IMF Executive Board Concludes 2013 Article IV Consultation and First Post-Program Monitoring with the Former Yugoslav Republic of Macedonia

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On June 14, 2013, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation and First Post-Program Monitoring with Macedonia.[1]

Background

Following a shallow recession in 2012, a modest recovery is forecast for 2013, with baseline growth expected to reach 2 percent. So far, industrial production has strengthened in February and March, but indicators do not yet point to a solid recovery in domestic demand. Nonetheless, the baseline growth forecast remains feasible, provided that public infrastructure works and foreign investment projects accelerate as planned. The weak external environment and difficult liquidity conditions for the domestic private sector present important downside risks.

Inflation is expected to moderate to 2.5 percent in 2013, as the effects of energy price hikes wear off and food prices decline. Cost side pressures are limited, with nominal wage growth of 0.2 percent in 2012, and 1.2 percent in early 2013. The current account widened to 3.9 percent of GDP in 2012, with the impact of weaker trade partly offset by high private transfers. Private financial flows, particularly FDI flows, have been modest, but public sector net external borrowing has helped build up reserves, which remain adequate.

Weaker revenues and the start of the arrears clearance process widened the 2012 cash deficit to 3.8 percent of GDP. Keeping the cash deficit contained required expenditure compression beyond the ceilings established in the supplementary budget, and the adjustment fell mainly on capital expenditure. Central government debt rose to 33.8 percent of GDP at end-2012.

The deficit for the first quarter of 2013, at 2.4 percent of projected 2013 GDP, already represents two thirds of the annual target of 3.5 percent of GDP. The revenue outturn was dominated by large VAT refunds, in accordance with the authorities' commitment to clear arrears. On the expenditure side, subsidies and other transfers rose substantially relative to the same quarter of the previous year. While this appears to be an intra-annual reallocation of expenditure, further expenditure compression will likely be needed to meet the deficit target. The authorities were not considering a supplementary budget at the time of the discussions, noting that on current revenue trends the required adjustment could be accommodated within normal buffers.

Substantial net domestic issuance in 2012 as well as in the first quarter of 2013 has helped finance the higher deficits. In line with previous IMF advice, the Treasury has continuously sought to lengthen debt maturities. As a result, longer dated securities currently make up 25 percent of the total debt stock, up from 5 percent at end-2011.

Banking sector indicators suggest that the system is in overall sound shape, but non-performing loans (NPLs) are increasing. As of December 2012, the capital adequacy ratio stood at 17.1 percent, and over 29 percent of total assets were highly liquid. Deposits provide the main funding source. The NPL ratio rose to 11.7 percent in February 2013, but provisions exceed NPLs.

After steadily decelerating in 2012, credit growth is expected to remain subdued in 2013. Loan growth declined from 5.2 percent (year-on-year) in December 2012 to 4.4 percent in February 2013, even as deposit growth accelerated from 4.4 percent to 5.1 percent.

The absence of pressures on the exchange rate allowed the National Bank of the Republic of Macedonia (NBRM) to lower the policy rate by 25 basis points to 3.5 percent in January 2013, and to gradually reduce its stock of outstanding central bank bills (its main sterilization instrument) over the last six months. In addition, in order to stimulate private credit growth, the NBRM lowered reserve requirements by the amount of new loans to domestic net exporters and electricity producers, effective January 1, 2013.

Adoption of amendments to the banking law early this year closed some long standing gaps in the crisis management framework. The amendments ensure that the NBRM is able to impose fit-and-proper requirements on bank management and owners, and pave the way for the central bank to widen the class of collateral that banks may use to access liquidity support.

Executive Board Assessment

Executive Directors commended the authorities for their economic management, which has helped maintain financial and external stability despite difficult circumstances. While the economy is poised for a moderate recovery in 2013, underpinned by acceleration in public investment and FDI projects, it still faces a challenging external environment but with limited policy space. Directors called for continued commitment to sound policies and structural reforms. Efforts should focus on reducing risks to the outlook, preserving macroeconomic stability, generating stronger growth, and boosting income convergence and employment.

Directors agreed that the near-term policy mix should remain supportive to sustain the still fragile recovery, particularly given monetary policy constraints. However, as the crisis subsides, fiscal policy should be anchored in a well-articulated and credible medium-term strategy. The strategy should strike a balance between increasing growth and ensuring fiscal and debt sustainability, reducing debt and the deficit over time. They emphasized that a greater focus on multi-annual budgeting would provide a good framework for assessing fiscal space and avoiding payment arrears. Directors commended the clearance of arrears and encouraged the authorities to implement measures to improve fiscal management, including public financial management. With some infrastructure spending shifting off-budget, they urged tight control on the pace of indebtedness of public sector enterprises. Directors highlighted the need to analyze the evolution of, and risks to, the broader public sector debt in setting budgetary targets and prioritizing spending.

Directors took note that the exchange rate peg has served Macedonia well. They generally agreed that the still-weak growth, contained inflation, adequate reserves, and the absence of immediate balance of payments pressures may allow for an accommodative stance to stimulate credit growth. However, the central bank should stand ready to raise rates in the event that risks materialize and exchange rate pressures emerge.

Directors noted that the banking sector is sound, with high capital adequacy ratios and ample liquidity. Nonetheless, they emphasized that continued vigilance is necessary in light of potential shocks. It will also be important to monitor the increasing nonperforming loans. Directors commended the authorities for the recent changes to the banking law, which have closed all but one of the identified gaps in the crisis management framework.

Directors welcomed the improvements in the business climate and the progress made in attracting foreign direct investment. Further structural reforms will be essential to generate sustainable strong growth, speed up income convergence, and reduce unemployment. Developing stronger linkages between FDI projects and the domestic economy, building the needed infrastructure, and strengthening education and training opportunities should be key priorities going forward.

Former Yugoslav Republic of Macedonia: Selected Economic Indicators

	2008	2009	2010	2011	2012
	Annual percentage change, unless otherwise specified				
Real GDP	5.0	-0.9	2.9	2.9	-0.3
Real domestic demand	6.7	-2.9	-0.1	5.3	1.8
Consumption	6.9	-4.7	1.4	4.0	-0.9
Gross investment	4.7	1.0	-3.6	13.5	11.0
Net exports 1/	-3.1	2.7	3.0	-3.3	-2.4
CPI inflation (annual average)	8.4	-0.8	1.5	3.9	3.3
Unemployment rate (annual average)	33.8	32.2	32.1	31.4	31.3
	Percent of GDP				
Current account balance	-12.8	-6.8	-2.0	-3.0	-3.9
Trade balance	-26.2	-23.3	-20.5	-22.4	-23.7
Exports of goods	40.1	28.8	35.5	42.3	41.1
Imports of goods	-66.3	-52.1	-56.0	-64.8	-64.8
Private transfers	13.9	16.4	18.9	18.7	20.9
External debt (percent of GDP)	49.2	56.4	58.2	64.6	68.6
Gross investment	26.8	25.9	25.5	27.2	28.8
Domestic saving	14.0	19.1	23.5	24.2	24.9
Public	3.9	0.6	1.1	1.3	0.2
Private	10.0	18.5	22.4	22.8	24.7

Foreign saving	12.8	6.8	2.0	3.0	3.9
Central Government Gross Debt	20.6	23.8	24.2	27.8	33.8
Central Government & Road Fund Gross Debt	20.7	23.8	24.2	27.8	33.8
Central Government Balance	-0.9	-2.7	-2.4	-2.5	-3.8
Memorandum items:					
Nominal GDP (billions of denars)	412	411	434	462	463
Nominal GDP (billions of euros)	6.7	6.7	7.1	7.5	7.5
GDP per capita (EUR)	3280	3265	3430	...	...

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

1/ Contribution to growth.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

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

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