3.5	3.7	3.7	3.7	3.7

Source: IMF staff.

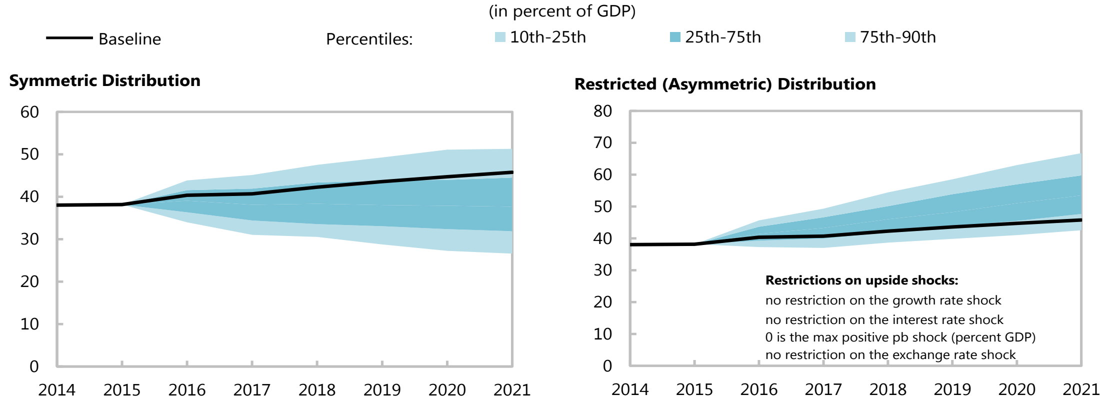
FYR Macedonia General Government DSA Risk Assessment

Heat Map

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

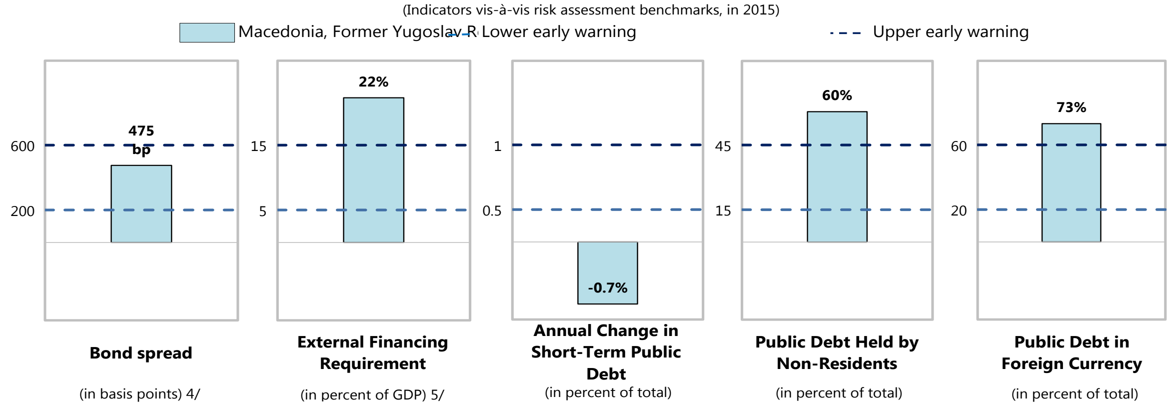
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2015)



Source: IMF staff.

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

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

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

Lower and upper risk-assessment benchmarks are:

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

4/ Long-term bond spread over German bonds, an average over the last 3 months, 25-Jun-16 through 23-Sep-16.

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

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

(in percent of GDP unless otherwise indicated)

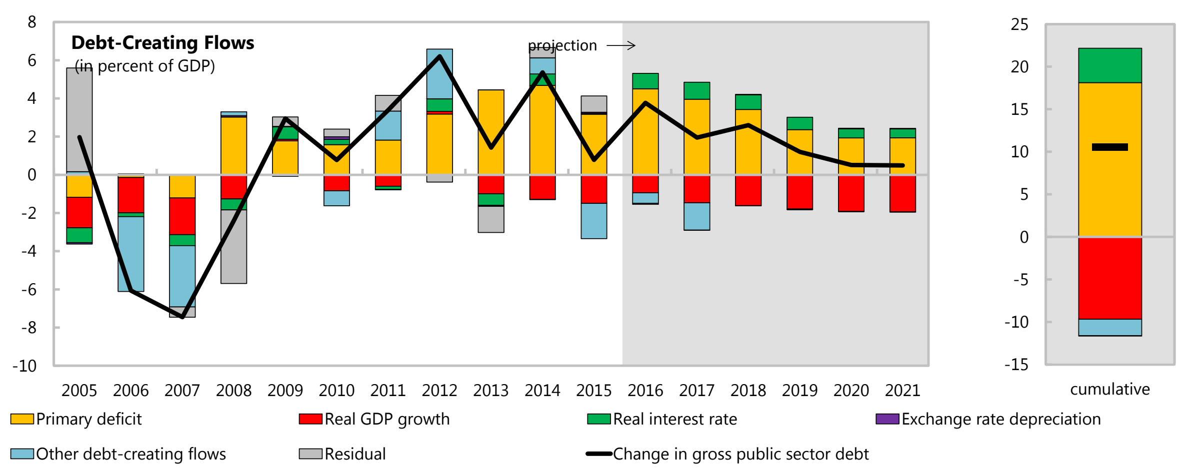
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2005-2013 [2/]	2014	2015	2016	2017	2018	2019	2020	2021
Nominal gross public debt	31.1	43.4	44.2	47.9	49.9	52.5	53.7	54.2	54.7
Public gross financing needs	12.0	16.3	16.3	17.4	15.3	14.8	13.6	14.4	17.3
Real GDP growth (in percent)	3.3	3.5	3.7	2.2	3.2	3.4	3.6	3.8	3.8
Inflation (GDP deflator, in percent)	3.3	1.1	2.8	1.1	1.3	1.6	1.9	2.2	2.2
Nominal GDP growth (in percent)	6.7	5.1	5.8	3.7	4.5	5.1	5.6	6.1	6.1
Effective interest rate (in percent) [4/]	3.0	2.8	3.0	3.0	3.3	3.3	3.3	3.2	3.2

As of September 23, 2016		
Sovereign Spreads		
EMBIG (bp) 3/		387
5Y CDS (bp)		409
Ratings	Foreign	Local
Moody's	n.a.	n.a.
S&Ps	BB-	BB-
Fitch	BB	BB

Contribution to Changes in Public Debt

	Actual			Projections							
	2005-2013	2014	2015	2016	2017	2018	2019	2020	2021	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	0.1	5.4	0.8	3.8	2.0	2.6	1.2	0.5	0.5	10.5	
Identified debt-creating flows	0.0	4.8	-0.1	3.8	2.0	2.6	1.2	0.5	0.5	10.6	
Primary deficit	1.5	4.7	3.2	4.5	4.0	3.4	2.4	1.9	1.9	18.1	-1.5
Primary (noninterest) revenue and grants	30.7	27.5	28.8	28.9	29.5	29.5	29.5	29.5	29.5	176.6	
Primary (noninterest) expenditure	32.2	32.2	32.0	33.4	33.5	33.0	31.9	31.5	31.5	194.7	
Automatic debt dynamics [5/]	-1.1	-0.7	-1.4	-0.1	-0.6	-0.8	-1.1	-1.4	-1.5	-5.6	
Interest rate/growth differential [6/]	-1.1	-0.7	-1.5	-0.1	-0.6	-0.8	-1.1	-1.4	-1.5	-5.6	
Of which: real interest rate	-0.1	0.6	0.0	0.8	0.9	0.8	0.7	0.5	0.5	4.1	
Of which: real GDP growth	-1.0	-1.3	-1.5	-0.9	-1.5	-1.6	-1.8	-1.9	-1.9	-9.7	
Exchange rate depreciation [7/]	0.0	0.0	0.1	…	…	…	…	…	…	…	
Other identified debt-creating flows	-0.4	0.8	-1.9	-0.6	-1.4	0.0	0.0	0.0	0.0	-1.9	
Privatization receipts (negative)	-0.8	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Changes in cash, deposits, and securitie:	0.4	0.9	-1.9	-0.6	-1.4	0.0	0.0	0.0	0.0	-1.9	
Residual, including asset changes [8/]	0.1	0.5	0.9	-0.1	0.0	0.0	0.0	0.0	0.0	-0.1	



Source: IMF staff.

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

2/ Based on available data.

3/ Long-term bond spread over German bonds.

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

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

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

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

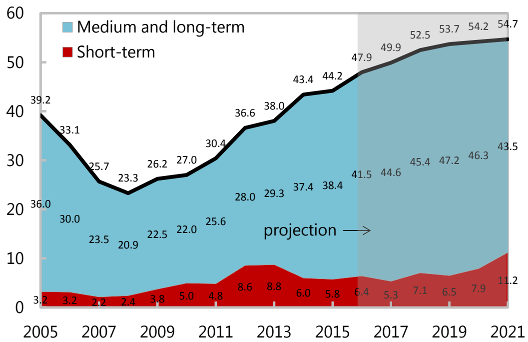
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

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

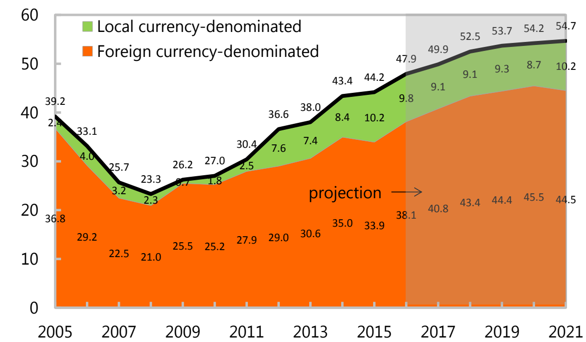
FYR Macedonia Non-Financial Public Sector DSA -
Composition of Non-Financial Public Sector Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



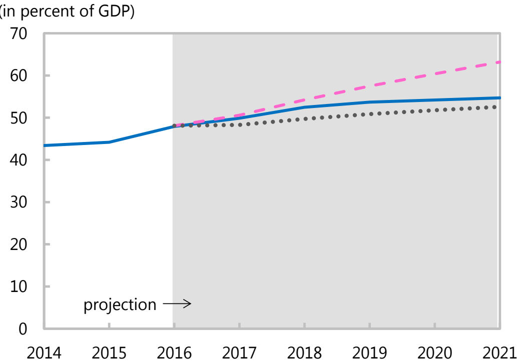
By Currency
(in percent of GDP)



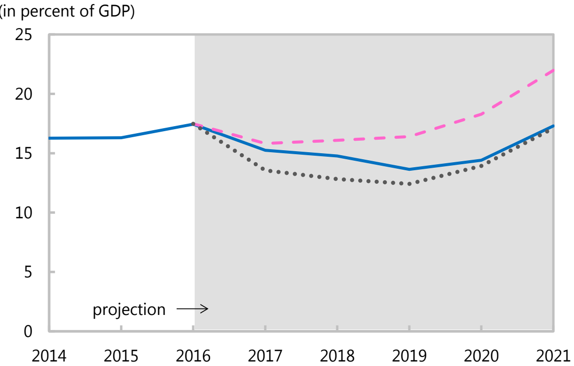
Alternative Scenarios

Baseline   Historical   Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

Baseline Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	2.2	3.2	3.4	3.6	3.8	3.8
Inflation	1.1	1.3	1.6	1.9	2.2	2.2
Primary Balance	-4.5	-4.0	-3.4	-2.4	-1.9	-1.9
Effective interest rate	3.0	3.3	3.3	3.3	3.2	3.2
Constant Primary Balance Scenario						
Real GDP growth	2.2	3.2	3.4	3.6	3.8	3.8
Inflation	1.1	1.3	1.6	1.9	2.2	2.2
Primary Balance	-4.5	-4.5	-4.5	-4.5	-4.5	-4.5
Effective interest rate	3.0	3.3	3.3	3.2	3.1	3.0

Historical Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	2.2	3.2	3.2	3.2	3.2	3.2
Inflation	1.1	1.3	1.6	1.9	2.2	2.2
Primary Balance	-4.5	-2.2	-2.2	-2.2	-2.2	-2.2
Effective interest rate	3.0	3.3	3.0	2.9	2.7	2.5

Source: IMF staff.

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

Name	Description	Impact on debt 1/
Primary Balance Shock	Minimum shock equivalent to 50% of planned adjustment (50% implemented), or baseline minus half of the 10-year historical standard deviation, whichever is larger. There is an increase in interest rates of 25bp for every 1% of GDP worsening in the primary balance.	3.7
Real GDP Growth Shock	Real GDP growth is reduced by 1 standard deviation for 2 consecutive years; revenue-to-GDP ratio remains the same as in the baseline; level of non-interest expenditures is the same as in the baseline; deterioration in primary balance lead to higher interest rate (see above); decline in growth leads to lower inflation (0.25 percentage points per 1 percentage point decrease in GDP growth).	5.2
Interest Rate Shock	Interest rate increases by difference between average real interest rate level over projection and maximum real historical level, or by 200bp, whichever is larger.	1.8
Real Exchange Rate Shock	Estimate of overvaluation or maximum historical movement of the exchange rate, whichever is higher; pass-through to inflation with default elasticity of 0.25 for EMs and 0.03 for AEs.	0.2
Combined Macro-Fiscal Shock	Shock size and duration based on the underlying shocks.	9.6

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

INTERNATIONAL MONETARY FUND

FORMER YUGOSLAV REPUBLIC OF MACEDONIA

October 24, 2016

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By	European Department

CONTENTS

FUND RELATIONS

(As of September 29, 2016)

Missions. Article IV, Skopje, September 21-29, 2016. Concluding statement is available at: https://www.imf.org/en/News/Articles/2016/09/30/MS093016-Macedonia-Staff-Concluding-Statement-of-the-2016-Article-IV-Mission

Staff team. Jesmin Rahman (head), La-Bhus Fah Jirasavetakul, Murad Omoev, Jubum Na (all EUR), and Gjorgji Nacevski (local economist).

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

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

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

General Resources Account:	SDR Million	Percent of Quota
Quota	140.30	100.00
Fund holdings of currency	140.30	100.00
Reserve position	0.00	0.00

SDR Department:	SDR Million	Percent of Allocation
Net cumulative allocation	65.62	100.00
Holdings	3.75	5.72

Outstanding Purchases and Loans: None

Latest Financial Arrangements:

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

1/ Formerly PCL.

Projected Payments to the Fund (Expectation Basis)[1]
(SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2016	2017	2018	2019	2020
Principal					
Charges/Interest	0.01	0.03	0.03	0.03	0.03
Total	0.01	0.03	0.03	0.03	0.03

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

Article IV Consultations:
The first consultation with the FYR of Macedonia was concluded in August 1993. The last consultation was concluded on September 3, 2015 (IMF Country Report 15/242). The FYR Macedonia is on the standard 12-month Article IV consultation cycle.

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

Table 1. Technical Assistance Since 2006

Purpose	**Department**		**Date**
Banking Law	LEG/MCM		June 2006
Central Bank Law	LEG/MCM		July 2007
FX Reserves Modeling	RES/MCM		February 2012 February 2013
Macroeconomic Modeling at NBRM	MCM		May 2007 November 2009 September 2010 November 2010 May 2011 November 2011 February 2012 November 2012 March 2013 November 2013 March 2014
Liquidity, Cash and Debt Management	MCM		April 2007
Contingency Planning and Crisis Preparedness	MCM		February 2009
Stress Testing	MCM		February 2011
Domestic Debt Market Development	MCM		October 2011
Provisioning Regulation	MCM		November 2012
Expenditure Rationalization	FAD		November 2007
Public Financial Management	FAD		September 2009
Medium-Term Budgeting	FAD		May 2011
Budgeting Framework/Payment Arrears	FAD		March 2012
Public Financial Management	FAD		November 2012
Tax Policy	FAD		September 2006 July 2007
Tax Administration	FAD		April 2007 July 2009 April 2010 June 2011 September 2013 December 2014 April 2016 May 2016 July 2016
Tax Audit Function	FAD		February 2016
Tax Arrears Management	FAD		March 2013 October 2014
Large Taxpayers Office	FAD		March 2016

Table 1. Technical Assistance Since 2006 (concluded)

Tax Compliance Management	FAD		November 2013 March 2014 October 2014 February 2015 October 2015
National Accounts Statistics	STA		April 2007 June 2007 January 2008 May 2008 September 2008 December 2008 June 2009 August 2011 September 2012 March 2013 October 2013
Export and Import Deflators	STA		December 2007
Government Finance Statistics	STA		June 2006 December 2007 October 2008 January 2015 June 2016
Balance of Payments Statistics	STA		October 2006 October 2008
SDDS Subscription	STA		December 2010
STA TA Evaluation	STA		September 2012
Safeguards Assessment	FIN		February 2011
Regional Advisors			
Revenue Administration	FAD		2015-
Public Financial Management	FAD		2015-
National Accounts	STA		2012-2014
Resident Experts			
Tax Administration	FAD		October 2006–August 2011
Banking Supervision	MCM		May 2006–May 2008
FSAP Participation and ROSCs (since 2003)			
FSAP	MCM/WB		May-June 2003
FSAP update	MCM/WB		March 2008
Data ROSC	STA		February 2004
Fiscal ROSC	FAD		February 2005

IMF–WORLD Bank Collaboration

Background

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

Key Areas of World Bank Involvement

- The World Bank program in FYR Macedonia focuses on two interrelated themes: i) Growth and Competitiveness; and ii) Skills and Inclusion. For Growth and Competitiveness, successful poverty reduction would need sustained private sector led growth, making FYR Macedonia more attractive as a destination for investments and as a country whose private companies can compete at the regional and global level. For Skills and Inclusion, the fruits of growth can be shared broadly if more Macedonians have access to better jobs and if public services are of good quality and delivered efficiently. Since FYR Macedonia's future is clearly linked to the European integration, the Bank's Country Partnership Strategy (CPS) actively promotes the EU accession agenda and this represents a cross-cutting theme of the strategy. Next fiscal year is the mid-term of the CPS implementation, and the Bank is planning a Performance and Learning Review, which will be an opportunity to evaluate progress with the strategy and consider possible adjustments for the outer years.
- The Bank continues to be engaged in the transport sector through two projects. The National and Regional Roads Rehabilitation Project (US$ 71 million) is helping enhance the connectivity of selected national and regional roads, primarily to Corridors X and VIII, and to improve the Public Enterprise for State Roads' capacity for road safety and climate resilience. The new Road Upgrading and Development Project's objective (US$90.95 million) is to improve transport connectivity for road users along Corridor VIII between Skopje and Deve Bair, and to improve the asset management and planning functions of the Public Enterprise for State Roads. The implementation of the Electric Power Development Energy Community of South East Europe Project APL3 (US$44 million) is in its final phase. Its objective was to improve the transmission grid, including an interconnection with Serbia. There are two investments in the area of local government development. The first is the Municipal Services Improvement Project (MSIP) (US$75 million), which is helping to improve transparency, financial sustainability and delivery of targeted municipal services in selected municipalities. The high demand from the municipalities has led to a second Municipal Services Improvement Project (US$28.04 million), approved in January this year, which is still not effective. In addition to this, the EU has provided

additional financing of US$17.72 million, to complement MSIP activities in rural municipalities. The World Bank is also active in the human development sector through the Conditional Cash Transfer Project (US$25 million), and the Skills Development and Innovation Support Project (US$24 million).

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

Macedonia–Bank and Fund Planned Activities in Macrocritical Structural Reform Areas June 2016–May 2017			
Title	**Products**	**Provisional Timing of Missions**	**Expected Delivery Date**
1. Fund work program	Article IV Report	September 2016	November 2016
	Technical assistance on Revenue Administration Reforms (Tax Compliance and Risk Management, Arrears Management, Large Taxpayers Office)	Short-term expert visits FY17	TA report after the mission
	Technical assistance on Revenue Administration Reforms	Regular short-term visits of region-based long-term expert FY17	
	Technical assistance on Government Finance Statistics	Short-term expert visits FY17	TA report after the mission
2. Bank work program	Public Expenditure Review	Completed	Report shared with the Government in January 2016
	Southeastern Europe Regular Economic Update	Continuous and periodic missions	June and December
	Municipal Services Improvement Project	Continuous	Project closing March 2019
	Municipal Services Improvement Project 2	Project not yet effective	Project closing March 2021
	National and Regional Road Rehabilitation Project	Continuous	Project closing September 2019
	Road Upgrading and Development Project	Continuous	Project closing December 2020
	Conditional Cash Transfers Project	Continuous	Project closing December 2017
	Energy Community South East Europe Adaptable Program Loan 3	Continuous	Project closing July 2016
	Skills Development and Innovation Support Project	Continuous	Project closing May 2019
	Local and Regional Competitiveness Project	Project not yet effective	Project closing December 2019

STATISTICAL ISSUES

(As of September 29, 2016)

I. Assessment of Data Adequacy for Surveillance	
General: Data provision has some shortcomings but is broadly adequate for surveillance. Areas that would benefit most from further improvement are national accounts and government finance statistics.	
National accounts: Quality of national account measurement need to be improved. In 2013, by Decision of the Government of the Republic of Macedonia, amendments were made to the National Classification of Activities—NKD Rev.2 and entailed significant changes in the decomposition of historical data. The primary objective of the Classification of Activities is to provide a basis for comparing statistical data of the Republic of Macedonia on European and world level, i.e. in its content and structure is completely harmonized with the European Classification of Activities NACE Rev.2. **Price statistics:** Improvements to the CPI have been introduced in accordance with international standards and EU regulations to align the Classification of Individual Consumption According to Purpose (COICOP).	
Government finance statistics: Debt data on a disaggregated basis for the broader public sector are not available on a regular basis. Macedonia does not report government finance statistics to the Fund for publication in either the *Government Finance Statistics Yearbook* (GFSY) or the *International Financial Statistics* (*IFS*).	
Monetary sector: EUR receives a monthly electronic report of monetary statistics, covering the balance sheet of the central bank, the commercial banks and other depository corporations.	
External sector: External sector statistics meet international standards. In additional to monthly balance of payments data, the authorities compile and disseminate international investment position (IIP) data, reserve assets and foreign currency liquidity data, and external debt statistics.	
II. Data Standards and Quality	
FYR Macedonia participates in the General Data Dissemination System (GDDS), and, since November 2011, in the Special Data Dissemination Standard (SDDS).	Data ROSC published on September 29, 2004.

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

(As of September 29, 2016)

	Date of Latest Observation	Date Received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]	Memo Items:	
						Data Quality – Methodological Soundness[8]	Data Quality – Accuracy and Reliability[9]
Exchange Rates	9/23/16	9/23/16	D	W	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	9/15/16	9/30/16	D	W	M		
Reserve/Base Money	Jul. 16	8/20/16	M	M	M	O, LO, LO, O	O, LO, O, O, O
Broad Money	Jul. 16	8/20/16	M	M	M		
Central Bank Balance Sheet	Jul. 16	8/20/16	M	M	M		
Consolidated Balance Sheet of the Banking System	Jul. 16	8/20/16	M	M	M		
Interest Rates[2]	Jul. 16	8/30/16	M	M	M		
Consumer Price Index	Aug. 16	Sep. 16	M	M	M	O, O, O, LO	LO, O, LNO, O, LO
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Dec. 15	Mar. 16	A	A	A	LO, LNO, LO, O	LO, LO, LO, LO, LNO
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	Aug. 16	Sep. 16	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Dec. 15	Mar. 16	Q	Q	Q		
External Current Account Balance	Jul. 16	8/30/16	M	M	M	O, LO, O, LO	LO, O, LO, O, LO
Exports and Imports of Goods and Services	Jul. 16	9/05/16	M	M	M		
GDP/GNP	Jun. 16	Sep. 16	Q	Q	Q	O, LO, O, LO	LO, O, LNO, O, O
Gross External Debt	Mar. 16	Jun. 16	Q	Q	Q		
International Investment Position[6]	Mar. 16	Jun. 16	Q	Q	Q		

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

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

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

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

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

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

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

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

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