FOR AGENDA

EBS/14/3

January 15, 2014

To: Members of the Executive Board

From: The Secretary

Subject: **Former Yugoslav Republic of Macedonia—Ex Post Evaluation of Exceptional Access Under the 2011 Precautionary and Liquidity Line Arrangement**

Attached for consideration by the Executive Directors is a paper on the ex post evaluation of exceptional access under the 2011 Precautionary and Liquidity Line arrangement for the former Yugoslav Republic of Macedonia, which is tentatively scheduled for discussion on **Wednesday, January 29, 2014**. At the time of circulation of this paper to the Board, the authorities of the former Yugoslav Republic of Macedonia have indicated that they need more time to consider whether they will consent to the Fund's publication of this paper. Publication will only proceed upon the receipt by the Fund of the member's explicit consent. Any requests for modifications for publication are expected to be received two days before the Board concludes its consideration.

Questions may be referred to Ms. Carare, ICD (ext. 39749).

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 Friday, January 24, 2014; and to the European Bank for Reconstruction and Development, following its consideration by the Executive Board.

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

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INTERNATIONAL MONETARY FUND

FORMER YUGOSLAV REPUBLIC OF MACEDONIA

EX POST EVALUATION OF EXCEPTIONAL ACCESS UNDER THE 2011 PRECAUTIONARY AND LIQUIDITY LINE ARRANGEMENT

January 13, 2014

EXECUTIVE SUMMARY

The Precautionary and Liquidity Line (PLL), the former Precautionary Credit Line (PCL) was intended to support the maintenance of neutral macroeconomic policy settings. FYR Macedonia had sound policies and institutions prior to the global economic crisis. Despite the emergence in 2008 of some vulnerabilities, FYR Macedonia weathered the crisis well until the end of 2010. The Executive Board approved a two-year PCL arrangement in January 2011 for FYR Macedonia with access of up to 600 percent of quota (500 percent upfront). The PCL was intended as a significant additional buffer that could help preserve stability, to insure against external shocks and to send a positive signal that existing policy settings were sound. It envisaged the maintenance of current rather than adjustment policies, and featured correspondingly light conditionality. The authorities were not expected to draw on the PCL unless external conditions would deteriorate significantly.

The authorities purchased under the PCL in March 2011. At the time of the program request, the authorities planned a Eurobond in the first half of 2011. However, in February 2011, early parliamentary elections were called for June 2011. The authorities drew some of their PCL resources in March 2011 (SDR 197 million or EUR 221 million, equivalent to 286 percent of quota) on the grounds that the unanticipated elections had impaired their market access and resulted in a balance of payments need.

In the months following the purchase, the government broadly adhered to the policies agreed at the outset of the program, and subsequently did not request the completion of the Second Review. With the implementation of broadly neutral policies on track the Executive Board completed the First Review in September 2011. However, moderate weaknesses in fiscal institutional capacity (domestic arrears) that were not apparent at the PCL launch gradually become clearer in late 2011 and in 2012, prompting efforts to address them. The authorities secured foreign bank financing in November 2011 and early January 2013 (under a World Bank Public Expenditure Policy Based Guarantee, PEPBG) and July 2012 (private loan), and informed staff that they would not pursue completion of the Second Review of the PLL. Since then the government has

made progress in addressing these issues, with the support of the World Bank-guaranteed loans.

This Ex Post Evaluation (EPE) report finds that FYR Macedonia's PCL was consistent with Fund rules and practices. Conditionality under the program was appropriate for the type of arrangement. Program conditions were adjusted parsimoniously at the First Review to reflect FYR Macedonia's March 2011 purchase, while remaining consistent with program objectives. This report confirms that FYR Macedonia met all four criteria for exceptional access to Fund resources. It also confirms that FYR Macedonia qualified for the PCL as assessed at the time of its program request and at the First Review, based on the country's track record of sound policies, its commitment to continue them, and its strong performance against three out of five specific qualification criteria.

FYR Macedonia benefited from the PCL, especially when the program was active, but some of its vulnerabilities became apparent after the First Review. The PCL effectively insured FYR Macedonia against external shocks and helped the government adhere to their planned policies without the need for a large adjustment. This reduced the costs to the country when economic growth turned out much lower than expected. Over the two-year period of the program, external and public debt increased but remained sustainable, and reserves built up further. However, signs of deteriorating public financial management emerged as the renewed downturn took hold from late 2011. Moreover, the March 2011 purchase under the PCL highlighted weaknesses in FYR Macedonia's debt management practices and large deficit financing needs beyond the First Review, including overreliance on the external bond market and underdevelopment of domestic financing sources. Many factors concurred to make the completion of the Second Review challenging if it had been requested (slippages in public financial management, weaknesses in the public debt management practices, the short time to set and assess conditionality for a Third and subsequent Reviews, etc).

In hindsight, despite the deterioration of the quality of some fiscal institutions, the PCL was the right instrument for FYR Macedonia at the time, and it was well designed. At the outset of the program, FYR Macedonia did not have an adjustment need, nor a need to provide financing room to pursue a program of structural reforms. The authorities expressed interest in a PCL arrangement following the Fund's Decision to establish the new instrument in 2010, and not in a precautionary Stand-By Arrangement. The PCL was designed to provide insurance against a reasonable stress scenario, and was based on continuation of sound but neutral policies. The deterioration of the quality of fiscal institutions was not apparent at the outset of the program, and therefore could not have been addressed through stronger conditionality. It is not clear that a precautionary Stand-By Arrangement would have produced better outcomes.

***Ex post,* although FYR Macedonia's alternatives to drawing under the PCL were costlier, should they have been undertaken they would have contributed to a**

stronger track record of access to market financing. In hindsight, FYR Macedonia could have avoided purchasing in March 2011 if it had implemented a mix of some adjustment policies, gradually increased its domestic market financing, and if it had proceeded in the summer or fall of 2011 with the planned Eurobond issuance. This would have helped FYR Macedonia demonstrate a stronger track record of access to market financing, and arguably take advantage of lower yields in the future after the program has run its course, and in 2012, if it had maintained the program active over its entire length. The yields on its sovereign bonds benefitted considerably once the program was approved and remained active.

In hindsight, the analysis at the program request could have flagged risks coming from domestic developments. The PLL is designed to insure against external shocks, and staff would have had less reason to flag political risks than in a typical program case. However, in hindsight, it would have been better if the original report would have flagged political risks, especially given the instances in recent years of early elections, and the brief episodes of macroeconomic volatility that they induced. Another domestic risk that could have been flagged at the time of the program request was that the institutional quality might erode under pressure. Taking into account that improvements in public financial management were recent at the outset of the program, it would have been reasonable to flag the risk that institutions might revert to previous patterns of behavior in the event of financial stress. In this context, the arrears that emerged in 2011 represented a departure from the baseline but a foreseeable risk.

Authorized for distribution by
European Department and Strategy Policy and Review Department

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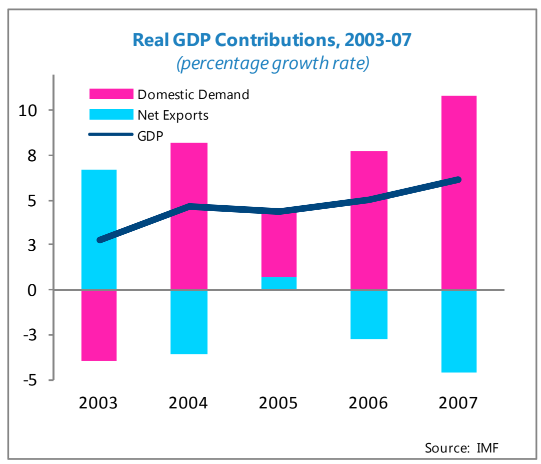
INTRODUCTION

1. **The Executive Board approved a two-year Precautionary and Liquidity Line (PLL)[1] arrangement for the Former Yugoslav Republic of Macedonia (FYR Macedonia) in January 2011.** The PLL featured access of 600 percent of quota (SDR 413.4 million, or EUR 479.3 million), of a two-year arrangement, with 500 percent of quota available in the first year. FYR Macedonia made a purchase of SDR 197 million (286 percent of quota) in March 2011, entailing actual use of resources above the exceptional access threshold. The arrangement expired in January 2013. The Fund's rules require an Ex Post Evaluation (EPE) of exceptional access decisions within a year of the arrangement ending. This requirement ensures uniformity of treatment across countries. As with all EPEs, the purpose of this report is to determine whether justifications presented at the outset of the program were consistent with Fund policies and to review performance under the program. In particular, the report reviews performance against program objectives, and evaluates whether the program design, macroeconomic strategy and financing appropriately addressed members' challenges, in line with Fund policy, including the case made for exceptional access.

CONTEXT

A. Strong Policy Track Record but Emerging Vulnerabilities

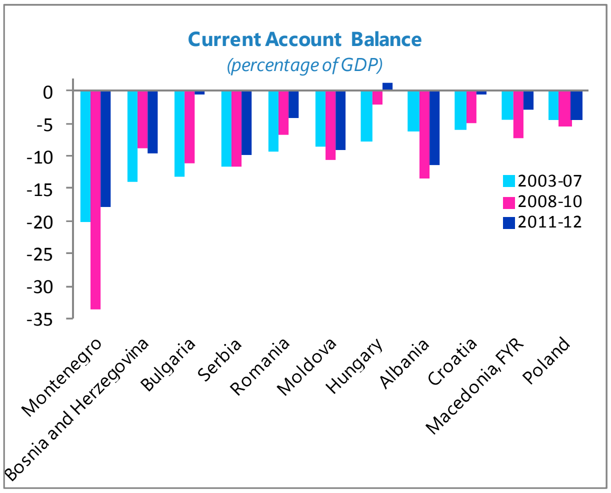
2. **Prior to the global financial crisis, FYR Macedonia enjoyed macroeconomic stability.** FYR Macedonia grew at about 4.6 percent on average in real terms during 2003–07 (text chart), due to strong and steady domestic demand. Rapid private sector credit growth, positive real wage growth, and low inflation supported private consumption. Private savings and foreign capital contributed to strong investment growth. A stable exchange rate and increased integration in the central European supply chain supported exports growth. A large trade deficit was financed primarily by stable private transfers (about 15 percent of GDP in net terms, consisting mainly of remittances). Current account deficits were

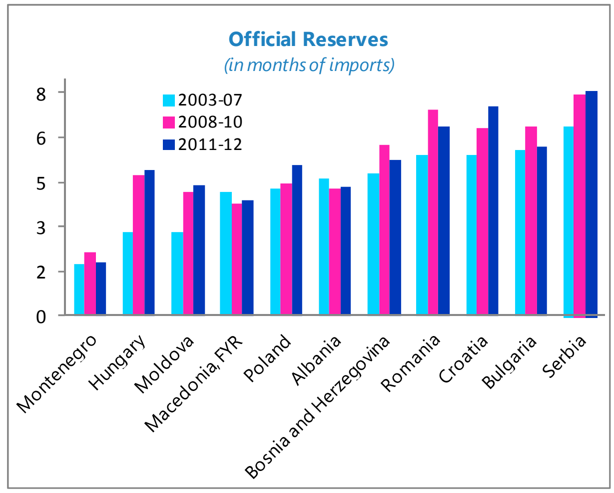


[1] The Precautionary and Liquidity Line (PLL) was introduced in November 2011, replacing the previously established Precautionary Credit Line (PCL). This report refers to the FYR Macedonia's arrangement as a PCL from the program request (January 2011) until the change of the instrument, and thereafter as a PLL. In general we refer to the arrangement as PLL.

relatively modest—on average 4.4 percent of GDP during 2003–07 (text chart), showcasing a more sustainable growth approach than some other eastern European countries that overheated considerably during this period. In 2008, however, the current account widened to about 13 percent of GDP, due to several factors including an expansionary fiscal policy, a sudden drop in exports when global trade collapsed, and a drop in private transfers (Figure 1 and Table 1).

External Sector Regional Comparisons, 2003–2012



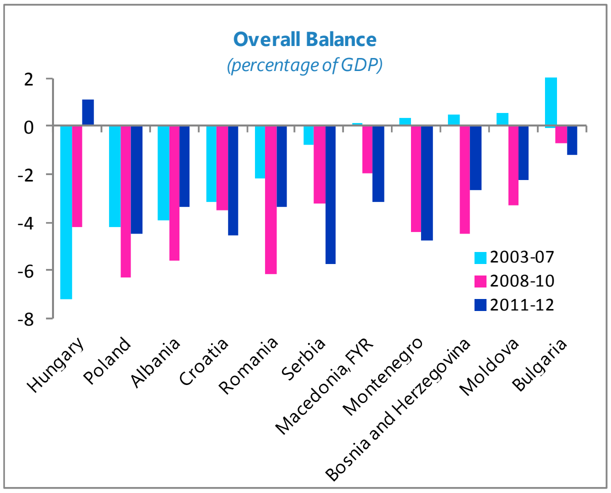


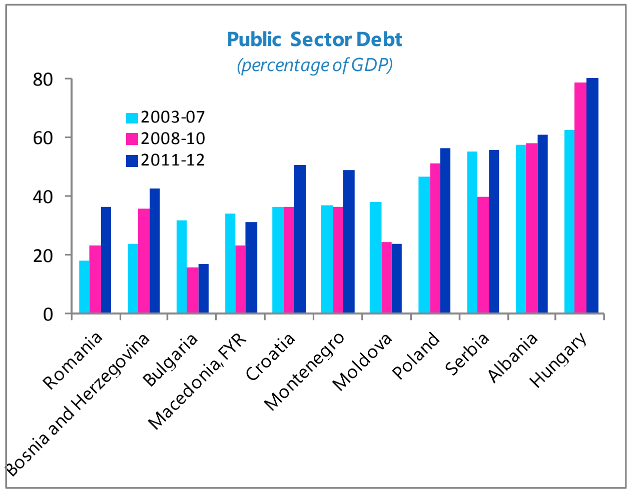
Source: IMF IFS and WEO.

3. The authorities maintained broadly balanced budgets and made efforts to improve budget quality in the pre-crisis period. During 2003–07, the overall fiscal balance was on average a small surplus of 0.1 percent of GDP (text chart, Tables 2 and 3). Fiscal impulses were modest (about ½ percent on average in 2006–07), except in 2008 mainly due to an increase in public investment and some increase in pensions, leading to a fiscal deficit of 0.9 percent of GDP. The authorities made significant efforts during this period to improve budget quality. Substantial tax administration reforms were implemented to boost revenues[2] and to allow a reduction in tax rates and tariffs. Social security bases were harmonized, and there was a transition to second pillar pensions. The authorities also made consistent efforts to reduce financial losses in the electricity sector, and to improve arrears management, especially in the health care sector where arrears rose mainly due to an under financing of the health care reform.

[2] Supported by discussions during the fifteen-month Stand-By Arrangement (SBA) approved in April 2003, the three-year Stand-By Arrangement approved in August 2005, and IMF technical assistance.

Fiscal Policy Regional Comparisons, 2003–2012





Source: IMF WEO.

4. **The authorities had large financing needs and limited fiscal financing options.** Despite a broadly balanced budget and significant sales of the public telecom company, the fiscal financing needs were large due to large amortization payments (including early debt repayments)[3] and payments for domestic structural bonds.[4] Declining official financing sources made FYR Macedonia increasingly dependent on market finance. During this pre-crisis period, public sector debt declined significantly from about 38.4 percent of GDP in 2005 to 20.6 percent of GDP in 2008 (text chart, Table 5). The decline in the debt level occurred while debt management started to improve. There were some remaining vulnerabilities though, as the domestic Treasury bill market was then in its early stages, and FYR Macedonia's capacity to tap international markets was untested. The domestic securities market started deepening with the support of the Fund's technical assistance, and the first Eurobond issuance in late 2005 was successful. Moreover, the issuance helped extend the average maturity—as it had a ten year maturity—and lower the average interest rate on government debt.

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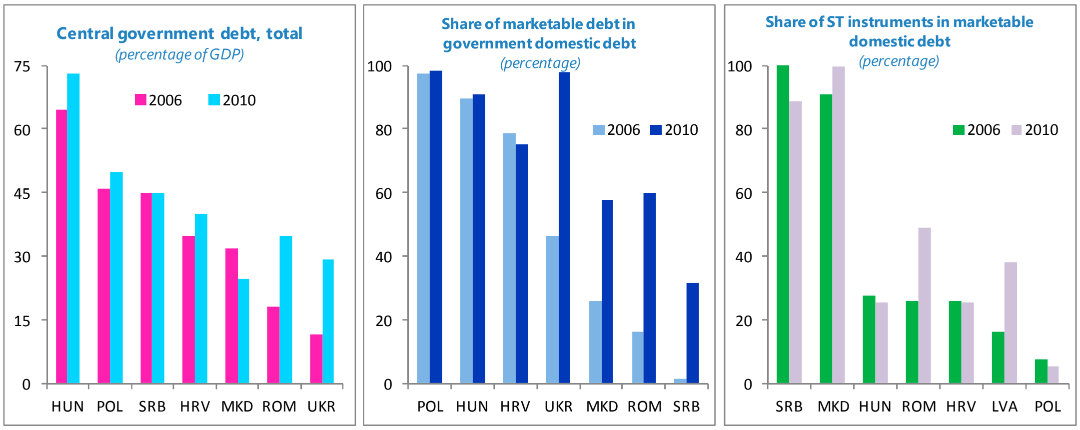
[3] During the 2005 SBA the authorities drew only the first purchase. Subsequently, the government repaid early the repurchases from the 2003 and 2005 programs, and paid in full its obligations under Paris Club (US$ 104 million).
[4] To cover historic liabilities.

Government Debt: Regional Comparisons



Source: IMF

5. Monetary and financial sector policies also contributed to macroeconomic stability. The central bank has been maintaining a peg to the euro, a strategy that delivered low inflation. The legal framework for the financial sector was comprehensively revised in line with international best practice. A new banking law was introduced to strengthen bank governance, increase minimum capital requirements, and tighten provisions on connected lending. A clear framework for consolidated supervision and for corrective action and/or resolution of weak or insolvent banks was established. Banks increased their profitability and lending, and remained well capitalized.

6. This strong policy mix led to manageable gross external financing requirements and a build-up in reserves, but in 2008 vulnerabilities appeared. The current account deficits were financed by FDI and portfolio investment inflows. The gross financing requirements over this period came mainly from building buffers in reserves to maintain the peg, financing of a small government deficit at times, and large debt amortization payments (Tables 6–8). Reserves gradually increased, but by 2008 the reserve cover deteriorated owing to a significant widening in the current account deficit while other financing sources remained roughly unchanged.

B. Initial Fallout from the Global Crisis

7. The global trade collapse and sudden stop in capital markets at the end of 2008 brought the economy to an abrupt halt. As elsewhere, by the end of 2008 the collapse in export demand and increased risk aversion in the global financial markets led to a sudden stop in external financing sources. As credit growth decelerated rapidly, the economy began to contract, leading to a decline in tax revenues. The sustainability of the exchange rate peg became uncertain with rapid currency substitution and cash outflows of residents. Uncertainties about the spring 2009 presidential and municipal elections aggravated the situation. The central bank ran down foreign exchange reserves: by May 2009, its reserves had fallen below EUR 1.2 billion (75 percent of short-term debt), a loss of almost a third compared to the October 2008 peak.

C. Strong Policy Response Mitigated the Impact of the Crisis

8. Monetary tightening helped preserve external sustainability and the peg. In addition to its foreign exchange intervention, the central bank raised its policy rate from 7 to 9 percent in April 2009 to stem balance of payment pressures and preserve an adequate level of official reserves. Reserve and liquidity requirements were tightened. As external and domestic conditions improved, the central bank began reducing its policy rate in December 2009, bringing it back down to 4.5 percent by September 2010 (Tables 9–10).

9. Fiscal policy struck a balance between cushioning the economy, and keeping public finances sound. As the economic downturn took a toll on general government revenues the government imposed a public sector wage freeze. A small fiscal stimulus was injected into the economy in 2009 through increases in some current and capital expenditures. In 2010 the fiscal policy stance became broadly neutral, as discretionary spending was cut in the face of lower than expected revenues. The overall fiscal deficit expanded to about 2.7 percent of GDP in 2009, and it declined slightly to 2.4 percent of GDP in 2010. Public sector debt jumped about 4 percent to 28 percent. Early in 2010 the government incurred payment arrears on VAT refunds and government invoices, but cleared them by October.

10. The banking system remained sound, and progress continued on structural reform. Throughout the crisis, the banking sector remained sound, relying on domestic sources of funding, preserving strong capital adequacy and liquidity ratios, and keeping non-performing loans in check with adequate provisioning (Table 11).[5] The two Greek owned banks, representing 26 percent of system assets, were healthy overall.[6] However, credit growth remained subdued at 7 percent year-on-year, from a low base. On the structural front, the authorities made some progress in improving the business environment, and implemented some measures at attracting foreign direct investment.

11. After the initial shock, the economy recovered well. Exports recovered rapidly starting in the second half of 2009, though private domestic demand grew more slowly. As private transfers also recovered, the current account deficit improved markedly, stabilizing at 2 percent of GDP by

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[5] Reliance on foreign financing (excluding capital) was low, at 8.4 percent of assets. Non-performing loans (NPLs) rose from 6.8 percent of loans at end-2008 to 10.4 percent at end-September 2010 as a result of the economic downturn, but they were 93 percent covered by provisions.

[6] Stopanska Bank is the largest bank in FYR Macedonia with 23 percent of system assets, and is systemically important. Its capital ratio was above the system average. This bank does not rely on its parent for funding, and has not experienced deposit outflows. The second Greek bank, Alpha Bank, holds 3 percent of system assets and has been hit harder by the downturn, but it reorganized its portfolio and lending practices, received a capital injection from its parent, and consolidated.

2010. In the end the economy contracted mildly in 2009 (-0.9 percent), and returned to growth of 2.9 percent in 2010.

12. However, external vulnerabilities persisted. The government was able to finance its deficit mostly through private market financing. The government issued a Eurobond in July 2009 at a yield of just under 10 percent, at a maturity of 3½ years, when the global risk aversion was still high. The government also started issuing foreign exchange linked T-bills to reduce its financing costs and to increase reserves. However, the net new issuance of domestic public securities was offset by the continuation of large payments of structural bonds. Moreover, while reserves recovered gradually, the reserve cover had eroded compared to the pre-crisis period, as the crisis lowered significantly the debt maturity profile. Reserves declined from 110 percent of short-term debt in 2008 to 103 percent of short-term debt in 2010.

PROGRAM STRATEGY AND IMPLEMENTATION

A. Program Strategy

13. FYR Macedonia requested a PCL arrangement in December 2010 to insure against external shocks. FYR Macedonia's 2009 recession, albeit mild, had been caused by spillovers from the global economic crisis. By late 2010, the economy was recovering and a balance of payments need was not projected for 2011 or 2012 under the baseline. However, the authorities saw continuing risks from heightened global risk aversion, especially in the European sovereign bond markets. To help insure against these risks, the authorities requested a PCL, a new instrument recently designed by the Fund for countries with sound fundamentals and policies but moderate vulnerabilities. The Executive Board approved the PCL arrangement in January 2011.

14. The PCL was intended to support the maintenance of neutral macroeconomic policy settings. As its name indicated, the PCL was explicitly intended as precautionary; the authorities were not expected to draw unless external conditions deteriorated. Staff and the authorities envisaged the PCL as representing a significant additional buffer that could help preserve stability and avoid the need for contractionary macroeconomic policy responses to temporary external shocks. The PCL was also intended to send a positive signal that existing policy settings were sound, thus supporting investor confidence and providing insurance.

15. The PCL featured exceptional access, at 600 percent of quota. The two-year arrangement included access of 500 percent of quota in the first year, and an additional 100 percent in the second. The length of the arrangement—two years rather than one—reflected concerns that external risks were persistent. The size of the arrangement—notwithstanding no actual BOP need under the baseline—reflected financing needs under a "reasonable" stress scenario based on negative shocks to EU growth and sovereign debt markets. Spillover effects contemplated under the stress scenario included FYR Macedonia's possible loss of access to sovereign debt markets in 2011–12. In this scenario, the access of up to 600 percent in 2011–12 would maintain gross international reserves at 85 percent of short-term debt.

16. The main risks recognized at the launch of the program were external rather than domestic. The January 2011 staff report flagged the potential for spillovers from euro area financial turbulence as the main risk, affecting FYR Macedonia through both the current account (lower demand for Macedonia's exports) and the capital account (loss of access to capital markets curbing financial for external debt service and the fiscal deficit). Although external political risks were recognized—resolution of the name dispute with Greece was seen as an upside risk—the staff report did not discuss domestic political risks. A possible risk of a deterioration of the public financial management under tighter financing conditions was also not flagged. Although a tail risk, the political risk could also have been flagged as in the recent period FYR Macedonia had several instances of early elections that may have induced brief episodes of macroeconomic volatility (see Context section).

B. Program Implementation

17. At the outset of the PCL, the macroeconomic policies were shifting into neutral following a period of mild fiscal and monetary easing. Staff and the authorities considered it appropriate for macroeconomic policies going into 2011 to focus on continuity rather than economic adjustment, taking into account the then-absence of balance of payments need and no domestic imbalances.[7] The 2011 budget targeted a deficit of 2½ percent of GDP, close to the 2010 outcome. The 2012 policies were not discussed at program request. Monetary policy was centered on maintaining an exchange rate peg to the euro: staff and the authorities agreed that the peg had been delivering low and stable inflation and a stable real exchange rate, without contributing either to undue output volatility or external imbalances.

18. In addition to macroeconomic policy continuity, the PCL envisaged some structural reforms:[8]

- *Financial sector:* Although the financial sector and banking regulatory framework were assessed as sound, the PCL envisaged further strengthening of financial sector regulation, notably a new law intended to strengthen the central bank's independence and bring its practices fully in line with EU standards.[9]

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[7] Although high, the unemployment rate declined from about 36 percent in early 2007 to 31 percent in late 2010.

[8] As the section on qualification criteria shows, some progress was needed in the financial sector, and improving data quality, but not in other areas where structural reforms were implemented.

[9] The European Commission has recognized FYR Macedonia as an EU candidate since 2005, and in 2009 recommended the opening of accession negotiations. However, the EU Council has not yet taken a decision to launch accession negotiations.

- *Data quality:* FYR Macedonia committed to subscribe to the IMF's Special Data Dissemination Standard (SDDS). Data quality was assessed as "broadly adequate" for surveillance but with shortcomings in national accounts and government finance statistics.

- *Promoting growth:* the reform agenda included investments in road and rail infrastructure; a new energy law to liberalize the energy market and improve incentives for energy efficiency and investment; efforts to improve the business environment through cadastral reform and privatization of several loss-making state-owned enterprises; and in 2012–13, a narrowing of the labor tax wedge through modest reductions in social contribution rates.[10]

19. FYR Macedonia drew under the PCL in March 2011, citing actual balance of payments need caused by uncertainties associated with unexpected early elections. The original program envisaged a balance of payments surplus of about EUR 198 million, and private external financing for the central government of EUR 190 million in 2011 based on a Eurobond issuance in the first half of the year. In March 2011, the authorities purchased SDR 197 million (286 percent of quota, EUR 221 million), which they used mainly for financing the fiscal deficit. The authorities represented, based on their meetings with external banks, that election-related uncertainties (in February 2011 early parliamentary elections were called for June 2011, Box 1) had impaired their access to external markets and made it expensive if not impossible to issue a new Eurobond. They also represented that the anti-corruption commission had advised against issuing a Eurobond prior to the June election. The authorities also concluded that domestic markets did not represent a feasible alternative.

20. At the time of the First Review under the PCL in September 2011 focus shifted to improving public debt management. The March 2011 purchase under the PCL indicated weaknesses in FYR Macedonia's debt management practices, and vulnerabilities in large fiscal deficit financing needs, including overreliance on the external bond market and underdevelopment of domestic financing sources (Table 12). In view of the purchase, the authorities agreed to target a higher level of international reserves, and to a structural benchmark to improve debt management, drawing on IMF technical assistance (Second Review).

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[10] The Informational Annex in the program request staff report mentions that the World Bank and the Fund would encourage the authorities to implement realistic, predictable, and transparent budget procedures. In particular, the Fund would also encourage the authorities to anchor fiscal policies in a credible medium-term fiscal framework. However, these measures were not featured in the discussion of program objectives, nor part of the program's conditionality.

Box 1. Political Risks

Early parliamentary elections had not been foreseen at the time of PCL approval in mid-January 2011. The governing coalition had more than a two-thirds parliamentary majority, with the next elections not due until mid-2012. But from late January 2011, for reasons unrelated to policies under the PCL, the main opposition party boycotted the parliament and demanded fresh elections. The coalition initially resisted but in late February announced parliamentary elections for June 2011. The June elections returned the coalition to office with a clear, but less than two-thirds, majority.

Staff would have had less reason to flag political risks than in a typical program case. Several factors were reassuring. First, the coalition's parliamentary majority was large. Second, Macedonia's policy track record was sound enough to qualify for a PCL. Third, Macedonia's PCL did not envisage difficult adjustment policies whose implementation would have been vulnerable to a loss of political support.

While in hindsight it would have been better if the original report had flagged political risks, the omission seems to reflect a genuine surprise rather than insufficient understanding of the political situation. Some independent observers prior to January 2011 saw a modest risk of early elections; see for example the December 2010 report by the Economist Intelligence Unit (EIU). But the EIU report saw this risk stemming mainly from a possible breakdown in relations between the governing coalition parties. In the event, relations between the coalition partners remained intact.

21. In the second half of 2011, the government contained the cash-basis fiscal deficit in the face of a revenue shortfall, but payment arrears emerged. The government responded to below budgeted revenues with underexecution of budgeted spending, especially on transfers and on investment in the second half of 2011. However, it also incurred arrears of about 0.1 percent of GDP to a foreign supplier of medical equipment and another 0.1 percent on VAT refunds. Beyond these confirmed amounts, reports by businesses of late government payments to suppliers suggested that the actual amount of arrears was higher.

22. The government secured private foreign financing after December 2011. In November 2011, the government concluded an external bank loan of EUR 130 million that was backed by a World Bank Public Expenditure Policy Based Guarantee (PEPBG) of EUR100 million. It subsequently reached agreement in July 2012 on a EUR 75 million foreign bank loan. Having secured their fiscal financing needs for 2012 and into 2013, in April 2012 the authorities informed staff that they would not longer pursue completion of the Second Review under the PLL and let the arrangement expire in January 2013 as initially planned. In January 2013 a second World Bank guarantee of EUR 155million of a commercial loan of EUR 250 million was undertaken to help with the 2013 financing needs.[11]

[11] Besides helping FYR Macedonia to access international markets, the World Bank PEPBG loans supported key reforms, including the gradual elimination of public payment arrears, and the improvement of financial management practices in the public sector, such as introducing safeguards to prevent future emergence of arrears.

PROGRAM OUTCOMES (2011–EARLY 2013)

23. The pace of economic recovery slowed down in 2011 due to disappointing export performance compared to expectations at the outset of the program. Real GDP growth in 2011 was just under 3 percent (text table) falling short of expectations owing to a worse than anticipated external environment that eroded export growth. Private consumption held up in spite of a continued deceleration in credit growth. Overall inflation was higher than expected. Nominal GDP was in line with the program's forecast (Figure 2).

FYR Macedonia: Real Sector Forecasts and Outcomes, 2010–2012

	2010	2011			2012		
		Prog.	1st review	Actual	Prog.	1st review	Actual
	(percent change unless otherwise indicated)						
Real GDP	2.9	3.5	3.0	2.9	4.5	3.7	-0.4
Real domestic demand	-0.1	4.2	3.9	5.3	3.9	4.3	1.9
Consumption	0.8	3.5	1.5	3.4	3.9	3.8	-1.7
Private consumption	1.4	3.6	1.5	4.6	4.2	3.8	-1.7
Public consumption	-2.0	2.8	5.0	0.6	1.9	3.4	-1.8
Gross investment	-3.6	7.3	11.5	13.5	4.0	6.5	16.1
Exports	24.2	16.6	11.4	10.4	14.2	11.1	0.0
Imports	9.4	13.9	10.6	13.2	10.1	10.0	4.3
Nominal GDP (billions of denars)	434	458	464	460	490	499	459
CPI, average	1.5	2.5	4.4	3.3	2.0	2.0	3.3
CPI, eop	3.0	1.8	3.7	4.7	2.0	2.0	4.7

Sources: FYR Macedonia IMF staff reports and IMF staff calculations.

24. The 2011 cash deficit target of 2½ percent of GDP was met. Although nominal GDP turned out as expected, government revenues were lower than expected (text table), mostly due to lower than expected social security contributions and capital revenue. To maintain the targeted deficit, expenditures were clawed back equally mainly through lower capital expenditures, transfers and goods and services.

FYR Macedonia: Central Government Operations Forecasts and Outcomes, 2010–2012

	2010	2011			2012 1/		
	Actual	Prog.	1st	Actual	Prog.	1st	Actual
	(percentage of GDP)						
Total Revenues 2/	30.3	30.9	31.5	29.7	31.7	31.5	30.0
Tax Revenues and Contributions	25.9	25.4	26.0	25.8	n.a.	n.a.	25.6
Non-Tax Revenues 3/	2.8	3.1	3.2	2.8	n.a.	n.a.	2.7
Capital Revenues 4/	1.3	1.4	1.5	0.9	n.a.	n.a.	1.0
Expenditures 2/	32.7	34.0	34.0	32.2	33.9	33.7	33.8
Wages and salaries	5.2	5.1	5.0	5.0	n.a.	n.a.	5.0
Goods and services	3.4	3.7	3.6	3.0	n.a.	n.a.	3.2
Capital Expenditures	3.5	5.0	4.9	3.9	5.0	5.0	4.1
Overall fiscal balance	-2.4	-2.5	-2.6	-2.5	-2.2	-2.2	-3.9
Cyclic adjusted balance	-2.5	-2.1	-1.7	-2.8	-2.2	-1.8	-3.5

Sources: IMF Staff and MoF estimates.

Notes:
1/ For 2012 forecasts we used data published in the Macroframework tables of the of 2010 Article IV and First Review Staff Reports. No other details available.
2/ Excluding revenues from lending.
3/ Excluding profits from financial institutions.
4/ Including profits from financial institutions.

25. Performance in the external sector was better than expected in 2011. At 2.5 percent of GDP, the current account deficit was about 2 percentage points of GDP lower than expected at program request (text table), due to an improved balance of services. The net financial flows turned out almost as expected, although both the inflows and outflows were significantly underestimated. As such the surplus of the balance of payments was higher than expected, by about EUR 134 million. Official reserves were EUR 223 million higher than envisaged (more than the entire PCL purchase). Reserve cover improved to 4.4 months of imports and 112 percent of short-term debt.

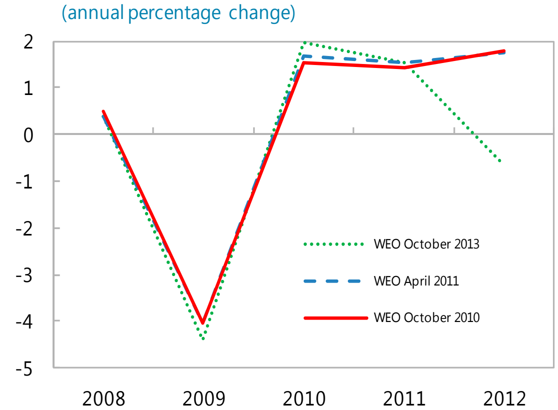
FYR Macedonia: External Sector Forecasts and Outcomes, 2010–2012

	2010	2011			2012		
		Prog.	1st review	Actual	Prog.	1st review	Actual
	(percent of GDP)						
Current account deficit	-2.0	-4.6	-5.5	-2.5	-5.4	-6.7	-3.0
Trade balance	-20.5	-22.3	-22.5	-22.1	-22.9	-22.9	-23.6
Private transfers	19.0	18.3	17.5	18.9	18.2	17.1	21.1
FDI	2.2	3.5	4.9	4.5	3.2	5.0	1.0
MLT Loans	0.9	1.1	5.7	6.2	1.3	0.5	0.9
Public sector	0.6	0.4	4.6	4.9	0.5	-0.1	0.8
Banks	1.3	0.2	0.2	0.7	0.2	0.2	-0.3
Currency and deposits (net)	-2.4	-0.7	-0.5	-3.1	-0.7	-0.6	-1.5
Overall balance (Million Euros)	61	198	333	332	295	316	120
Reserves/short-term debt (at remaining maturity)	103	104	121	112	103	120	107
Reserves/months of prospective imports	3.7	3.7	3.7	4.4	3.9	4.0	4.5
Reserves (millions of euros)	1,715	1,846	2,041	2,069	2,141	2,357	2,193

Sources: FYR Macedonia IMF staff reports.

26. **The economy entered a shallow recession in 2012, due to much lower than expected external demand.** In 2012 real GDP contracted by 0.4 percent, as opposed to growing at 4.5 percent as had been projected. The turmoil in the European sovereign bond market dragged on and affected trade and external financial conditions. Credit to the private sector declined, as banks tightened credit conditions and increased provisioning for non-performing loans (as elsewhere). Inflation was higher than expected, contributing also to an unanticipated contraction in private consumption. Nominal GDP was considerably lower than expected.

Euro Area Real GDP Growth Vintages
(annual percentage change)



Source: IMF WEO

27. **The overall cash deficit in 2012 was higher than anticipated, as revenues fell owing to worse than expected economic activity.** The initial target of the deficit, 2½ percent of GDP was relatively ambitious. As the economic situation deteriorated in 2012 instead of improving, as expected at the program request or the First Review, revenues fell. The government continued the policy implemented under the previous recession, trying to strike a balance between cushioning the economic contraction and preserving debt sustainability. Cash expenditures were not compressed to the same extent, but instead turned out more or less as initially envisaged. The government started

clearing some arrears.[12] The cash deficit ended up at 3.9 percent of GDP. With growth and revenues much lower than expected, but expenditures held constant, a small fiscal impulse estimated at ¾ percent of GDP was injected in the economy.

28. The external sector continued to perform well. The current account widened slightly compared to 2011, due to the further weakening of external trade. However, this turned out to be better than anticipated since the deterioration in the trade balance was smaller than the increase in private transfer compared to expectations. As FDI and portfolio inflows proved disappointing and in a context of continued deposit outflows, reserves increased modestly (by EUR 124 million compared with 2011 outturn). Reserve cover remained appropriate, although it slipped compared to 2011, at 107 percent of short-term debt.

29. Moderate weaknesses in fiscal institutional capacity that were not apparent at the launch of the PCL gradually became clearer at the end of 2011 and in 2012, prompting efforts to address them. The PCL request staff report took into account the generally positive findings of the 2006 fiscal transparency ROSC, and subsequent efforts both to upgrade medium-term budgeting capacity and to make use of IMF and EU technical assistance to implement further improvements. On the other hand, the 2011–12 experience revealed weaknesses in several areas, which the authorities have since been addressing:

- *Public debt management*, as indicated by FYR Macedonia's need to draw on the PCL in March 2011, was targeted for improvement at the PCL First Review, with a structural benchmark on publication of a road map for reform in consultation with Fund staff. An IMF technical assistance mission in October 2011 and Selected Issues paper for the 2011 Article IV consultation recommended measures to develop the domestic debt market. Since then the authorities made progress in lengthening domestic debt maturities and in deepening domestic debt markets.

- *Treasury operations*, as indicated by the buildup of arrears in 2011. The 2012 and 2013 Article IV reports discussed subsequent corrective measures under way to improve Treasury reporting procedures for multi-annual liabilities and for liabilities arising from signed contracts; an IT upgrade is also in progress.

- *Medium-term budgeting*, which was suspended. The PCL request staff report (January 2011) noted that the authorities annually prepared a three-year fiscal strategy. But the 2013 Article IV

[12] In December 2012, the government recognized a stock of 1.2 percent of GDP of accumulated arrears (by September 2012), taking the commitment to clear them in 2012 and in the first months of 2013.

staff report noted that the last such strategy document, covering 2011–13, was published in December 2010. The authorities argued that the suspension of the strategy documents reflected the extreme uncertainty facing policymakers through the global downturn, but planned to provide parliament with a new medium-term fiscal and debt management strategy before the 2014 budget.

- *Government finance statistics*, which cover central government but are not readily available for general government.
- *Overly optimistic revenue assumptions*, which contributed to a lower quality budget implementation than expected: the government reduced expenditures but also incurred arrears.

30. The authorities did not request the completion of the Second Review. Several concurrent factors would have made the completion of the Second Review challenging even if it had been requested (slippages in public financial management, weaknesses in the public debt management practices, the short time to set and assess conditionality for a Third and subsequent Reviews etc). There were extensive discussions with the authorities on the need for public financial management and debt management reforms to improve fiscal institutions, reduce fiscal financing vulnerabilities, and increase transparency regarding arrears. Ultimately the authorities made the decision not to seek completion of the PLL review. Nonetheless, they pursued several of the Fund staff's recommendations in the area of arrears prevention and debt management (including tapping the domestic T-bill market).

31. Owing mainly to weak activity, public debt and external debt increased by 10 percentage points during the program period but remained sustainable. Central government debt increased from 24 percent of GDP in 2010 to 34 percent in 2012. This mostly reflected deteriorating activity rather than loose fiscal policy (the cumulative fiscal impulse was only around 1 percent of GDP over 2011–12). Gross external debt (public and private) increased from 58 percent of GDP in 2010 to 69 percent in 2012. In the staff's most recent baseline scenarios (second PPM staff report), public debt and external debt are each projected to remain sustainable, and broadly stable in the medium term (Figures 3 and 4, and Tables 13 and 14). Capacity to repay the Fund remained intact from the program request until the latest analysis (second PPM staff report).

32. Financial stability was maintained due to the resilient structure of bank funding, notwithstanding a trend increase in non-performing loans. With banks mainly financed by domestic deposits, no deleveraging took place during the regional financial turmoil. Confronted with a steady increase in non-performing loans, banks further increased provisioning, thus preserving satisfactory capital adequacy ratios broadly in line with program requirements, albeit at the cost of a decline in profitability. Yet banks also seem to have turned increasingly risk averse alongside the economic downturn, maintaining record high liquidity ratios by purchasing central bank bills, which probably took a toll on credit to the private sector, and impeded the domestic market financing of the deficit.

33. Structural reforms continued under the program. The government pursued structural reforms to improve the business climate, and adopted a new Energy Law to strengthen the long-term prospects of the energy sector, besides continuing to invest in infrastructure and education, and to promote FDI.

FYR Macedonia: Banking Sector Outcomes, 2010-2012

	2010	2011	2012
CAR	16.1	16.8	17.1
CAR Tier 1	13.4	14.1	14.5
ROE	7.3	3.4	3.8
Liquid assets/Total liabilities	25.3	25.3	29.4
Liquid assets/Short-term liabilities	38.5	39.6	48.2
Loan to deposit ratio	87.5	86.4	88.1
External funding/Total liabilities	53.5	50.8	47.3
NPL/Gross loans	9.0	9.5	10.1
Provisions to NPL	100.7	101.9	107.1

Sources: FYR Macedonia IMF staff reports.

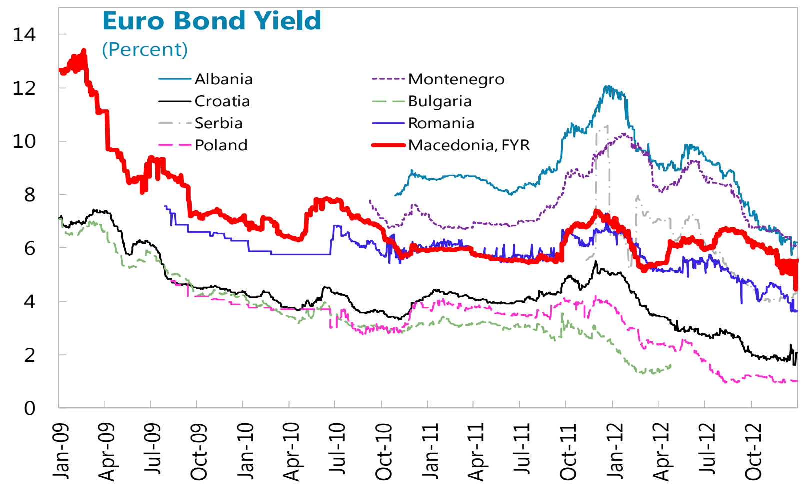
PROGRAM DESIGN

A. External and Fiscal Financing

34. The 2011 deficit financing need was not trivial. The government's capacity to finance its deficit, as envisaged under the original program, relied on its ability to issue its Eurobond in the first half of 2011. This turned out to be a point of vulnerability. The PCL purchase of EUR 221 million (3 percent of GDP) covered the planned Eurobond issuance of EUR 190 million plus a small buffer. It also covered about a third of FYR Macedonia's gross fiscal financing need for 2011 and represented more than the overall fiscal deficit financing need for 2011. Based on its initial discussions with banks in March 2011, in the pre-election period, the government represented that the necessary issuance would have been hard to obtain or prohibitively costly. In the absence of sufficient external sources of deficit financing, the government noted that the domestic market would have not been able to absorb a large quantity of government securities in addition to the planned redemptions. At the time the largest banks were consolidating at the regional basis and limiting new exposure to sovereign risk. However, the banking system was liquid, and banks were investing in central bank bills, at a 4.2 percent yield. With the benefit of hindsight, offering a higher interest rate than the central bank was offering, and coordinating the issuance of Treasury bills with the liquidity operations of the central bank would have allowed the government to finance domestically a larger part of the deficit than initially planned. In the end this deficit financing strategy was pursued in 2012, but not in 2011.

35. The government's PCL purchase enabled the financing of the 2011 deficit at low cost. *Ex post* secondary market yields on the 2005 FYR Macedonia Eurobond issuance were about

6 percent in the spring of 2011 (and they stayed at this level until about October 2011), considerably lower than the 2009 issuance, and in the middle range of yields in the region. The Volatility Index (VIX) rose in the second half of 2011, suggesting increased global risk aversion, and therefore tougher conditions in which to issue. However, these data suggest, with the benefit of hindsight, that a Eurobond issuance might have been possible in the summer or early fall of 2011, after the election, at relatively low yields. However, FYR Macedonia decided earlier in the year to purchase more than the deficit financing need for the year, and by comparison, the annual costs to FYR Macedonia of its PCL purchase were only 1.5 percent in 2011 and 2012.[13]



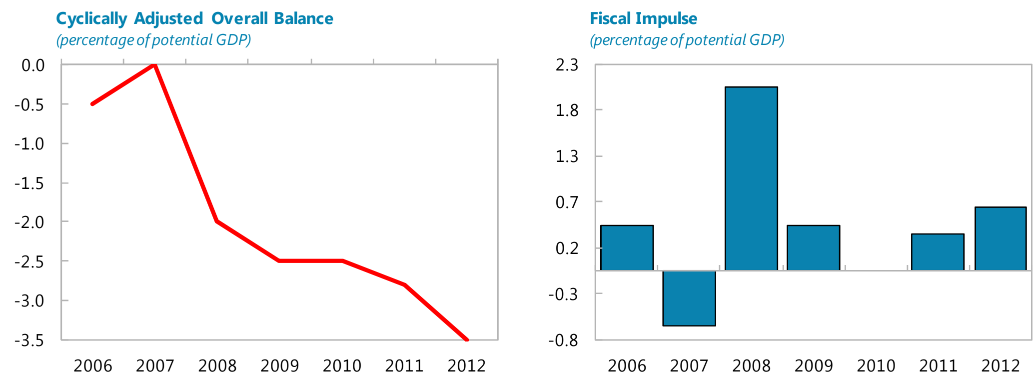
Sources: Bloomberg.

36. A counterfactual of substantially tighter fiscal policy would have been needed in absence of external sources of financing. Even with the PCL purchase providing financing for a larger fiscal deficit than otherwise, the fiscal impulse in 2011–12 was limited to a little over 1 percent of GDP, delivered mostly in 2012 to limit the negative effects of the external shock. The authorities continued to freeze the wage bill and refrained from cutting social security contributions as they had planned before the onset of the crisis. To avoid entirely the PCL purchase, and in the absence of a Eurobond issuance, the authorities would have had to reduce their borrowing needs through substantial further deficit-reducing measures on both the revenue and expenditure sides. Such measures were not necessarily needed to address macroeconomic imbalances, and would have slowed further the real economy. That said, though not explicitly discussed in the First Review staff report, with the benefit of hindsight (see part D of this section), a mix of some adjustment, some gradual increase in domestic market financing, and proceeding with the Eurobond issuance after the elections in 2011 would have been appropriate. This policy and financing mix would have required a lot of effort, as it would have entailed (i) financing the deficit more through the domestic market in the first half of the year, at a higher interest rate, (ii) seizing the opportunity to issue a Eurobond

[13] This excludes the commitment fee, but this is refunded to the member for amounts that it purchases.

after the elections in the summer of 2011, and of a lower size than initially planned, while conditions in the market seemed to remain stable, and (iii) if necessary, adjusting policy in the second half of the year, even if this would not have been necessary on macroeconomic grounds. The authorities' decision to purchase under the PLL the entire deficit financing need early in 2011 was legal, and cost effective. However, implementing a different policy and financing mix would have helped FYR Macedonia demonstrate a stronger track record of access to market financing, which could have lowered market borrowing costs in the future.

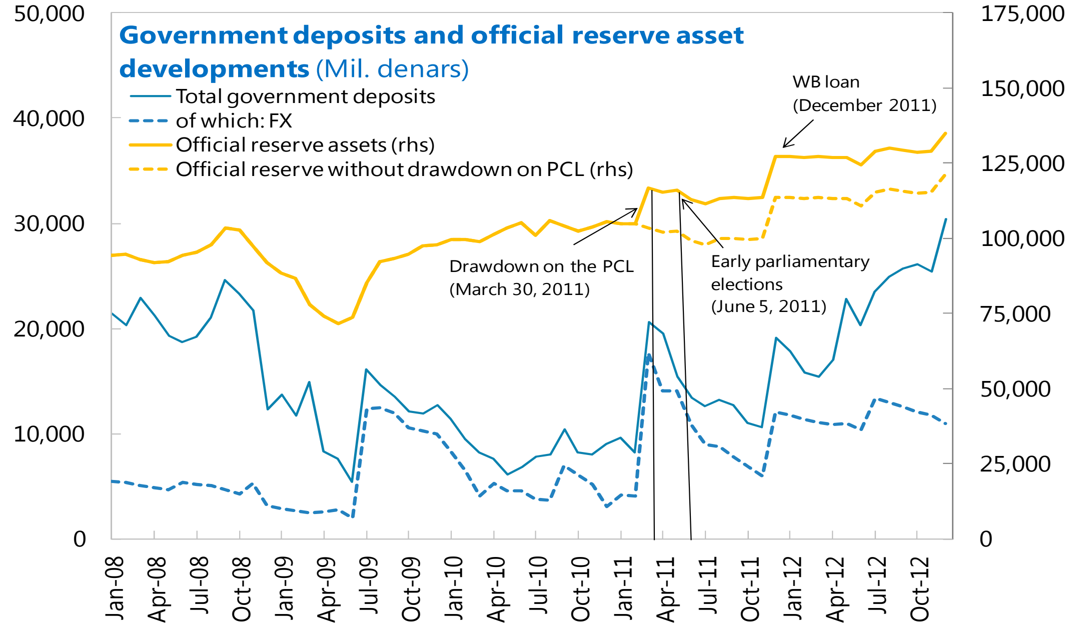
FYR Macedonia: Fiscal Stance, 2006-12



Source: IMF

B. Reserve Path

37. A lower path of foreign reserve accumulation could still have been consistent with external sustainability. The accumulation of foreign reserves from about EUR 1.7 billion in 2010 to EUR 2.2 billion in 2012 met the country-specific range of EUR 1.5–2 billion that had been estimated by staff in 2009 to provide adequate buffers to weather the crisis. Had the authorities not drawn on the PCL resources, and access the Eurobond market instead, in the summer or fall of 2011 with the original planned amount, the level of reserve coverage would probably have remained appropriate based on country-specific simulations. However, without a Eurobond issuance or a PCL purchase, the level of reserves might have been low unless significant adjustment would have taken place.



Sources: NBRM; and IMF staff

C. Institutional Soundness and Safeguards

38. The program request included conditionality against external arrears accumulation. The arrangement required meeting the continuous performance criteria of non-accumulation of external arrears, along with other conditionality (below), to qualify for completing a review. Moreover, the authorities also emphasized in the attachment of their program request (definition and adjustors section) that their policy was not to accumulate arrears and in the event that such arrears occurred, they should be included in the definition of the deficit for purposes of the arrangement. The statistical annex of the staff report for the program request noted that the quality of the government finance statistics is affected by lack of data on arrears, including hospital arrears.

39. The program implementation was hampered by a weak public financial management system, including a lack of transparency on arrears. During the discussions after the completion of the First Review (December 2011 and April 2012) the government acknowledged only nominal amounts of arrears besides the arrears to an external supplier[14] and delays in VAT refunds, amounting to 0.2 percent of GDP in total. The subsequent staff report noted that complaints from business community about large accumulation of arrears in the second half of 2011 would suggest maybe a higher stock of domestic arrears. The authorities announced in December 2012 that the size of arrears accumulated until September 2012 was 1.2 percent of GDP.

[14] The arrears to the external supplier (about 0.1 percent of GDP) were cleared in early 2012 with their owed interest.

40. Better public financial management should have been in place. In 2012 the government started the process to clear the arrears and change to the commitment, recording, and control systems of spending by line ministries, to avoid the recurrence of arrears. The 2013 Article IV noted though that the emergence of arrears were not only due to an improperly controlled system, but also to optimistic revenue assumptions.

D. Market Confidence

41. With the benefit of hindsight, markets would have preferred an active PLL or a different implementation of policies. Yields on the secondary markets were falling prior to the PCL approval. The approval tightened considerably the difference between FYR Macedonia yields, and regional peers' yields. This effect lasted a few months after the government announced the non-completion of the Second Review and accessing other sources of financing (mid-April 2012). Subsequently the yields on FYR Macedonia Eurobond rose more than elsewhere in the region in the second half of 2012 (by about 2 percent). Afterwards, while secondary market yields eased downwards for the regional peers, the FYR Macedonia Eurobond yield remained elevated. While it is hard to disentangle other effects, market confidence in government policies seemed to have been higher during the time when the PLL program was active, when both policies and institutions were sound, and approved as such by completion of reviews.

E. Conditionality

42. Conditionality under FYR Macedonia's PLL was appropriate for the type of arrangement. The original program included indicative targets on the fiscal deficit and net international reserves, and the standard program continuous performance criteria related to trade and exchange restrictions, discriminatory currency arrangements, multiple currency practices, and non-accumulation of external debt payments arrears.

43. Program conditions were adjusted parsimoniously at the First Review to reflect FYR Macedonia's March 2011 purchase. Staff's overall First Review assessment was that FYR Macedonia's performance was consistent with the PCL-supported program. However, the purchase under the PCL indicated limitations in public debt management practices. Accordingly, the authorities agreed at the First Review to a structural benchmark on publication of a report laying out a road map for debt management reform. The authorities also agreed to increase the program's NIR floor by EUR 50 million, to safeguard their stronger gross reserve position following the PCL purchase. Fiscal indicative targets remained unchanged. Stronger program conditionality would not have been needed to achieve program goals, and it was not needed as there was no need at the time for a large adjustment or ambitious program of structural reforms.

44. It is not clear that a precautionary Stand-By Arrangement would have produced better outcomes. FYR Macedonia did not need a macroeconomic adjustment to be supported by a

Stand-By Arrangement, even of a precautionary nature. Moreover, FYR Macedonia did not request such arrangement; it requested a PCL. The PCL/PLL is designed to insure qualified countries against external shock. A domestic political shock triggered the PCL purchase in FYR Macedonia as it affected the government's capacity to finance the deficit through external market sources, as initially planned, and therefore presented a balance of payments need. The deterioration of the quality of fiscal institutions was not apparent at the outset of the program, and FYR Macedonia qualified for a PCL (see next section). Since these slippages were not present at the outset of the program, stronger conditionality was not needed. It is therefore not clear that a precautionary Stand-By Arrangement would have produced better outcomes, even if it would have been an option requested by authorities.

CONSISTENCY WITH FUND RULES AND PRACTICES

A. Review of Qualification Criteria for Exceptional Access

45. FYR Macedonia met all four criteria for exceptional access to Fund resources. Taking these criteria in turn:[15]

1. *The member is experiencing or has the potential to experience exceptional balance of payments pressures on the current or capital account resulting in a need for Fund financing that cannot be met within the normal limits.* At the outset of the program, FYR Macedonia did not experience actual balance of payments pressures. However, staff's ex ante stress scenario as well as the episode of "sudden stop" in private capital inflows experienced in 2008–09 indicated potential for FYR Macedonia to face financing needs beyond normal access limits due to (i) a possible risk of much lower growth than expected (due to lower external demand), and (ii) lower net capital flows.

   - At the program request, staff's stress scenario assumed a 1 percentage point downward shock to real GDP growth in the European Union (EU). Compared with the baseline, the shock led to a wider trade deficit for FYR Macedonia, lower transfers and FDI, an outflow of bank deposits, and a loss of access to sovereign debt markets in 2011–12.
   - The potential for a stress scenario to materialize remained present through 2011 and 2012, given the ongoing potential for negative shocks to EU growth and sovereign debt markets throughout this period.

[15] Except for the first criterion, which needs to be considered separately, a country qualifying for a PCL or PLL will also meet the exceptional access criteria.

- Subsequent developments highlighted risks in FYR Macedonia's external environment, and the plausibility of the original stress scenario assumptions; (i) EU output contracted by 0.3 percent in 2012 instead of growing by some 2.1 percent as envisaged by the April 2011 WEO forecast, with activity particularly weak in southeastern Europe, and (ii) while FYR Macedonia's financial sector remained resilient, European sovereign debt markets remained volatile in 2012, FDI turned out much lower than expected, and net outflows of currency and deposits were larger than expected.

2. *A rigorous and systematic analysis indicates that there is a high probability that the member's public debt is sustainable in the medium term.* At the program request, debt was relatively low and sustainable. It was expected to increase in 2011–12, and it was projected to remain within sustainable bounds thereafter (26 percent of GDP by 2015). The second PPM staff report notes in the Appendix of Debt Sustainability Analysis that "Government debt dynamics—contingent on meeting the outlined medium-term fiscal targets—are stable under the baseline, but sensitive to growth and primary balance shocks."

3. *The member has prospects of gaining or regaining access to private capital markets within the timeframe when Fund resources are outstanding.* This criterion was also met, even allowing for temporary disruption to market access during February–March 2011 owing to domestic political uncertainty, and another spike in sovereign bond spreads in December 2011 as a result of euro area spillovers.

4. *The policy program provides a reasonably strong prospect of success, including not only the member's adjustment plans but also its institutional and political capacity to deliver that adjustment.* The overarching objective of the program, to provide insurance to FYR Macedonia against external shocks, was met. Economic adjustment was not an objective of the program, which envisaged a continuation of already-sound policies and, given the conjuncture, neutral macroeconomic policy settings. The 2013 Article IV staff report found that FYR Macedonia had maintained external and financial stability despite a difficult environment.

B. Review of Qualification Criteria for the PCL/PLL

46. The Decision on the PCL—and its successor the Precautionary and Liquidity Line (PLL)[16]—sets both general and specific criteria for assessment (Appendix I). To qualify for the PCL/PLL, a country must meet the general criteria of sound economic policies and institutions (paragraph 2a of the Decision), and perform strongly in at least three of the five specific criteria as outlined below, with no substantial underperformance in any of the five (Decision paragraph 2b). A

[16] In contrast to the PCL, the PLL is available to countries with an actual balance of payments need at the time of program approval.

country that meets the general "soundness" criteria should have a track record of sound economic fundamentals and sound institutional policy frameworks, and "remain(s) committed to maintaining such policies in the future, all of which give confidence that the member will take the policy measures needed to reduce any remaining vulnerabilities and will respond appropriately to the balance of payments difficulties that it might encounter." In addition, the country cannot fail any of four disqualifying criteria relating to sustained loss of market access, the need to undertake a large macroeconomic or structural policy adjustment, unsustainable public debt, or widespread bank insolvencies (Decision paragraph 2c).

47. FYR Macedonia met the PCL/PLL criteria at the program request and First Review. The Fund assessed Macedonia's performance to be strong in three of the five qualification areas—fiscal policy, monetary policy, and financial sector soundness and supervision—but with moderate underperformance in external position/market access and in data adequacy at the program request and the First Review. The authorities did not request completion of a Second Review, at which time the Fund would have reassessed Macedonia against the qualification criteria.

General criteria: "soundness"

48. FYR Macedonia had established a track record of sound policies and its commitment to those policies in the future by the time of the PCL request in 2011. Assessments of overall soundness largely reflect the broad conclusions of Article IV consultations in the period leading to the program request (specifics of individual policy areas are assessed separately below). The broad conclusions of the 2009 and 2010 Article IV consultations are consistent with a positive overall assessment. Prior to 2009 FYR Macedonia also had a strong track record of sound policies. Good performance under previous IMF SBAs helped. However, as noted in the Context section, policy space was in any case constrained. Large financing needs, the need to improve public debt management, and the effort to maintain a successful peg left little room for expansionary policies.

> *Executive Board assessment, 2009 Article IV:* "Executive Directors praised the Macedonian authorities for the conduct of macroeconomic policies, which contributed to a modest downturn in Macedonia's economy relative to other countries in the region."
>
> *Executive Board assessment, 2010 Article IV (program request):* "Executive Directors … commended the Macedonian authorities for their sound macroeconomic and financial policies, which helped to contain the impact of the global crisis, and welcomed prospects for a return to more robust growth in 2011 and beyond."
>
> "…Directors believed that Macedonia met the Precautionary Credit Line (PCL) qualification requirements and that such an arrangement would mitigate the risk of contagion, including by signaling sound policies."

Specific criteria: performance across sectors

49. FYR Macedonia fully met three out of five specific criteria at the program request and at the First Review of the program. At the outset of the program in January 2011 and at the First

Review under the PCL in September 2011, the Fund assessed that FYR Macedonia performed strongly in three of the specific criteria, relating to fiscal policy, monetary policy, and the financial sector; it moderately underperformed against the remaining two criteria, relating to the external sector and market access, and data quality. Based on the information available at the time of the assessments, these assessments were appropriate. Taking the five criteria in turn:

- *Fiscal policy:* FYR Macedonia was assessed as a strong performer in this area. This was consistent with its track record of moderate fiscal deficits and public debt levels, and of strong commitment to announced deficit targets; it was also consistent with its medium-term budgeting framework and fiscal strategy then in place.

- *Monetary policy:* FYR Macedonia was assessed as a strong performer in this area. This was consistent with its track record of sustaining an exchange rate peg to the euro that had contributed to low inflation for over a decade, without evidence of exchange rate misalignment.

- *Financial sector soundness and supervision:* FYR Macedonia's financial sector was assessed to be sound and its supervision adequate, with appropriate extra attention to this criterion (Box 2 of the original PCL request staff report) in light of the difficult external environment.

- *External position and market access:* FYR Macedonia initially scored well in this area but with some remaining vulnerabilities, which were highlighted by the March 2011 purchase and subsequent uneven access to external financing.

- *Data adequacy:* Data quality was assessed as adequate for surveillance and program monitoring, but with shortcomings in national income accounts and government finance statistics (GFS). FYR Macedonia regularly reports public debt data for the central government but not for the broader public sector (general government). FYR Macedonia was not subscribing to the Special Data Dissemination Standard (SDDS) at the time of the program launch.

50. The Fund reassessed performance against the five criteria only at the First Review. The First Review included a full reassessment against each of the specific criteria, reaching the same conclusions for each as at the program launch. The fact of the March 2011 purchase was explicitly taken into account in the criterion on external position and market access: the assessment noted that Macedonia continued to score well on measures of the external position, but that the authorities' decision to draw on the PCL illustrated the remaining vulnerability in the area of external access, and that this was subject to both domestic and external risks. The Fund did not subsequently reassess performance against the five criteria. However, as discussed above, slippages had emerged in public financial management, which would have had implications for the criterion on institutional strength. In the event, the authorities did not request completion of a Second Review under the PLL that would have entailed such reassessment.

51. FYR Macedonia did not fail any of the four disqualifying criteria under paragraph 2(c) of the PLL decision as assessed up until the First Review. Taking these in turn:

- *Sustained loss of market access:* FYR Macedonia's purchase in March 2011 was not associated with a sustained loss of market access; the country secured foreign bank loans in November 2011 and July 2012 (¶22).

- *Need for large economic or structural adjustment:* FYR Macedonia's PCL was intended as an insurance program, not an adjustment program (¶44). The 2013 Article IV found that current policy settings are broadly appropriate: although FYR Macedonia will require medium-term fiscal consolidation, macroeconomic policies should remain supportive of growth in the near term.

- *Unsustainable public debt:* FYR Macedonia's public debt has increased but remains within sustainable bounds (¶31).

- *Widespread bank insolvencies:* FYR Macedonia maintained financial sector stability (¶32).

POSSIBLE LESSONS

52. FYR Macedonia benefitted from the PCL, and the experience underlines the importance of maintaining not only sound policies, but also strong institutions and governance. Under the PCL, FYR Macedonia increased its reserve cover, and continued its policy stance without the need to resort to a substantial adjustment. Moreover, while the program was active, FYR Macedonia enjoyed relatively low secondary market bond yields compared with its regional peers. However, the March 2011 purchase under the PCL indicated that there were weaknesses in FYR Macedonia's debt management practices and large deficit financing needs, including overreliance on the external bond market and underdevelopment of domestic financing sources. Furthermore, signs of deteriorating public financial management emerged as the renewed downturn took hold from end-2011. The experience underlines the importance of maintaining not only sound policies, but strong institutions and governance as well. Significant efforts were made and are under way to remedy the remaining weaknesses, with the help of the World Bank loans guarantees.

53. It is not clear that a precautionary Stand-By Arrangement would have produced better outcomes, and—not facing a requirement to adjust—FYR Macedonia requested a PCL to insure against external shocks. In 2010, the authorities recognized FYR Macedonia's external vulnerabilities and wanted to insure against them. FYR Macedonia had repaid early the purchases from its previous SBAs with the Fund,[17] and it did not have an adjustment need (either for balance of payments purposes, or for providing the financing room to pursue a program of structural reforms). In these circumstances, FYR Macedonia expressed interest in a PCL arrangement following the

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[17] Including from the precautionary 2005 SBA which was requested not for a balance of payments adjustment need, but to support the implementation of a vast program of reforms.

Fund's Decision to establish the new instrument, and not in a precautionary SBA. The PCL was designed to provide insurance against a reasonable stress scenario, and was based on continuation of sound but neutral policies. The deterioration of the quality of fiscal institutions was not apparent at the outset of the program, and therefore the latter did not require stronger conditionality. As such, it is not clear that a precautionary SBA would have produced better outcomes. However, the cost of the insurance with a PLL was low. For PLL credit not drawn, FYR Macedonia paid a modest commitment fee, but in return the PLL gave a positive signal to markets. If drawn, the cost would be significantly less than the cost of financing at market interest rates,[18] notwithstanding that the cost of the PLL is aligned[19] with the cost of the Fund's other GRA instruments.

54. With the benefit of hindsight, although FYR Macedonia's alternatives to drawing under the PCL were costlier, should they have been undertaken they would have demonstrated a stronger track record of access to market financing and could have lowered future market borrowing costs. In hindsight, FYR Macedonia could have avoided purchasing in March 2011 if it had implemented a mix of some adjustment policies, gradually increased its domestic market financing, and proceeded in the summer or fall of 2011 with the planned Eurobond issuance. This would have helped FYR Macedonia demonstrate a stronger track record of access to market financing, which may be beneficial in the future. In addition, FYR Macedonia could have arguably taken advantage of lower yields in 2012, if it had kept the program active over its entire length. The yields on its sovereign bonds eased considerably once the program was approved and remained active. However, such counterfactual of policy mix and financing options would have had much higher shorter-term costs: a large adjustment was not necessarily needed on macroeconomic grounds[20] (and was not discussed at the program request or at the time of the First Review) and would have been probably politically costly. Moreover, alternative market sources had higher yields than the PLL, and tapping those would have required greater efforts to coordinate with domestic banks and the central bank to increase the issuances compared to initial plans, and deft planning to time the international markets after the elections.

55. In hindsight, the program request could have flagged political risks. The circumstances in which FYR Macedonia drew on the PCL—early parliamentary elections—came about because a tail risk, not flagged at the time of the program request, materialized. The early elections that took place in June 2011 were unlikely at the time of the program request. In hindsight, it would have been better if the original report had flagged political risks, especially given the instances in recent years of early elections, and the macroeconomic volatility that they induced (especially related to remittances, see Context section). But it is hard to make this case based on the information available at the time. Staff would have had less reason to flag political risks than in a typical program case,

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[18] While a precautionary SBA would probably have a similar financial cost it would be associated most likely with stronger conditionality and "stigma".

[19] The November 2011 review of the PLL did not change this characteristic.

[20] As it would have defeated the purpose of having a PCL.

based on the coalition's large parliamentary majority, the country's track record of sound economic policies, and in the absence of envisaged difficult adjustment policies whose implementation would have been vulnerable to a loss of political support. Moreover, by their nature, PLL programs focus on insuring against external risks, and therefore flag mostly external shocks.

56. A more plausible risk, which could have been flagged at the time of the program request, was that institutional quality might erode under pressure. The staff report for the original PCL request gave FYR Macedonia due credit for putting in place a medium-term budgeting framework, for clearing arrears, and for commitment not to accumulate new arrears. It was reasonable, in a baseline, to see these developments as consistent with institutional soundness in the fiscal area. That said, taking into account that these improvements were recent, it would have been reasonable to flag the risk that institutions might revert to previous patterns of behavior in the event of financial stress. In this context, the arrears that emerged in 2011 represented a departure from the baseline but a foreseeable risk.

Appendix I. Qualification for a PCL/PLL Arrangement

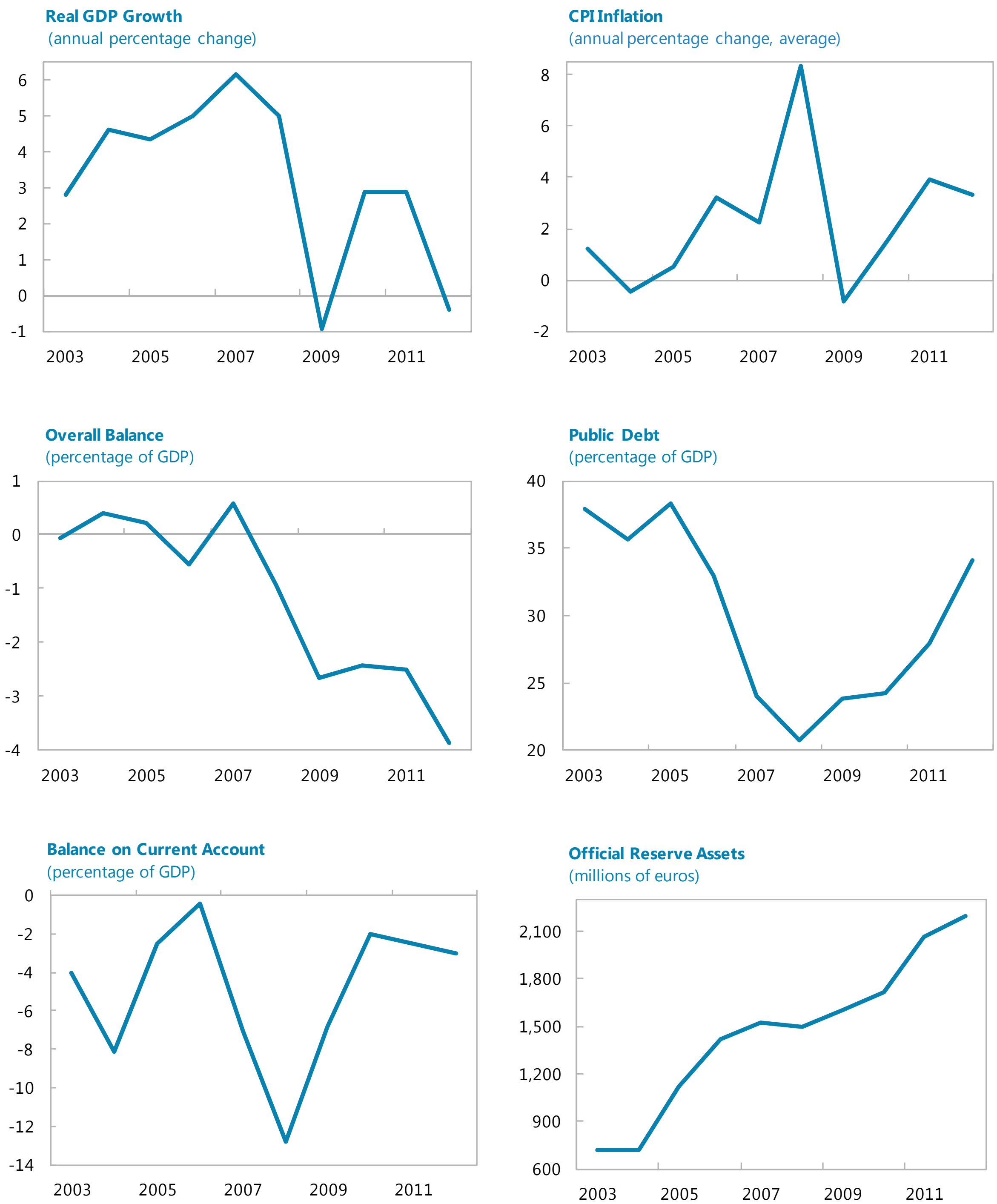
Excerpts from Executive Board decision 15017–(11/112), November 21, 2011:

2. (a) A PLL arrangement shall be approved upon request in cases where the Fund assesses that the member (i) has sound economic fundamentals and institutional policy frameworks, (ii) is implementing—and has a track record of implementing—sound policies, and (iii) remains committed to maintaining such policies in the future, all of which give confidence that the member will take the policy measures needed to reduce any remaining vulnerabilities and will respond appropriately to the balance of payments difficulties that it is encountering or might encounter.

(b) In addition to requiring a generally positive assessment of the member's policies by the Executive Board in the context of the most recent Article IV consultations, a member's qualification for a PLL arrangement shall be assessed in the following areas (with the member being expected to perform strongly in most of these areas and not to substantially underperform in any of them): (i) external position and market access, (ii) fiscal policy, (iii) monetary policy, (iv) financial sector soundness and supervision, and (v) data adequacy.

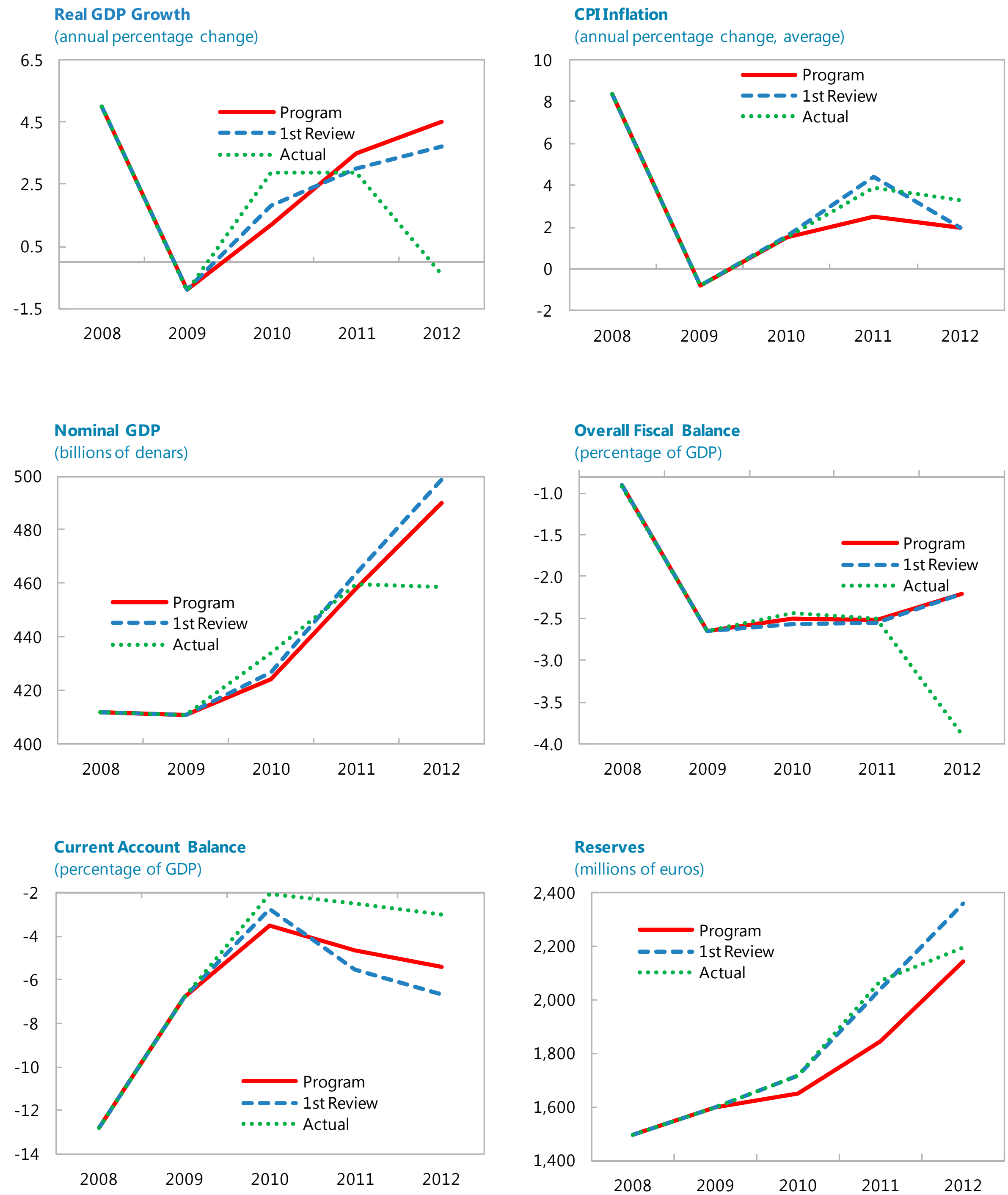
(c) Notwithstanding paragraph 2(b) above, the Fund shall not approve a PLL arrangement for a member facing any of the following circumstances: (i) sustained inability to access international capital markets, (ii) the need to undertake a large macroeconomic or structural policy adjustment (unless such adjustment has credibly been launched before approval), (iii) a public debt position that is not sustainable in the medium term with a high probability, or (iv) widespread bank insolvencies.

Figure 1. FYR Macedonia: Macroeconomic Framework, 2003–2012



Source: NBRM; SSO; MoF

Figure 2. FYR Macedonia: Program Forecasts and Outcomes, 2008–2012



Source: IMF

Figure 3. FYR Macedonia: Public Debt Sustainability Analysis

(Percent of GDP, unless otherwise indicated)

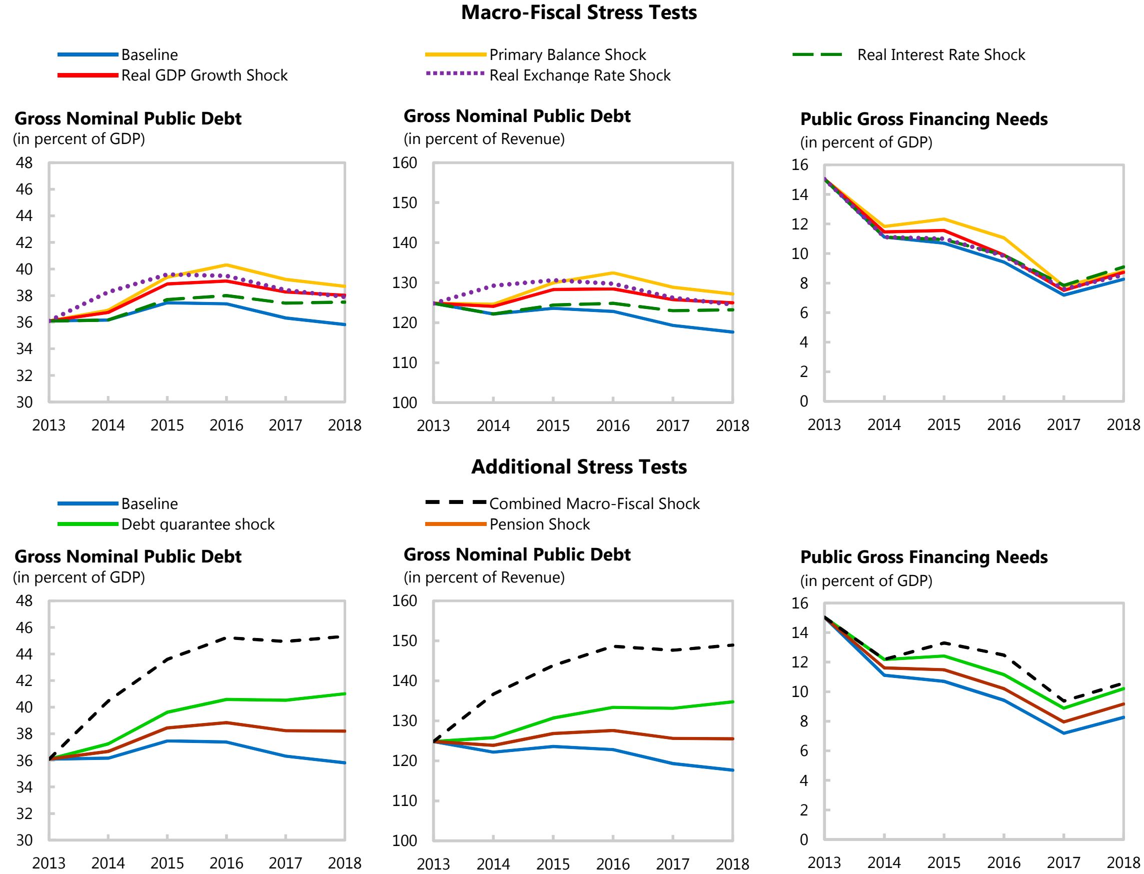
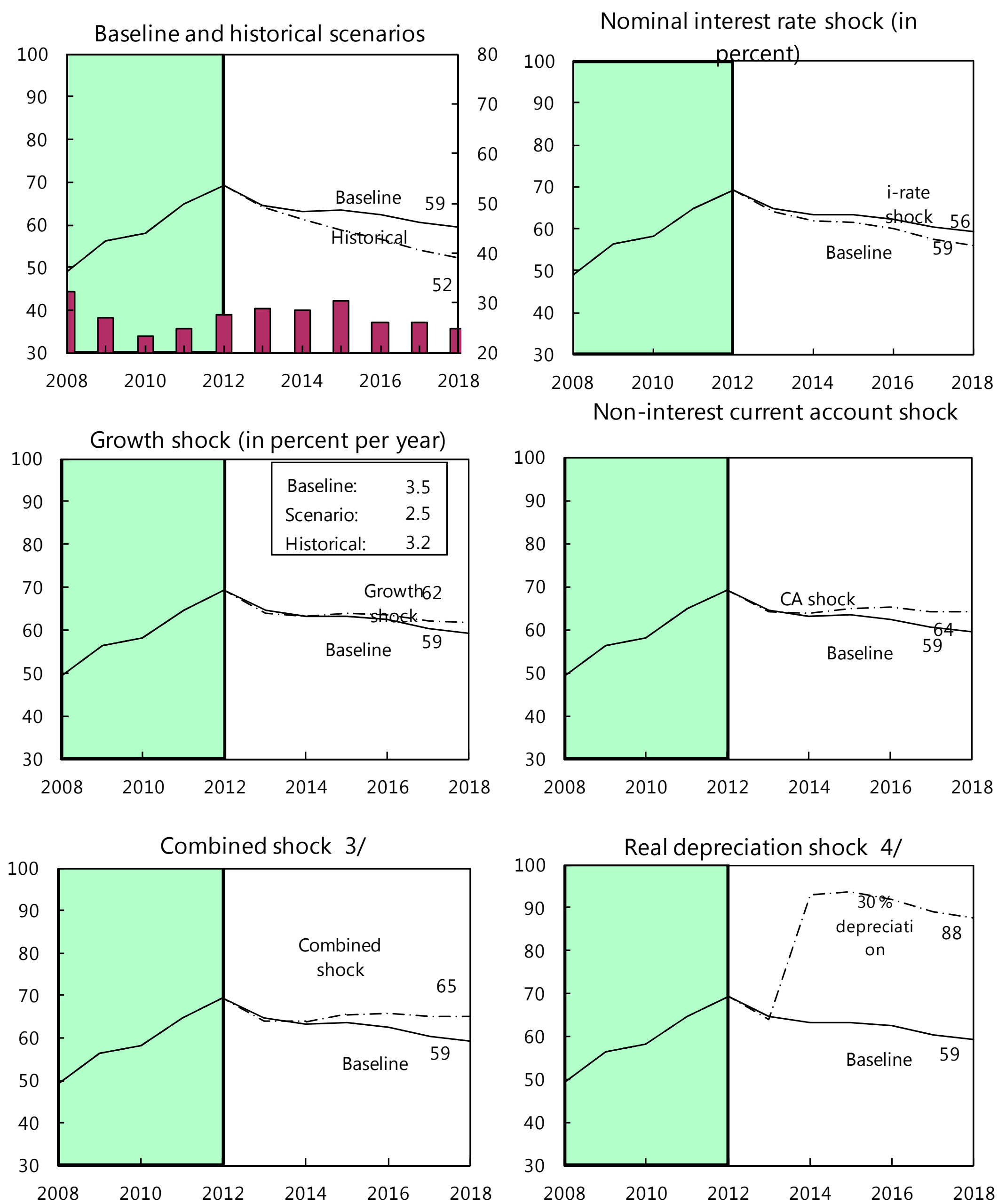


Figure 4. FYR Macedonia: External Debt Sustainability

(Percent of GDP, unless otherwise indicated)



Sources: International Monetary Fund, Country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

Table 1. FYR Macedonia: Macroeconomic Framework, 2007–2012

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

	2007	2008	2009	2010	2011	2012
Real GDP	6.1	5.0	-0.9	2.9	2.9	-0.4
Real domestic demand	9.2	6.7	-3.3	0.3	5.3	1.9
Consumption	6.4	7.1	-3.9	0.9	3.4	-1.7
Private	7.7	6.9	-4.9	1.5	4.0	-1.7
Public	0.2	8.1	0.6	-2.1	0.6	-1.8
Gross investment	23.2	4.8	-0.7	-2.0	13.5	16.1
Exports (volume)	12.0	-7.0	-16.0	24.6	10.4	0.0
Imports (volume)	16.3	0.0	-15.2	10.6	13.2	4.3
Contributions to growth						
Domestic demand	10.8	8.1	-4.1	0.4	6.2	2.3
Net exports	-4.6	-3.1	3.2	2.5	-3.3	-2.6
Central government operations (percent of GDP)						
Revenues	32.7	33.1	31.2	30.3	29.7	30.0
Expenditures	32.1	34.0	33.9	32.7	32.2	33.8
Of which: capital	3.8	4.9	3.3	3.5	3.9	4.1
Balance	0.6	-0.9	-2.7	-2.4	-2.5	-3.9
Savings and investment (percent of GDP)						
Domestic saving	17.6	14.0	19.4	23.5	23.7	26.4
Public	4.4	3.9	0.6	1.1	1.4	0.2
Private	13.2	10.0	18.8	22.4	22.3	26.2
Foreign saving	7.1	12.8	6.8	2.0	2.5	3.0
Gross investment	24.6	26.8	26.2	25.5	26.2	29.4
Consumer prices						
Period average	2.3	8.4	-0.8	1.5	3.9	3.3
End-period	6.7	4.1	-1.6	3.0	2.8	4.7
Memorandum items:						
Current account balance (percent of GDP)	-7.1	-12.8	-6.8	-2.0	-2.5	-3.0
Gross official reserves (millions of euros)	1,524	1,495	1,598	1,715	2,069	2,193
in percent of ST debt	117	110	106	103	112	107
in months of prospective imports	3.6	4.4	4.1	3.7	4.4	4.5
Gross Central Government Debt (percent of GDP)	24	21	24	24	28	34
Public Sector Gross Debt (percent of GDP) 1/	27	24	27	28	32	39
External debt (percent of GDP)	48	49	56	58	65	69
Nominal GDP (billions of denars)	365	412	411	434	460	459

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

1/ Total Public Sector (including MBDP, municipalities, public sector non-financial enterprises; w/o NBRM).

Table 2. FYR Macedonia: Central Government Operations, 2007–2012
(Billions of denars)

	2007	2008	2009	2010	2011	2012
Total Revenues 1/	119.4	136.2	128.3	131.6	136.4	137.5
Tax Revenues and Contributions	103.2	115.1	109.9	112.4	118.7	117.4
PIT	8.9	8.7	8.7	8.9	9.5	9.6
CIT	5.9	8.6	4.4	3.7	3.9	3.7
VAT (net)	33.0	36.2	35.2	37.7	42.2	38.5
Excises	13.3	14.3	14.5	14.9	15.5	16.6
Custom Duties	6.2	6.3	5.2	4.7	3.8	4.1
Other Taxes 2/	2.5	2.9	2.9	3.9	4.0	4.3
Social Contributions	33.5	38.2	38.8	38.7	39.8	40.8
Pensions	21.9	25.6	26.3	26.1	26.9	27.5
Unemployment	1.5	1.8	1.8	1.7	1.7	1.7
Health	10.0	10.9	10.7	10.9	11.2	11.5
Non-Tax Revenues 3/	10.4	12.9	12.6	12.1	12.7	12.4
Capital Revenues 4/	4.9	6.9	5.0	5.6	3.9	4.6
Of which: Telecom dividend	2.9	3.8	2.4	2.5	2.3	2.5
Grants	0.9	1.3	0.8	1.5	1.1	3.0
Expenditures 1/	117.3	140.0	139.2	142.2	147.9	155.2
Current Expenditures 5/	103.7	120.2	126.0	127.4	130.9	137.1
Wages and salaries	23.6	20.8	22.7	22.6	23.1	22.7
Goods and services	14.8	18.7	16.2	14.7	13.9	14.6
Transfers	62.4	77.9	84.6	86.9	90.4	95.5
Pensions	28.2	33.4	36.5	37.6	39.2	40.9
Health	16.1	19.1	18.7	19.3	20.5	20.9
Local Governments	3.7	10.5	12.8	13.3	14.1	15.4
Other	14.4	15.0	16.7	16.6	16.6	18.3
Interest	2.9	2.6	2.4	3.2	3.5	4.2
Capital Expenditures	13.7	20.1	13.4	15.3	17.7	18.8
Lending minus repayment 6/	-0.2	-0.2	-0.2	-0.5	-0.8	-0.6
Overall fiscal balance	2.2	-3.8	-10.9	-10.5	-11.5	-17.8
Financing	-3.6	2.4	10.9	10.5	11.5	17.8
Domestic	7.6	-0.1	0.1	5.9	-9.4	13.6
Central Bank deposits	12.7	3.2	-0.3	4.0	-7.3	-12.0
Other domestic financing	-5.1	-3.3	0.4	1.9	-2.1	25.7
Privatization receipts	-0.7	1.7	0.1	0.0	0.3	0.1
Foreign	-10.5	0.8	10.7	4.6	20.6	5.1
Private			0.0	4.6	13.1	4.6
Official			10.7	0.0	7.6	0.5
Memo items:						
Gross debt (as share of GDP)	24	21	24	24	28	34
Nominal GDP (billions of denars)	365	412	411	434	460	459
Stock of government deposits at the NBRM (EUR mln eop)			11	12	8	19

Sources: IMF Staff and MoF estimates.
Notes:
1/ Excluding revenues from lending.
2/ Including Tax Revenues (SRA).
3/ Excluding profits from financial institutions.
4/ Including profits from financial institutions.
5/ Excluding lending guarantees.
6/ Excluding: (i) revenues from lending from total expenditure; and (ii) lending guarantees from current expenditures.

Table 3. FYR Macedonia: Central Government Operations, 2007–2012
(Percent of GDP)

	2007	2008	2009	2010	2011	2012
Total Revenues 1/	32.7	33.1	31.2	30.3	29.7	30.0
Tax Revenues and Contributions	28.3	28.0	26.7	25.9	25.8	25.6
PIT	2.4	2.1	2.1	2.0	2.1	2.1
CIT	1.6	2.1	1.1	0.9	0.8	0.8
VAT (net)	9.0	8.8	8.6	8.7	9.2	8.4
Excises	3.6	3.5	3.5	3.4	3.4	3.6
Custom Duties	1.7	1.5	1.3	1.1	0.8	0.9
Other Taxes 2/	0.7	0.7	0.7	0.9	0.9	0.9
Social Contributions	9.2	9.3	9.5	8.9	8.7	8.9
Pensions	6.0	6.2	6.4	6.0	5.8	6.0
Unemployment	0.4	0.4	0.4	0.4	0.4	0.4
Health	2.7	2.6	2.6	2.5	2.4	2.5
Non-Tax Revenues 3/	2.8	3.1	3.1	2.8	2.8	2.7
Capital Revenues 4/	1.4	1.7	1.2	1.3	0.9	1.0
Of which: Telecom dividend	0.8	0.9	0.6	0.6	0.5	0.6
Grants	0.2	0.3	0.2	0.3	0.2	0.7
Expenditures 1/	32.1	34.0	33.9	32.7	32.2	33.8
Current Expenditures 5/	28.4	29.2	30.7	29.3	28.5	29.9
Wages and salaries	6.5	5.1	5.5	5.2	5.0	5.0
Goods and services	4.1	4.6	3.9	3.4	3.0	3.2
Transfers	17.1	18.9	20.6	20.0	19.7	20.8
Pensions	7.7	8.1	8.9	8.7	8.5	8.9
Health	4.4	4.6	4.6	4.4	4.5	4.6
Local Governments	1.0	2.5	3.1	3.1	3.1	3.3
Other	4.0	3.6	4.1	3.8	3.6	4.0
Interest	0.8	0.6	0.6	0.7	0.8	0.9
Capital Expenditures	3.8	4.9	3.3	3.5	3.9	4.1
Lending minus repayment 6/	-0.1	0.0	-0.1	-0.1	-0.2	-0.1
Overall fiscal balance	0.6	-0.9	-2.7	-2.4	-2.5	-3.9
Financing (net)	-1.0	0.6	2.7	2.4	2.5	3.9
Domestic	2.1	0.0	0.0	1.4	-2.0	3.0
Central Bank deposits	3.5	0.8	-0.1	0.9	-1.6	-2.6
Other domestic financing	-1.4	-0.8	0.1	0.4	-0.5	5.6
Privatization receipts	-0.2	0.4	0.0	0.0	0.1	0.0
Foreign	-2.9	0.2	2.6	1.1	4.5	1.1
Private			0.0	1.1	2.8	1.0
Official			2.6		1.6	0.1
Memo items:						
Gross debt (as share of GDP)	24	21	24	24	28	34
Nominal GDP (billions of denars)	365	412	411	434	460	459
Stock of government deposits at the NBRM (EUR mln eop)			11	12	8	19

Sources: IMF Staff and MoF estimates.
Notes:
1/ Excluding revenues from lending.
2/ Including Tax Revenues (SRA).
3/ Excluding profits from financial institutions.
4/ Including profits from financial institutions.
5/ Excluding lending guarantees.
6/ Excluding: (i) revenues from lending from total expenditure; and (ii) lending guarantees from current expenditures.

Table 4. FYR Macedonia: Central Government Financing, 2009–2012

	2009		2010		2011		2012	
	mil. EUR	percent of GDP	mil. EUR	percent of GDP	mil. Euros	Percent of GDP	mil. Euros	Percent of GDP
Total Financing Requirement	**294**	**4.4**	**293**	**4.2**	**628**	**8.4**	**711**	**9.5**
Fiscal deficit	178	2.7	171	2.4	187	2.5	289	3.9
Gross Amortizations	117	1.7	122	1.7	441	5.9	422	5.6
Maturing Treasury bills and bonds					310	4.1	336	4.5
Domestic structural bonds	77	1.1	80	1.1	81	1.1	30	0.4
External	40	0.6	42	0.6	50	0.7	57	0.8
Total Financing Sources	**264**	**3.9**	**208**	**3.0**	**628**	**8.4**	**713**	**9.5**
Use of government deposits	-4	-0.1	55	0.8	-119	-1.6	-200	-2.7
Issuance of Government securities					354	4.7	786	10.5
Net Treasury bonds issuance	100	1.5	110	1.6	47	0.6	447	6.0
External financing	213	3.2	127	1.8	386	5.2	127	1.7
o/w private	175	2.6	0	0.0	130	1.7	75	1.0
o/w official	47	0.7	84	1.2	268	3.6	60	0.8
o/w IMF PLL					221	3.0		

Source: MoF; and IMF staff estimates

Table 5. FYR Macedonia: Composition of Central Government Debt, 2009–2012

	2009		2010		2011		2012	
	(share of GDP)	(share of debt)	(share of GDP)	(share of debt)	(share of GDP)	(share of debt)	(share of GDP)	(share of debt)
External	16.5	69.2	16.6	68.6	21.2	75.7	21.5	63.4
Private	4.8	20.4	4.6	19.0	6.5	23.4	7.1	20.8
Official	11.6	48.9	12.0	49.6	14.6	52.3	14.5	42.5
Domestic	7.3	30.8	7.6	31.4	6.8	24.3	12.4	36.6
Structural Bonds	4.2	17.7	3.2	13.2	2.0	7.3	1.7	5.0
Government Securities	3.1	13.1	4.4	18.2	4.7	17.0	10.8	31.6
Gross Debt	23.8	100.0	24.2	100.0	27.9	100.0	34.0	100.0
NBRM Deposits	3.1		2.1		4.2			
Net Debt	20.7		22.2		23.9		34.0	
Memo Items:								
Foreign currency debt 1/	21.6		22.6		25.5		26.7	
Short-term debt	3.1		4.4		4.5			

Source: MoF and Staff estimates.
Note:
1/ Includes foreign currency indexed debt issued on the domestic market.

Table 6. FYR Macedonia: Balance of Payments, 2007–2012

(Millions of Euros, unless otherwise indicated)

	2007	2008	2009	2010	2011	2012
Current account	-421	-862	-457	-144	-189	-226
Trade balance	-1,181	-1,763	-1,560	-1,448	-1,648	-1,757
Exports	2,472	2,693	1,933	2,530	3,211	3,107
Imports	-3,653	-4,455	-3,492	-3,978	-4,859	-4,863
Services (net)	28	9	16	37	97	46
Income (net)	-281	-94	-47	-100	-131	-148
Transfers (net)	1,012	985	1,133	1,367	1,531	1,699
Of which						
Official	24	49	35	31	77	60
Private	988	936	1,098	1,337	1,417	1,572
Of which: Cash exchange	830	774	928	1,155	1,237	1,389
Capital and financial account	598	795	507	203	512	328
Capital account (net)	4	-12	20	12	9	20
Financial account	594	807	487	191	503	308
Direct investment (net)	507	409	137	159	337	78
Portfolio investment (net)	114	-51	104	-57	-76	77
Of which: Eurobonds disbursements	0	0	175	0	0	0
Of which: Eurobonds amortizations	0	0	0	0	0	0
Other investment	-27	448	246	89	242	153
Trade credits (net)	-23	-4	169	71	-13	170
MLT loans (net)	-96	281	34	67	463	67
Public sector	-121	36	7	39	367	62
Disbursements	81	69	47	98	457	161
of which : IMF credit	0	0	0	0	221	0
Amortization	-202	-32	-40	-59	-89	-99
of which : Repayment to the IMF	0	0	0	0	0	0
Banks (net)	54	-1	16	94	53	-24
Non-Banks (net)	-29	246	12	-66	43	29
ST loans (net)	44	-44	16	62	-27	-4
Currency and deposits (net)	-11	207	-62	-171	-232	-115
Of which: Commercial banks	51	251	-60	-81	-98	113
Other (net)	59	8	88	60	50	35
Errors and omissions	-40	-24	27	1	9	18
Overall Balance	137	-91	77	61	332	120
		(Percent of GDP)				
Current account	-7.1	-12.8	-6.8	-2.0	-2.5	-3.0
Of which						
Trade balance	-19.8	-26.2	-23.3	-20.5	-22.1	-23.6
Private transfers	16.6	13.9	16.4	18.9	19.0	21.1
FDI (net)	8.5	6.1	2.0	2.2	4.5	1.0
		(Year-on-year percent change)				
Exports of G&S (Value)	28.3	10.3	-24.7	25.9	24.8	-2.1
Volume	12.0	-7.0	-16.0	24.6	10.4	0.0
Price	14.5	18.6	-10.3	1.1	13.0	-2.1
Imports of G&S (Value)	25.0	21.7	-20.3	12.9	20.3	1.4
Volume	16.3	0.0	-15.2	10.6	13.2	4.3
Price	7.5	21.7	-6.0	2.1	6.2	-2.8
Terms of trade (2008=100)		100.0	95.4	94.5	100.5	101.2
Memorandum Items:						
Nominal GDP	5,965	6,720	6,703	7,057	7,475	7,456
ST debt at residual maturity (year-end)	1,305	1,353	1,510	1,666	1,846	2,041
Gross foreign exchange reserves	1,524	1,495	1,598	1,715	2,069	2,193
Months of prospective imports of G&S	3.6	4.4	4.1	3.7	4.4	4.5
Percent of short-term debt (residual maturity)	117	110	106	103	112	107
External debt (percent of GDP)	48	49	56	58	65	69
Medium and long-term	29	32	38	40	44	46
Short-term	19	17	19	19	21	23
External debt service	1,197	1,397	1,427	1,608	1,796	1,970
Percent of exports of G&S	39	41	56	50	45	50
Percent of exports of G&S and private transfers	29	32	39	35	33	35

Sources: NBRM; and IMF staff estimates.

Table 7. FYR Macedonia: External Financing Requirements, 2009–2012

(Millions of Euros, unless specified otherwise)

	2008	2009	2010	2011	2012
Gross financing requirements	2,151	1,787	1,621	1,810	2,157
Current account deficit	862	457	144	189	226
ST debt amortization (original maturity)	1,131	1,163	1,242	1,313	1,588
MLT debt amortization 1/	157	168	235	308	344
Financing sources	2,151	1,787	1,621	1,810	2,157
FDI (net)	409	137	159	337	78
ST debt disbursements	1,163	1,242	1,313	1,588	1,725
MLT debt disbursements	439	202	302	770	410
of which: Syndicated loan disbursment	0	0	0	0	75
Sovereign Eurobond disbursment	0	175	0	0	0
Other 2/	112	133	-36	-527	67
Net change in reserves (-: increase)	29	-103	-117	-358	-125
Gross international reserves (GIR)	1,495	1,598	1,715	2,069	2,193
GIR as % of ST debt	110	106	103	112	107
GIR as % of Fund New Metric	124	131	125	127	130

Sources: NBRM; and IMF staff estimates.

1/ Excluding the amortization of MLT intercompany loans, which is included in FDI (net).

2/ Including the capital account balance, net errors and omissions, currency and deposits, portfolio investments, flows and stock data.

Table 8. FYR Macedonia: External Debt Decomposition, end-2010

	Millions of Euros	Percent of GDP
Total External Debt	4,299	61.9
Total External MLT Debt	2,793	40.2
Private	1,613	23.2
Intecompany Loans	617	8.9
Loans	932	13.4
Other	65	0.9
Public 1/	1,180	17.0
Official Creditors	929	13.4
Private Creditors	251	3.6
Total External ST Debt	1,506	21.7
Private	1,505	21.7
Intercompany Debt	363	5.2
Trade Credits	779	11.2
Arrears	161	2.3
Other	202	2.9

Sources: NBRM and IMF Staff Estimates

1/ Public includes general government and monetary authorities.

Table 9. FYR Macedonia: Monetary Survey, 2007–2012

(Billions of denars, unless specified otherwise)

	2007	2008	2009	2010	2011	2012
NFA	109	91	95	100	125	126
Central Bank	94	91	93	101	123	129
Commercial Banks	15	0	2	-1	2	-3
NDA	67	105	112	133	130	140
Credit to Government (net)	-11	-8	-5	9	-2	2
From Banks (net)	11	6	9	15	14	29
of which: Credit (Tbills)	13	9	13	18	17	32
From Central Bank (net)	-21	-14	-14	-6	-16	-27
of which: Deposits	-21	-12	-13	-9	-19	-30
Credit to Private Sector (Gross)	130	175	180	193	208	219
From Banks	129	173	179	192	208	219
Denars	98	134	140	144	151	164
FX	31	39	39	48	58	54
From Central Bank	1	2	2	1	0	0
Other Items (net)	-53	-62	-63	-70	-76	-81
Broad Money (M3)	176	196	207	233	255	266
Currency in Circulation	18	18	16	17	19	20
Total Deposits	158	178	191	216	236	246
Denars	90	94	90	107	122	135
FX	68	84	101	109	113	111
	(Year-on-year percent change)					
Private Sector Credit	39	34	3	7	8	5
Broad Money	29	11	6	12	10	4
Private Sector Deposits	32	13	7	13	9	4
	(Contribution to annual growth in broad money)					
NFA	1.1	-10.3	1.9	2.5	10.7	0.5
NDA	28.2	21.5	4.1	9.7	-1.0	3.9
	(Percent of GDP)					
Private Sector Credit	35.7	42.5	43.9	44.5	45.3	47.7
Broad Money	48.2	47.5	50.5	53.6	55.5	58.1
Private Sector Deposits	43.3	43.2	46.5	49.7	51.3	53.7
Memorandum Items:						
Money Multiplier	4.6	4.8	4.5	4.7	4.8	4.8
Reserve Requirement Ratio (% of deposits)						
Denars	10	10	10	10	10	10
FX Indexed	10	10	20	20	20	20
FX	10	10	13	13	13	13
Velocity	2.1	2.1	2.0	1.9	1.8	1.7

Sources: NBRM; and IMF staff estimates.

Table 10. FYR Macedonia: Central Bank Survey, 2007–2012

(Billions of denars, unless specified otherwise)

	2007	2008	2009	2010	2011	2012
NFA	94	91	93	101	123	129
Assets	95	92	98	105	142	143
Liabilities	-1	-1	-5	-5	-19	-14
NDA	-57	-50	-47	-52	-69	-73
Banks (net)	-21	-19	-17	-27	-32	-26
of which:						
NBRM Bills and short-term facilities	-21	-19	-16	-26	-32	-27
Central Government (net)	-20	-11	-11	-4	-13	-25
of which:						
Deposits at Central Bank	-21	-12	-13	-9	-19	-30
Denar	-15	-9	-3	-6	-7	-19
FX	-6	-3	-10	-3	-12	-11
State and Local Governments (net)	-2	-3	-2	-3	-2	-2
Other items (net)	-14	-17	-17	-19	-21	-20
Reserve Money	38	41	46	49	54	56
Currency in Circulation	18	18	16	17	19	20
Other	20	23	30	32	34	36
Cash in Vaults	2	3	3	3	3	4
Total Reserves	18	20	26	29	31	32
on Denar Deposits	11	10	14	16	17	19
on FX Deposits	7	10	12	13	14	13
	(Contribution to annual growth in reserve money)					
NFA	30.4	-9.2	5.6	16.0	44.7	11.9
NDA	-10.2	17.2	6.8	-9.4	-35.2	-7.7
Reserve Money	20.2	8.0	12.4	6.6	9.5	4.3
Memorandum Items:						
NBRM Bills (percent of GDP)	5.8	4.2	3.9	6.0	7.0	5.7
Govt Deposits at Central Bank (Percent of GDP)	5.7	3.0	3.1	2.1	4.2	6.6

Sources: NBRM; and IMF staff estimates.

Table 11. FYR Macedonia: Financial Soundness Indicators of the Banking System, 2007–2012

(In Percent)

	2007	2008	2009	2010	2011	2012
Capital adequacy						
Regulatory capital/risk weighted assets	17.0	16.2	16.4	16.1	16.8	17.1
Tier I capital/risk weighted assets 1/	15.7	14.0	13.8	13.4	14.1	14.5
Equity and reserves to Assets	11.4	11.5	11.4	10.6	11.0	11.2
Asset composition						
Structure of loans						
Enterprises (loans to enterprises/total loans)	55	54	59	59	58	57
Households (loans to households/total loans)	38	39	38	37	37	36
Lending with foreign currency component to private sector	55	57	59	59	59	55
Foreign currency lending/total credit to private sector	25	23	23	26	28	26
Foreign currency indexed lending/total credit to private	30	34	36	33	31	30
NPLs 2/						
NPLs/gross loans	7.5	6.7	8.9	9.0	9.5	10.1
NPLs net of provision/own funds	-5.0	-6.2	-0.6	-0.3	-0.9	-3.7
Provisions to Non-Performing Loans	114.3	118.1	101.4	100.7	101.9	107.1
Large exposures/own funds	181.4	118.0	213.3	200.4	189.6	205.1
Connected lending						
Banking system exposure to subsidiaries and shareholders/own funds	5.6	3.1	4.6	6.3	4.6	3.5
Banking system equity investments/own funds	4.9	3.9	1.5	1.5	1.6	1.8
Earning and profitability						
ROAA 3/	1.8	1.4	0.6	0.8	0.4	0.4
ROAE 3/	15.0	12.5	5.6	7.3	3.4	3.8
Interest margin/gross income 4/	57.0	58.9	62.6	61.8	60.0	60.7
Noninterest expenses/gross income 5/	60.3	64.0	64.5	68.2	69.7	65.3
Personnel expenses/noninterest expenses	38.4	36.5	36.9	36.1	34.1	33.1
Interest Rates						
Local currency spreads	4.5	3.2	2.8	2.3	3.2	3.5
Foreign currency spreads	6.5	4.2	4.2	4.4	4.8	4.6
Interbank market interest rate	3.1	5.3	6.2	2.7	2.2	2.1
Liquidity						
Highly liquid assets/total assets 6/	20.9	16.9	20.6	25.3	25.3	29.4
Highly liquid assets/total short-term liabilities 7/	28.2	24.0	30.1	38.5	39.6	48.2
Liquid assets/total assets	34.7	22.9	25.6	30.9	31.2	32.4
Liquid assets/total short-term liabilities	46.8	32.4	37.4	46.9	48.9	53.0
Customer deposits/total (noninterbank) loans	128.4	107.7	108.2	114.3	115.7	113.5
Foreign currency deposits/total deposits	44.5	48.1	56.2	53.5	50.8	47.3
Including foreign exchange-indexed 8/	51.5	54.8	60.9	55.5	52.7	48.3
Central bank credit to banks/bank liabilities	0.1	0.01	0.01	0.01	0.01	0.4
Sensitivity to market risk						
Net open foreign exchange position/own funds	38.2	25.1	13.0	18.9	21.3	11.4

Sources: NBRM's Financial Stability Unit.

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

2/ Includes loans to financial and nonfinancial sector.

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

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

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

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

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

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

Table 12. FYR Macedonia: Conditionality Under the PCL Arrangement, 2011–2012

Indicative targets

Target date	Time frame for assessment	Target	Outcome
Central government overall fiscal deficit, ceiling (billions of denar) 1/			
May 31, 2011	First Review of the PCL	6.40	6.46
November 30, 2011	Second Review 3/	11.60	10.54 4/
Net international reserves (billions of euros) 2/			
May 31, 2011	First Review	1.15	1.44
November 30, 2011	Second Review 3/	1.30 5/	1.35

Structural benchmark

Publish a report laying out a road map for debt management reform, in consultation with Fund staff	Second Review 3/	Not assessed during the PCL. The authorities did not publish a report but consulted with Fund staff on reforms, including the introduction of regular auctions of 5-year domestic bonds in September 2011. MCM provided TA on debt management in October 2011.

Performance criteria (continuous)

Standard performance criteria as specified in Attachment A of Decision No. 10464-(93/130), related to:
trade and exchange restrictions;
bilateral payments arrangements;
multiple currency practices; and
non-accumulation of external debt payment arrears. 6/

Sources: MoF, NBRM, and Fund staff estimates.

1/ Covers the central government as defined in the Annual Budget Document. Defined to include arrears in central government payments, including of non-disputed VAT refunds.
2/ Defined as the difference between the NBRM's reserve assets and its reserve liabilities. Targets originally set assuming that the government would issue a eurobond in the amount of €190 million during the course of 2011.
3/ Outcomes were not assessed during the PCL, since the Second Review did not take place.
4/ Reported outcome refers to cash-basis deficit only. The 2011 Article IV staff report, paragraph 12 (SM/12/104), reported that the deficit was somewhat larger on an accrual basis due to arrears. However, exact data on arrears incurred by the central government during January-November 2011 are not readily available.
5/ Original target: EUR 1.35 billion. The First Review increased the target by EUR 50 million, but also included a downward adjustor of up to EUR 100 million in the event of shortfall in planned issuance of external debt to private investors by end-November 2011.
6/ The 2011 Article IV staff report, paragraph 12 (SM/12/104), reported that the government failed to make payments totaling €7.6 million due to an external supplier of medical equipment in the second half of 2011 and eventually reached agreement to make the overdue payments (plus interest) in January 2012.

Table 13. FYR Macedonia: Public Debt Sustainability Analysis – Baseline Scenario

(Percentage of GDP, unless specified otherwise)

Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2006-2010 [2/]	2011	2012	2013	2014	2015	2016	2017	2018
Nominal gross public debt	25.1	27.9	34.1	36.1	36.2	37.5	37.4	36.3	35.8
Public gross financing needs	0.4	7.6	8.7	15.0	11.1	10.7	9.4	7.2	8.3
Real GDP growth (in percent)	3.6	2.9	-0.4	2.5	3.0	3.6	3.9	4.0	4.0
Inflation (GDP deflator, in percent)	4.4	3.0	0.1	4.0	3.0	1.8	3.0	2.9	2.2
Nominal GDP growth (in percent)	8.2	5.9	-0.3	6.6	6.2	5.5	7.0	7.1	6.4
Effective interest rate (in percent) [4/]	3.0	3.3	3.3	3.3	3.2	3.1	3.4	3.5	3.3

As of June 30, 2013		
Sovereign Spreads		
Spread (bp) 3/		388
CDS (bp)		401
Ratings	Foreign	Local
Moody's	n.a.	n.a.
S&Ps	BB-	BB-
Fitch	BB+	BB+

Contribution to Changes in Public Debt

	Actual			Projections							
	2006-2010	2011	2012	2013	2014	2015	2016	2017	2018	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	-2.8	3.71	6.18	2.0	0.1	1.3	-0.1	-1.1	-0.5	1.7	
Identified debt-creating flows	-2.9	2.68	6.55	2.0	0.1	1.3	-0.1	-1.1	-0.5	1.7	
Primary deficit	0.4	1.7	3.0	3.1	2.6	1.8	1.1	1.1	1.1	11.0	-1.6
Primary (noninterest) revenue and grants	32.1	29.7	30.0	28.9	29.6	30.3	30.4	30.4	30.4	180.1	
Primary (noninterest) expenditure	32.6	31.4	32.9	32.0	32.2	32.1	31.6	31.6	31.6	191.1	
Automatic debt dynamics [5/]	-1.4	-0.6	1.0	-1.1	-1.0	-0.8	-1.3	-1.2	-1.0	-6.4	
Interest rate/growth differential [6/]	-1.4	-0.6	1.0	-1.1	-1.0	-0.8	-1.3	-1.2	-1.0	-6.4	
Of which: real interest rate	-0.4	0.1	0.9	-0.3	0.0	0.4	0.1	0.2	0.3	0.8	
Of which: real GDP growth	-1.0	-0.7	0.1	-0.8	-1.0	-1.2	-1.4	-1.4	-1.4	-7.2	
Exchange rate depreciation [7/]	0.0	0.0	0.0	...	...	...	...	...	...	...	
Other identified debt-creating flows	-1.9	1.5	2.6	-0.1	-1.5	0.3	0.0	-1.0	-0.6	-2.9	
Privatization receipts (negative)	-1.4	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Changes in cash, deposits, and securitie	-0.6	1.6	2.6	-0.1	-1.5	0.3	0.0	-1.0	-0.6	-2.8	
Residual, including asset changes [8/]	0.0	1.0	-0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	

Table 14. FYR Macedonia: External Debt Sustainability Framework, 2008–2018

(Percentage of GDP, unless specified otherwise)

	2008	2009	2010	2011	2012	10-Year Historical Average	10-Year Standard Deviation	Projections 2013	2014	2015	2016	2017	2018	Debt-stabilizing non-interest current account 6/
Baseline: External debt	49.2	56.4	58.2	64.8	69.3			**64.6**	**63.2**	**63.4**	**62.4**	**60.4**	**59.4**	**-5.1**
Change in external debt	1.5	7.2	1.8	6.7	4.4			-4.6	-1.5	0.2	-1.0	-2.0	-1.0	
Identified external debt-creating flows (4+8+9)	2.1	3.4	-2.2	-4.2	1.1			-0.9	-0.5	0.5	-0.2	-1.0	-1.2	
Current account deficit, excluding interest payments	11.5	5.7	0.6	0.8	1.4			1.7	2.8	4.1	3.5	2.9	2.6	
Deficit in balance of goods and services	26.1	23.0	20.0	20.8	22.9			21.2	21.6	22.2	21.3	19.8	18.9	
Exports	50.4	38.0	45.5	53.6	52.7			51.9	57.8	60.5	63.6	65.1	67.3	
Imports	76.5	61.1	65.5	74.4	75.6			73.1	79.4	82.7	84.9	85.0	86.2	
Net non-debt creating capital inflows (negative)	-5.3	-3.6	-1.4	-3.5	-2.1			-2.7	-3.0	-3.0	-3.0	-3.0	-3.0	
Automatic debt dynamics 1/	-4.0	1.2	-1.4	-1.5	1.8			0.0	-0.2	-0.5	-0.7	-0.8	-0.7	
Contribution from nominal interest rate	1.4	1.1	1.4	1.7	1.7			1.6	1.6	1.6	1.6	1.6	1.6	
Contribution from real GDP growth	-2.1	0.5	-1.6	-1.6	0.3			-1.6	-1.8	-2.2	-2.3	-2.3	-2.3	
Contribution from price and exchange rate changes 2/	-3.2	-0.3	-1.3	-1.7	-0.1			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	-0.6	3.9	4.0	10.9	3.3			-3.7	-1.0	-0.3	-0.8	-1.0	0.2	
External debt-to-exports ratio (in percent)	97.6	148.2	127.8	120.9	131.5			124.6	109.3	104.9	98.1	92.7	88.3	
Gross external financing need (in billions of euros) 4/	2.2	1.8	1.7	1.9	2.1			2.3	2.4	2.7	2.5	2.7	2.7	
in percent of GDP	32.2	27.0	23.4	24.8	27.8			29.0	28.6	30.5	26.2	26.0	24.9	
Scenario with key variables at their historical averages 5/								**64.0**	**61.4**	**58.8**	**56.5**	**54.0**	**52.3**	**-6.7**
Key Macroeconomic Assumptions Underlying Baseline														
Real GDP growth (in percent)	5.0	-0.9	2.9	2.9	-0.4	3.2	2.3	2.5	3.0	3.6	3.9	4.0	4.0	
GDP deflator in euros (change in percent)	7.3	0.7	2.3	3.0	0.1	3.2	3.4	4.0	3.0	1.8	3.0	2.9	2.2	
Nominal external interest rate (in percent)	3.2	2.2	2.6	3.2	2.6	2.8	0.6	2.5	2.6	2.7	2.7	2.7	2.7	
Growth of exports (euro terms, in percent)	10.3	-24.7	25.9	24.8	-2.1	11.7	15.9	5.0	18.3	10.3	12.5	9.7	9.9	
Growth of imports (euro terms, in percent)	21.7	-20.3	12.9	20.3	1.4	10.1	13.5	3.1	15.3	9.8	9.8	7.2	7.9	
Current account balance, excluding interest payments	-11.5	-5.7	-0.6	-0.8	-1.4	-3.6	3.8	-1.7	-2.8	-4.1	-3.5	-2.9	-2.6	
Net non-debt creating capital inflows	5.3	3.6	1.4	3.5	2.1	4.9	2.8	2.7	3.0	3.0	3.0	3.0	3.0	

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 dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

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

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

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

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

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

Annex. Authorities' Views

The Macedonian Authorities' Views on the Ex Post Evaluation

January 2014

1. In general, the authorities broadly agree with the findings of the ex post evaluation report. The report points out the sound policies and institutions in the Republic of Macedonia, prior and during the global economic crisis.

   In the past period, the Republic of Macedonia maintained macroeconomic stability, significantly improved the business environment and managed to attract higher level of FDIs. Notwithstanding the implications of the global economic crisis, it managed to keep its sound fiscal policy and low level of indebtedness. External and public debt increased, but remained sustainable, and reserves built up further. Moreover, the Fund staff believes that both public debt and external debt are projected to remain sustainable and stable over the medium term. The Fund's report also finds that the banking system is well capitalized, and expects continued progress on structural policies.

   In hindsight, the Authorities agree with the finding in the report that the PCL resources helped the country secure its budget financing needs with the lowest possible cost and risk for the debt portfolio, which is in line with the key debt management objectives.

   The authorities agree with the Fund's finding in the report, that the PCL effectively insured the country against external shocks and helped the Government adhere to sound polices without large adjustments.

2. However, the authorities disagree on specific findings and conclusions, and have various remarks on the Report.

- Weaknesses in public debt management cannot be considered a reason for withdrawing funds under the instrument, especially not in light of the extensive elaboration on the underlying reasons subsequently given in the report.

  Namely, the withdrawal of funds under the PCL instrument was a result of the political situation and the early parliamentary elections announced in the beginning of 2011. Any kind of new borrowing was prohibited during the election period, whilst all government institutions, worked at a technical level, carrying out the necessary functions only.

At the same time, the domestic market of government securities was not liquid enough, and it had no capacity to respond to the budget financing needs. The authorities disagree that it was a result of weaknesses in public debt management. It was rather a result of the asymmetric treatment of government securities, in terms of adhering to the liquidity ratios, by the banks. At that time, the banks preferred to adhere to the liquidity ratios by placing their liquid assets in central bank bills.

In the meantime, the authorities undertook numerous measures and achieved substantial progress with the development of the domestic debt market.

As a result of a series of operations of early and voluntary debt prepayment concluded under very favorable terms and conditions, the level of public debt decreased from 38.4% of GDP in 2005 to 20.6% of GDP at the end of 2008. Therefore, it is not quite understandable for the authorities how the connection between the decrease of public debt in this period and the vulnerability of public debt management is (being) made in the Report.

Hence, the report's finding that the decline in the debt level was associated with increased vulnerabilities related to debt management seems confusing and contradictory.

- The occurrence of arrears seems to be overemphasized in light of their full clearance by the authorities. Namely, the Government of the Republic of Macedonia publicly announced the amount of arrears and presented a robust action plan for their clearance in September 2012. The action plan was successfully completed by the end of February 2013, and subsequently the arrears were reduced to zero. Since then, all payments are executed regularly and the stock of arrears is 0 (zero). The Ministry of Finance has undertaken reform measures to prevent further reoccurrence of arrears, improving its procedures and systems related to the management and control functions of the Treasury system. The whole exercise related to arrears was planned, designed and implemented with the full support from the IMF and the World Bank.

- The Authorities disagree on the finding that besides central government debt, no other level of debt is reported. The Ministry of Finance regularly discloses data on the level of both the central government debt and the guaranteed debt on a monthly basis on its website, in the Bulletin of the Ministry of Finance and the Pre-Accession Economic Programme, which are publicly available documents shared with the EU and other international institutions. Also, the Republic of Macedonia has subscribed to the Special Data Dissemination Standard (SDDS) in 2011 and all requested data is properly disclosed.