EBS/14/2
Correction 3

February 18, 2014

To: Members of the Executive Board

From: The Secretary

Subject: **Former Yugoslav Republic of Macedonia—Second Post-Program Monitoring Discussions**

The attached correction to EBS/14/2 (1/14/14) has been provided by the staff:

Typographical Error

Page 8, para. 11, line 14: for "increase from 44" read "increase from 41½"

Questions may be referred to Ms. Vladkova Hollar (ext. 39695) and Mr. Gerard (ext. 39576) in EUR.

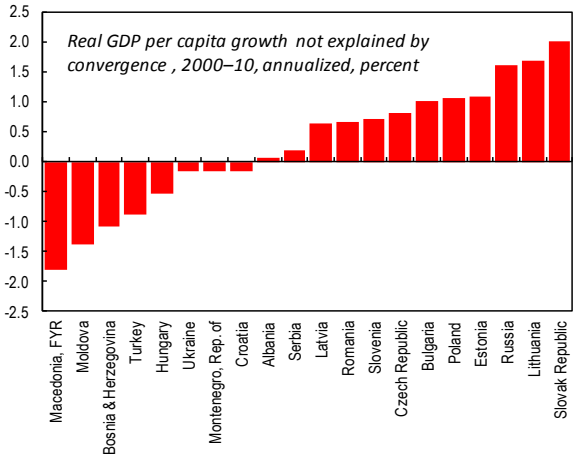
This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

Att: (1)

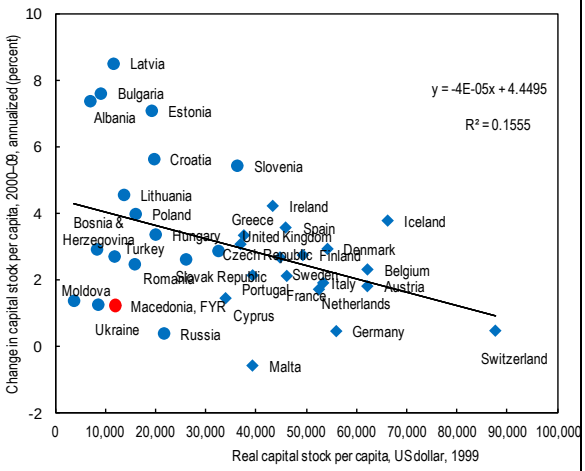
Other Distribution:
Department Heads

Convergence Growth and Bottlenecks

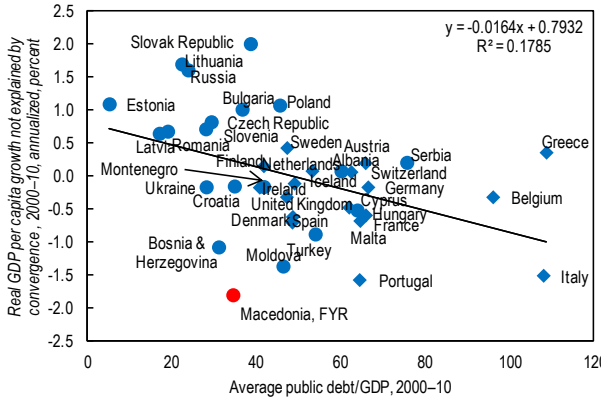
Growth has been weaker than would have been expected given initial income levels…



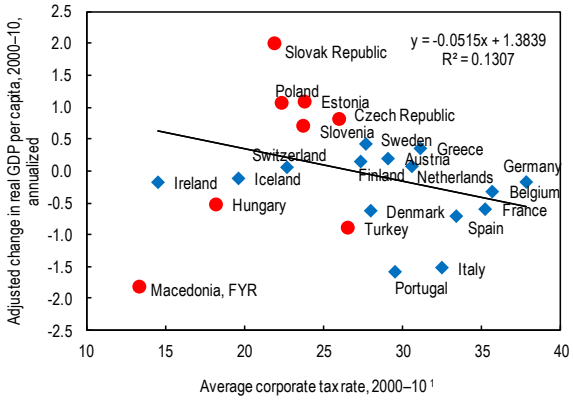
Modest capital flows and weaker investment rates seem to be the key culprits…



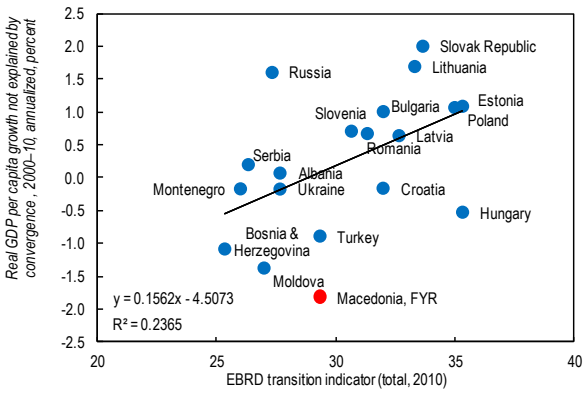
Government debt levels are moderate…



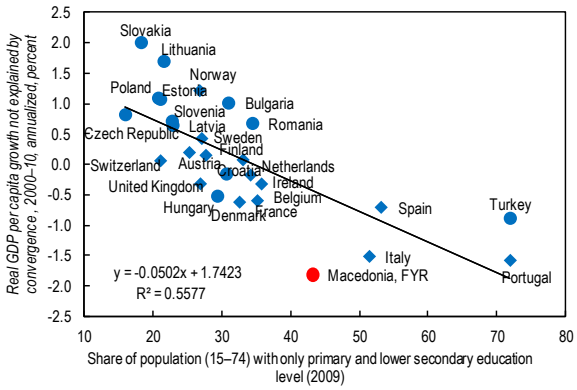
…and corporate tax rates are low.



Economic liberalization proceeded faster than in regional peers…



…although a high share of the population with only basic education may also be a constraint.

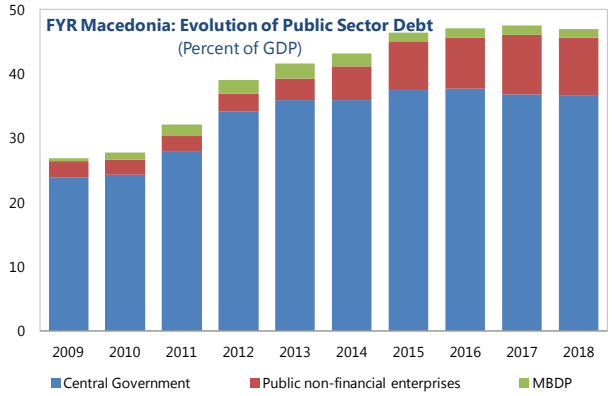


Sources: Adapted from International Monetary Fund, 2011, *Regional Economic Outlook: Europe—Navigating Stormy Waters* (Washington, October).

deficit and lowering the negative contribution of net exports to activity. However, with private transfers assumed to continue to normalize to about 18.5 percent of GDP, the current account deficit would widen to just under 4 ½ percent of GDP. Over the medium term, these dynamics of strong imports, catching-up exports, declining transfers and modest but steady foreign direct investment flows are expected to remain in place, widening the current account deficit through 2015 but gradually improving it thereafter.

10. Reserve accumulation would resume in 2014, largely on account of public sector external borrowing. In view of a strong pipeline of foreign-financed projects in the tradable sector, mainly concentrated in the automotive industry, foreign direct investment is projected to strengthen, albeit to the modest level of 3.8 percent of GDP, covering about 80–85 percent of the projected current account deficit in the next two years. Sizable public sector medium-term external borrowing, largely reflecting the implementation of foreign-financed construction projects, is expected to dominate net inflows on the financial account. In the near term, absent disruptive valuation effects, these developments would allow for the resumption of reserve accumulation.

11. The growth of public sector debt continues to outpace that of central government debt. While general government debt remains close to central government debt, public sector debt has been progressively diverging from central government debt. The Public Enterprise for State Roads (PESR) has signed a EUR 550 million credit line with the Chinese Ex-Im bank to be disbursed over the 2014–18 period. The Macedonian Bank for Development Promotion (MBDP) has contracted an additional credit line of about EUR 100 million from the EIB for SME financing. Overall, staff projects public sector debt to increase from ~~44~~ 41½ to 49 percent of GDP in the period 2013–18 (text graph).



Sources: Ministry of Finance; and IMF staff calculations.
PESR debt is projected to increase from 1.5 to 6 percent of GDP in the period 2014-18, at a pace of about EUR100 million per year until 2018 for the Miladnovic-Stip and Kicevo-Ohrid motorways; debt of other SOEs is projected to decrease from 3.8 to 3.3 percent of GDP over the 2014-18 period, based on amortization of existing debt and no new investment activity.

POLICY DISCUSSIONS

The authorities broadly agreed with staff's advice on the policy mix—namely that they should start shifting away from providing stimulus by ending monetary easing and by gradually withdrawing fiscal stimulus, proceeding apace with the economic recovery. Discussions focused on fiscal risks from operations of the broader public sector and the nature of the risks to the external position, particularly in the context of weaker private capital flows.

A. Fiscal Policy

12. Despite likely overstated budgetary space, the deficit target for 2014 appears attainable. While different factors have been at play, revenues have, on average, consistently