FOR AGENDA

SM/08/329

November 12, 2008

To: Members of the Executive Board

From: The Secretary

Subject: **Former Yugoslav Republic of Macedonia—Staff Report for the 2008 Article IV Consultation**

Attached for consideration by the Executive Directors is the staff report for the 2008 Article IV consultation with the former Yugoslav Republic of Macedonia, which is tentatively scheduled for discussion on **Monday, December 1, 2008**. At the time of circulation of this paper to the Board, the Secretary's Department has not received a communication from the authorities of the former Yugoslav Republic of Macedonia indicating whether or not they consent to the Fund's publication of this paper; such communication may be received after the authorities have had an opportunity to read the paper.

Questions may be referred to Mr. Griffiths (ext. 35354), Ms. Chen (ext. 34423), and Mr. Lopez-Murphy (ext. 37647) in EUR.

Unless the Documents Section (ext. 36760) is otherwise notified, the document will be transmitted, in accordance with the procedures approved by the Executive Board and with the appropriate deletions, to the European Central Bank and the WTO Secretariat on Thursday, November 20, 2008; and to the European Bank for Reconstruction and Development following its consideration by the Executive Board.

This document, together with a supplement providing an informational annex, will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities. The supplement, which is not being distributed in hard copy, will also be available in the Institutional Repository; a link can be found in the daily list (http://www-int.imf.org/depts/sec/services/eb/dailydocumentsfull.htm) for the issuance date shown above.

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INTERNATIONAL MONETARY FUND

FORMER YUGOSLAV REPUBLIC OF MACEDONIA

Staff Report for the 2008 Article IV Consultation

Prepared by Staff Representatives for the 2008 Consultation with
Former Yugoslav Republic of Macedonia

Approved by Poul M. Thomsen and Adnan Mazarei

November 11, 2008

Contents Page

Figures

Boxes

Attachments

I. Introduction and Executive Summary

1. **Macroeconomic vulnerabilities are growing, while the expiry of the Fund arrangement in August means the loss of an important macroeconomic policy anchor**. Performance under the program has generally been good, especially at first (Table 1). Growth this year is expected to reach 6 percent, up from 5 percent in 2007, while living standards and employment have improved. However, a shift to more expansionary policies increased external vulnerabilities, with the current account deficit rising to a projected 14 percent of GDP this year, a 10 percentage point increase. As a result, international reserves are projected to fall below three months of imports, and other indicators of external vulnerability are worsening.

2. **The new government's economic program aims to raise growth further, but does not address these vulnerabilities**. Plans to increase the central government deficit permanently to about 2 percent of GDP (in the election manifesto) or perhaps even higher (the new government's revised plan presented during the mission) risk worsening external vulnerabilities. Though the fixed exchange rate regime has served the economy well, under these new policies it may come under pressure. The mission therefore called for containing the current account deficit by limiting fiscal expansion to allowing the automatic stabilizers to work. Together with some monetary tightening, this would protect the peg.

3. **Although the mission took place before the intensification of international financial turmoil, its focus on policies to reduce external vulnerability remains relevant**. However, the turmoil means that this report's projections have greater than normal uncertainty. If the turmoil continues, they are subject to considerable downside risk.

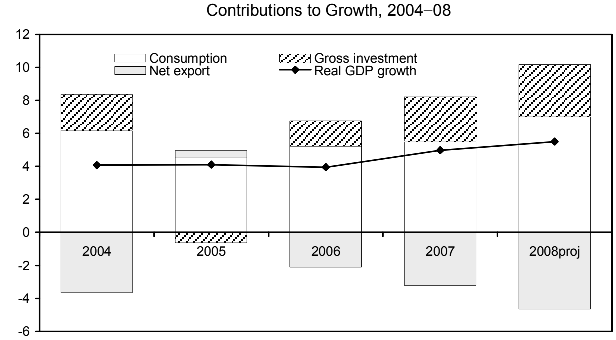
II. Recent Developments

A. Real Sector

Growth has been strong, but inflation and the current account deficit have worsened

4. **Growth has picked up, led by stronger domestic demand and increasing investment, in part FDI related (Figure 1, Table 2).** In 2007 improved terms of trade and remittances boosted incomes and domestic demand. This raised growth to 5 percent. Though these favorable shocks have reversed, in the first half of 2008 growth increased to 6 percent (led by construction, wholesale and retail

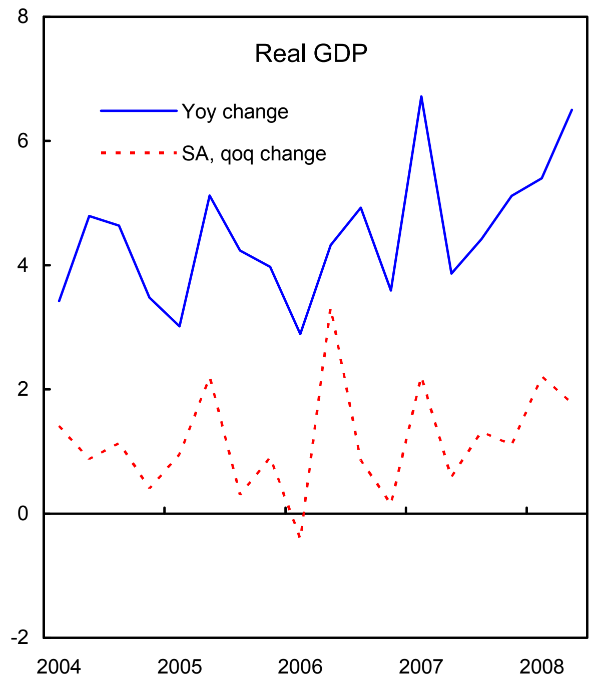
Contributions to Growth, 2004–08



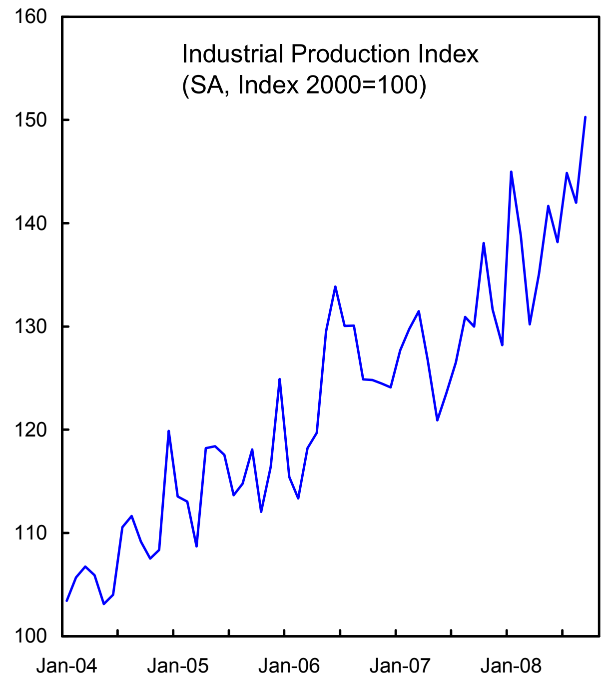
Sources: WEO; and IMF staff estimates.

Figure 1. FYR Macedonia: Real Sector Indicators, 2004–08

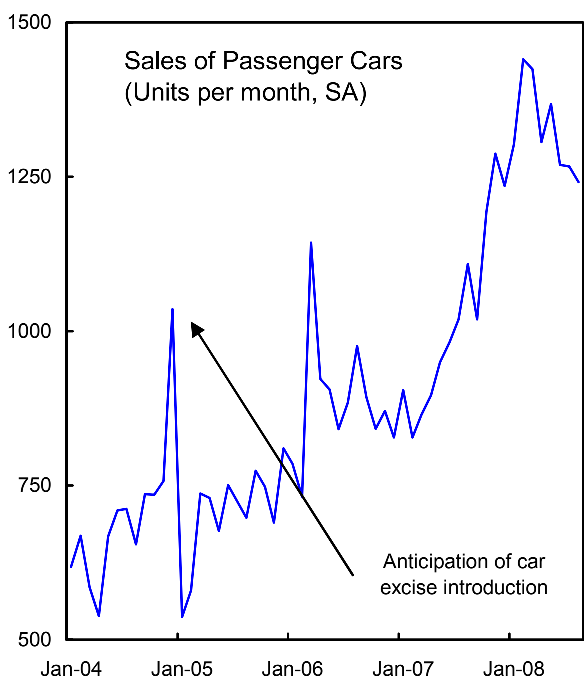
Official data shows growth has been robust...



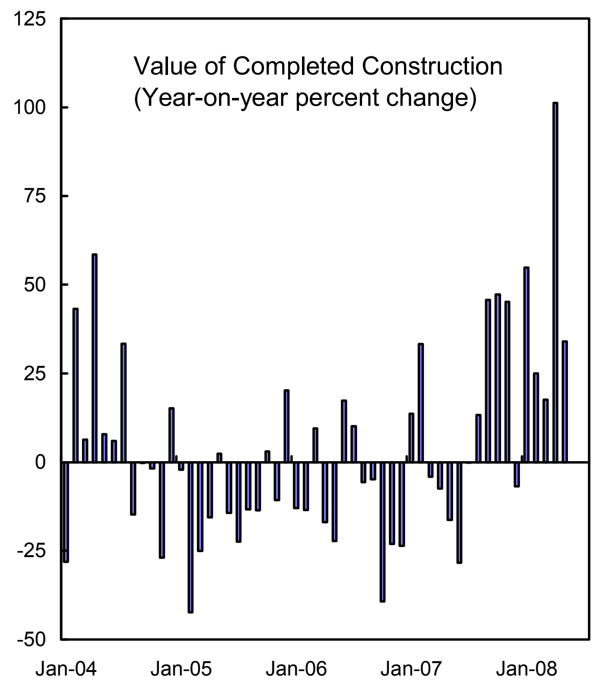
…supported by rising industrial production...



…brisk car sales...

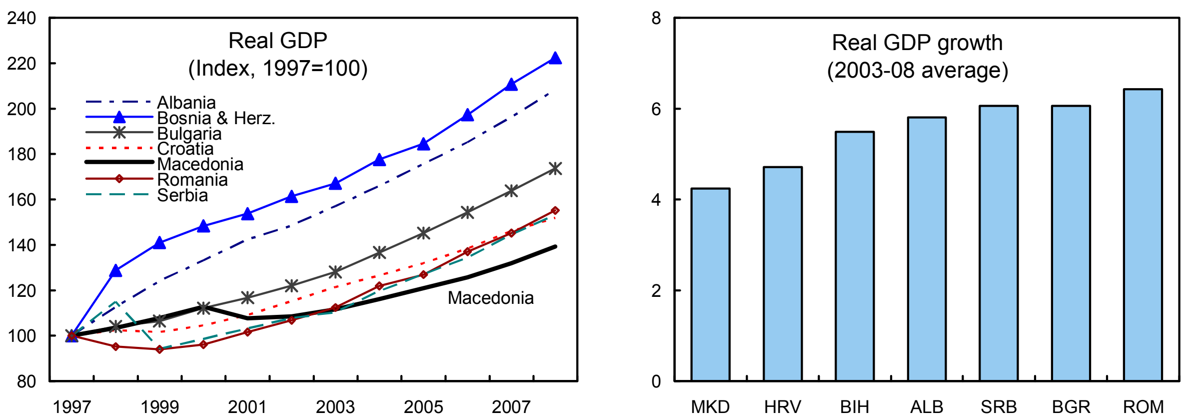


…and higher construction.



Sources: State Statistical Office; NBRM; and IMF staff estimates.

trade) while industrial production growth reached double digits. Strong investment (in part reflecting higher FDI) and the high unemployment rate (still around 35 percent; discussed in SM/06/255) suggest few capacity constraints and considerable scope for continuing this favorable supply response. But there is plenty of room for catch up.



Sources: NBRM; WEO; and IMF staff estimates.

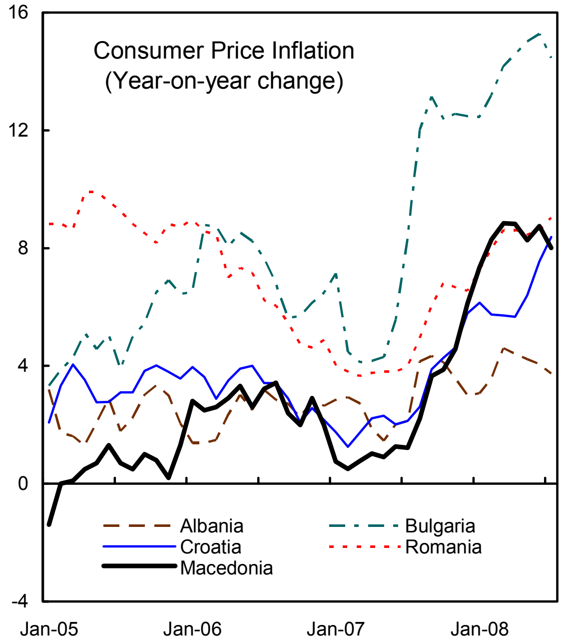
5. **Inflation has risen despite the exchange rate anchor, mainly because of outside supply shocks (Figure 2)**. From 2002 to 2006 inflation averaged less than 1 percent, sometimes with periods of deflation. This was low given the potential for productivity convergence and associated Balassa-Samuelson effects. Inflation jumped to around 10 percent in early 2008, similar to the region, largely because of oil and food price increases (more than 30 percent of the basket) which should be one-off. Public sector wages have been increased substantially (10 percent each year for three years starting September 2007; private sector wages partially followed), as have pensions (13 percent in January 2008, a further 7.3 percent in July). Although higher inflation eroded any real wage increase, the nominal wage increases did insulate real incomes from the supply shocks. With core inflation low at around 3 percent, second-round effects on inflation have been limited, because of slack in the economy and because demand has spilled over to the current account.

B. External Sector

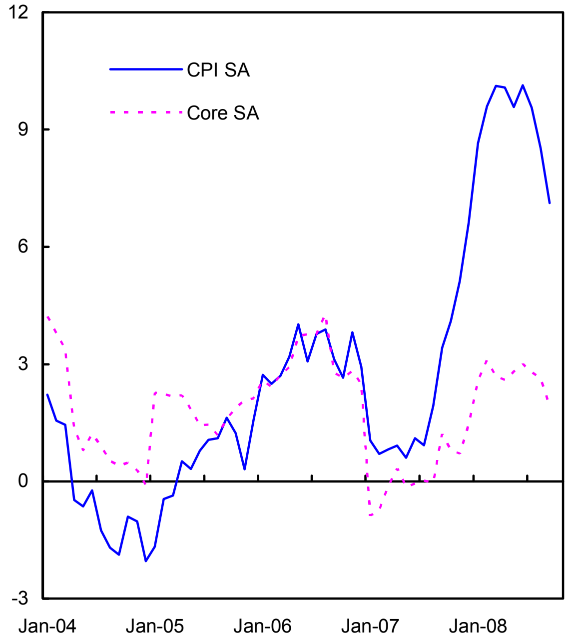
6. **The main risk to growth and macroeconomic stability is the widening current account deficit (Figures 3−4, Table 3).** Both the current account deficit's size (more than 10 percent of GDP in the last 12 months, high for Macedonia and now comparable to vulnerable countries in the region) and its rate of deterioration (more than 10 percent of GDP in one year) are significant.

Figure 2. FYR Macedonia: Inflation Developments, 2004–08

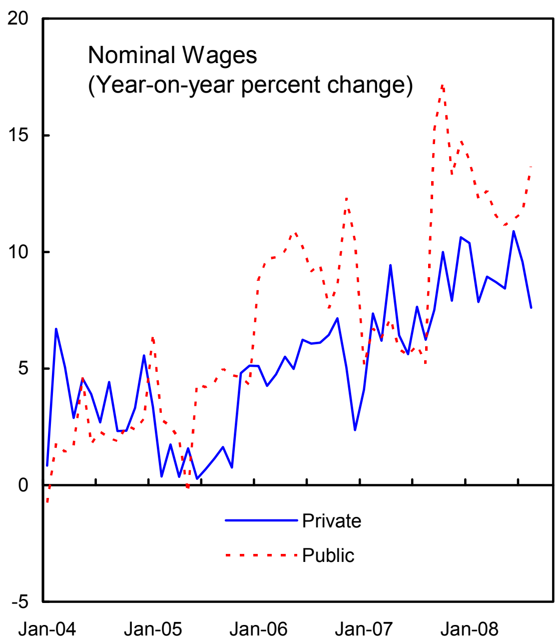
Headline inflation has risen, similar to the region...



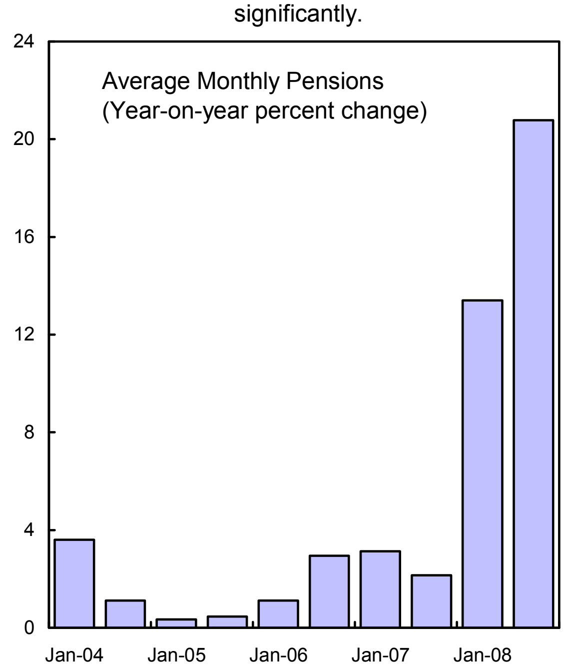
…but core inflation has remained low.



Nominal wages have increased ...



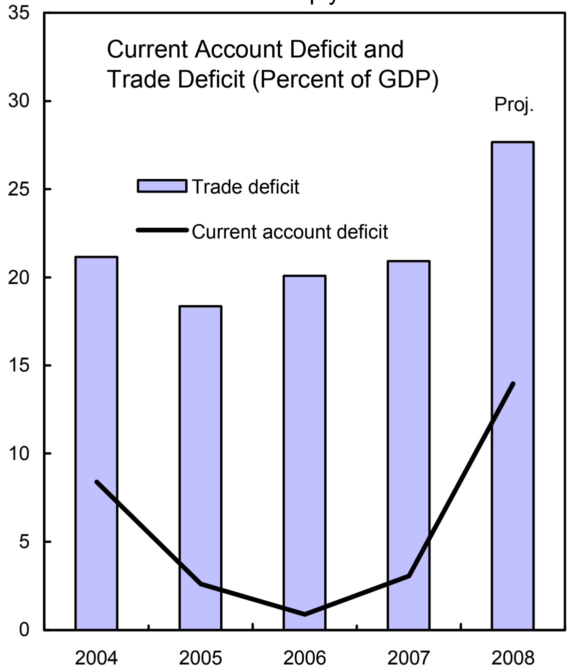
... and the government has raised pensions significantly.



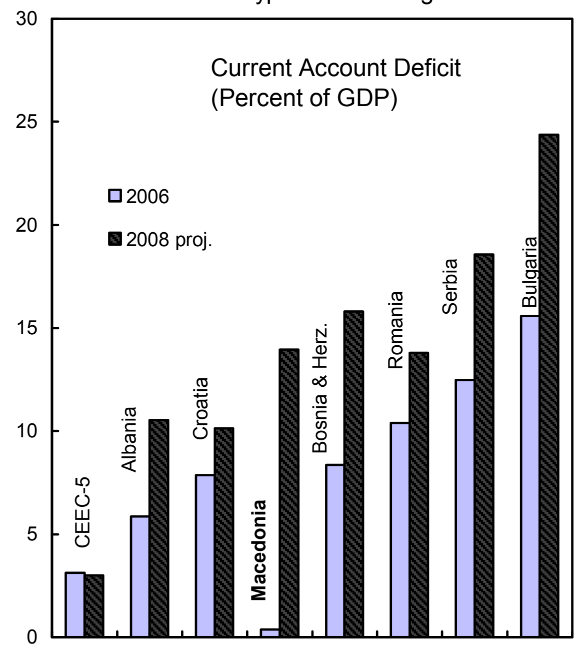
Sources: NBRM; SSO; and IMF staff estimates.

Figure 3. FYR Macedonia: External Sector Indicators, 2004-08

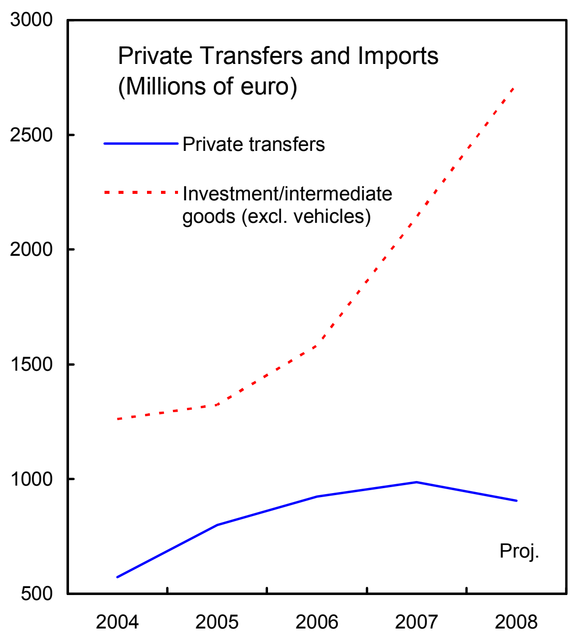
Current account and trade deficits have risen sharply...



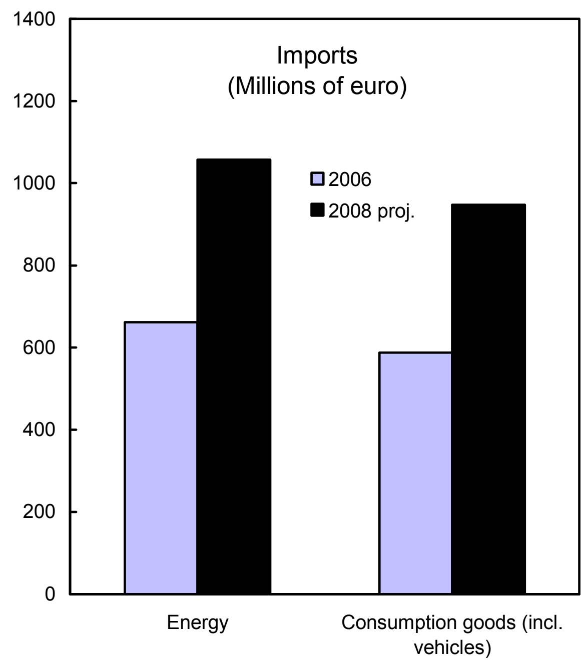
... to levels typical for the region...



…driven by higher FDI-related imports and lower private transfers...



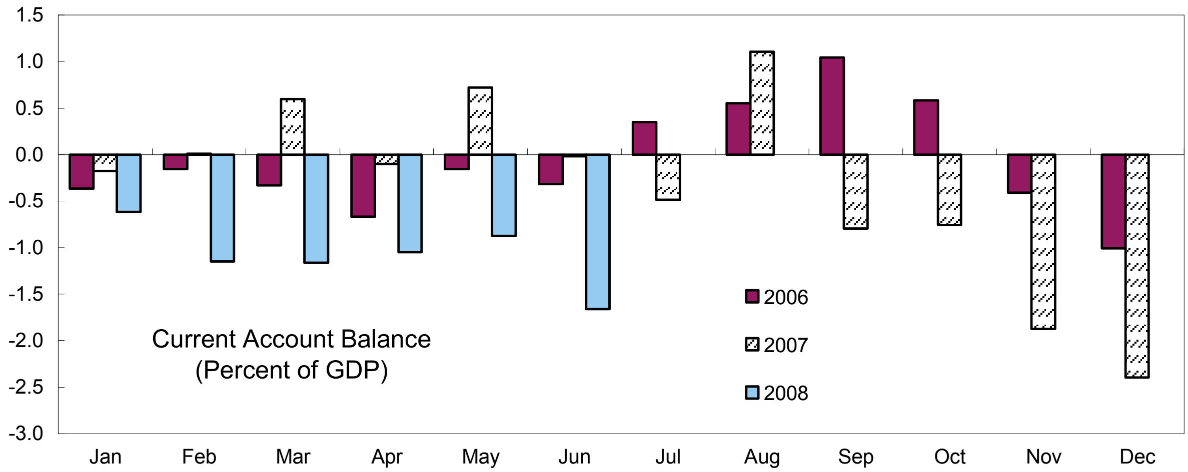
... but also higher energy and consumption imports.



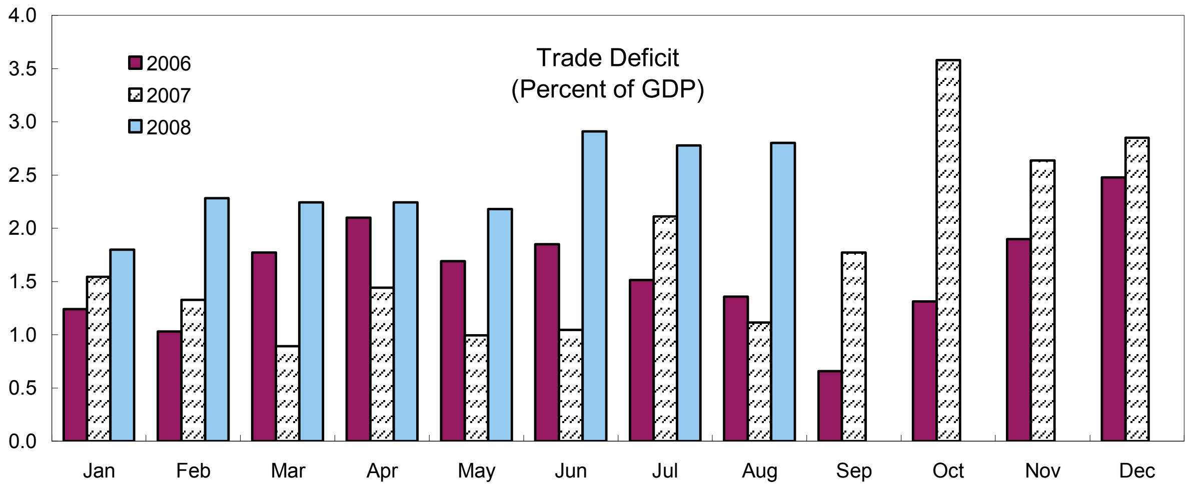
Sources: State Statistical Office; and NBRM.

Figure 4. FYR Macedonia: Recent Current Account Developments, 2006–08

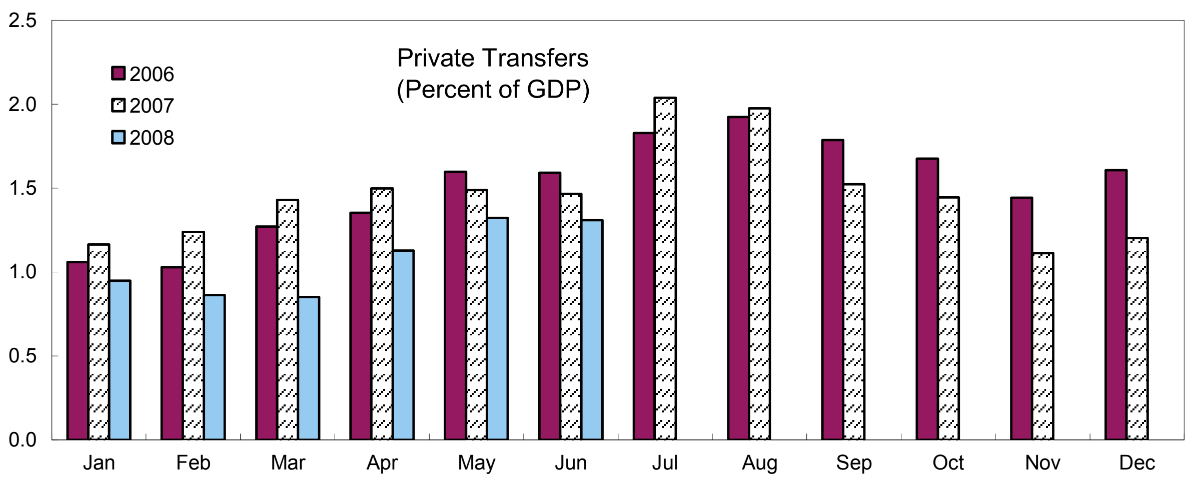
The current account deficit over the last 12 months has reached 11 percent of GDP...



…driven by a growing trade deficit...



and falling private transfers.



Sources: State Statistical Office; and NBRM; and IMF Staff estimates.

Current Account and Trade Balance Developments in 2008
(projected, in percent of GDP)

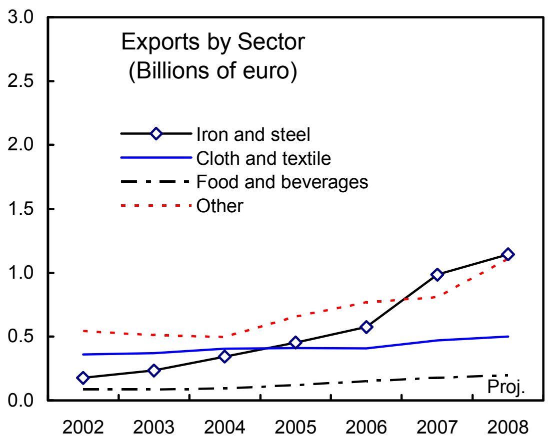
Change in Current Account		Change in Trade Balance	
Trade Balance	-6.7	Non-energy	-4.5
Private Transfers	-3.2	*Of which:* Iron and steel	-2.9
Telecom Dividend	-1.1	*Of which:* Vehicles	-1.0
		Energy	-2.2
		Of which: Electricity	-1.6
Total	-11.0		-6.7

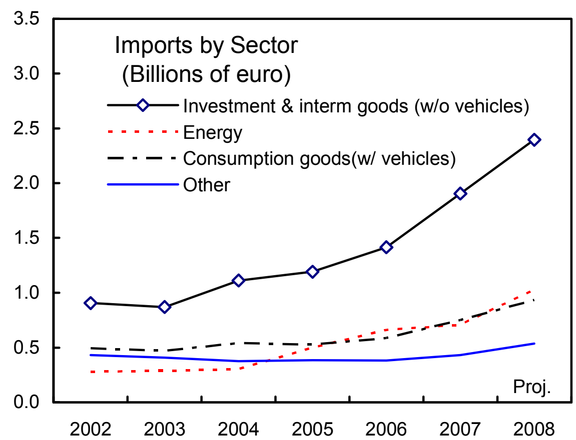
7. **The trade deficit is projected to rise from 21 percent of GDP in 2007 to 28 percent in 2008**. Main causes include:

- **Rapid import growth.** Imports of investment and intermediate goods, energy (due to increasing electricity demand since retail prices are frozen, shortfalls in domestic production, and higher world prices) and consumption have all grown rapidly. Increased exports of metals (though prices of nickel, a major export, have recently fallen sharply), and food (rebounding from last year's drought) only partly offset this.

- **Private transfers fell more than 30 percent y/y in the first quarter**, reflecting uncertainties over inflation, June's elections, and Kosovo. With political stability returning, private transfers recovered somewhat in the second quarter, as have portfolio inflows (which fell earlier this year, along with the stock market).

- **A severe deterioration in the terms of trade** which, after improving by 4 percent in 2007, fell 7 percent in 2008.





Sources: NBRM; SSO; and IMF staff estimates.

8. **The sudden current account deterioration reflects some increase in investment, but mainly lower private savings.** Investment is projected to increase by close to

20 percent, led by the government sector (SSO expenditure data through the first half of the year suggest the increase might be even larger). Saving is projected to fall by around 7 percent of GDP, financed by rapid household credit growth.

Vulnerabilities have been growing, even before the international financial turmoil

9. **External financing has been adequate but vulnerabilities were already growing ahead of the international financial turmoil (Box 1):**

- FDI has increased significantly and should cover over half of this year's current account deficit. However, more than half of this FDI represents parent company loans, which increase external debt and are easier than greenfield investment to reverse. Around 60 percent of the FDI is in non-tradables such as real estate and financial services, which may not generate the future current account surpluses needed to repay the FDI.

- The current account deficit may be understated, as the officially measured deficit treats all cash exchange of foreign currency into denars as current transactions. This treatment is correct for remittances and unrecorded exports, but not for capital inflows or conversion of mattress money. (Conversely at times of worsening confidence, residents converting denars into foreign currency mattress money would be misrecorded as a higher current account deficit, when really it is asset substitution. However, in this case vulnerability would still be increasing).

- External vulnerability indicators are deteriorating (Figure 5, Table 4).

- As in the region, a large portion of lending (around 55 percent) is either foreign currency linked or denominated. Banks transfer their currency risk into credit risk, as most borrowers are unhedged against a change in the denar-to-euro rate. This makes maintenance of the exchange rate anchor critical for financial stability. Interest rate risk is similarly transferred by banks to their customers, with rates on most credit products adjustable.

Box 1. Implications of International Financial Turmoil

The staff is in close contact with the Macedonian authorities and financial sector representatives regarding potential spillovers from global developments.

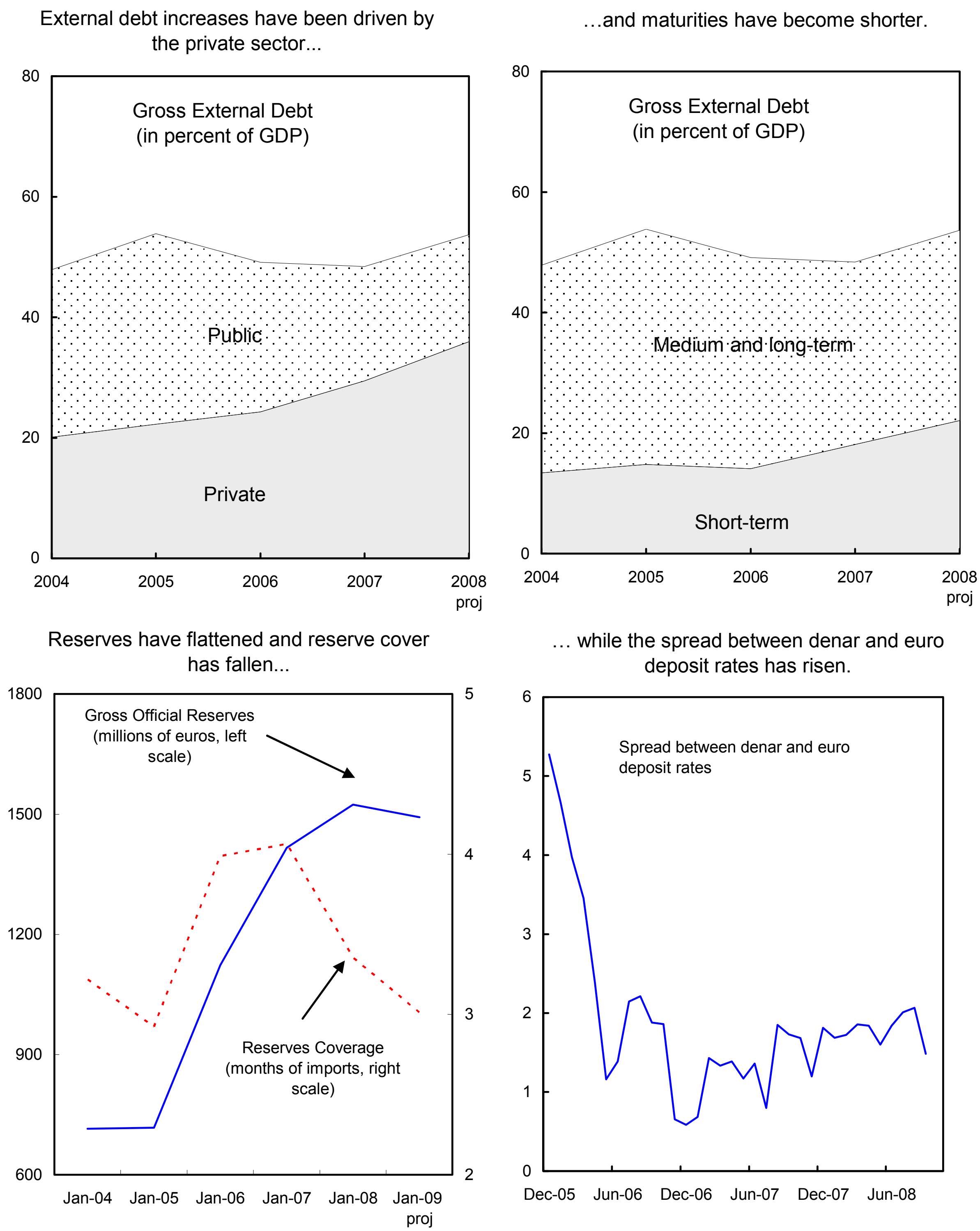
The direct impact has been limited so far:

- Banks rely mainly on domestic deposits rather than international credit lines to fund lending. The banking system's loan-to-deposit ratio is well below 100 percent. Interbank lending is small (6 percent of GDP in 2007, largely overnight). Macedonian banks do not seem exposed to sub-prime lending overseas, and the domestic mortgage market is tiny (less than 3 percent of GDP).
- Foreign bank presence has increased, but few are internationally active. The two most important mother banks—National Bank of Greece, which owns the largest Macedonian bank (Stopanska Banka) and Nova Ljubljanska Banka, which owns the third largest bank (Tutunska)—appear not to have incurred major losses in the international financial crisis.
- At €20,000, the deposit insurance level would traditionally be regarded as quite high (eight times per capita GDP, covering 70 percent of deposits).
- Pension funds have invested very conservatively, with foreign equities just 2 percent of assets.
- There have been no significant shifts from denar to euro deposits. The NBRM's reserves have recently increased slightly, but commercial banks' net foreign assets have declined.
- Portfolio inflows have dropped significantly (1 percent of GDP in 2008), contributing to sizeable stock market declines.

However, the indirect impact could grow. Lower world growth could worsen the current account deficit, through lower export demand (60 percent goes to the EU), falling export prices (metals are 40 percent of exports), or weaker private transfers (including remittances). Major metal producers have already started to reduce production and lay off workers. Against this, lower world oil prices would help. While increasing significantly in 2008, foreign direct investment could be sensitive to tighter international credit markets, and portfolio investment is declining. Liquidity pressures in the parents of foreign owned bank subsidiaries could lead to a withdrawal of credit lines.

In short, despite its relative insulation (until recently) from international financial markets, as a small, open economy, Macedonia would not be immune to a prolonged world recession.

Figure 5. FYR Macedonia: Indicators of External Vulnerability, 2004–08



Sources: State Statistical Office; and NBRM.

III. The Policy Response

10. **Against the background of increasing international financial turmoil, discussions focused on**: (i) the appropriateness of the government's plans for continued fiscal expansion; (ii) the scope under the fixed exchange rate for monetary tightening; (iii) competitiveness; and (iv) structural reforms to raise potential output.

A. Fiscal Policy

Fiscal policy has turned increasingly procyclical

11. The government first took office in 2006, committed to reforming and lowering taxes. To pay for this it proposed cutting government spending by 2 percent of GDP and raising modestly the central government deficit to 1½ percent of GDP. In the event, spending increased, but revenue overperformance (and failure to execute spending) helped the government meet or surpass the deficit targets (Table 5). Rapid domestic demand growth (boosting VAT), a near-doubling of corporate income tax (paradoxical given the introduction of zero tax for reinvested profits, but perhaps explained by the government's elimination of the double-deduction for investment), improved tax administration (formalization of the shadow economy), and higher non-tax and capital revenues all boosted revenues.

Box 2. Tax Policy Reform 2006−08

- Lower personal and corporate income tax rates: flat 12 percent rate from 2007, 10 percent from 2008
- Zero taxation of reinvested profits, with no double deduction for investment from 2007
- Creation of technological and industrial zones with tax concessions (January 2007)
- Harmonizing minimum social insurance contribution bases (July 2007)
- VAT cut from 18 to 5 percent for computers, medicines, and public transport (October 2007)
- Introduction of a presumptive turnover tax for small businesses (January 2008)

12. **While the central government budget has run a surplus of almost 3 percent of GDP in the first three quarters of 2008, fiscal policy has turned procyclical**:

- Spending accelerated at the end of 2007 (especially on investment). Though the central government ran a 0.6 percent of GDP surplus in 2007, the fourth quarter had a 2½ percent of GDP deficit. Part of this spending was actually executed in 2008.

- Pensions were increased 13 percent in January 2008, then another 7 percent in July—even though the pension system is in deficit.

- Rather than letting the automatic stabilizers work and save revenue overperformance, July's supplementary budget increased government spending by 4 percent of GDP to almost 40 percent of GDP (Figure 6).

- Public sector wages were increased by 10 percent in October 2008, for the second year running.

- While the central government deficit planned for 2008 appears low, the overall public sector fiscal deficit including losses in the electricity sector (paid for by deferred maintenance and deterioration of the capital stock) is much greater (see the Selected Issues). Perhaps by as much as 1−2 percent of GDP.

The new government intends further fiscal expansion

13. **Despite the worsening current account deficit and this year's strong growth, the new government plans further fiscal expansion.** In its successful June re-election campaign, the government pledged to increase spending on public wages, pensions, agriculture, and education, and to cut social security contributions substantially (reducing minimum social contributions, and reducing rates from 32 to 22 percent over three years). Improved tax administration and a higher central government deficit of around 2 percent of GDP would finance this. However, the government explained to the mission that it intended to raise the deficit even further—to 3 percent of GDP in 2009 and 4 percent in 2011—for additional infrastructure investment. Compared to the record under the Fund program of near budget balance, this plan would represent a paradigm shift in fiscal policy.

14. **The staff cautioned that this planned fiscal expansion could exacerbate Macedonia's medium-term external vulnerabilities (Table 6—Baseline Scenario)**:

- The authorities' planned 4 percent of GDP fiscal deficit in the fourth quarter will boost growth slightly in 2008, but mostly increases the current account deficit (to around 14 percent of GDP) and worsens external vulnerabilities.

- Growth is assumed to slow to 4 percent in 2009 due to the international financial turmoil. Discussions during the mission centered on the attainability of the authorities' medium-term 6–8 percent output growth objective (see the Selected Issues). However, even this revised 4 percent projection is subject to considerable downside risk.

- Despite the widening of the fiscal deficit to 4 percent of GDP in 2011, the current account deficit is assumed to narrow gradually. This assumes that the previous terms of trade deterioration finally increases savings, and that past FDI boosts export supply. The government (but not the NBRM) argued the export response and current account adjustment would be more powerful.

- However, external vulnerabilities increase significantly, with reserve cover falling below three months of imports, external debt rising from 48 percent of GDP at end-2007 to more than 75 percent by 2013, and short-term external debt increasing significantly.

- The likelihood of a "sudden stop" and crisis would increase, particularly if the government's plans for substantial external financing (averaging 4 percent of GDP annually) fail. Abrupt current account adjustment would follow, with growth much lower than projected in Table 6.

15. **The staff recommended postponing these spending increases and to use fiscal policy to reduce external vulnerabilities (Table 7—Staff Alternative Scenario, Figure 7, see also Selected Issues)**:

- The staff proposed saving this year's revenue overperformance, and not execute the discretionary spending increases in the supplementary budget. This would produce a central government budget surplus (excluding electricity sector losses) of around 1½ percent of GDP. This would limit the current account deficit to 12 percent of GDP.

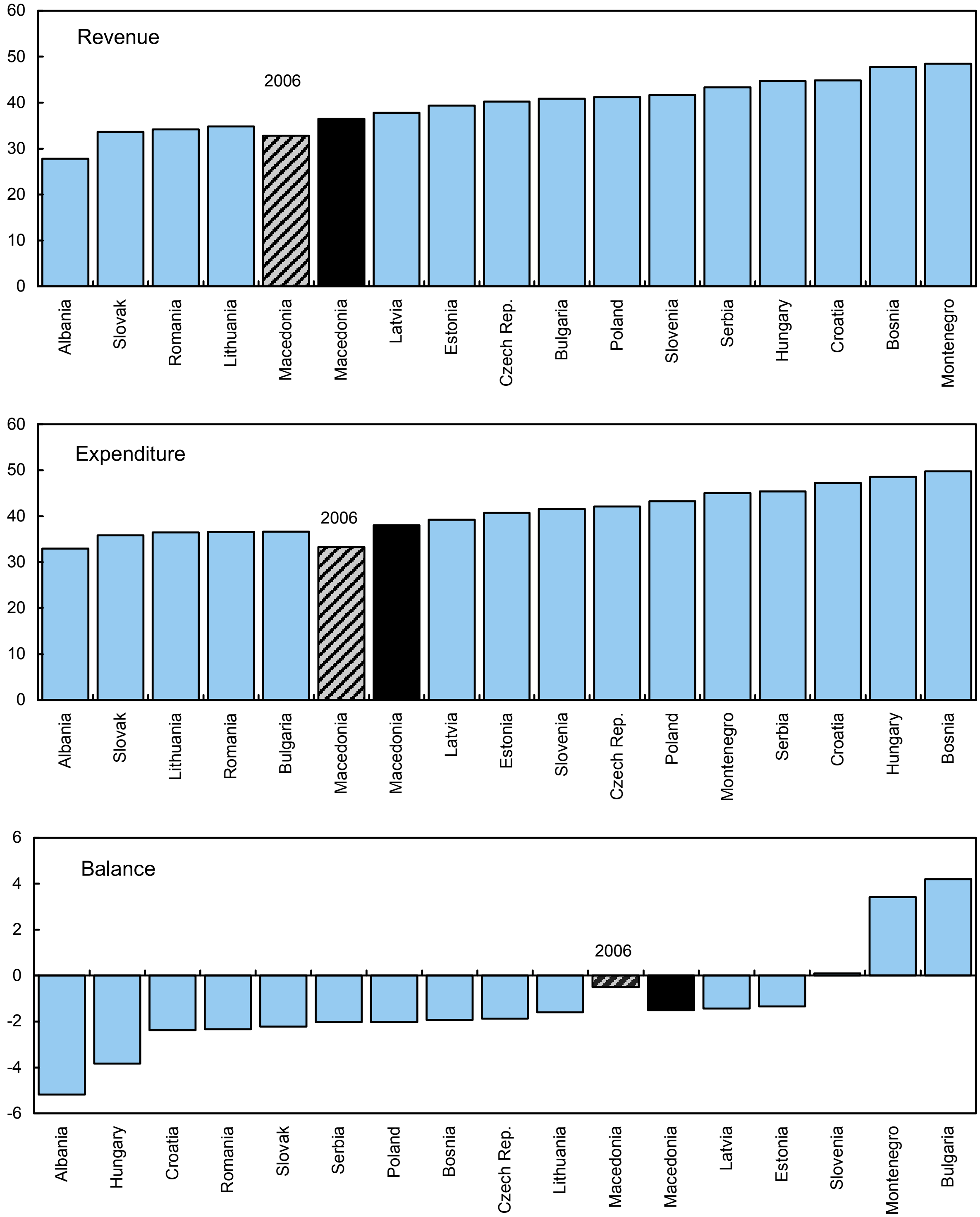
- In 2009 fiscal policy would be tighter than proposed by the authorities (so growth would be slightly lower, at 3 percent), but the automatic stabilizers give a fiscal stimulus of around 1½ percent of GDP.

- The current account deficit falls more rapidly, due to the tighter fiscal stance and stronger export response.

- External vulnerabilities are lower in this alternative scenario. Interest rates fall, private investment increases, and medium-term growth is higher, compared to the baseline.

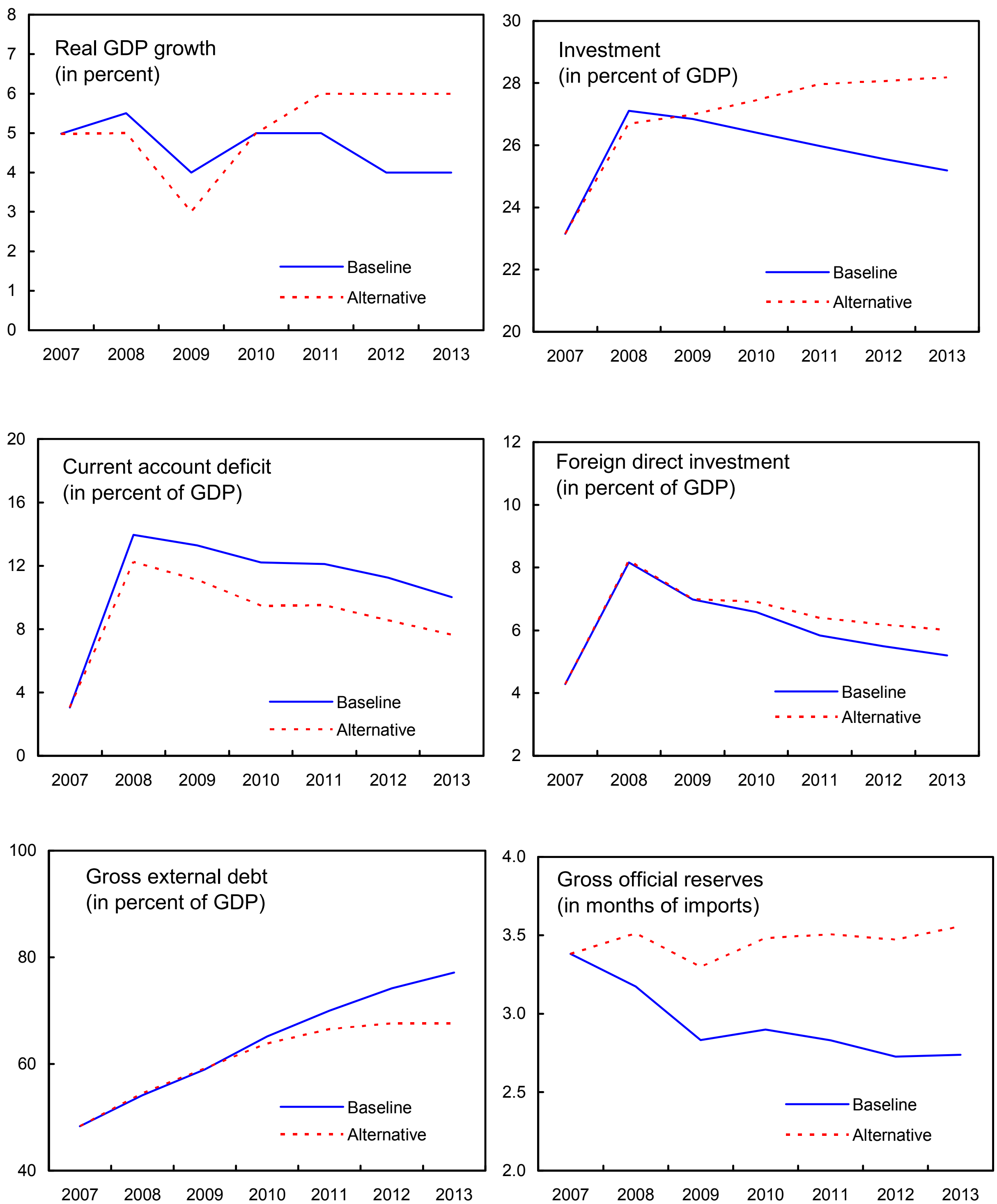
16. **Notwithstanding these vulnerabilities, the government reaffirmed its plans for further fiscal expansion**. The government argued that past fiscal prudence and debt reduction had been at the expense of a much lower public capital stock. The government believed that its strong track record would continue to attract foreign investment, even though international financial conditions were more difficult. Given the worsened world economic outlook, the government argued that fiscal expansion could prove usefully countercyclical. However, during the Annual Meetings the government made clear that it stood ready to adjust its plans, should conditions deteriorate markedly.

Figure 6. General Government - Regional Comparison, 2008
(Percent of GDP)



Source: WEO.

Figure 7. FYR Macedonia: Medium-Term Scenarios, 2007–13



Sources: State Statistical Office; Ministry of Finance; NBRM; and IMF staff estimates.

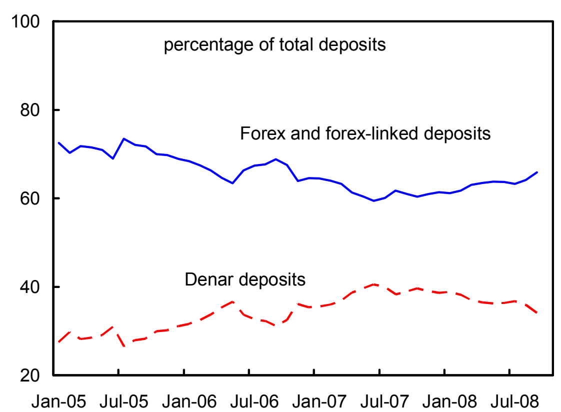
B. Monetary and Financial Sector

After easing through 2007 the NBRM has started to tighten monetary policy

17. **Monetary policy eased for much of the program, driven by capital inflows and reserve accumulation under the peg (Figures 8–9, Tables 8–9).** From 2005 to 2007, gross reserves increased by €400 million (6 percent of GDP). The NBRM issued central bank and treasury bills to sterilize, but this attracted further inflows. With limited ability to resist these forces, and facing pressure from the Ministry of Finance, central bank rates fell below 5 percent, low by historical standards and only a little above ECB rates.

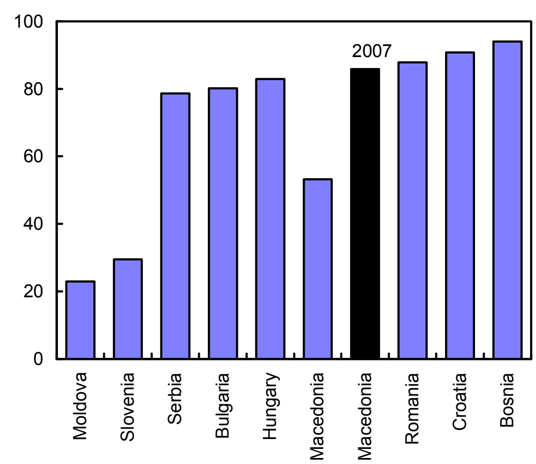
18. **Despite expanding rapidly, the Macedonian banking system remains small compared to the region, with credit only around 40 percent of GDP**. Banks with majority foreign ownership have increased their market share to more than 85 percent of total assets, versus 50 percent at end-2006 (however, only one of these banks is active internationally). With increasing bank competition, commercial lending rates fell below 10 percent (real rates were even lower) and credit growth in 2007 increased to almost 40 percent.

Euroization



Sources: NBRM

Asset share of Foreign Banks (percent)

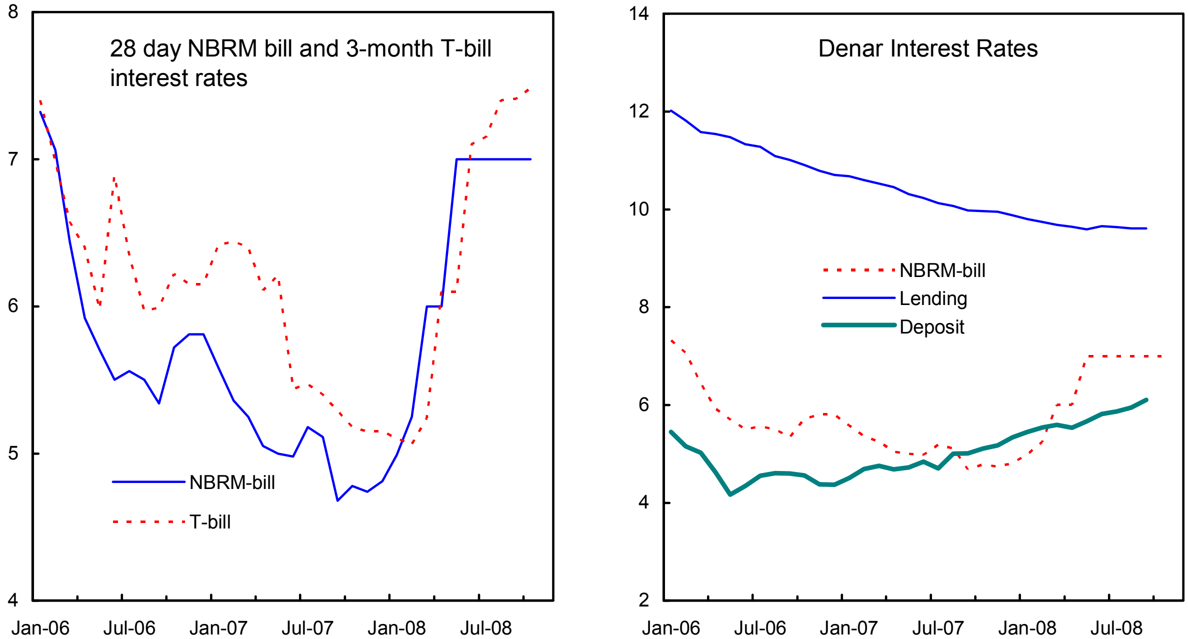


Data for 2006, unless indicated otherwise.
Sources: NBRM; and EBRD.

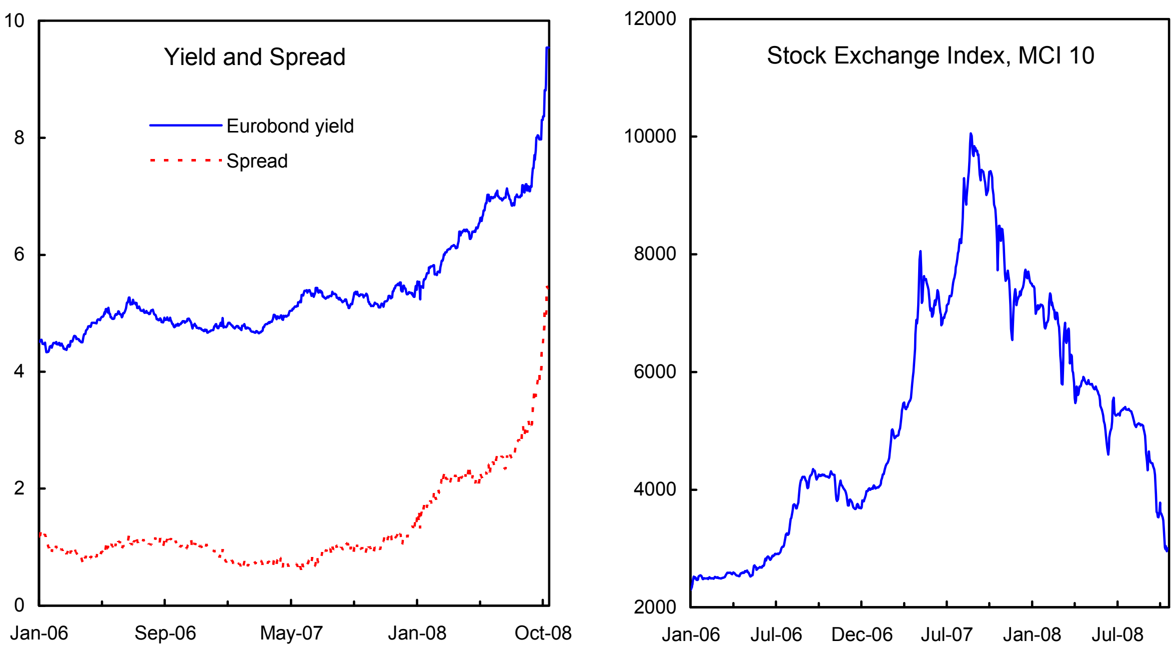
19. **During 2008, the NBRM started to tighten monetary policy.** The NBRM switched to an interest rate tender (to increase the signaling role of its policy rate) and gradually raised central bank rates to 7 percent. In March it raised capital adequacy requirements for overdraft and credit card loans. Given uncertainties over the transmission mechanism, in June it also introduced quantitative controls, requiring banks to place low interest deposits if their household credit growth was set to exceed 40 percent by end-year.

Figure 8. FYR Macedonia: Financial Market Developments, 2006–08

The NBRM increased rates in 2008. While deposit rates have partly followed, increased bank competition has pushed lending rates lower.

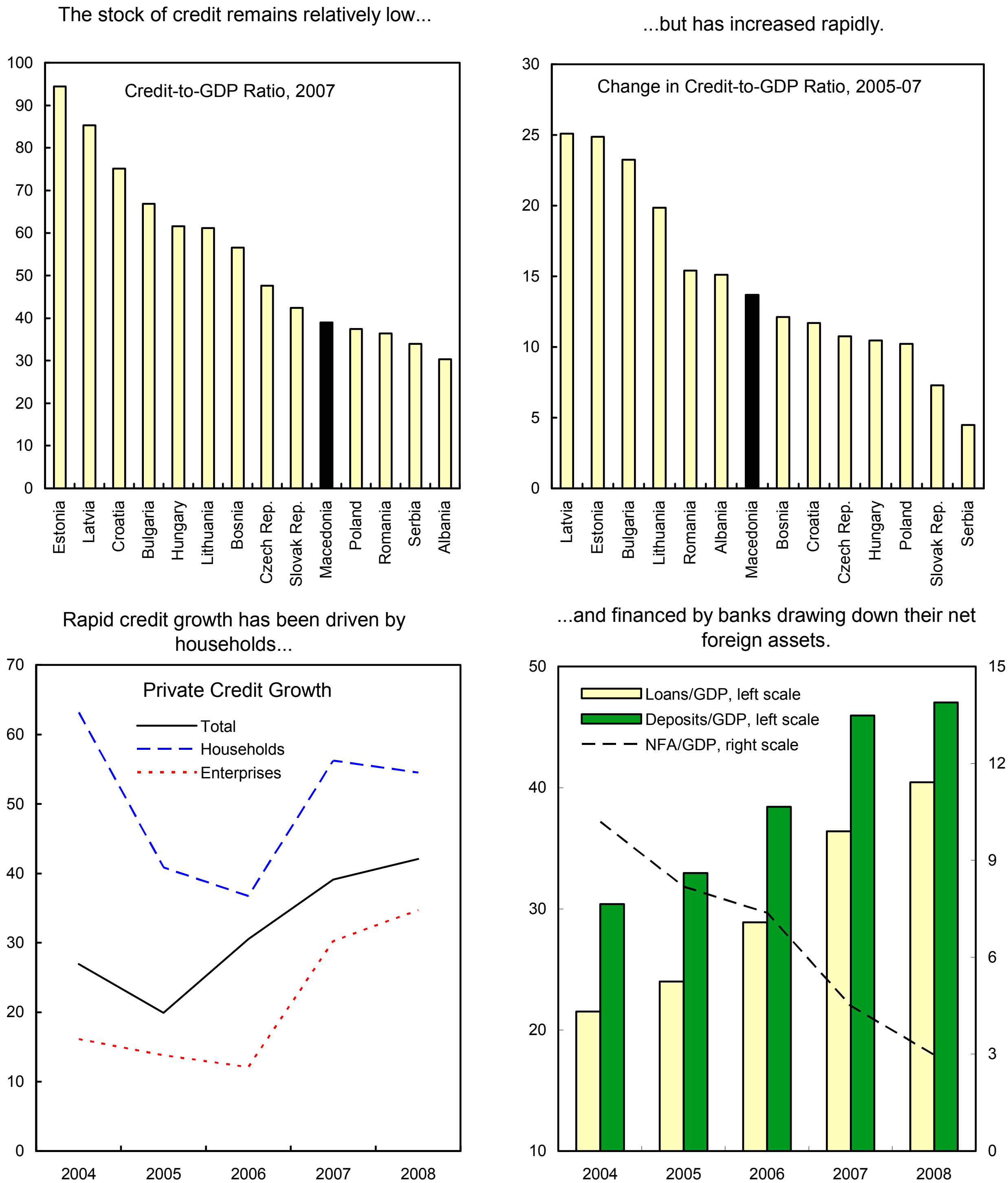


International financial turmoil has had limited impact on the real economy, but its impact can be seen in wider eurobond spreads and sharp declines in the stock market.



Sources: NBRM; and IMF staff estimates.

Figure 9. FYR Macedonia: Credit Developments, 2004-08



Sources: NBRM; and IMF staff estimates.

Increased vulnerabilities mean further action may be required

20. **The mission welcomed the NBRM's actions but recommended further interest rate increases to slow credit growth**. Despite the fixed exchange rate, the central bank now had room to raise interest rates, since international reserves had leveled off. Commercial banks had increased deposit rates in line with higher NBRM rates. Lending rates had fallen, but this reflected increased competition and that central bank rates had been too low to be binding. If increased sufficiently, higher central bank rates should eventually cause commercial banks to raise lending rates. However, while the NBRM was open to taking further action should credit growth not slow sufficiently, the government opposed monetary tightening.

21. **The staff suggested replacing the NBRM's quantitative controls when they expire in January.** The effectiveness of controls had been undermined, since many banks had decided to pursue market share through rapid credit growth, by paying the penalty of compulsory low interest rate deposits. That said, if foreign credit lines dry up credit growth could fall rapidly. The mission recommended replacing the controls with higher reserve requirements and increased capital requirements for riskier loans (less distortionary than the current bank-by-bank controls, and would also help protect credit quality). The mission also encouraged strengthened reporting requirements on leasing companies, to prevent evasion of the controls.

22. **The banking system seems relatively healthy, though rapid credit growth and court challenges to the NBRM's enforcement powers are of concern (Tables 10−11, Figure 10)**. Stress tests for the Financial Sector Assessment Program (FSAP) update indicate the banking system is sufficiently capitalized to withstand a wide range of shocks, but recent rapid increases in credit need to be carefully monitored (see the accompanying Financial System Stability Assessment for details). The authorities should also develop contingency plans for responding to crises. Although the 2007 Banking Law substantially strengthened the legal and regulatory framework, recent Constitutional Court rulings limit the NBRM's ability to resolve problem banks and to ensure that bank owners are "fit and proper". The authorities agreed to develop new legislation, consistent with the Constitution, that restores these essential powers.

The peg remains appropriate as long as fiscal and monetary policies are supportive

23. **Risks to future external stability are increasing (Tables 12−14)**. The current account deficit is not sustainable at this year's projected level, with estimates suggesting modest overvaluation of around 10 percent (Box 3, Figure 11)—although these are subject to considerable uncertainty. However, the size and speed of the current account deterioration despite little real exchange rate movement suggests exchange rate policies are not the cause, though these could become an issue unless there is macroeconomic policy adjustment. As

outlined in the staff scenario (Table 7), a combination of policy tightening, structural reforms, and sustained strong foreign direct investment (but which is export-oriented) could maintain external stability. Risks on the capital account are also growing, where projections suggest that significant new external borrowing will be needed to stabilize reserve cover. Maturities are also likely to shorten.

Box 3. Assessment of Competitiveness and External Stability

The assessment of competitiveness and external stability is mixed.[1/]

On the plus side, export growth has been strong (though not well-diversified), structural competitiveness indicators are improving, and (until recently) unit labor costs and the real exchange rate have shown competitiveness gains.

However, formal assessment of the real exchange rate gives diverse results. The simple PPP approach shows undervaluation, while CGER-based assessments suggest some overvaluation:

- ERER results (relating the exchange rate to fundamentals) suggest overvaluation of around 2-3 percent in the most recent period, reflecting real appreciation beginning in late 2007.
- MBA results show a 3.0 percent of GDP gap between the norm and underlying current account deficit, suggesting overvaluation of 3 to 11 percent, depending on the trade elasticities.
- ESA results suggest 6 to 17 percent overvaluation, depending on trade elasticities and the target net international investment position (the assessment considers the average IIP for other SEE countries and for all transition countries).

This assessment is subject to considerable uncertainty. It is difficult to analyze "the" equilibrium real exchange rate in a rapidly evolving transition economy. There are also significant uncertainties over projections of private transfers, the world economic outlook, and coefficients from econometric estimates.

Real Exchange Rate Assessment

Approach	Assessment
Purchasing Power Parity Approach (PPP)	Undervalued
Equilibrium Real Exchange Assessment (ERER)	Overvalued 2−3 percent
Macroeconomic Balance Approach (MBA)	Overvalued 3−11 percent
External Sustainability Approach (ESA)	Overvalued 6−17 percent

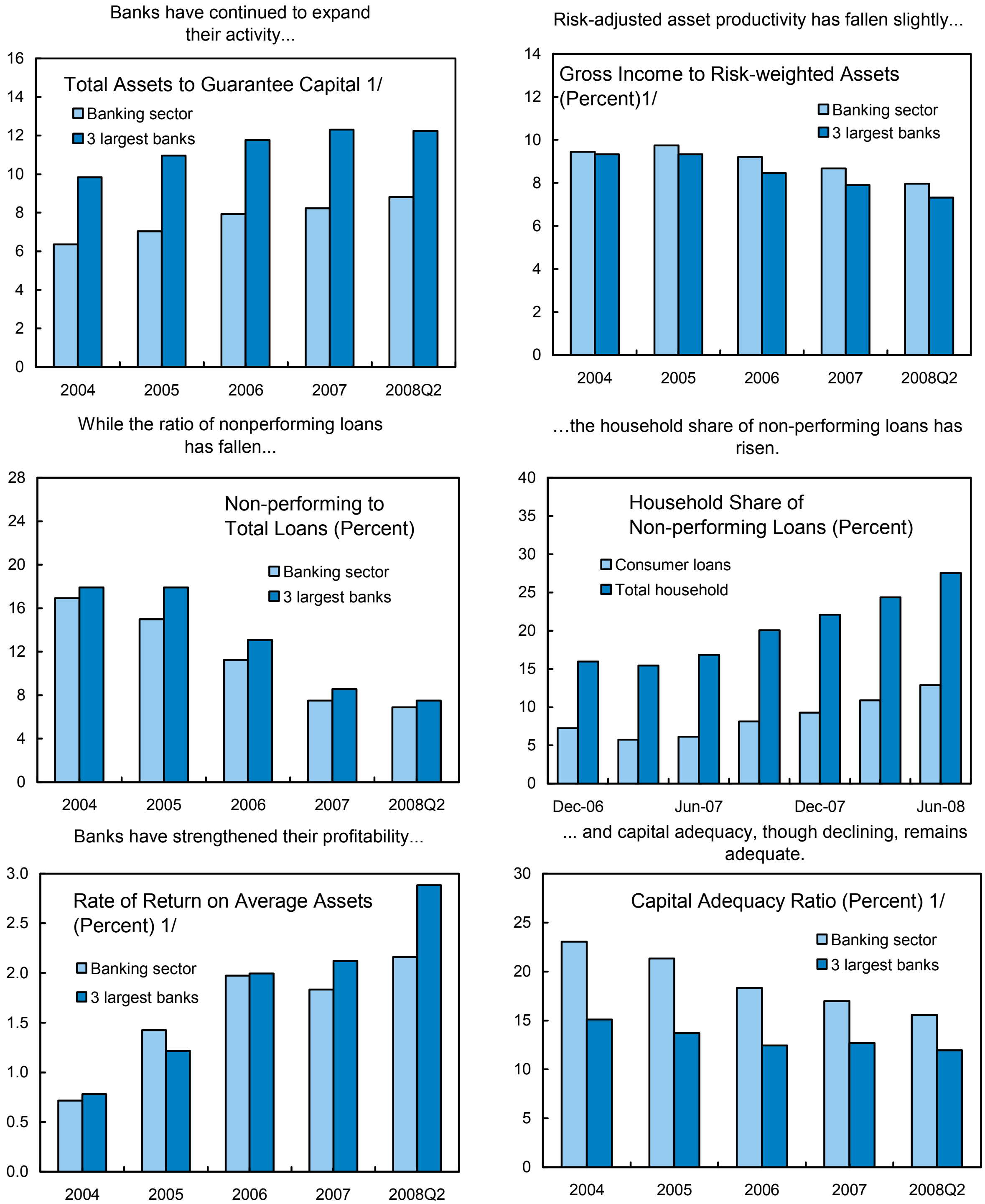
Macroeconomic Balance Approach: Estimation of Underlying Current Account Deficit and Norm (in percent of GDP)

Underlying Current Account (2013 projection)	-10.0
Estimated Current Account Norm	-7.0
Deviation of underlying from norm	-3.0

Sources: WEO, Imam and Minoiu (2008), Rahman (2008), NBRM, and staff estimates.

1/ For further details, see Table 4, Figure 5, and the Selected Issues.

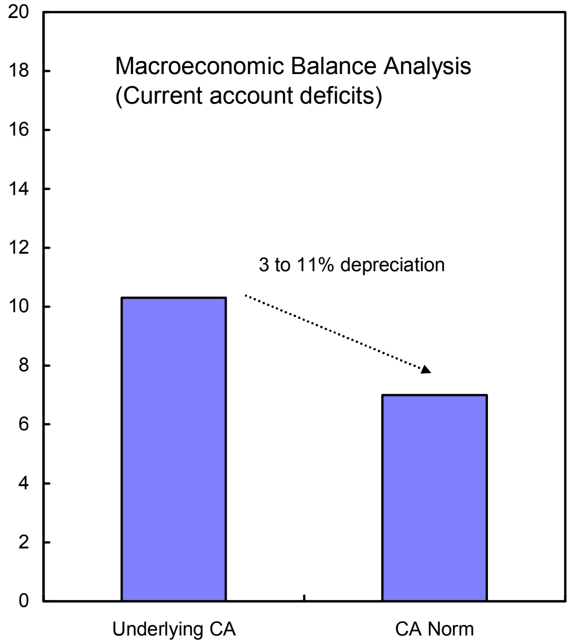
Figure 10. FYR Macedonia: Banking Sector Developments, 2004–08



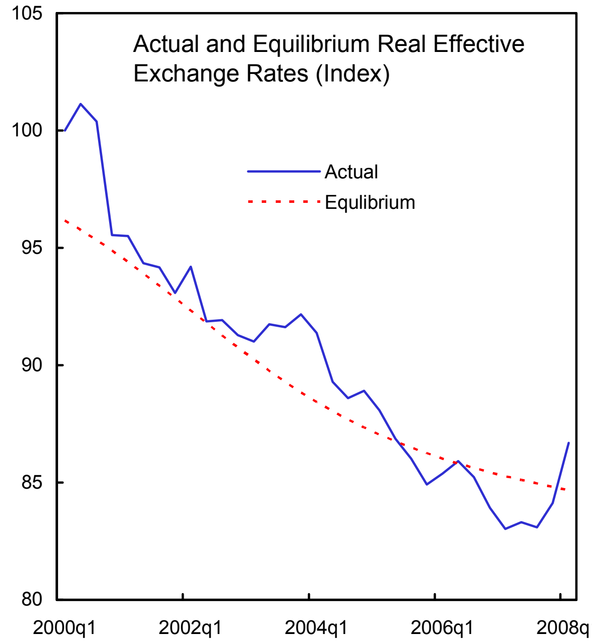
Sources: NBRM; and Fund staff estimates.
1/ Total assets include off-balance sheet items.
2/ Adjusted for unallocated provisions for potential losses.

Figure 11. FYR Macedonia: Exchange Rate Assessment, 2000-08

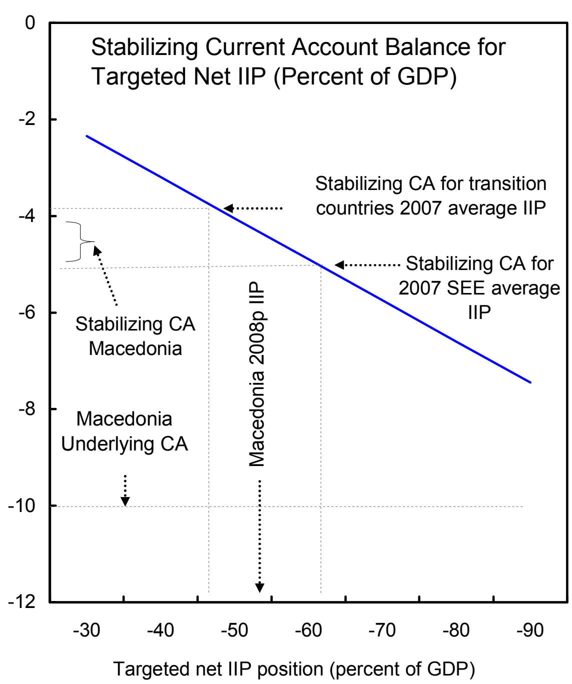
The underlying current account deficit is above the current account norm, implying some overvaluation.



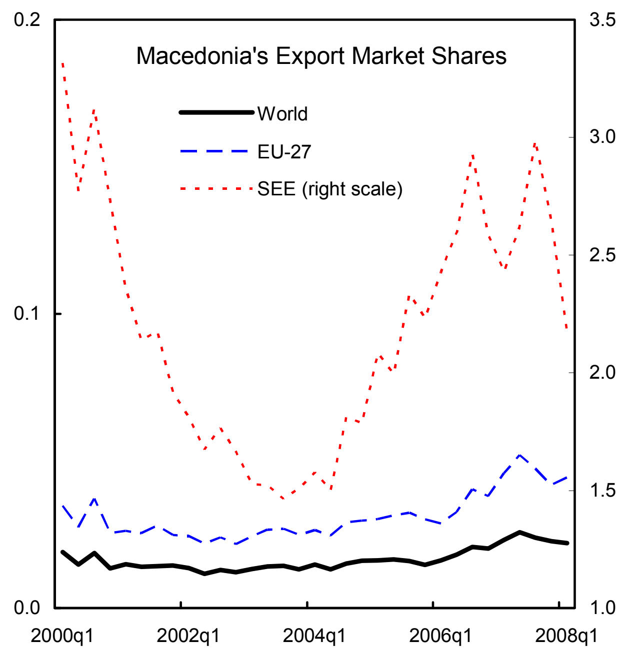
Estimates of the equilibrium real exchange rate suggest recent shift to modest overvaluation.



Stabilizing the net IIP at 2008 level (within the range of peer countries) would require reduction in Macedonia's CAD



Macedonia's export market shares have been increasing but are sensitive to ToT movements.



Sources: WEO; IFS, DOTS; and IMF staff estimates.

Note: The current account norm is estimated using coefficients from Imam and Minoiu (2008) and Rahman (2008). The underlying current account = medium-term (2013) projection. The IIP-stabilizing current account position assumes potential growth of 5 percent and 3 percent inflation.

24. **The fixed exchange rate regime has been appropriate, but its maintenance depends on supportive policies**. Macedonia is a small open economy, with trade concentrated towards the Euro area, incomplete financial market integration, and partial euroization. This makes fixed exchange rates appropriate (SM/06/252). The fixed exchange rate is also a valuable nominal anchor. However, unless structural reforms are able to attract sustained FDI (at a time of increased international financial turmoil) or the terms of trade improve, then macroeconomic policies may need to adjust to protect the peg, even if sometimes this means sacrificing internal balance.

C. Structural Reform

25. **The fixed exchange rate makes structural reform critical for competitiveness and raising potential growth.** The new government's strong majority makes it well placed to accelerate these reforms.

26. **The mission welcomed the government's plan to reduce minimum social contributions, provided the fiscal cost is offset.** Reducing minimum contributions will encourage the low paid to enter the formal economy. While a useful first step, the mission urged the government to go further and abolish minimum contributions altogether. The mission strongly commended the government for preparing to include food and transport allowances as taxable income. This would remove a source of distortion and tax avoidance, and could help finance lower labor tax rates.

27. **However, the government's more ambitious plan to cut rates for all workers by 10 percentage points over three years will cost more than 2½ percent of GDP**. The mission cautioned that this will worsen the social funds' already weak financial condition. It could lower standards of health services today and result in inadequate future pensions. Unless compliance improves dramatically, additional measures will be needed to pay for the fiscal costs.

28. **The mission urged the government to improve public expenditure management, to ensure that the planned increase in public investment was not wasted.** Investments should be subjected to cost-benefit analysis, integrated into the annual budget, and future operating and maintenance costs included. Instead of repeatedly introducing supplementary budgets with new spending, more time should be spent improving the original budget, then ensuring its implementation.

29. **The government has greatly strengthened tax administration**. Creation of a large taxpayer office has improved compliance and simplified tax preparation for firms, while recent Public Revenue Office law amendments will improve staff flexibility. The authorities also intend to harmonize the bases for social security contributions with the personal income tax, and to make these depend on gross rather than net wages. This will ease the computation

burden and simplify tax administration, and has the potential to raise additional revenues. The mission strongly supports this ambitious reform.

30. **The business environment is also improving (Table 15)**. The authorities have implemented a 'regulatory guillotine' (abolishing unnecessary regulations) and expanded coverage of the real estate cadastre. Time for business registration was cut from five days to four hours, and tax rates lowered. As a result, Macedonia recorded excellent improvements in the World Bank's 'Doing Business' surveys. However, privatization has slowed (missing opportunities to bring in outside investment and expertise) and protracted disputes with foreign investors have complicated business conditions in the energy sector.

31. **Despite these improvements, electricity sector distortions have worsened, increasing the trade and budget deficits (see Selected Issues).** The government took the difficult step of ending electricity subsidies for large-users, and making them pay import prices. This saved the budget 2 percent of GDP. However, domestic retail prices have been kept at low levels. Domestic production shortfalls due to low rainfall and insufficient maintenance have increased the electricity trade deficit to almost 5 percent of GDP. The mission urged the government to respect the independence of the energy regulatory commission, especially when setting prices, so that electricity firms could cover costs. The government also needs to develop measures to protect the poor from electricity price increases.

IV. Staff Appraisal

32. **Expansionary macroeconomic policies, improvements in the business climate, and a surge in FDI have boosted growth**. Though there is substantial room for catch up, living standards have improved and employment have increased.

33. **While growth has improved, macroeconomic vulnerabilities have increased**. Inflation reached double digits this year, but now has started to decline due to lower food prices and the exchange rate anchor. However, the current account deficit has widened dramatically, by more than 10 percent of GDP in one year, to a projected 14 percent of GDP. The real exchange rate may have become somewhat overvalued. However, worsening terms of trade, and rapid increases in pensions and public sector wages, public investment, and household credit have been the main causes of the current account deterioration.

34. **Recent international financial turmoil will increase external vulnerabilities**. While the direct impact of the turmoil on Macedonia's financial sector has been limited, the indirect impact is growing. Export demand has started to fall, with the metals sector laying off workers. Potentially lower FDI and portfolio inflows (due to tighter international credit markets) and weaker remittances (driven by lower world growth) could create additional balance of payments pressures.

35. **Macroeconomic vulnerabilities could have been reduced by letting the automatic stabilizers work**. The government should have acted countercyclically by saving this year's strong revenue overperformance, even if this meant running a central government budget surplus. Instead, the government's decision to raise spending by almost 4 percent of GDP, if implemented, will add to domestic demand and worsen the current account deficit.

36. **Plans for further increases in the fiscal deficit ignore these growing macroeconomic vulnerabilities and should be reconsidered.** Increasing the central government deficit to 3 percent of GDP in 2009, then to 4 percent by 2011, will increase pressure on inflation and the current account.

37. **Monetary policy should be in line with the fixed exchange rate regime**. Despite the constraints of the exchange rate peg, the central bank could have raised interest rates more aggressively earlier this year, given the slowdown in reserve accumulation. This might have reduced credit growth and lessened the current account deficit deterioration. Credit controls should be replaced when they expire in January by raising reserve requirements, or increasing capital requirements on riskier loans. Looking ahead, higher interest rates would also help slow credit growth, though the international financial turmoil may also have this effect. In either case, the priority of monetary policy should be to protect the exchange rate.

38. **Macroeconomic policy adjustment would support the fixed exchange rate**. Pre-announcing expansionary fiscal deficit targets over the medium term is risky, given that fiscal policy needs to be ready to respond flexibly to defend the peg. Reversing this planned fiscal expansion would reduce external vulnerabilities, and lessen the risk of a "sudden stop" in the event of an unanticipated shock. The central bank would then have less need to increase interest rates, so private investment would be higher. While projections of external sustainability are subject to far greater uncertainty than normal, the government should be ready to tighten fiscal policy should risks to external stability increase.

39. **Significant progress has been achieved since the 2003 FSAP in improving banking supervision**. Implementation of the FSAP update recommendations would strengthen financial sector supervision, and address gaps in nonbank financial sector supervision. However, residents' unhedged foreign exchange borrowing remains a significant vulnerability. The authorities should develop contingency plans in case of spillovers from the international financial turmoil. They should also find a way to restore the NBRM's supervisory powers that were recently ruled unconstitutional.

40. **Structural reform is critical to sustained rapid economic growth, and to economic convergence.** The government's efforts to improve the business climate, encourage foreign direct investment, and cutting labor taxes to stimulate employment will increase potential growth. However, the government should reinvigorate its privatization

plans, address the budgetary and trade deficit problems caused by artificially low electricity prices, and strengthen the social safety net to protect the poorest electricity consumers.

41. **In sum, while the authorities have reformed the economy and boosted growth, increasing external vulnerabilities could put these gains at risk, and call for reconsidering plans for fiscal expansion, and for accelerating structural reform**. Since the Stand-By Arrangement has expired in August 2008, it is recommended that the next Article IV consultation with FYR Macedonia take place in 12 months.

Table 1. Effectiveness of Fund Policy Advice

Macroeconomic Policy

- For much of the program, the main objectives of macroeconomic stability, boosting growth, and reducing external vulnerability were achieved.
- Growth averaged around 5 percent, and though inflation picked up in late 2007 through 2008 this is due mainly to food and energy price shocks, so should prove temporary.
- International reserves increased significantly in 2006 and 2007, boosting confidence in the peg and allowing significant interest rate reductions.
- However, the sharp deterioration in the current account deficit in 2008—though largely covered by increased FDI—points to increased external vulnerability.

Fiscal Policy—maintaining a low central government deficit

- At first the government followed Fund advice and even out-performed the program's deficit targets, running a small 0.6 percent of GDP deficit in 2006 and a 0.6 percent surplus in 2007.
- However, with inflation increasing and the threat of a widening current account deficit, in early 2008 Fund staff advised saving the revenue overperformance, and running a surplus of around 1-2 percent of GDP.
- The authorities instead increased spending to try to meet this year's 1.5 percent of GDP deficit target, pointing to the need to raise public investment and that government debt ratios are low.

Tax Administration—improving revenue collection

- The partnership between the government and the FAD-Dutch tax administration reform project has been successful. Implementation of the reforms has been impressive, and government ownership very strong.
- In part because of these reforms, the share of revenues in GDP increased by around 1 percentage point, despite substantial cuts in tax rates.
- Creation of a large taxpayer office has strengthened compliance and improved taxpayer services, while recent amendments to the Public Revenue Office (PRO) law will improve flexibility in rewarding performance.
- The authorities have now brought forward a critical element of these reforms—integrating collections from the three separate social funds into the PRO—to January 2009. This will greatly simplify the collection (and payment) of taxes and social contributions.

Tax Policy

- The Fund has supported many but not all of the government's tax-cutting initiatives.
- Staff concerns over lowering personal and corporate income taxes to a flat 12 percent in 2006 and 10 percent in 2007 proved misplaced, since revenues held up much better than projected.
- Fund advice to abolish the double deduction for depreciation, to harmonize minimum contribution bases for social insurance (and abolish so-called complexity factors), to introduce a simplified tax system for small businesses, and to base health contributions for part-time workers on hours actually worked rather than assuming full time work (which will reduce the labor tax wedge and help encourage part-time work) has been followed, and generally has been effective.

Table 1. Effectiveness of Fund Policy Advice (Concluded)

Rationalizing Government Spending

- At the government's request, FAD technical assistance gave detailed advice to help it meet its 2006 manifesto commitment to cut the share of government spending in the economy by 2 percent of GDP (to help pay for planned tax cuts).
- However, with tax revenues rising sharply, the government ignored this goal and did not implement these recommendations.

Banking Law

- The new Banking Law, adopted by Parliament in May 2007, was prepared with the help of extensive MCM TA.
- In keeping with international best practice, the new law strengthens banks' governance, tightens provisions on connected lending, and establishes a framework for consolidated supervision.
- The law also contains provisions to protect the governor's decisions in the areas of bank licensing, administration and bankruptcy from reversal by the courts. This enabled the NBRM to successfully close a small but lingering problem bank in October 2007.
- However, contrary to the government's earlier assessment, critical provisions of the new Law have recently been found unconstitutional. Corrective amendments now need to be prepared.

Central Bank Law

- A new Central Bank law, prepared with the help of MCM and LEG TA, is expected to be submitted to Parliament soon.
- The primary objective of the NBRM will remain to achieve and maintain domestic price stability, and the NBRM will retain full autonomy in achieving that goal. However, responsibility for exchange rate policy will be shared by the NBRM and MOF.
- The draft law strengthens the NBRM's governance, including by providing a clearer division of responsibilities between the Governor and the NBRM Council.

For both the 2007 Banking Law and the pending Central Bank Law, the effectiveness of Fund technical assistance was enhanced by the anchor provided by the Stand-By Arrangement.

Table 2. FYR Macedonia: Selected Economic Indicators, 2004–08

	2004	2005	2006	2007	2008 Proj.
	(Percent change)				
Real economy					
Real GDP	4.1	4.1	4.0	5.0	5.5
Consumer prices					
Period average	-0.4	0.5	3.2	2.3	8.5
End of period	-2.1	1.6	3.0	6.7	5.5
Real wages, period average	4.4	2.0	4.1	5.6	…
Unemployment rate (average)	37.2	37.3	36.0	34.9	34.8
	(In percent of GDP, unless otherwise indicated)				
Government finances					
Central government balance	0.7	0.3	-0.5	0.6	-1.5
Revenues (including grants)	36.5	35.6	32.9	34.3	36.8
Expenditures	35.8	35.3	33.4	33.7	38.2
Central Government debt 1/					
Gross	36.6	39.5	31.5	24.2	21.7
Net	32.5	31.9	22.5	25.6	17.8
Money and credit					
Broad money (M3, percent change)	16.1	14.9	24.5	29.4	13.0
Private sector credit growth (percent change)	25.0	20.5	30.5	39.1	35.1
Short-term lending rate (percent) 2/	11.8	10.8	9.5	8.6	8.7
NBRM short-term rate (28-day bill, end-period) 3/	10.0	8.5	5.8	4.8	7.0
	(In millions of euros, unless otherwise indicated)				
Balance of payments					
Exports	1,345	1,643	1,903	2,441	2,949
Imports	2,259	2,501	2,923	3,614	4,694
Trade balance	-914	-858	-1,020	-1,173	-1,745
In percent of GDP	-21.1	-18.4	-20.1	-20.9	-27.6
Current account balance	-363	-121	-45	-171	-881
In percent of GDP	-8.4	-2.6	-0.9	-3.0	-14.0
Overall balance	-23	345	305	65	-65
Official gross reserves	717	1,123	1,417	1,524	1,507
In months of imports	2.9	4.0	4.1	3.4	3.2
External debt service ratio 4/	20.7	18.4	22.6	30.7	27.5
External debt to GDP ratio (percent) 5/	47.9	53.9	49.1	48.4	54.2
Exchange rate					
Denars/Dollar (average) 6/	48.6	49.3	48.8	44.7	40.3
Denars/Euro (average) 6/	61.3	61.3	61.2	61.2	61.2
Real effective exchange rate (CPI-based, percent change) 7/	-2.3	-3.4	-1.6	-2.0	4.3

Sources: Data provided by the authorities; and IMF staff projections.

1/ Movements in 2005 and 2006 reflect the issuance of a Euro 150 million Eurobond and repayment of the London club debt. Net debt is defined as gross debt minus NBRM deposits of the central government.

2/ Weighted averages for December of each year. For 2008, the data is for September.

3/ For 2008, the data is as of October.

4/ Debt service due including IMF as percent of exports of goods and services. Excludes rollover of trade credits.

5/ Total external debt, including trade credit. Revised methodology applied to data beginning in 2004.

6/ Data for 2008 is through end-September.

7/ Data for 2008 is through end-June.

Table 3. Macedonia: Balance of Payments (Baseline), 2007−13 1/

(In millions of Euros)

	2007	2008		2009	2010	2011	2012	2013
	Prel.	Prog.	Proj.	Projections				
Current account	-171	-343	-881	-916	-919	-990	-986	-939
(Excluding official transfers)	-195	-410	-945	-992	-1,018	-1,098	-1,101	-1,055
Trade balance (fob)	-1,173	-1,471	-1,745	-1,842	-1,963	-2,087	-2,136	-2,149
Exports	2,441	2,690	2,949	3,107	3,430	3,795	4,115	4,432
Imports	-3,614	-4,161	-4,694	-4,949	-5,394	-5,882	-6,251	-6,581
Services (net)	26	33	27	28	41	59	72	85
Income (net; including net interest) /2	-33	-20	-132	-194	-172	-215	-262	-290
Of which: Telecom dividend	0	-71	-71	-92	-30	-30	-30	-30
Transfers (net)	1,010	1,115	970	1,092	1,175	1,254	1,339	1,415
Official	24	67	63	76	100	107	115	116
Private	986	1,048	906	1,016	1,075	1,146	1,224	1,299
Of which: cash exchange	695	750	605	710	755	808	866	921
Capital and financial account	306	594	838	875	1,090	1,054	1,014	969
Capital account (net)	1	-20	-25	0	0	0	0	0
Financial account	304	614	863	875	1,090	1,054	1,014	969
Net disbursements	-39	205	86	191	372	361	327	286
Disbursements	300	451	295	489	692	707	715	709
Amortization	-339	-246	-209	-298	-320	-346	-388	-424
Of which: prepayments 3/	170	0	0	0	0	0	0	0
Direct and portfolio investment (net)	351	407	511	540	571	555	563	574
Direct investment	240	282	515	481	496	478	482	487
Of which: nonprivatization related FDI	250	282	493	481	496	478	482	487
Portfolio investment	111	125	-5	59	75	78	81	87
Currency and deposits (net)	6	-48	96	39	35	30	24	19
Of which: commercial banks	68	31	122	110	110	110	110	110
Other credits (net)	-13	50	170	105	111	108	99	90
Of which: trade credits	-33	38	175	90	95	90	80	70
Errors and omissions	-70	0	-22	0	0	0	0	0
Overall balance	65	251	-65	-41	171	64	27	30
Financing	-65	-251	65	41	-171	-64	-27	-30
Net foreign assets (flows)	-144	-251	30	41	-171	-64	-27	-30
Valuation effects on the stock of NFA (increase: -)	-6	0	4	0	0	0	0	0
Change in the stock of NFA (increase:-)	-149	-251	34	41	-171	-64	-27	-30
Change in gross foreign reserves (increase:-)	-108	-251	17	41	-171	-64	-27	-30
IMF (net)	-42	0	0	0	0	0	0	0
Other (net)	0	0	17	0	0	0	0	0
Change in arrears 4/	79	0	35	0	0	0	0	0

Sources: Data provided by the authorities; and IMF staff estimates and projections.

1/ NBRM recently issued revised BOP statistics based on new surveys and other sources, resulting in some changes to current and capital accounts from 2003 onwards.

2/ For 2008 and beyond, the figures include accrued interest on reserves.

3/ Amortization payments include prepayment of London Club debt in 2006 and Paris Club debt in 2007.

4/ Private sector arrears.

5/ Gross international reserves in percent of short-term debt (residual basis) plus current account deficit (0 if surplus)

6/ Revised debt series completed end-2007 resulted in upward revisions in debt stock beginning 2004. Program figures (2008) were adjusted for

7/ Debt service due including IMF as percent of exports of goods and services. Excludes rollover of trade credits.

8/ Including IMF.

Table 3. FYR Macedonia: Medium-Term Balance of Payments (Baseline), 2007−13, (Concluded) 1/

	2007	2008		2009	2010	2011	2012	2013
	Prel.	Prog.	Proj.	Projections				
Memorandum items:								
Current account (in percent of GDP)	-3.0	-5.8	-14.0	-13.3	-12.2	-12.1	-11.3	-10.0
(Excluding official transfers)	-3.5	-6.9	-15.0	-14.4	-13.5	-13.4	-12.6	-11.3
Trade balance (in percent of GDP)	-20.9	-24.8	-27.6	-26.7	-26.1	-25.5	-24.4	-22.9
Exports f.o.b. (in percent of GDP)	43.5	45.3	46.7	45.1	45.6	46.4	47.0	47.3
Imports, f.o.b. (in percent of GDP)	64.5	70.1	74.4	71.8	71.6	71.9	71.3	70.2
Non-energy trade balance (in percent of GDP)	-11.0	-14.5	-15.5	-17.5	-16.6	-17.0	-16.4	-15.7
Of which : vehicles (in percent of GDP)	-3.8	-4.3	-4.8	…	…	…	…	…
food (in percent of GDP)	-3.8	-3.5	-3.5	…	…	…	…	…
iron & steel (in percent of GDP)	7.5	6.9	4.6	…	…	…	…	…
Energy trade balance (in percent of GDP)	-9.9	-10.3	-12.1	-9.3	-9.4	-8.5	-7.9	-7.3
Of which: electricity (in percent of GDP)	-3.2	-3.6	-4.8	…	…	…	…	…
Export growth (value, fob)	28.3	9.6	20.8	5.3	10.4	10.6	8.4	7.7
Import growth (value, fob)	23.6	16.4	29.9	5.4	9.0	9.1	6.3	5.3
Export growth rate (volumes)	19.3	15.8	20.8	8.7	12.6	11.8	9.8	9.1
Import growth rate (volumes)	19.0	15.9	22.1	10.2	10.5	8.9	6.5	5.4
Export price increase	7.6	-5.3	0.0	-3.1	-1.9	-1.0	-1.2	-1.3
Import price increase	3.9	0.4	6.3	-4.4	-1.3	0.1	-0.2	-0.1
Terms of trade	105.2	96.8	98.9	100.2	99.6	98.4	97.4	96.2
Nickel prices (in thousands of Euros/metric tonne)	27.1	20.4	15.1	12.1	11.5	11.0	10.8	10.5
Oil prices (US$ per barrel)	71	87	101	75	81	84	86	86
Oil prices (Euro per barrel)	52	59	68	53	54	55	56	56
Food prices (world), percent change (Euro-based index)	5.6	1.9	19.3	0.4	-7.7	-1.4	-2.0	-1.9
Net income (in percent of GDP)	-0.6	-0.3	-2.1	-2.8	-2.3	-2.6	-3.0	-3.1
Private transfers, net (in percent of GDP)	17.6	17.7	14.4	14.7	14.3	14.0	14.0	13.9
Of which: cash exchange (in percent of GDP)	12.4	12.6	9.6	10.3	10.0	9.9	9.9	9.8
formal remittances (in percent of GDP)	2.8	2.7	2.6	2.4	2.3	2.3	2.3	2.3
other private transfers (in percent of GDP)	2.4	2.3	2.2	2.0	1.9	1.8	1.8	1.7
Net FDI (in percent of GDP)	4.3	4.7	8.2	7.0	6.6	5.8	5.5	5.2
Of which: nonprivatization related FDI (in percent of GDP)	4.5	4.7	7.8	7.0	6.6	5.8	5.5	5.2
Gross reserves (in millions of Euros)	1,524	1,774	1,507	1,467	1,638	1,702	1,729	1,759
(In months of following year's imports of G&S)	3.4	4.1	3.2	2.8	2.9	2.8	2.7	2.7
Reserve Cover 5/	117.3	107.4	67.5	53.0	51.8	47.0	43.3	40.7
Short-term debt (in percent of official reserves) 6/	66.6	75.1	94.4	119.9	128.5	143.5	160.3	175.9
On residual basis (in percent of official reserves)	88.8	89.0	108.3	140.3	148.0	163.8	182.7	199.9
Excl. intercompany- (FDI) related loans	65.6	…	77.3	100.1	104.5	114.9	127.6	138.9
External debt service ratio (in percent) 6/ 7/	30.7	11.9	27.5	33.1	37.0	39.9	42.9	45.1
External debt to GDP ratio (in percent) 6/ 8/	48.4	55.2	54.2	59.0	65.2	70.0	74.2	77.2
Medium- and long-term (in percent of GDP)	30.3	32.8	31.6	33.5	37.2	40.1	42.6	44.2
Short-term (in percent of GDP)	18.1	22.4	22.5	25.5	27.9	29.8	31.6	33.0
Of which : Intercompany lending (direct investment)	6.3	…	7.4	8.5	9.5	10.2	10.9	11.5
Nominal GDP (in millions of euros)	5,607	5,938	6,313	6,895	7,530	8,182	8,765	9,373

Sources: Data provided by the authorities; and IMF staff estimates and projections.

1/ NBRM recently issued revised BOP statistics based on new surveys and other sources, resulting in some changes to current and capital accounts from 2003 onwards.
2/ For 2008 and beyond, the figures include accrued interest on reserves.
3/ Amortization payments include prepayment of London Club debt in 2006 and Paris Club debt in 2007.
4/ Private sector arrears.
5/ Gross international reserves in percent of short-term debt (residual basis) plus current account deficit (0 if surplus)
6/ Revised debt series completed end-2007 resulted in upward revisions in debt stock beginning 2004. Program figures (2008) were adjusted for
7/ Debt service due including IMF as percent of exports of goods and services. Excludes rollover of trade credits.
8/ Including IMF.

Table 4. FYR Macedonia: Indicators of Financial and External Vulnerability, 2004–08

	2004	2005	2006	2007	2008
Financial indicators					
Broad money (end of period; percent change from end of previous year)	16.1	14.9	24.5	29.4	13.0
Private sector credit (end of period; percent change from end of previous year)	25.0	20.5	30.5	39.1	35.1
Share of non-performing loans in total bank exposure (end of period, in percent)	13.2	10.9	7.6	5.7	…
NPLs of nonfinancial private sector/gross loans to nonfinancial private sector (percent) 1/	17.0	15.0	11.2	7.5	6.9
Foreign currency deposits (end of period, in percent of broad money)	44.8	46.9	44.6	39.0	41.9
Indexed and foreign currency credit to private sector					
(end of period, in percent of total credit to private sector)	42.3	47.8	54.4	57.1	55.8
External Indicators					
Exports (percent change, in terms of Euro)	11.8	22.2	15.8	28.3	20.8
Imports (percent change, in terms of Euro)	15.5	10.7	16.9	23.6	29.9
Current account balance (in percent of GDP)					
(Including official grants)	-8.4	-2.6	-0.9	-3.0	-14.0
(Excluding official grants)	-9.7	-3.7	-2.0	-3.5	-15.0
Foreign direct investment (in percent of GDP)	6.0	1.6	6.8	4.3	8.2
Gross official reserves					
(In millions of euros)	717	1,123	1,417	1,524	1,507
(In months of next year's imports of goods and services)	2.9	4.0	4.1	3.4	3.2
(In percent of private denar broad money)	84.1	119.0	115.5	86.8	74.0
(In percent of broad money)	46.4	63.7	64.1	53.0	44.0
Ratio of indexed and foreign currency deposit to gross official reserves	114.4	78.6	75.1	73.4	90.8
Ratio of NFA of the monetary system to broad money (in percent)	72.7	80.3	78.0	61.0	48.7
Total external debt (in percent of GDP)	47.9	53.9	49.1	48.4	54.2
Of which : public sector (in percent of GDP)	27.8	31.6	24.8	18.9	17.8
Short-term external debt (by remaining maturity, including trade credit)					
(In percent of GDP)	13.4	14.8	14.1	18.1	22.5
(In percent of official reserves)	80.8	61.6	50.5	66.6	94.4
External debt service payments (in percent of exports of goods and services) 2/	20.7	18.4	22.6	30.7	27.5
Exchange rate (denar per U.S. dollar, period average)	48.6	49.3	48.8	44.7	40.3
REER (average percent change; (-) depreciation)					
CPI-based	-2.3	-3.4	-1.6	-2.0	4.3
ULC-based	5.7	-13.8	-5.3	-9.1	6.7

Source: Staff calculations and estimates based on the data provided by the NBRM.

1/ Data as of 2008 Q2.
2/ Excluding trade credit.

Table 5. FYR Macedonia: Central Government Operations 2006−09

	2006	2007	2008			2009	
			Program	Baseline	Alternative	Baseline	Alternative
			(In percent of GDP)				
Total revenue	32.9	34.3	32.7	36.8	36.8	34.5	34.5
Tax revenue	28.7	29.5	27.1	30.1	30.1	29.0	29.0
Personal Income Tax	2.7	2.6	2.2	2.3	2.3	2.3	2.3
Corporate Income Tax	1.5	1.7	1.4	2.3	2.3	2.3	2.3
VAT	8.8	9.6	9.4	10.0	10.0	10.0	10.0
Excises	3.9	3.9	3.7	3.7	3.7	3.7	3.7
Custom Duties	1.7	1.8	1.9	1.9	1.9	1.9	1.9
Other taxes	0.6	0.7	0.7	0.7	0.7	0.7	0.7
Pension contributions	6.0	5.8	5.2	5.9	5.9	5.2	5.2
Unemployment contributions	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Health contributions	3.0	2.9	2.4	2.9	2.9	2.4	2.4
Nontax revenue	3.2	3.0	4.0	4.4	4.4	3.9	3.9
Capital Revenue	0.6	1.4	1.1	1.7	1.7	1.1	1.1
Of which: Telecom dividend	0.0	0.8	0.7	1.0	1.0	0.7	0.7
Grants	0.5	0.3	0.5	0.6	0.6	0.5	0.5
Total expenditure	33.4	33.7	34.1	38.2	35.3	37.5	34.5
Current expenditure	30.5	29.7	28.6	31.3	31.3	30.6	31.6
Wages and salaries	7.5	6.9	6.0	5.9	5.9	5.9	6.2
Goods and services	4.2	4.3	4.8	5.6	5.6	4.8	5.6
Transfers	17.8	17.6	17.1	19.1	19.1	19.1	19.1
Pensions	8.2	7.7	7.4	8.1	8.1	8.1	8.1
Health	5.1	4.7	4.2	4.7	4.7	4.7	4.7
Local governments	0.7	1.1	2.5	2.7	2.7	2.7	2.7
MEPSO subsidies	...	0.2	0.2	0.4	0.4	0.4	0.4
Other	...	...	...	3.2	3.2	3.2	3.2
Interest	1.0	0.8	0.6	0.7	0.7	0.7	0.7
Capital expenditure	3.0	4.0	5.5	6.9	4.0	6.9	5.2
Lending minus repayment	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Fiscal Balance	-0.5	0.6	-1.4	-1.5	1.5	-3.0	0.0
Fiscal Balance below the line	-0.4	1.1	-1.4	-1.5	1.5	-3.0	0.0
Financing	0.4	-1.1	1.4	1.5	-1.5	3.0	0.0
Domestic	-3.2	2.2	0.6	-0.3	-3.3	0.7	-1.2
Central Bank	-2.3	3.7	0.9	0.3	-2.7	1.0	-0.9
Other domestic financing	-0.9	-1.5	-0.3	-0.6	-0.6	-0.3	-0.3
Privatization receipts	6.5	-0.2	0.1	0.9	0.9	0.2	0.2
Foreign	-3.0	-3.1	0.8	0.9	0.9	2.1	1.0
Memorandum items:							
Contributions to second pillar pensions	0.4	0.5	0.6	0.6	0.6	0.6	0.6
GDP (billion denars)	310.9	343.0	387.1	387.1	384.3	422.7	411.7

Source: MOF and IMF staff estimates.

Table 5. FYR Macedonia: Central Government Operations (Baseline), 2006−09 (Concl.)

	2006	2007	2008			2009	
			prog.	baseline	alternative	baseline	alternative
			(In billion denars)				
Total revenue	102.3	117.6	126.4	142.3	141.3	145.8	142.0
Tax revenue	89.2	101.3	105.0	116.5	115.6	122.6	119.4
Personal Income Tax	8.4	8.9	8.3	8.9	8.8	9.7	9.5
Corporate Income Tax	4.7	5.9	5.3	9.0	8.9	9.8	9.6
VAT	27.2	33.0	36.3	38.6	38.4	42.2	41.1
Excises	12.2	13.3	14.2	14.4	14.3	15.7	15.3
Custom Duties	5.4	6.2	7.4	7.4	7.4	8.1	7.9
Other taxes	1.8	2.5	2.6	2.7	2.7	3.0	2.9
Pension contributions	18.6	20.1	20.2	22.6	22.5	22.2	21.6
Unemployment contributions	1.4	1.5	1.5	1.7	1.6	1.6	1.5
Health contributions	9.4	10.0	9.2	11.2	11.1	10.4	10.1
Non Tax revenue	9.9	10.4	15.3	17.0	16.9	16.5	16.1
Capital Revenue	1.8	4.9	4.1	6.6	6.5	4.7	4.5
Of which: Telecom dividend	0.0	2.9	2.6	3.7	3.7	3.0	2.9
Grants	1.4	0.9	2.0	2.2	2.2	2.1	2.1
Total expenditure	104.0	115.4	132.0	147.9	135.7	158.5	141.6
Current expenditure	94.8	101.8	110.5	121.1	120.3	129.2	130.1
Wages and salaries	23.4	23.6	23.2	23.0	22.7	25.1	25.5
Goods and services	12.9	14.8	18.7	21.5	21.5	20.4	23.1
Transfers	55.3	60.5	66.3	73.9	73.4	80.7	78.6
Pensions	25.4	26.3	28.5	31.3	31.1	34.2	33.3
Health	15.8	16.1	16.3	18.1	18.1	19.8	19.3
Local governments	2.1	3.7	9.5	10.5	10.4	11.4	11.1
MEPSO subsidies	...	0.8	0.8	1.5	1.5	1.6	1.6
Other	...	...	...	12.5	12.3	13.7	13.2
Interest	3.1	2.9	2.3	2.7	2.7	3.0	2.9
Capital expenditure	9.3	13.7	21.4	26.9	15.4	29.4	21.4
Lending minus repayment	0.0	-0.1	0.0	-0.1	-0.1	-0.1	-0.1
Fiscal Balance	-1.7	2.2	-5.5	-5.7	5.8	-12.7	0.0
Fiscal Balance below the line	-1.1	3.7	-5.542	-5.7	5.8	-12.7	0.0
Financing	1.1	-3.7	5.542	5.7	-5.8	12.7	0.0
Domestic	-9.8	7.5	2.146	-1.2	-12.6	3.0	-4.9
Central Bank	-7.2	12.7	3.3	1.2	-10.2	4.2	-3.7
Other domestic financing	-2.6	-5.2	-1.154	-2.4	-2.4	-1.3	-1.2
Privatization receipts	20.3	-0.7	0.2	3.3	3.4	0.8	0.8
Foreign	-9.4	-10.5	3.196	3.5	3.5	8.9	4.1
Memorandum items:							
Contributions to second pillar pensions	1.3	1.9	2.31	2.3	2.3	2.5	2.5
GDP	310.9	343.0	387.1	387.1	384.3	422.7	411.7

Source: MOF and IMF Staff estimates.

Table 6. FYR Macedonia: Macroeconomic Framework (Baseline), 2007–13

(Percentage change, unless otherwise indicated)

	2007	2008		2009	2010	2011	2012	2013
	Est.	Prog.	Proj.	Projections				
Real GDP	5.0	5.0	5.5	4.0	5.0	5.0	4.0	4.0
Real domestic demand	6.9	6.6	8.6	5.8	5.0	4.3	2.7	2.1
Consumption	5.6	5.1	7.1	6.0	5.2	4.4	2.8	2.0
Private	5.6	5.8	6.5	6.0	5.0	4.0	3.0	2.0
Public	5.5	2.0	10.0	6.0	6.0	6.0	2.0	2.0
Fixed investment	14.4	14.3	17.9	5.2	4.3	3.8	2.1	2.1
Private	16.2	14.5	16.5	5.0	4.0	3.5	2.5	2.5
Public	5.8	13.0	25.0	6.0	6.0	5.0	0.0	0.0
Exports (volume)	19.3	15.8	20.8	8.7	12.6	11.8	9.8	9.1
Imports (volume)	19.0	15.9	22.1	10.2	10.5	8.9	6.5	5.4
Contributions to growth	5.0	5.0	5.5	4.0	5.0	5.0	4.0	4.0
Domestic demand	8.2	7.9	10.5	7.3	6.4	5.4	3.4	2.6
Net exports	-3.2	-2.9	-5.0	-3.2	-1.4	-0.4	0.6	1.4
Central government operations (percent of GDP)								
Revenues	34.3	32.7	36.8	34.5	33.8	33.3	33.0	33.0
Expenditures	33.7	34.1	38.2	37.5	37.3	37.3	35.0	34.0
Of which: capital	4.0	5.5	6.9	6.9	6.9	6.5	4.5	4.0
Balance	0.6	-1.4	-1.5	-3.0	-3.5	-4.0	-2.0	-1.0
Savings and investment (percent of GDP)								
Domestic saving	20.1	18.8	13.2	13.6	14.2	13.9	14.3	15.2
Of which: public	3.7	2.0	2.4	0.9	0.4	-0.2	1.7	2.6
Foreign saving 1/	3.0	5.8	14.0	13.3	12.2	12.1	11.3	10.0
Gross investment	23.2	24.6	27.1	26.8	26.4	26.0	25.6	25.2
Fixed investment	19.7	21.3	23.4	23.2	22.8	22.5	22.0	21.7
Consumer prices								
Period average	2.3	4 to 5	8.5	3.0	3.0	3.0	3.0	3.0
End-period	6.7	2.0	5.5	3.0	3.0	3.0	3.0	3.0
Memorandum items:								
Current account balance (in percent of GDP)	-3.0	-5.8	-14.0	-13.3	-12.2	-12.1	-11.3	-10.0
Gross official reserves (in million Euro)	1,524	1,774	1,507	1,467	1,638	1,702	1,729	1,759
Gross official reserves (in months of imports)	3.4	4.1	3.2	2.8	2.9	2.8	2.7	2.7
Central government gross debt (in percent of GDP)	24.2	25.7	21.7	22.9	24.4	26.5	26.7	26.0
Foreign direct investment (percent of GDP)	4.3	4.7	8.2	7.0	6.6	5.8	5.5	5.2
External debt (in percent of GDP)	48.4	55.2	54.2	59.0	65.2	70.0	74.2	77.2
Nominal GDP (in billion denars)	343.0	364.1	387.1	422.7	461.7	501.6	537.4	574.7
Nominal GDP (in million Euro)	5,607	5,938	6,313	6,895	7,530	8,182	8,765	9,373

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

1/ Current account deficit.

Table 7. FYR Macedonia: Macroeconomic Framework (Staff Alternative), 2007–13

(Percentage change, unless otherwise indicated)

	2007	2008		2009	2010	2011	2012	2013
	Est.	Prog.	Proj.	Projections				
Real GDP	5.0	5.0	5.0	3.0	5.0	6.0	6.0	6.0
Real domestic demand	6.9	6.6	6.6	4.4	4.4	4.7	4.2	4.0
Consumption	5.6	5.1	5.3	4.2	3.8	3.8	3.6	3.4
Private	5.6	5.8	6.0	5.1	4.6	4.6	4.3	4.0
Public	5.5	2.0	2.0	0.0	0.0	0.0	0.0	0.0
Fixed investment	14.4	14.3	14.8	5.3	7.8	8.9	6.8	6.9
Private	16.2	14.5	16.5	5.0	8.0	9.0	7.0	7.0
Public	5.8	13.0	6.0	7.0	7.0	8.0	6.0	6.0
Exports (volume)	19.3	15.8	20.8	8.7	12.6	12.0	10.4	9.9
Imports (volume)	19.0	15.9	19.4	9.4	9.7	8.6	6.9	6.5
Contributions to growth	5.0	5.0	5.0	3.0	5.0	6.0	6.0	6.0
Domestic demand	8.2	7.9	8.1	5.4	5.6	5.8	5.1	4.9
Net exports	-3.2	-2.9	-3.1	-2.4	-0.5	0.2	0.9	1.2
Central government operations (percent of GDP)								
Revenues	34.3	32.7	36.8	34.5	34.0	33.5	33.5	33.5
Expenditures	33.7	34.1	35.3	34.4	34.0	34.5	34.5	34.5
Of which: capital	4.0	5.5	4.0	5.2	6.0	6.5	6.5	6.5
Balance	0.6	-1.4	1.5	0.0	0.0	-1.0	-1.0	-1.0
Savings and investment (percent of GDP)								
Domestic saving	20.1	18.8	14.5	15.9	18.0	18.5	19.5	20.5
Of which: public	3.7	2.0	4.8	3.4	3.4	2.5	2.5	2.5
Foreign saving 1/	3.0	5.8	12.2	11.1	9.5	9.5	8.6	7.6
Gross investment	23.2	24.6	26.7	27.0	27.5	28.0	28.1	28.2
Fixed investment	19.7	21.3	23.0	23.3	23.8	24.4	24.5	24.7
Consumer prices								
Period average	2.3	4 to 5	8.5	2.0	3.0	3.0	3.0	3.0
End-period	6.7	2.0	5.5	2.0	3.0	3.0	3.0	3.0
Memorandum items:								
Current account balance (in percent of GDP)	-3.0	-5.8	-12.2	-11.1	-9.5	-9.5	-8.6	-7.6
Gross official reserves (in million Euro)	1,524	1,774	1,621	1,649	1,897	2,042	2,156	2,262
Gross official reserves (in months of imports)	3.5	4.1	3.5	3.3	3.5	3.5	3.5	3.6
Central government gross debt (in percent of GDP)	24.2	25.7	21.8	20.3	18.7	18.1	17.5	17.1
Foreign direct investment (percent of GDP)	4.3	4.7	8.2	7.0	6.9	6.4	6.2	6.0
External debt (in percent of GDP)	48.4	55.2	54.5	59.1	63.9	66.5	67.6	67.6
Nominal GDP (in billions of denars)	343.0	364.1	384.5	411.8	447.5	489.5	535.1	584.5
Nominal GDP (in millions of euros)	5,607	5,938	6,271	6,717	7,299	7,985	8,728	9,533

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

1/ Current account deficit.

Table 8. FYR Macedonia: Central Bank Accounts 2005–09

(End-period; in billions of denars unless otherwise indicated)

	2005	2006	2007	2008		2009
	Dec	Dec	Dec	Sept	Dec	Dec
	Actual	Actual	Actual	Actual	Proj.	Proj
	(At current exchange rates)					
Net foreign assets (NFA) 1/	66.3	85.1	94.3	103.0	91.2	88.7
Net domestic assets (NDA)	-40.5	-53.9	-56.8	-62.7	-50.3	-45.2
Banks (net)	-8.9	-14.0	-25.5	-20.0	-17.2	-16.2
Of which: instruments (NBRM bills)	-8.9	-14.0	-25.6	-20.0	-17.2	-16.2
Central government (net)	-18.3	-25.5	-12.8	-21.1	-11.6	-7.4
Of which: deposits	-21.6	-27.7	-13.8	-22.1	-12.6	-8.4
Municipalities (net)	-0.7	-0.6	-1.6	-2.9	-2.9	-2.9
Other items (net)	-12.7	-13.7	-16.8	-18.7	-18.7	-18.7
Reserve money	25.8	31.3	37.6	38.8	40.9	43.5
Currency	14.4	16.2	17.9	16.6	19.0	19.5
Other	11.3	15.1	19.7	22.3	21.9	24.0
Cash in vaults	1.4	1.5	2.0	2.3	2.3	2.3
Total reserves	9.9	13.5	17.7	20.0	19.6	21.7
On denar deposits	4.6	7.2	10.4	10.2	10.0	10.7
On FX deposits	5.3	6.4	7.3	9.8	9.6	10.9
	(Year-on-year growth rates, percent)					
Net foreign assets	58.5	28.4	10.8	9.3	-3.3	-2.8
Reserve money	22.0	21.4	20.2	19.4	8.7	6.5
Currency	2.0	12.2	10.6	-1.2	5.8	3.0
	(Contribution to year-on-year change in base money)					
Net foreign assets	115.9	73.1	29.5	26.9	-8.4	-8.0
Net domestic assets	-93.8	-51.8	-9.3	-3.0	17.1	14.5
Memorandum items:						
Reserve money/GDP (in percent)	9.0	10.1	11.0	10.3	10.6	10.3
Program exchange rate (denars per euro)	61.3	61.3	61.3	61.3	61.3	61.3
GDP (yearly total) 2/	286.6	310.9	343.0	376.3	387.1	422.7

Sources: NBRM, and IMF staff projections.

1/ Beginning in March 2008, the projections include accrued interest on securities of 4 million euros.
2/ Measured on a rolling basis as a sum of nominal GDP of four preceding quarters including the last quarter of each period.

Table 9. FYR Macedonia: Monetary Survey, 2005–09

(End-period; in billions of denars unless otherwise indicated)

	2005	2006	2007	2008		2009
	Dec	Dec	Dec	Sept	Dec	Dec
	Actual	Actual	Actual	Actual	Proj.	Proj.
	(At current exchange rates)					
Net foreign assets (NFA)	89.7	108.0	109.8	111.9	100.9	94.6
NBRM 1/	66.3	85.1	94.3	103.0	91.2	88.7
Domestic money banks (DMBs)	23.5	22.9	15.4	9.0	9.7	5.9
Net domestic assets (NDA)	19.2	27.6	65.8	85.1	97.4	123.2
Credit to the government	-12.2	-17.9	-6.4	-16.6	-6.9	-4.4
Banks	6.8	8.2	8.0	7.4	7.5	5.9
NBRM (net)	-19.0	-26.1	-14.4	-24.0	-14.5	-10.2
Of which: municipalities	-0.7	-0.6	-1.6	-2.9	-2.9	0.0
Credit to the private sector	68.8	89.8	124.9	160.2	168.7	201.5
In denars 2/	51.7	66.4	94.5	122.4	131.3	154.5
In foreign currency	17.1	23.4	30.4	37.8	37.4	47.1
Other items (net)	-37.4	-44.3	-52.7	-58.5	-64.3	-74.0
Broad money (M3)	108.9	135.6	175.5	197.1	198.3	217.7
Currency in circulation	14.4	16.2	17.9	16.6	19.0	19.5
Private denar deposits 2/ 3/	43.4	59.0	89.1	98.0	96.2	103.1
Private foreign currency deposits	51.1	60.4	68.5	82.5	83.1	95.1
	(Year-on-year growth rates, percent)					
NFA domestic money banks	-13.3	-2.3	-32.6	-48.4	-37.3	-39.3
Credit to the private sector	20.5	30.5	39.1	38.4	35.1	19.5
Denar credit	12.9	28.5	42.3	40.8	39.0	17.6
Foreign currency credit	50.7	36.6	30.0	31.1	23.0	26.0
Broad Money	14.9	24.5	29.4	22.1	13.0	9.8
Private denar deposits	13.8	36.0	51.0	24.6	8.1	7.1
Private foreign currency deposits	20.2	18.3	13.4	25.0	21.2	14.4
Memorandum items:						
M3/GDP (percent)	38.0	43.6	51.2	52.4	51.2	51.5
Forex and forex indexed deposits/total deposits (percent)	68.9	64.6	61.4	65.9	67.0	69.0
Broad money multiplier (M3/reserve money)	4.2	4.3	4.7	5.1	4.9	5.0
NFA of DMBs/forex deposits (percent)	56.3	48.5	33.2	22.7	23.2	17.7
Private credit (percent of GDP)	24.0	28.9	36.4	42.6	43.6	47.7
Nominal GDP (yearly total) 4/	286.6	310.9	343.0	376.3	387.1	422.7

Sources: NBRM, and IMF staff projections.

1/ Beginning in March 2008, the projections include accrued interest on securities of 4 million euros.

2/ Includes foreign currency indexed.

3/ Includes municipal and public enterprise accounts.

4/ Measured on a rolling basis as a sum of nominal GDP of four preceding

Table 10. FYR Macedonia: Financial Soundness Indicators, 2004–08

	2004	2005	2006	2007	2008Q2
Capital adequacy					
Regulatory capital/risk weighted assets	23.0	21.3	18.3	17.0	15.6
Tier I capital/risk weighted assets	27.4	24.3	18.9	15.7	14.0
Asset composition and quality					
Sectoral loans to nonfinancial enterprises/total loans					
Enterprises	63.5	61.7	59.0	54.9	54.3
Households	26.1	30.6	33.4	37.7	38.5
Foreign currency lending					
Foreign currency lending/total credit to private sector	20.0	25.4	26.3	24.6	23.2
Foreign currency indexed lending/total credit to private sector 1/	20.6	23.8	26.4	30.1	31.5
NPLs /gross loans 2/	17.0	15.0	11.2	7.5	6.9
NPLs net of provision /capital 2/	3.8	2.9	0.7	-5.0	-5.1
Large exposures/capital	219.0	189.7	194.7	181.4	121.0
Connected lending					
Banking system exposure to shareholders/capital	7.4	4.3	5.2	5.6	3.2
Banking system equity participation/capital	6.7	7.0	6.3	4.9	4.6
Earning and profitability					
ROAA 3/	0.6	1.2	1.8	1.8	2.2
ROAE 3/	3.1	7.5	12.3	15.0	19.1
Interest margin/gross income	49.6	53.8	57.1	57.0	59.4
Noninterest expenses/gross income	80.5	68.1	63.6	60.3	59.1
Personnel expenses/noninterest expenses	39.2	42.1	41.1	38.4	38.2
Interest rate spreads (in percentage points)					
Local currency	5.5	6.5	6.3	4.5	3.8
Foreign currency	5.6	6.5	6.7	6.5	5.9
Interbank market	6.9	8.7	4.9	3.1	4.6
Liquidity					
Highly liquid assets/total assets 4/	12.0	14.9	17.7	20.6	17.8
Highly liquid assets/total short-term liabilities 5/	17.8	22.0	25.6	28.7	25.1
Customer deposits/total (noninterbank) loans	143.4	142.3	137.1	128.3	118.5
Foreign currency deposits/total deposits (from the balance sheet-excluding deposits of banks)	54.4	55.7	51.8	44.5	45.3
Central bank credit to banks/bank liabilities 6/	0.9	0.7	1.3	2.0	0.5
Sensitivity to market risk					
Net foreign exchange position /capital	52.2	51.6	47.0	38.2	29.9

Source: NBRM's Financial Stability, Banking Regulations and Methodology Department.

1/ The ratio differs from that used in the monetary survey due to different definitions.
2/ Includes only loans to nonfinancial sector.
3/ Adjusted for unallocated provisions for potential loan losses.
4/ Highly liquid assets are defined as cash and balances with the NBRM, NBRM bills, and accounts with foreign banks. Large drop in 2006 compared to 2005 is due to change in methodology.
5/ Short-term liabilities are defined as deposits and other liabilities with a maturity of one year or less. Large drop in 2006 compared to 2005 is due to change in methodology.
6/ The increase in 2006 is due to loans channeled through NBRM, not NBRM credit to banks.

Table 11. FYR Macedonia: Main Findings of the 2008 FSAP Update

Since the 2003 FSAP, the Macedonian financial sector has strengthened and deepened. Favorable macroeconomic conditions helped the banking sector grow by more than 20 percent annually during 2004−07. However, the non-bank financial sector is still small. All key recommendations of the 2003 FSAP have been at least partially implemented.

Rapid credit growth is a concern, particularly given the recent deterioration in the current account. Credit growth has been led by lending to households. Lending has primarily been financed by customer deposits, but increasingly by banks drawing down their assets held abroad. Given their net creditor position, Macedonian banks have not been directly effected by the international financial market turmoil (Box 1).

Stress test results suggest the banking system is sufficiently capitalized to withstand a wide range of shocks, though the large banks face some vulnerability to credit risk. This is not surprising as they dominate the market. In addition, similar to the region, much lending is either denominated or linked to foreign currencies. This transforms banks' currency risk into credit risk, as most borrowers are unhedged. Also, most loans are adjustable rate, so banks do not carry interest rate risk.

Bank supervision has improved significantly. The new Banking Law enacted in 2007 was a major improvement. Its provisions helped the authorities close a small problem bank in 2007.

Most elements of a financial safety net are in place with the establishment of a lender of last resort facility since the 2003 FSAP.

Key recommendations of the FSAP update include:

- Use prudential measures to limit household credit growth and improve credit quality. The NBRM's controls have proved ineffective, with banks exceeding the limits.
- Monitor trends in asset quality and strengthen stress testing, particularly for credit risk.
- The authorities should pass new legislation, consistent with the Constitution, that restores the NBRM's supervisory powers in resolving problem banks, and ensuring that bank owners are "fit and proper".
- Improve financial safety net arrangements by developing contingency plans and conducting crisis simulation exercises.
- Establish the new insurance supervisory agency—failure to do so means there is now a regulatory and supervisory vacuum.
- Strengthen the supervision and enforcement capacity of Macedonian Securities Exchange Commission.
- The pension supervisory agency should introduce risk-based supervision.

Table 12. External Debt Sustainability Framework (Baseline), 2003−13

(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	Debt-stabilizing non-interest current account 6/
Baseline: External debt	46.0	47.9	53.8	49.1	48.4	54.2	59.0	65.2	70.0	74.2	77.2	-6.0
Change in external debt	7.8	1.9	6.0	-4.7	-0.7	5.8	4.8	6.2	4.8	4.2	3.0	
Identified external debt-creating flows (4+8+9)	0.9	3.0	-3.6	-10.4	-7.9	7.1	7.0	5.2	5.2	5.0	3.7	
Current account deficit, excluding interest payments	2.9	7.5	1.6	-0.5	1.5	12.4	11.6	10.3	9.9	8.8	7.6	
Deficit in balance of goods and services	-93.5	-101.2	-107.0	-113.3	-128.7	-144.1	-139.1	-139.5	-140.9	-141.0	-140.4	
Exports	37.5	39.5	44.0	46.8	54.1	58.4	56.4	57.0	58.0	58.8	59.2	
Imports	-56.0	-61.7	-62.9	-66.5	-74.6	-85.7	-82.7	-82.5	-82.8	-82.3	-81.2	
Net non-debt creating capital inflows (negative)	-2.1	-3.2	-2.7	-7.0	-6.3	-4.5	-4.3	-4.3	-3.9	-3.7	-3.5	
Automatic debt dynamics 1/	0.1	-1.3	-2.5	-2.9	-3.2	-0.8	-0.3	-0.8	-0.8	-0.2	-0.3	
Contribution from nominal interest rate	1.2	0.9	1.0	1.4	1.5	1.5	1.7	1.9	2.2	2.4	2.5	
Contribution from real GDP growth	-1.0	-1.8	-1.8	-2.0	-2.2	-2.4	-2.0	-2.7	-3.0	-2.6	-2.8	
Contribution from price and exchange rate changes 2/	-0.1	-0.4	-1.7	-2.3	-2.5	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	6.9	-1.1	9.6	5.7	7.2	-1.3	-2.2	1.0	-0.4	-0.8	-0.7	
External debt-to-exports ratio (in percent)	122.6	121.2	122.3	104.8	89.3	92.7	104.6	114.3	120.5	126.2	130.4	
Gross external financing need (in billions of euros) 4/	513	1,093	913	1,104	1,367	2,241	2,638	2,998	3,441	3,816	4,134	
In percent of GDP	12.5	25.3	19.5	21.7	24.4	35.5	38.2	39.8	42.0	43.5	44.1	
Scenario with key variables at their historical averages 5/						54.2	53.0	55.0	55.4	55.3	55.3	-5.0
Key Macroeconomic Assumptions Underlying Baseline												
Real GDP growth (in percent)	2.8	4.1	4.1	4.0	5.0	5.5	4.0	5.0	5.0	4.0	4.0	
GDP deflator in euros (change in percent)	0.1	0.9	3.7	4.4	5.3	6.7	5.0	4.0	3.5	3.0	2.8	
Nominal external interest rate (in percent)	3.1	2.1	2.2	2.7	3.4	3.5	3.4	3.5	3.6	3.7	3.5	
Growth of exports of goods & services (euro terms, in percent)	6.7	11.1	20.5	15.6	27.6	21.6	5.3	10.4	10.6	8.4	7.7	
Growth of imports goods & services (euro terms, in percent)	-0.6	16.1	10.3	14.8	23.8	29.3	5.4	9.0	9.1	6.4	5.5	
Current account balance, excluding interest payments	-2.9	-7.5	-1.6	0.5	-1.5	-12.4	-11.6	-10.3	-9.9	-8.8	-7.6	
Net non-debt creating capital inflows	2.1	3.2	2.7	7.0	6.3	4.5	4.3	4.3	3.9	3.7	3.5	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in euro terms, g = real GDP growth rate, e = nominal appreciation (increase in euro 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 $[-\rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock. ρ increases with an appreciating domestic currency $(\varepsilon > 0)$ 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; euro 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, euro deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Table 13. FYR Macedonia: Fiscal Debt Sustainability Framework (Baseline), 2003–13

(In percent of GDP, unless otherwise indicated)

	Actual							Projection						
	2003	2004	2005	2006	2007			2008	2009	2010	2011	2012	2013	Debt-stabilizing primary balance 9/
Public sector debt 1/	39.0	36.6	39.5	33.0	25.6			22.0	23.2	24.7	26.8	27.0	26.2	-1.3
Of which: foreign-currency denominated	37.7	34.7	37.1	29.0	22.5			19.4	20.4	21.7	23.5	23.7	23.1	
Change in public sector debt	-4.0	-2.4	3.0	-6.6	-7.4			-3.5	1.1	1.5	2.0	0.2	-0.7	
Identified debt-creating flows	-0.5	-1.5	-1.6	-8.4	-2.4			-1.9	1.1	1.5	2.0	0.2	-0.8	
Primary deficit	-1.0	-1.3	-1.2	-0.5	-1.5			0.8	2.3	2.8	3.3	1.3	0.3	
Revenue and grants	38.4	36.5	35.2	32.9	34.3			36.8	34.5	33.8	33.3	33.0	33.0	
Primary (non-interest) expenditure	37.4	35.2	34.0	32.5	32.8			37.6	36.8	36.6	36.6	34.3	33.3	
Automatic debt dynamics 2/	0.0	-1.1	-1.9	-2.1	-2.2			-2.3	-1.1	-1.2	-1.2	-1.0	-1.0	
Contribution from interest rate/growth differential 3/	-0.2	-1.1	-1.8	-2.1	-2.2			-2.3	-1.1	-1.2	-1.2	-1.0	-1.0	
Of which: contribution from real interest rate	1.0	0.4	-0.4	-0.7	-0.8			-1.0	-0.3	-0.2	-0.1	0.0	0.0	
Of which: contribution from real GDP growth	-1.2	-1.5	-1.4	-1.4	-1.5			-1.2	-0.8	-1.1	-1.1	-1.0	-1.0	
Contribution from exchange rate depreciation 4/	0.1	0.0	-0.1	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
Other identified debt-creating flows	0.6	0.9	1.5	-5.9	1.3			-0.4	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	-0.3	-0.2	-0.2	-6.5	0.2			-0.9	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.9	1.1	1.2	0.7	1.1			0.5	0.0	0.0	0.0	0.0	0.0	
Residual	-3.5	-0.9	4.6	1.9	-5.0			3.9	0.0	0.0	0.0	0.0	0.0	
Public sector debt-to-revenue ratio 1/	101.5	100.2	112.3	100.3	74.6			59.9	67.2	73.1	80.3	81.7	79.5	
Gross financing need 5/	3.2	2.4	3.1	8.4	5.4			7.0	9.0	10.1	10.7	9.1	8.5	
In million euros	131.8	103.9	145.7	426.2	304.1			440.3	620.7	757.3	877.5	800.7	800.7	
Key macroeconomic and fiscal assumptions						7-Year Historical Average	7-Year Standard Deviation							Projected Average
Real GDP growth (in percent)	2.8	4.1	4.1	4.0	5.0	2.3	3.3	5.5	4.0	5.0	5.0	4.0	4.0	4.6
Average nominal interest rate on public debt (in percent) 6/	2.6	2.5	2.7	2.7	2.8	2.9	0.5	2.7	3.6	3.5	3.2	3.0	3.0	3.2
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	2.4	1.1	-1.1	-1.6	-2.3	-0.2	1.6	-4.2	-1.4	-0.6	-0.2	0.0	0.0	-1.1
Nominal appreciation (increase in U.S. dollar value of local currency, in percent)	-0.4	0.0	0.2	0.0	0.0	-0.1	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Inflation rate (GDP deflator, in percent)	0.3	1.3	3.8	4.4	5.1	3.1	1.7	7.0	5.0	4.0	3.5	3.0	3.0	4.2
Growth of real primary spending (deflated by GDP deflator, in percent)	-1.5	-2.0	0.6	-0.9	6.1	2.8	6.1	20.8	1.8	4.4	5.0	-2.6	-2.6	4.5
Primary deficit	-1.0	-1.3	-1.2	-0.5	-1.5	0.4	2.6	0.8	2.3	2.8	3.3	1.3	0.3	1.8
						Stress Tests for Public Debt Ratio								Debt-stabilizing primary balance 9/
A. Alternative Scenarios														
A1. Key variables are at their historical averages in 2008-13 7/								32.3	31.9	31.6	31.2	30.9	30.7	-0.8
A2. No policy change (constant primary balance) in 2008-13								27.3	25.4	23.6	22.0	20.7	20.1	-1.1
B. Bound Tests														
B1. Real interest rate is at baseline plus one standard deviations								28.0	29.0	30.5	32.4	32.7	31.7	-1.4
B2. Real GDP growth is at baseline minus one-half standard deviation								30.1	33.1	37.0	42.0	45.7	44.7	-1.5
B3. Primary balance is at baseline minus one-half standard deviation								30.1	32.1	34.5	37.4	38.5	38.7	-1.9
B4. Combination of B1-B3 using one-quarter standard deviation shocks								29.5	31.2	33.4	36.0	36.9	36.9	-1.4
B5. One time 30 percent real depreciation in 2006 8/								41.0	41.1	41.7	42.9	42.5	40.9	-2.1
B6. 10 percent of GDP increase in other debt-creating flows in 2006								36.7	37.1	37.9	39.3	39.0	37.8	-2.0

1/ Consolidated central government gross debt.

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

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

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

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

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

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

8/ Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

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.

Table 14. FYR Macedonia: Composition of Central Government Debt, 2007–08

	2007		2008 1/	
	Percent of GDP	Percent of gorss debt	Percent of GDP	Percent of gorss debt
Gross debt	24.2	100.0	20.5	100.0
External debt	15.7	64.8	13.7	67.1
Multilateral	11.1	46.0	9.4	45.8
Bilateral	1.2	5.1	1.6	7.8
Private	3.3	13.7	2.8	13.5
Domestic	8.5	35.2	6.7	32.9
Structural bonds	7.1	29.2	5.5	27.1
Treasury bills and bonds	1.4	6.0	1.2	5.8
NBRM deposits	4.0	16.7	4.1	19.8
Net debt	20.2	83.3	16.4	80.2
Memo items:				
Fx-denominated debt	22.5	92.8	16.8	81.8
Short term debt	0.9	3.9	1.2	5.9

Source: NBRM, MOF

1/ End-June 2008 outturn.

Table 15. FYR Macedonia: Level and Composition of External Debt, 2004–08

	2004	2005	2006	2007	2008
Gross external debt (million euros)	2,071	2,518	2,495	2,712	3,419
Gross external debt (percent of GDP)	47.9	53.9	49.1	48.4	54.2
Maturity structure					
Medium-Long-Term (percent of total)	72.0	72.5	71.3	62.6	58.4
Short-Term share (percent of total)	28.0	27.5	28.7	37.4	41.6
Creditor					
Official (percent of total)	44.2	39.8	38.8	29.0	24.4
Private sector share (percent of total)	55.8	60.2	61.2	71.0	75.6
Debtor					
Public (percent of total)	58.0	58.7	50.6	39.1	32.8
Private (percent of total)	42.0	41.3	49.4	60.9	67.2

Source: NBRM, MOF

Table 16. FYR Macedonia: Rankings of Selected Competitiveness and Structural Indicators (0=lowest, 100=best) 1/

	Macedonia		Best performers 2/				Distance 3/	
	2006	2007	Country	2006	Country	2007	2006	2007
World Bank Doing Business survey	46	58	Estonia	90	Estonia	90	-44	-33
Starting a business	54	88	Romania	92	Estonia	89	-38	-1
Dealing with licenses	43	57	Estonia	93	Estonia	92	-51	-35
Employing workers	29	28	Bulgaria	67	Czech Rep.	69	-38	-41
Registering property	51	49	Lithuania	98	Lithuania	98	-47	-49
Getting credit	75	73	Slovak Rep.	93	Slovak Rep.	96	-19	-23
Protecting investors	54	53	Slovenia	89	Slovenia	89	-35	-36
Paying taxes	42	44	Estonia	82	Latvia	89	-40	-44
Trading across borders	45	60	Estonia	96	Estonia	96	-51	-37
Enforcing contracts	53	53	Latvia	98	Latvia	98	-45	-46
Closing a business	29	29	Lithuania	82	Lithuania	83	-53	-54
World Economic Forum								
Global Competitiveness	71	66	Estonia	86	Estonia	84	-15	-18
Institutions	52	54	Estonia	78	Estonia	77	-26	-23
Infrastructure	43	44	Estonia	72	Estonia	66	-28	-22
Macroeconomic stability	81	77	Estonia	86	Estonia	89	-5	-12
Health and primary education	93	87	Slovenia	98	Slovenia	94	-5	-7
Higher education and training	64	63	Estonia	84	Estonia	86	-21	-23
Goods market efficiency	66	65	Estonia	88	Estonia	85	-22	-20
Labor market efficiency	...	68		...	Slovak Rep.	83	...	-16
Financial market sophistication	56	64	Czech Rep.	79	Estonia	82	-23	-18
Technological readiness	45	47	Estonia	88	Estonia	86	-43	-39
Transparency international								
Corruption Perception Index	27	33	Estonia	67	Slovenia	66	-40	-33
EBRD transition indicators	72	73		92		92	-21	-20
Large scale privatization	77	77		92		92	-15	-15
Small scale privatization	92	92		100		100	-8	-8
Enterprise restructuring	62	62		85		85	-23	-23
Price liberalization	100	100		100		100	0	0
Trade and foreign exchange system	100	100		100		100	0	0
Competition policy	46	54		85		85	-39	-31
Banking reform	62	62		92		92	-31	-31
Nonbank financial institutions	54	54		92		92	-39	-39
Overall infrastructure reform	54	54		85		85	-31	-31

Sources: EBRD; Transparency International; World Bank; World Economic Forum; and IMF staff calculations.

1/ For comparability, all indices have been normalized so that they range from 0 (lowest) to 100 (best).

2/ Country name and index of best performers among: Albania, Bosnia-Herzegovina, Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, FYR Macedonia, Montenegro, Poland, Romania, Serbia, Slovak Republic, and Slovenia. Country names are not shown for EBRD transition indicators due to the presence of multiple entries.

3/ Distance of Macedonia from best performer for each index.

INTERNATIONAL MONETARY FUND

Public Information Notice

EXTERNAL RELATIONS DEPARTMENT

Attachment: Draft Public Information Notice

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Washington, D. C. 20431 USA

IMF Concludes 2008 Article IV Consultation with the former Yugoslav Republic of Macedonia

On December 1, 2008, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the former Yugoslav Republic of Macedonia.[1]

Background

Growth has picked up, led by stronger domestic demand and increasing investment. In 2007 improved terms of trade and remittances boosted incomes and domestic demand. This raised growth to 5 percent. Though these favorable shocks have reversed, in the first half of 2008 growth increased to 6 percent (led by construction, wholesale and retail trade) while industrial production growth reached double digits. Strong investment growth (in part reflecting higher FDI) and the high unemployment rate (still around 35 percent) suggest few capacity constraints and considerable scope for continuing this favorable supply response. But compared to the region past economic growth has been tepid, and there is plenty of room for catch up.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. This PIN summarizes the views of the Executive Board as expressed during the December 1, 2008 Executive Board discussion based on the staff report.

Inflation has risen despite the exchange rate anchor, mainly because of external shocks. From 2002 to 2006 inflation averaged less than 1 percent, sometimes with periods of deflation. Inflation jumped to around 10 percent in early 2008, similar to other countries in the region, largely because of oil and food price increases. Higher nominal wage increases prevented a fall in real incomes.

Through 2007 the sharp increase in foreign exchange reserves resulted in monetary policy easing. From 2005 to 2007, the central bank's gross reserves increased by €400 million (almost 7 percent of GDP). Though offset partially by sales of central bank bills, the central bank's purchases of foreign exchange increased the supply of denars. This pushed central bank bill rates below 5 percent and commercial bank lending rates to less than 10 percent. With competition intensifying, credit growth increased to almost 40 percent, stimulating domestic demand and imports, and also potentially increasing risks in the banking system. To contain these risks, in 2008 the central bank started to tighten monetary policy. The NBRM has gradually increased central bank bill rates to 7 percent, raised capital requirements for overdrafts and credit card loans, and introduced controls on household credit growth.

In 2006 and 2007 the central government budget was broadly in balance, but fiscal policy is turning increasingly expansionary. Tax revenue increased despite substantial tax cuts, owing to improved tax administration, domestic demand growth (which boosts VAT), and a near-doubling of corporate income tax revenues. Fiscal policy plans for the remainder of 2008 and the medium term are expansionary. For 2008, the fiscal deficit target of 1.5 percent of GDP in 2008 represents an expansion of 2.1 percent of GDP compared to 2007. The government intends to raise the fiscal deficit to 3 percent of GDP in 2009, and to 4 percent in 2011.

The current account deficit has widened sharply, and has become the main risk to continued growth and macroeconomic stability. Both the size of the current account deficit—around 14 percent of GDP projected for this year—and the speed of its deterioration (more than 10 percent of GDP in one year) are of concern. This deterioration has three main components: a rising trade deficit, falling private transfers, and lower net factor income due to a large telecom dividend payment. Indicators of external vulnerability, such as international reserve cover of imports, or of short-term foreign debt, have also weakened.

Recent international financial turmoil poses additional uncertainties. There has been little direct impact, since Macedonian banks do not seem exposed to subprime lending overseas and rely mainly on domestic deposits rather than international credit lines to fund lending. However, the indirect impact is likely to grow. A slowdown in the world economy could worsen the current account deficit through reduced export demand, falling export prices, and weaker remittances, and could also threaten growth.

Executive Board Assessment

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

FYR Macedonia: Selected Economic Indicators, 2004–08

	2004	2005	2006	2007	2008 Proj.
	(Percent change)				
Real economy					
Real GDP	4.1	4.1	4.0	5.0	5.5
Consumer prices					
Period average	-0.4	0.5	3.2	2.3	8.5
End of period	-2.1	1.6	3.0	6.7	5.5
Real wages, period average	4.4	2.0	4.1	5.6	…
Unemployment rate (average)	37.2	37.3	36.0	34.9	34.8
	(In percent of GDP, unless otherwise indicated)				
Government finances					
Central government balance	0.7	0.3	-0.5	0.6	-1.5
Revenues (including grants)	36.5	35.6	32.9	34.3	36.8
Expenditures	35.8	35.3	33.4	33.7	38.2
Central Government debt 1/					
Gross	36.6	39.5	31.5	24.2	21.7
Net	32.5	31.9	22.5	25.6	17.8
Money and credit					
Broad money (M3, percent change)	16.1	14.9	24.5	29.4	13.0
Private sector credit growth (percent change)	25.0	20.5	30.5	39.1	35.1
Short-term lending rate (percent) 2/	11.8	10.8	9.5	8.6	8.7
NBRM short-term rate (28-day bill, end-period) 3/	10.0	8.5	5.8	4.8	7.0
	(In millions of euros, unless otherwise indicated)				
Balance of payments					
Exports	1,345	1,643	1,903	2,441	2,949
Imports	2,259	2,501	2,923	3,614	4,694
Trade balance	-914	-858	-1,020	-1,173	-1,745
In percent of GDP	-21.1	-18.4	-20.1	-20.9	-27.6
Current account balance	-363	-121	-45	-171	-881
In percent of GDP	-8.4	-2.6	-0.9	-3.0	-14.0
Overall balance	-23	345	305	65	-65
Official gross reserves	717	1,123	1,417	1,524	1,507
In months of imports	2.9	4.0	4.1	3.4	3.2
External debt service ratio 4/	20.7	18.4	22.6	30.7	27.5
External debt to GDP ratio (percent) 5/	47.9	53.9	49.1	48.4	54.2
Exchange rate					
Denars/Dollar (average) 6/	48.6	49.3	48.8	44.7	40.3
Denars/Euro (average) 6/	61.3	61.3	61.2	61.2	61.2
Real effective exchange rate (CPI-based, percent change) 7/	-2.3	-3.4	-1.6	-2.0	4.3

Sources: Data provided by the authorities; and IMF staff projections.

1/ Movements in 2005 and 2006 reflect the issuance of a Euro 150 million Eurobond and repayment of the London club debt. Net debt is defined as gross debt minus NBRM deposits of the central government.
2/ Weighted averages for December of each year. For 2008, the data is for September.
3/ For 2008, the data is as of October.
4/ Debt service due including IMF as percent of exports of goods and services. Excludes rollover of trade credits.
5/ Total external debt, including trade credit. Revised methodology applied to data beginning in 2004.
6/ Data for 2008 is through end-September.
7/ Data for 2008 is through end-June.