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IMF Executive Board Concludes Second Post-Program Monitoring Discussions and Ex-Post Assessment of Exceptional Access with the former Yugoslav Republic of Macedonia

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On January 29, 2014, the Executive Board of the International Monetary Fund (IMF) concluded the Second-Post Program Monitoring Discussions (PPM)[1] with the former Yugoslav Republic of Macedonia. The Executive Board also discussed the Ex-Post Evaluation (EPE) of Exceptional Access Under the 2011 Precautionary and Liquidity Line Arrangement (PLL).[2]

Following a contraction of 0.4 percent in 2012, growth is restarting, and less tentatively than expected earlier, with activity expanding 3.2 percent in the first three quarters of 2013. However, a sustained improvement in investment amid signs of a pickup in private credit would be needed to balance the risks to the outlook, and to help maintain growth momentum into next year.

The trade deficit has improved, and is projected at 22 percent of GDP at end-2013, from 23.6 percent in 2012, mainly due to weaker-than-anticipated imports, while exports have been increasing, with a notable contribution from free trade zones. With private transfers weakening from historic highs to 19 percent of GDP, the current account deficit is projected to widen slightly, to 3.4 percent of GDP. Net foreign direct investment has picked up recently and is expected to reach 3.3 percent of GDP—a strengthening relative to 2012—particularly as capital outflows in the form of profit repatriation and intercompany loans that were observed in 2012 have diminished.

Despite marginally net positive balance of payment flows, sizable negative price effects affecting gold and foreign securities have resulted in an erosion of the stock of official reserve assets by about €200 million since end-2012. Nonetheless, at over 25 percent of GDP, the stock of foreign exchange reserves provides a significant buffer, and capacity to repay remains adequate.

The banking sector remains healthy, with high capital and liquidity ratios, although profitability has been declining. Non-performing loans have fallen to 11.8 percent of total loans, reversing the previous trend increase. In the face of a deceleration in credit growth to about 3 percent in the first half of 2013, in July the National Bank of the Republic of Macedonia reduced the central bank bill rate (the main policy instrument) and the 7-day deposit facility rate by 25 basis points, to 3.25 percent and 1.50 percent, respectively. Yet credit growth has remained subdued, especially to the corporate sector—partly due to bank risk aversion, partly to continued portfolio cleaning.

The return to publishing a medium-term fiscal strategy, in line with recommendations in the 2013 Article IV consultation, is a good step forward in anchoring expectations. The 2014 budget is appropriately contractionary, and the deficit target appears attainable. While the authorities aptly target an acceleration of large capital expenditures—railways, gasification, hospitals—space for these outlays could be constrained by increases in entitlement spending.

Central government debt remains moderate, at 34.3 percent of GDP, but public sector debt has been progressively diverging from central government debt, as infrastructure needs are met by investment and borrowing by public enterprises, and as financing for SMEs is provided through external lines of credit extended to the Macedonian Bank for Development Promotion. Overall, staff projects public sector debt to increase from 41 to 49 percent of GDP in the period 2013–18.

The EPE reviewed Macedonia's engagement with the IMF under the 2011 two-year PLL arrangement. Macedonia made a purchase under the PLL of SDR 197 million (286 percent of quota) in March 2011.

The EPE finds that the PLL effectively insured 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. However, the purchase highlighted weaknesses in debt management practices, and arrears were accumulated after the First Review under the PLL, when the arrangement was no longer active. The authorities have since taken steps to address these issues.

Ex post, although Macedonia's alternatives to drawing under the PLL were costlier, they would have contributed to a stronger track record of access to market financing, and would have arguably helped Macedonia take advantage of lower yields in 2012 and after the program had run its course. In hindsight, the program request could have flagged risks coming from domestic developments, namely, the risk of early elections and an erosion of the quality of fiscal institutions.

Executive Board Assessment[3]

Executive Directors noted that Macedonia's economic growth has continued to strengthen and inflation has decelerated. In the period ahead, it will be important to address external and fiscal vulnerabilities and gradually tighten fiscal and monetary policies while fostering balanced and sustainable growth.

Directors welcomed the re-established medium-term fiscal strategy, which outlines a gradual withdrawal of stimulus starting in the 2014 fiscal year. Given the importance of public infrastructure in unlocking growth potential, Directors emphasized the need to ensure fiscal space for priority capital expenditure. They also called for further improvements in public financial and debt management, building on the progress to date. In this connection, they encouraged the authorities to monitor a broad concept of public debt encompassing off-budget spending by public enterprises.

Directors agreed that further monetary easing is not needed in the context of a stronger-than-expected economic recovery and high banking liquidity. They encouraged the authorities to continue to carefully monitor balance of payments pressures and welcomed their readiness to tighten monetary policy as needed to preserve the currency peg. They underscored, in this regard, the importance of maintaining a robust international reserves position.

Directors commended the authorities' efforts to attract foreign direct investments (FDI) and noted their positive impact on exports and job creation. They stressed the need to continue to facilitate spillovers of FDI to the domestic productive sector to ensure more balanced and sustained growth. Continued efforts to improve job skills and qualifications will also be important.

Directors welcomed the staff's EPE under the 2011 PLL arrangement. Most Directors agreed that the PLL was the right instrument for Macedonia at the time of its approval by providing effective insurance against external shocks without the need for a large adjustment. However, a number of Directors noted that fiscal institutional weaknesses became apparent after the arrangement's approval, and that the purchase was used in response to a domestic rather than external shock. In light of this, they considered that a different policy and financing mix could have helped Macedonia establish a stronger track record of market access. Directors generally saw merit in flagging domestic risks even in programs designed to insure only against external shocks. Overall, Directors agreed that the experience has underlined the importance of maintaining sound policies, strong institutions, and governance.

Former Yugoslav Republic of Macedonia: Selected Economic Indicators

	2009	2010	2011	2012	2013 (proj.)
	Annual percentage change, unless otherwise specified				
Real GDP	-0.9	2.9	2.9	-0.4	2.5
Real domestic demand	-3.3	0.3	5.3	1.9	0.1
Consumption	-3.9	0.9	3.4	-1.7	3.1
Gross Investment	-0.7	-2.0	13.5	16.1	-10.1
Net Exports 1/	3.2	2.5	-3.3	-2.6	2.4
CPI inflation (annual average)	-0.8	1.5	3.9	3.3	2.8
Unemployment rate (annual average)	32.2	32.0	31.4	31.0	28.7
	In percent of GDP				
Current account balance	-6.8	-2.0	-2.5	-3.0	-3.4
Trade balance	-23.3	-20.5	-22.1	-23.6	-22.0
Exports of goods	28.8	35.9	43.0	41.7	41.1
Imports of goods	52.1	56.4	65.0	65.2	63.1
Private Transfers	16.4	18.9	19.0	21.1	19.1
External debt	56.4	58.2	64.8	69.3	64.6
Gross investment	26.2	25.5	26.2	29.4	28.4
Domestic saving	19.4	23.5	23.7	26.4	25.0
Public	0.6	1.1	1.4	0.2	-0.5
Private	18.8	22.4	22.3	26.2	25.5
Foreign saving	6.8	2.0	2.5	3.0	3.4
Central government gross debt 2/	23.8	24.2	27.9	34.1	34.3
Central government balance	-2.7	-2.4	-2.5	-3.9	-3.9
Memorandum items:					
Nominal GDP (billions of denars)	411	434	460	459	489
Nominal GDP (billions of euros)	6.7	7.1	7.5	7.5	7.9
GDP per capita (euros)	3265	3430	3629	3615	...

Sources: NBRM; SSO; MOF; IMF staff estimates

1/ Contribution to growth.

2/ Data reflect actual end-December 2013 levels, which updates the staff report projection for 2013.

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[1] Post-Program Monitoring provides for more frequent consultations between the Fund and members whose arrangement has expired but that continue to have Fund credit outstanding, with a particular focus on policies that have a bearing on external viability. There is a presumption that members whose credit outstanding exceeds 200 percent of quota would engage in Post-Program Monitoring.

[2] The requirement for ex post evaluations (EPEs) was agreed by the IMF Executive Board in September 2002 for members using exceptional access in capital account crises, and extended to any use of exceptional access in February 2003. The aim of an EPE, which must be completed within a year of the arrangement ending, is to determine whether justifications presented at the outset of the individual program were consistent with IMF policies and to review performance under the program.

[3] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

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