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FYR Macedonia—December 2012 Staff Visit: Preliminary Findings

Skopje, December 17, 2012

An IMF team headed by Ivanna Vladkova Hollar visited Skopje December 12-17. The purpose of the visit was to assess economic and financial conditions and discuss economic policies with the authorities.

Growth slowed significantly in 2012, as weak domestic demand combined with slowing demand from abroad. Activity contracted in the first half of the year, but renewed construction activity is contributing to a positive trend in the second half, with zero growth expected for the year as a whole. Activity is poised to pick up in 2013, and could reach 2 percent, driven by a pipeline of foreign direct investment and public infrastructure projects.

External stability has been maintained despite the difficult external environment. Recent foreign direct investment in the tradable sector has strengthened the resilience of exports: non-oil related exports have declined less than one percent during the first 10 months of this year, compared to the same period of last year. Strong private transfers helped contain the 2012 current account to just under 3 percent of GDP. Reserves have risen slightly and, at €2.1 billion, remain adequate.

The revenue impact of the slowdown, in 2012 as well as cumulatively since the onset of the global crisis, has been substantial. The authorities have reacted, lowering expenditure ceilings via supplementary budgets, but additional pressure from committed yet unbudgeted expenditure has led to arrears. The relaxation of near-term financing constraints has allowed a temporary widening of the deficit targets—to about 3.5 percent of GDP—to accommodate the clearance of arrears, which has been underway since mid-September. The public recognition of arrears is a welcome step, and further transparency regarding the stock, the status of clearance process, as well as the authorities' strategy for their prevention—some elements of which are already being put in place—would help the credibility of fiscal framework.

After easing the stance of monetary policy in the second quarter, the NBRM has kept its policy rate unchanged at 3.75 percent, but has adopted a targeted reduction in the reserve requirement base, aimed at boosting credit demand by creating the conditions for lowering bank lending rates.

Banks remain well-capitalized and liquid, with fully provisioned NPLs and loan-to-deposit ratios well below one. Credit growth will likely remain moderate in 2013, as uncertainty about the outlook persists and bank risk aversion remains high. Nonetheless, credit supply is unlikely to be a critical constraining factor for near term growth, which is expected to be led primarily by

FDI and largely foreign-financed public investment. Public sector arrears clearance should help boost corporate liquidity and payment capacity.

The main risk remains an intensification of the euro area crisis, which could lead to pressures on the current account, external finances, and bank liquidity. The authorities are mindful of such risks. To preserve financial stability, they have stepped up their monitoring and contingency planning efforts, although work on bolstering the NBRM's authority to take necessary actions in the event of financial stress is still in progress. To mitigate external financing risks, a commercial loan backed by a World Bank guarantee is expected early in the year.

The team would like to thank the Macedonian authorities and our private sector interlocutors for their gracious hospitality and open discussions. The next regular IMF visit is provisionally planned for spring 2013, to engage in the Article IV consultations. In addition, we expect IMF management to recommend Post-Program Monitoring (PPM, see below) for Macedonia, a process of enhanced monitoring intended for all member countries that have substantial IMF credit outstanding following the expiration of their arrangements.

Web resources

IMF general page:	www.imf.org
Macedonia Resident Representative Office:	www.imf.org/skopje
Information on PPM:	www.imf.org/external/np/exr/facts/ppm.htm