April 13, 2020
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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 19/5-1

10:00 a.m., January 23, 2019

1. Former Yugoslav Republic of Macedonia—2018 Article IV Consultation

Documents: SM/18/290 and Correction 1; and Correction 2 ; and Supplement 1; and Supplement 1, Correction 1; SM/19/6; and Correction 1

Staff: Verkoren, MCM; Rahman, EUR; Goodman, SPR

Length: 52 minutes

Executive Board Attendance

T. Zhang, Acting Chair

Executive Directors	Alternate Executive Directors
	W. Nakunyada (AE), Temporary
	M. Bangrim Kibassim (AF), Temporary
G. Lopetegui (AG)	
	A. Park (AP), Temporary
	M. Coronel (BR), Temporary
	X. Cai (CC), Temporary
	J. Rojas (CE), Temporary
L. Levonian (CO)	
R. Kaya (EC)	
	A. Castets (FF)
S. Meyer (GR)	
S. Gokarn (IN)	
	I. Lopes (IT), Temporary
	Y. Saito (JA)
	K. Badsi (MD), Temporary
	M. Merhi (MI), Temporary
	R. Doornbosch (NE)
T. Ostros (NO)	
	L. Palei (RU)
M. Mouminah (SA)	
	K.Tan (ST)
	P. Trabinski (SZ)
	T. Hemingway (UK), Temporary
	P. Pollard (US), Temporary

H. Al-Atrash, Acting Secretary
J. Morco, Summing Up Officer
M. Gislen, Board Operations Officer
M. McKenzie, Verbatim Reporting Officer

Also Present
European Central Bank: A. Meyler. European Department: J. Decressin, A. Elashram, J. Meng, J. Poulain, J. Rahman. Finance Department: J. Hukka. Legal Department: I. Luca. Middle East and Central Asia Department: C. Purfield. Monetary and Capital Markets Department: M. Cihak, S. Iorgova, J. Morsink, C. Verkoren. Strategy, Policy, and Review Department: M. Goodman. World Bank Group: K. Smits.

Alternate Executive Director: P. Rozan (FF), M. Siriwardana (IN), F. Sylla (AF). Senior Advisors to Executive Directors: S. Evjen (NO), S. Keshava (SA), S. Potapov (RU), E. Rojas Ulo (AG). Advisors to Executive Directors: O. Bayar (EC), V. Djokovic (SZ), H. Mori (JA), M. Mulas (CE), T. Persico (IT), I. Skrivere (NO).

1. FORMER YUGOSLAV REPUBLIC OF MACEDONIA—2018 ARTICLE IV CONSULTATION

The staff representative submitted the following statement:

This statement provides information that has become available since the issuance of the staff report. The information does not alter the thrust of the staff appraisal.

Approval of the name change by the Macedonian parliament. On January 11, 2019, the authorities secured the required two-third-majority in the Macedonian Parliament to support the third and final approval of the constitutional changes related to the bilateral Prespa agreement with Greece. The bilateral agreement will also have to be approved by the Greek Parliament to become valid, after which the country's official name would become "Republic of North Macedonia". Resolution of the decades long dispute would bring the country closer to NATO membership and opening of EU accession negotiations.

Preliminary 2018 fiscal outcome. Preliminary numbers received from the authorities indicate that the overall fiscal deficit for 2018 is estimated to have reached -1.8 percent of GDP, significantly lower than what was envisaged in the supplementary budget approved late last year (-2.8 percent) or in staff's projections (-2.6 percent). This is mostly attributable to the overall large under execution of capital expenditures (1 percent of GDP) and goods and services spending (0.5 percent of GDP), although these have partially been offset by

weaker-than-budgeted non-tax revenues and grants. Meanwhile, tax revenues came out as budgeted with strong personal income tax and social security contributions collection at the end of the year. Staff continues to review this information. These developments do not materially affect staff's baseline projections as a catch-up in capital spending is not expected in 2019, but pose risks of higher under-execution of capital spending due to weaknesses in project documentation and delays in tendering.

Mr. Doornbosch and Mr. Tolici submitted the following statement:

On behalf of the Macedonian authorities, we would like to thank staff, led by Ms. Rahman, for their candid and constructive exchange of views during the Article IV mission and express our appreciation for the constructive policy findings and recommendations reflected in their report. The authorities broadly agree with staff's appraisal.

More than 13 years after achieving candidate status, Macedonia has removed a key hurdle to joining NATO and the European Union. In June 2018, an agreement on the formal name of Republic of North Macedonia started the process of settling down a decades long name dispute between Macedonia and Greece. The Macedonian Parliament approved on January 11, 2019 the constitutional amendments on the change of the name of Republic of Macedonia to Republic of North Macedonia. The ratification of the agreement in the Greek Parliament will remove the last hurdle for the accession to NATO, which should be formally completed by Summer 2020. Subject to Greek Parliament ratification of the bilateral agreement, and adequate progress with priority reforms, EU accession negotiations will be opened in 2019.

In 2018, the Macedonian economy has rebounded from stagnation, supported by a robust growth in export and private consumption. In the third quarter, the solid growth (3 percent yoy) was the result of favorable performance of exports and solid private consumption. Real GDP growth for 2018 is projected to reach between 2.3 percent (NBRM) and 2.8 percent (MoF), higher than the 2 percent set forward in the staff report, as high frequency indicators, in particular from industry, trade and tax collection, but construction as well, point to further economic growth during the last quarter of the year. Against the backdrop of a sustained economic recovery, the unemployment rate recorded the lowest level over the last twenty-five years although remaining relatively high at 20.8 percent.

Real GDP growth is projected to pick up further in 2019 to reach between 3.2 percent (MoF) and 3.5 percent (NBRM), versus a staff projection of 2.8 percent, mainly due to the expected rebound in infrastructure investment, robust exports and strong private consumption fueled by wage and credit growth.

On the basis of favorable economic prospects, Fitch has affirmed its BB rating with Positive Outlook in July and S&P Global Ratings affirmed its BB-/B ratings, with Stable Outlook in September 2018.

The authorities agree on the need to reform the economy and on the priorities highlighted by staff to increase productivity and inclusive growth. In 2018, the government started a wide range of reforms aimed at addressing labor market weaknesses, combating informality, strengthening institutions and anti-corruption efforts. To reduce the high youth and long-term unemployment, active labor market policies (ALMP) focusing on modernizing vocational training and developing internships and apprenticeships programs have been introduced. These programs have proven to deliver high employment retention. To attract FDI in high-value-added sectors, the authorities envisage secondary and tertiary education policies focused on reducing the technical and professional skills mismatch of young graduates. The authorities acknowledged the need for a better ALMP budget monitoring and agree with staff that employment incentives should be reevaluated in the context of cost effectiveness and impact durability.

The authorities made significant progress on judicial reform through the revision of the procedures on the appointment, appraisal, promotion and dismissal for judges, which provides buffers against undue interference in the judicial system. Additional legislative amendments needed to address the remaining gaps and reinforce the fight against corruption are expected to be discussed in the Parliament in February 2019.

In the latest World Bank 2019 Doing Business Report, Macedonia has moved up by one place, to10th best country in the world for doing business. This puts Macedonia in by far the highest position in the Southeastern European region, and ahead of 26 EU members. It reflects a continuing effort to facilitate businesses and support private investment and inflow of FDIs.

The authorities are strongly committed to sound fiscal policies and agree with staff's medium-term fiscal recommendations. They highly appreciate the Fund's ongoing technical assistance programs on tax administration and public financial management.

The authorities estimate a much better fiscal performance in 2018 than anticipated in the budget. The fiscal deficit is expected to be 1.8 percent of GDP instead of 2.7 percent of GDP because of good revenue performance and under-execution of capital expenditure on large infrastructure projects. In line with the medium term Fiscal Strategy, the 2019 budget targets a deficit of 2.5 percent of GDP, lower than staff's projection of 3 percent of GDP. The gap resulting mainly from differences in underlying GDP and revenue projections.

The government is achieving gradual fiscal consolidation by reducing the pension system deficit and improving targeting of social assistance spending. To improve the long-term sustainability, pension contribution rates will gradually increase from 18 to 18.8 percent in 2020. Benefit indexation will be changed to CPI only (from currently ½ average CPI and ½ average wage growth). Further measures may be considered in the future to address increasing demographic pressures.

The introduction of a more progressive personal taxation that replaced the current 10 percent flat tax reflects the authorities' focus on greater social justice and inequality reduction. A marginal PIT rate of 18 percent will be applied for top 1 percent earners, to the portion of income exceeding MKD 90,000 (about EUR 1,450 equivalent, or almost 4 times the average net wage).

The authorities have improved public financial management by better monitoring government arrears. These arrears have been reduced by about 0.6 percent of GDP. The new legal provisions introduced in 2018 require quarterly publication for all public entities of their overdue obligations. To achieve local government budget discipline, spending has been capped.

In the 2018-2021 Public Financial Management Reform Program, the government attaches high priority on improving the quality and transparency of public institutions. The 2018 IMF Fiscal Transparency Evaluation Report shows that Macedonia has made significant progress, but also provides a useful list of the main areas of focus for the future. Spending reports have significantly improved in quality and timeliness.

Monetary policy has been appropriate, supporting the economic recovery while keeping inflation expectations stable. The accommodative monetary stance during the entire year of 2018 has been maintained on the backdrop of the favorable foreign exchange market, a rather small output gap, and low and stable inflation. The three consecutive cuts in the key policy rate reflected the continuous favorable movements in the exchange rate market which indicate a solid external position and stable economic agents' expectations.

The accommodative policy stance supported credit recovery in both households and corporate sector (by 10.1 percent yoy and 5.8 percent yoy in the first eleven months of 2018). The strong growth of total deposits by 11.1 percent yoy during the same period was another sign of stable expectations and confidence. Considering the stable inflation outlook, the authorities suggest that there is room for further monetary policy easing, although they stand ready to tighten the monetary stance in case of large external shocks.

Financial System Stability Assessment

The authorities highly appreciate the financial system stability assessment by the Fund and the World Bank and broadly agree with the conclusions of the mission. They share staff's view on the strength and vulnerabilities of the financial system while noting its improved resilience.

The authorities are committed to implement the key recommendations:

Enhancing supervisory effectiveness by ensuring the independence of the central bank in its supervisory duties;

Increasing staffing levels;

Intensifying on-site and off-site supervision of systemically important banks through full-scope examinations;

Adopting a new law on banking resolution, implementing the latest international standards and best practices;

Broaden the recovery planning requirements to all banks (currently applied only to systemically important banks);

Perform more frequent crisis simulation exercises.

Improving the macro-prudential and crisis management framework.

It should be noted that since the previous FSAP in 2008, banking supervision and regulation have already been considerably strengthened by the adoption of international regulatory and supervisory standards, enrichment of supervisory tools and implementation of the FSAP recommendations (20 out of 23 recommendations were fully or partially implemented). As staff acknowledged, the legislative basis is strong and comprehensive, and supervision is largely compliant with the Basel Core Principles.

The banking system is well capitalized and liquid, owing to improved economic fundamentals as well as sound prudential policies. The total capital ratio slightly increased to 16.5 percent by end-June 2018. The overall NPL ratio continued the downward trend and dropped from 10 percent in 2015 to 5 percent in 2018.

The authorities will continue developing the supervision framework following the latest European and International standards. The Memorandum of Understanding concluded between NBRM and the European Central Bank in December 2018 will enhance the exchange of supervisory information and represent an essential step forward for further improvement in the integrity, stabilization and efficiency in the bank operations.

Adherence to International Data Standards

The authorities are continuing their efforts to reach full alignment with the international requirements in terms of data transparency and data quality. A notable achievement in this respect is the fulfillment of the requirements of the IMF SDDS Plus. As a result, the official adherence is expected at end January 2019.

Concluding Remarks

The long-awaited opening of the accession to NATO as well as the EU accession negotiations will strengthen the positive momentum, of which the authorities will take advantage to continue implementing their broad-based reform program, as well as to intensify attracting FDI. They are fully aware that a successful integration in the European Union can only be achieved if structural weaknesses in the labor market and public institutions are firmly addressed.

Mr. Villar and Mr. Rojas Ramirez submitted the following statement:

We thank staff for its comprehensive Art. IV report on the Former Yugoslav Republic of Macedonia and Mr. Doornbosch and Mr. Tolici for their helpful buff statement. We agree with the thrust of the staff's appraisal and welcome the positive developments in the country's economic policy and economic outcomes.

The FYR of Macedonia is completing a comprehensive strategy aiming at creating a strong labor market and strengthening institutions that may underpin productivity and sustained growth. The strategy includes the implementation of a comprehensive education policy addressed to improving the skills of the labor force, integrating youth and women and halting outward migration of skilled workers. Authorities are also committed to improving the institutional framework by strengthening the independence of the judiciary system, combating informality and fighting corruption.

Generating fiscal space to provide financing for structural reform and promote inclusive growth is critical for supporting the authorities' reform policy. We see efforts for implementing measures on expanding the VAT tax base, reducing the pension deficit and targeting social expenditures. We concur with staff in commending the authorities for improving fiscal transparency, as well as for fostering the fiscal consolidation process by targeting a zero-primary balance by 2023, broadening the tax base, rationalizing subsidies and improving property tax framework. Fiscal consolidation is necessary for setting debt indicators in a downward trend.

We notice that the monetary stance has been appropriate and in line with FSAP recommendations. The banking sector is in good capital position within satisfactory liquidity indicators. We welcome staff's recommendations on improving macroprudential policy framework, supervision, and regulation instruments, enhancing the crisis management resolution mechanism, and addressing AML/CFT deficiencies.

With these remarks, we wish the authorities of FYR of Macedonia success with their policy challenges.

Mr. Lopetegui and Mr. Rojas Ulo submitted the following statement:

We would like to thank staff for a clear and concise report and Mr. Doornbosch and Mr. Tolici for their helpful buff statement.

The economy of the Former Yugoslav Republic (FYR) of Macedonia is showing signs of recovery although the outlook remains challenging and calls for the continuity of the implementation of appropriate structural policies. After the country recently experienced GDP contraction caused by political uncertainties, in the first quarter of 2018 the economy started to rebound supported by net exports, and private and public consumption. Economic growth is projected to increase from 0.2 percent in 2017 to 2.0 percent in 2018 and growth is expected to rise and stabilize at 3.0-3.4 percent over the medium-term driven by higher public investment and net exports. Opening to EU and NATO access negotiations could boost investment and confidence. We support the government´s reforms focused on boosting productivity and speeding up convergence such as strengthening institutions, supporting employment, and reducing inequality and informality.

The target to achieve a zero-primary balance over the medium term to support structural reforms and building fiscal buffers is appropriate. The overall fiscal balance, following a minor reduction from -2.7 percent of GDP in 2017 to -2.6 percent of GDP in 2018, is projected to deteriorate to -3.0 percent of GDP in 2019 even with the net positive impact of the reforms for reducing the pension deficit and improving targeting social assistance benefits. Nevertheless, as shown in the report, in the medium term the overall fiscal balance is projected to decline to -2.4 percent of GDP. We concur with staff's recommendation that improving the fiscal balance over the long term is necessary to put debt on a firm downward path to limit vulnerabilities and create fiscal space to support sustainable growth. Recent PFM and transparency reforms are welcome, and building on this, the authorities should ensure adequate coverage of fiscal operations and accrual-base reporting.

The financial system's soundness indicators are positive but further efforts are necessary to strengthen oversight and improve the resilience of the economy. The staff report and the Financial System Stability Assessment (FSAP) show that the banking sector remains well-capitalized, liquid, and profitable. In addition, nonperforming loans (NPLs) have declined and remain well-provisioned. The authorities should continue to closely monitor the banking sector as stress tests confirm which high structural vulnerabilities remain in in key areas, such as FX credit risks and loan concentration. We support staff's recommendations to bolster the financial stability framework, with an enhanced macroprudential policy framework, eliminating supervisory gaps, and completing the bank resolution regime. We encourage the authorities to continue efforts in the implementation of the AML/CFT law.

We support the implementation of structural reforms focused on increasing economic growth and achieving income convergence. The economy maintains key challenges going forward centered on improving chronic structural weakness in the labor market and public institutions. Adequate macroeconomic policies generate resources for financing structural reforms and will help cushion against internal and external shocks. In addition, we concur on the need for continued efforts to ensure legislative reforms to strengthen governance to tackle corruption to improve climate investment, raise growth, and reduce informality. We support the implementation of a multi-pronged policy, centered on skills building, to address key labor market weaknesses to lift productivity, boost potential growth, and speed up convergence.

With these comments, we wish the Former Yugoslav Republic of Macedonia and its people success in their future endeavors.

Mr. Fachada and Mr. Coronel submitted the following statement:

We thank staff for the reports and Mr. Doornbosch and Mr. Tolici for their informative statement. Since the last Article IV discussed at the Board in November 2017, FYR Macedonia economic outlook has improved considerably, amidst lessened political tensions and concrete prospects of opening EU accession negotiations. We commend the authorities for setting the economy on a firmer path towards rebuilding fiscal and external buffers, revitalizing growth and advancing needed structural reforms.

Albeit at a slower pace than previously expected, Macedonia's GDP growth continues to recover from the economic paralysis of 2017 caused by the political crisis. The improvement in the political atmosphere has contributed to boost confidence and invigorate the structural reforms agenda. It is disappointing, however, that investment has yet to recover more forcefully, as noted by staff. We take notice that, for 2018 and 2019, authorities expect considerably higher GDP growth rates compared to staff, as mentioned by Messrs. Doornbosch and Tolici in their statement. On the other hand, we also take notice that staff's recent GDP projections have been relatively optimistic. In the last Article IV report, for instance, staff estimated GDP growth for 2017 at 1.9 percent vs. an actual outcome of 0.2 percent. In the same report, staff projected growth of 3.2 percent for 2018, now revised down to 2.0 percent. Could staff comment on whether the source of revision in 2017 and 2018 was only the length and intensity of the political crisis, or were there other relevant factors?

High unemployment remains a substantial challenge for the Macedonian economy. Despite the significant and consistent reduction of unemployment since 2008, it remains one of the highest in Europe, particularly among the youth. Long-term unemployment is particularly severe. We take note that the authorities are conscious of this challenge and are actively pursuing pro-job policies, including education and vocational training reforms, in tandem with intense efforts to deal with informality and improve the business environment to attract investment. Expectations should be managed prudently as high unemployment rates, not only in Macedonia but also in other Balkan states, reflect underlying structural problems that require a long-term approach.

Fiscal and monetary policies remain appropriate. We commend the authorities for their fiscal prudence, which is reflected in a relatively moderate—albeit increasing—public debt ratio. Monetary policy remains accommodative, given low inflation and absence of forex pressures. The banking system remains in good shape, despite underlying vulnerabilities. We welcome the FSAP recommendations and look forward to their effective implementation. Although there are pending issues to further enhance the country's macroprudential and surveillance policy frameworks, as highlighted in the FSAP report, recent progress has been satisfactory.

We commend the authorities for reviving the structural reforms agenda, including through an active legislative agenda aimed at improving governance and strengthening the anti-corruption framework. Progress in these areas is consistent with establishing Macedonia as a reliable destination for FDI, in line with its EU accession prospects. We take note that Macedonia has moved to 10th best country in the world for doing business in the latest World Bank Doing Business Report, reflecting, according to Messrs. Doornbosch and Tolici, a continuing effort to facilitate business and support private investment and FDI inflows. As discussed at the time of the last Article IV report at the Board in 2017, we remain puzzled by the disconnect between the ranking in the Doing Business Report and the picture painted by IMF staff in their reports.

Mr. Saito submitted the following statement:

We thank staff for informative set of reports and Mr. Doornbosch and Mr. Tolici for their insightful statement. We welcome that the FYR Macedonia's economy is recovering with the end of the political crisis and projected to pick up further in the medium term. It is also welcoming that FYR Macedonia has recently removed a key hurdle to joining NATO and the EU. However, further efforts for enhancing structural reforms are needed to raise productivity and speed up convergence. We agree with staff that addressing labor market weakness should be a priority. In the meanwhile, the policy mix with more ambitious fiscal consolidation and accommodative monetary policy is warranted. As we broadly concur with the thrust of the staff's appraisal, we will limit our comments to the following points:

Fiscal Policy

A more ambitious fiscal consolidation is needed to maintain debt sustainability and create policy space for countering negative shocks. We welcome that the draft 2019 budget includes measures to reduce the pension deficit and targeted social assistance spending in line with staff's previous recommendations. However, given the rapid rise of public debt over the last decade, steadfast implementation of the pension reform and further efforts for fiscal adjustment are necessary. Specifically, we see merit of targeting a zero-primary balance by 2023 with prudent revenue and expenditure measures. Regarding the divergence of views between authorities and staff on the 2019 deficit projections, staff mentioned the difference of GDP and wage growth projections. Could staff elaborate more on these differences? We also encourage the authorities to continue their efforts for ensuring long-term pension sustainability including tightening conditions for early retirement and gradually increasing statutory retirement ages to that of EU average.

Monetary Policy

Current accommodative monetary policy stance is appropriate. Given the negative output gap, benign inflation outlook and stable foreign exchange market conditions, we concur with staff that monetary policy stance should remain accommodative. However, the NBRM should be vigilant and respond appropriately to the reserve under-accumulation and tightening of global financial conditions.

Financial Stability Policy

Structural vulnerabilities in the financial system should be closely monitored and financial stability framework should be strengthened. We welcome staff's comprehensive financial system stability assessment and their finding that the banking sector is healthy, as banks are well capitalized, liquid and profitable and the share of NPLs has decreased. However, the authorities should monitor closely the structural risks such as indirect credits risk from unhedged borrowers' large FX exposures and high corporate portfolio concentrations as evidenced by stress tests. To address the structural vulnerabilities, we agree with staff's view that the financial stability framework including macroprudential policy framework, supervision and regulation framework, and crisis management and resolution should be strengthened. Specifically, we underscore the importance of developing contingency funding plans for banks as well as an emergency liquidity assistance framework for providing euro liquidity by the NBRM, given the significant euro funding needs for banks. We would like to hear staff's view on the desirable modalities of the emergency liquidity assistance of euro, including the funding source for NBRM.

Efforts for gradual de-euroization should be continued. While we welcome the policy efforts for enhancing de-euroization, we note that ratios of loan and deposit euroization have stopped declining recently. In this regard, we concur with staff that additional actions such as increasing FX reserve requirements are encouraged. As we learn from the excellent selected issues paper on Republic of Belarus the importance of developing de-dollarization strategy to anchor expectation, we would like to ask staff' view on the merit of creating a national strategy for de-euroization in FYR Macedonia and authorities' intention for this initiative.

Structural Policy

Creating job and strengthening institutions are key to raise productivity and achieve income convergence. We positively note that FYR Macedonia ranks 10th in the latest WB doing business indicator. At the same time, we are concerned about persistent high level of long term and youth unemployment due to skill shortages and labor mismatch. To address the labor market weakness, a multi-pronged approach including education policies and active labor market policies are needed. In particular, we underscore the importance of boosting basic skills through strengthening secondly education and upgrading vocational education system. In addition, reforms for governance, corruption and rule of law are also necessary to vitalize investment and foster private sector.

Mr. Psalidopoulos and Mr. Di Lorenzo submitted the following statement:

We thank staff for the comprehensive set of papers and Messrs. Doornbosch and Tolici for their informative buff statement. We support the staff’s appraisal and would like to provide the following comments.

The report rightly places particular emphasis on the structural challenges related to reforming the labor market while improving social inclusion. High unemployment – much of it being of long-term nature- and informality, hurt economic activity by lowering productivity, long term growth and tax revenues. A comprehensive set of structural reforms to tackle these weaknesses is indeed necessary. We take favorable note that authorities and staff share those priorities, and that the authorities are working on this front. To address skill shortages, alongside with improving the vocational training system, we would also underline that job matching can be enhanced by putting in place an efficient system of intermediation, for instance through specialized public agencies. In a context of high informality this could also foster the conditionality for the interesting proposal of a means-tested minimum guaranteed income.

A commitment to fiscal consolidation is needed to provide funding for active labor market policies and prevent the upward drift in public debt-to-GDP ratio. Public debt increased remarkably over the last years, bringing substantial gross financing needs and reducing available policy space to react in case of shocks. In light of persistent inefficiencies in VAT collection, payment of the tax refunds and planning risk-based audit activities, it is urgent to press ahead with the modernization of the tax administration, according to TADAT assessment. The initiative to cap cash payments could go a long way in fighting informality. Improving tax collection efficiency is also one of the dimensions where the PEFA has pointed for further improvement and we commend authorities for the past and underway efforts to foster fiscal transparency.

Improving governance and institutions along the lines recommended by the international institutions is paramount. Particular relevance should be attributed to enhancing the autonomy and accountability of the judiciary. We look forward to the adoption of the further legislative initiatives announced in these areas.

We support the FSSA recommendations and encourage the authorities to take steps to strengthen financial stability and ensure financial inclusion. We feel concerned by the vulnerabilities from the large share of FX exposures of potentially unhedged borrowers and from the high dependence on variable-rate loans. In these circumstances, the space for monetary policy reactions can also be potentially further constrained in either direction, besides what is already due to the exchange rate peg, increasing vulnerability to shocks. To create conditions to further improve exchange rate flexibility, consideration should be given to staff’s recommendations on additional regulatory and macro-prudential actions to ensure gradual dollarization. At the same time, we note that the increase in the share of domestic-denominated bonds is a step in the right direction also for what regards the de-euroization.

Mr. Ostros and Ms. Skrivere submitted the following statement:

We thank staff for the comprehensive Article IV and FSSA reports and Mr. Doornbosch and Mr. Tolici for the informative buff statement. As the prospects for the FYR Macedonia to open accession negotiations with the European Union are improving, the authorities should embark on a comprehensive reform agenda to address longstanding structural weaknesses in the labor market and strengthen public institutions. We broadly concur with staff’s appraisal and would like to offer the following points for emphasis.

While FYR Macedonia has considerably improved its business and investment climate over the past decade, further efforts are needed to address structural weaknesses in the labor market and public institutions. We encourage the authorities to sustain their commitment to strengthen judicial independence and rule of law, improve governance, and tackle corruption. The lack of trust in public institutions contributes to high informality, which in turn erodes the business environment, lowers tax revenues, and undermines the country's growth prospects. We also caution against further sharp increases in the minimum wage, as it can lead to greater activity in the shadow economy. We share staff's views on the need to improve the efficiency of public spending on education, strengthen vocational education and place a greater focus on internships and apprenticeships, as well as better align the education system outcomes with the skills demanded by employers.

We share staff's concerns regarding the buildup of risks to fiscal sustainability and encourage the authorities to advance fiscal consolidation efforts. We note with caution that the public debt has doubled over the past decade and the gross financing needs are around 15 percent of GDP, thus the policy space to respond to future shocks appears to be limited. In order to improve the debt trajectory, it is particularly important to avoid ad-hoc pension increases and ensure the long-term sustainability of the pension system. While the measures included in the 2019 budget go in the right direction, further adjustment might be warranted given the demographic pressures.

We appreciate the high quality of the financial sector assessment and share staff's advice on key policy measures to further strengthen the banking supervision and regulation framework. We welcome the authorities' commitment to implement the key FSAP recommendations, as indicated in their buff statement.

Mr. Sylla, Mr. Nguema-Affane and Mr. Bangrim Kibassim submitted the following statement:

We thank Staff for a set of interesting reports and Mr. Doornbosch and Mr. Tolici for their informative buff statement.

We welcome the improved macroeconomic situation in the Former Yugoslav Republic of Macedonia in 2018, with notably the rebound in economic activity driven by strong external and domestic demand. We commend the authorities for accelerating reform momentum following the end of the protracted political crisis. The FYR of Macedonia's economic outlook is positive, as growth is projected to increase further supported by higher public investment. Furthermore, we note that the country's prospects for the opening of EU accession negotiations have brightened following the agreement with Greece on the name change. Could staff elaborate on the prospects that the Greek Parliament approve this agreement? We agree that delays in public investment or in the name change process are significant downside risks. We therefore encourage the authorities to sustain the reform momentum to address vulnerabilities and create more policy space with a view to sustaining the economic rebound over the medium-term. We broadly agree with the trust of the staff policy recommendations in this regard and would like to make few comments for emphasis.

Fiscal consolidation should continue in order to strengthen fiscal and debt sustainability. In this regard, the authorities should steadfastly implement fiscal reforms and measures in the draft 2019 budget aimed at strengthening the tax policy and administration to improve tax compliance and performance and addressing weaknesses in the pension and social assistance systems. In particular, efforts to improve targeting of social programs should be stepped up to increase their efficiency. We encourage the authorities to consider staff recommendations for a more ambitious fiscal consolidation to create more fiscal space for financing much-needed institutional reforms and building buffers against shocks. We welcome the progress made in strengthening fiscal transparency as indicated in the 2018 IMF Fiscal Transparency Evaluation Report and look forward to further progress in this area in the context of their 2018-2021 Public Financial Management Reform Program. As the authorities' and Staff's 2019 deficit projections diverge, could Staff elaborate a bit on this divergence?

We take note of the agreement between the authorities and Staff on the appropriateness of the current accommodative monetary policy stance to support growth, amid stable inflation expectations and negative output gap. We welcome the authorities' readiness to tighten monetary policy if shocks materialize.

We note that the banking system remains profitable and liquid and that portfolio quality is improving. We commend the authorities for the progress made in strengthening banking supervision and regulation over the past decade and welcome their intention to address vulnerabilities identified in the recent FSAP to further strengthen the financial stability framework. We encourage the authorities to step up efforts to increase financial inclusion. Could staff elaborate on the households' distrust in financial institutions?

We share staff's views that structural reforms should focus on strengthening institutions, supporting employment and reducing inequality and informality to boost economic development and effectively raise productivity and potential growth in the FYR of Macedonia. While we welcome the decline of unemployment rate, however it remains high. We therefore encourage the authorities to press ahead with the restructuring of their education system and the development of active labor market policies including vocational training and apprenticeship programs and skills upgrading. We urge the authorities to further strengthen judiciary independence, enhance governance, enforce the rule of law, fight corruption and implement the national strategy on AML/CFT to improve the effectiveness of public institutions.

Mr. Alkhareif and Mr. Keshava submitted the following statement:

We thank staff for the informative set of reports and Mr. Doornbosch and Mr. Tolici for their helpful buff statement. We are in broad agreement with staff's analysis and policy recommendations and would limit our remarks to a few issues.

We take note of the progress towards approval of the name change of the country, which will bring resolution to the decades long dispute. In this connection, assuming ratification of the agreement, we would welcome staff elaboration on the priority reforms to be implemented before EU accession negotiations could begin.

We welcome the rebound in growth, albeit modest, in 2018 and the improved prospects for 2019 and over the medium term and encourage the authorities to take advantage of favorable conditions to build policy buffers. In this regard, we agree that a gradual and sustained fiscal consolidation and an accommodative monetary policy stance, along with growth-enhancing structural policies, constitute an appropriate policy mix. On international reserve coverage, while we are encouraged by the improvement following the Eurobond issuance, we echo staff recommendation on the need for continued efforts to boost reserves to underpin the stability of the exchange rate peg. Indeed, the peg is a key mitigating factor for euroization-related risks.

The public debt-to-GDP ratio is not very high, but its rapid rise over the past years underscores the importance of fiscal consolidation to ensure sustainability. In this context, we are encouraged by the better-than-expected fiscal outturn in 2018, but large under-execution of capital expenditures remain a concern. To address persistent under-execution, it is important for the authorities to strengthen capacity for project implementation. As regards the 2019 budget, the proposals to reduce the pension deficit and improve targeting of social assistance spending are steps in the right direction. Looking ahead, we see merit in staff recommendation for a more ambitious consolidation to put the public debt ratio on a firm downward path to safeguard fiscal sustainability, including by improving tax compliance and rationalizing agricultural subsidies. The authorities should also continue their efforts to further strengthen public financial management and enhance fiscal transparency.

The banking system is healthy, but close monitoring as underlined by the FSAP mission is essential in view of high structural vulnerabilities. These vulnerabilities, we note, include the still high euroization of banks' assets and liabilities, foreign currency lending to households, widespread use of variable-rate loans, and high corporate portfolio concentration. The FSAP has made a number of recommendations and we look forward to timely consideration by the authorities to further strengthen financial system resilience. The FSAP recommendations on broadening financial inclusion should also be accorded a priority.

Finally, we welcome the emphasis on important structural reforms in the staff report to help increase productivity and inclusive growth. In this context, priorities include addressing key labor market weaknesses such as growing skills shortages and high youth and long-term unemployment, reducing informality, and further strengthening institutions and governance.

With these remarks, we wish the authorities further success.

Mr. Meyer, Mr. Trabinski, Mr. Djokovic, and Mr. Buetzer submitted the following joint statement:

The restored political stability and prospects of joining the EU and NATO, following the period of political impasse, have resulted in renewed confidence, improved investor sentiment and a pickup in economic activity. The ongoing recovery, supported by the authorities' prudent and appropriate macroeconomic policies, provides an opportunity to reinvigorate the implementation of structural reforms, to bolster employment and growth, and accelerate income convergence. We thank staff for the valuable set of reports and Mr. Doornbosch and Mr. Tolici for their helpful buff statement. We broadly concur with the staff assessment and recommendations, and emphasize the following points:

We agree with staff that there is a need for sustained fiscal consolidation to reverse the trend of rising public debt, ensure debt sustainability, and build buffers. It is encouraging that the authorities share this view and aim to undertake corresponding measures. Indeed, FYR Macedonia still needs to find a balance between the need to support domestic demand and growth, and the preservation of fiscal sustainability. Staff outlines a sensible consolidation plan, encompassing measures on both the revenue and expenditure side.

In particular, we see merit in consolidating expenditures by better targeting social spending, reducing subsidies, and comprehensively reforming the pension system to address the large and rising deficit. At the same time, we caution against under-execution of spending on important structural reforms and high-priority infrastructure projects. Could staff provide more details on the decision to scrutinize the existing portfolio of construction projects and assess the associated delays (paragraph 5 of the report)?

On the revenue side, we note a declining path of tax revenues that should be halted. Staff's analysis indicates that there is much room for improving tax compliance and increasing VAT efficiency. This would entail strengthening the tax administration, including its funding, staffing, IT systems, and strengthening governance. Low tax morale and tax evasion call for resolute policy action, also in the context of fighting informality. The recent introduction of a progressive personal income tax system is welcome and may contribute positively to inclusive growth.

The accommodative monetary stance is appropriate, given the current macroeconomic conditions. CPI inflation remains low, and the inflation outlook is benign. Nonetheless, global uncertainties and domestic developments requires a cautious and data-dependent monetary policy. The authorities should remain vigilant and stand ready to adjust policy rates if economic developments would deviate from the forecast or if necessary to safeguard reserve accumulation.

The financial stability framework should be further enhanced. We welcome that banking supervision and regulation have improved considerably and that the financial sector appears overall resilient and well capitalized. However, the FSSA report identifies high structural vulnerabilities, including large FX exposures to unhedged borrowers, dependence on variable rate loans, and portfolio concentration. Against that background, priorities should include strengthening the prudential supervision and macroprudential policy frameworks and introducing a modern bank resolution framework. Renewed efforts to tackle the still considerable deposit and loan euroization are also needed.

The authorities should accelerate the implementation of structural reforms in order to address bottlenecks to growth and improve the business environment. As emphasized by staff – and also with view to the prospect of joining the EU – we strongly encourage the authorities to undertake policy action aimed at curtailing informality, strengthening governance and the rule of law, and implementing reforms that underpin the fight against corruption on all levels. We appreciate the candid and diligent analysis conducted in this regard in the staff report and ongoing technical assistance by the Fund to boost state capacity. The steps that the authorities have already taken in this direction, as outlined in the buff of Mr. Doornbosch and Mr. Tolici, are highly welcome.

Further, labor market and education system reforms are necessary to address labor market shortages, accelerate job creation, and increase labor market participation, especially by women. Policies should be designed in such a way that they help promote human capital accumulation, increase formal employment, and enhance job market transition. The structural reforms outlined above would promote higher FDI inflows and private domestic activity. This is of particular importance at the country's current juncture and may provide a springboard for stronger growth and convergence over the medium term.

Mr. de Villeroché, Mr. Castets and Mr. Rozan submitted the following statement:

We would like to thank staff for the detailed report, and Mr. Doornbosch and Mr. Tolici for their insightful buff statement. With growth picking up, and the prospect of accessing the EU, authorities should continue to push for structural reforms to lift productivity and speed up convergence, while maintaining fiscal sustainability. We share the staff's assessment and wish to offer the following comments:

The authorities should strive to rebuild policy space on the fiscal front, to fund development needs and face potential headwinds. In this regard, we are cautious regarding the expected deepening of the fiscal deficit in 2019 and encourage the authorities to pursue fiscal consolidation. We share staff's recommendations in this regard. We commend the authorities for enacting a pension reform which will enforce a CPI-only indexation of benefits. In addition, given the infrastructure needs of the country, we would like staff to further elaborate on the under execution of public capital expenditure observed in 2018.

We concur with staff's assessment that monetary policy remains appropriately accommodative, and that structural vulnerabilities in the financial sector should be addressed, in particular the large FX exposures and variable rate loans. We encourage the authorities to implement the recommendations of the recent FSAP review, by addressing residual gaps in supervision and by strengthening the macroprudential policy framework.

As highlighted by staff, a key issue for the country is the implementation of structural reforms to sustain long term growth, and in particular policies aimed at enhancing the functioning of the labor markets. Addressing the skills mismatch and continuing to implement active labor market policies will be necessary. We commend staff for the policies already initiated in 2018. The quality of public governance and the rule of law is also particularly important for the improvement of the business climate. We encourage the authorities to continue their close cooperation with the EU, the World Bank and the IMF to incorporate policy advice in this regard.

Mr. Tan and Mr. Pham submitted the following statement:

We thank staff for the comprehensive set of reports and Messrs. Doornbosch and Tolici for their informative buff statement.

With the recovering FYR Macedonia economy projected to grow up to 2.8 percent in 2019, the overall macroeconomic conditions are positive with low headline inflation, a declining current account deficit, and favorable foreign exchange market developments. At the same time, we recognize staff's assessment that there are risks on the downside, including renewed political uncertainty that could impede the investment rebound, spillovers from rising protectionism in the global economy and a tightening of international financial conditions. In this context, we agree with the broad thrust of staff's policy recommendations for structural reforms in the labor market, judiciary, and public administration to achieve higher productivity and faster income convergence and offer the following comments for emphasis.

Durable fiscal consolidation is essential to put public debt firmly on downward trajectory and rebuild fiscal space. We note staff's assessment that recurring primary deficits, driven by declining tax revenues and rising current spending, have almost doubled FYR Macedonia's public debt over the last decade. To make room for maneuver given high fiscal financing needs, we agree that the authorities should steadfastly implement the measures proposed in the draft 2019 budget. In particular, these include more efficient VAT collection and streamlining of untargeted subsidies, which would help reduce the pension deficit and ensure a more efficient social spending for the most vulnerable groups. In this regard, we welcome the authorities' proposed pension reforms and recent efforts to strengthen public financial management and increase fiscal transparency. Continued progress is warranted, especially in terms of budget documentation on SOE activities as well as spending plans of budget entities and public investment projects.

The authorities should continue to foster monetary and financial stability in support of sustainable growth. We agree that the accommodative monetary policy stance remains appropriate given low CPI inflation and stable foreign exchange conditions. Furthermore, we take positive note that the NBRM stands ready to tighten monetary policy should inflation accelerate and if the external environment were to worsen. While the FSSA report has assessed the banking sector to be healthy, the high degree of euroization and large net foreign exchange exposure of the non-financial corporate sector and households are sources of potential risks. As rightly pointed out by staff, further efforts to gradually increase deposit denarization and reduce foreign currency lending to households and corporates would be needed to strengthen financial system resilience. Overall, we welcome the authorities' continued efforts to strengthen the banking regulatory and resolution framework, ensure operational independence of the NBRM, boost staffing levels and intensify supervision for systemically important banks.

High structural unemployment rate remains a key challenge to the long-term development of FYR Macedonia. While we appreciate the authorities' efforts in creating more jobs in recent years, we note with concern that the official unemployment rate remains high at 21 percent with particularly high unemployment among youths, female and low-skilled workers. We are encouraged by the authorities' commitment to further address labor market weaknesses and lift productivity growth by increasing labor force participation through a mix of tax, social assistance, family leave, and active labor market policies. To promote a more conducive environment for business growth and increased investments, we support staff's recommendations on strengthening governance, the rule of law and the judicial system, as well as retaining skilled workers.

Mr. Sun and Ms. Cai submitted the following statement:

We thank staff for the well-written report and Messrs. Doornbosch and Tolici for their helpful buff statement. We welcome the economic recovery supported by investment, export, and private consumption. The progress made for the upcoming EU accession negotiations is encouraging. We agree with the thrust of the staff's appraisal and would limit our comments to the following.

Continued fiscal consolidation with a focus on pension deficit reduction is encouraged. We welcome the pension reform which will increase contribution rate. Tightening conditions for early retirement and gradually raising statutory retirement age would also be helpful for the consolidation. The rapidly rising public debt remains a concern. Therefore, more efforts are needed to enhance revenue administration. Preferential VAT treatment of certain goods and services that are not well in line with international standards should be eliminated. Enhancing local governments' fiscal autonomy and limiting central government's contingent debt, including through introducing a broad-based property tax reform, are also necessary. While the authorities' decision to scrutinize existing construction projects to improve public spending is welcome, priority social spending and growth-enhancing projects should be protected.

We agree with staff that the monetary policy stance is appropriate given the negative output gap, benign inflation outlook, and a stable foreign exchange market. While the banking sector is well-capitalized and liquid, structural vulnerabilities remain, including large FX exposures to potentially unhedged borrowers, high dependence on variable-rate loans, and loan concentrations. We encourage the authorities to closely monitor market developments and introduce more macro-prudential measures when needed. We agree with staff that a legal macroprudential mandate and the inter-agency consultation and coordination mechanism for macroprudential matters could enhance the central bank's capability to better safeguard financial stability.

More could be done to push forward structural reforms. Elevated long-term and youth unemployment rates should be addressed without delay, and more emphasis should be placed on reducing the skills shortage and mismatch. With public spending on education close to the EU-28 average, boosting efficiency should be a priority to enhance education quality. A strategic and long-term planning at the national level seems necessary in this regard, and we encourage the authorities to accelerate the planning process.

With these remarks, we wish the authorities every success in their policy endeavors.

Mr. Ray, Ms. Preston and Ms. Park submitted the following statement:

We thank staff for the well-written set of reports and Mr. Doornbosch and Mr. Tolici for their informative buff statement. The current economic upswing and period of macro and political stability provide an opportunity to progress important structural reforms needed to lift potential growth, support income convergence and successfully join the EU. The recent approval of the country's name change and the potential for this to progress the opening of EU accession negotiations is a positive development. Given the agreement between staff and the authorities on the key policy recommendations, we confine our comments to two areas.

With a broad structural reform agenda being implemented, prioritization of reforms towards those that will have the biggest pay-off is important. Addressing skills shortages and strengthening institutions is identified as key to boosting medium term economic growth prospects. And enhancing the quality of secondary and vocational education is seen as central to addressing skills shortages. We agree that improvements in the quality of education will play a role in addressing skills shortages, but at the same time note that it will take significant time for the benefits to be realized. Do staff view reforms to education and institutions as the most urgent and pressing to achieve authorities' goal of lifting potential growth and therefore real incomes?? Further, figure 8 suggests that the largest gains to global value chain trade are from improvements in the quality of infrastructure, which are more than double potential gains from improvements in the quality of education and four times the potential gains from improvements in institutions. Does this suggest that additional fiscal space created by staff's suggested measures should be directed towards an expansion in public spending on infrastructure alongside fostering private investment by addressing labor market and institutional weaknesses?

We agree that the structural vulnerabilities highlighted by the FSAP warrant close monitoring—notably risks due to the large foreign exchange exposures in both the government and household sector. Staff recommend more active mitigation of this risk through policies to support de-euroization, increases in FX reserve requirements, currency-differentiated premia for the deposit insurance facility, and prudential measures to curb FX lending. The authorities point to the exchange rate peg to the euro as a key mitigating factor to these risks. Do staff view the exchange peg as a sufficient risk mitigating factor? Are there remaining risks to be managed? Further, how does advice to pursue policies to support de-euroization reconcile with the authorities' medium-term goal of EU accession?

Mr. Palei and Mr. Potapov submitted the following statement:

We thank staff for a set of well written reports and Mr. Doornbosch and Mr. Tolici for their helpful buff statement. Protracted political uncertainties have taken a toll on growth and investments in FYR Macedonia.

GDP growth decelerated from 2.8 percent in 2016 to 0.2 percent in 2017, while large infrastructure projects were postponed. We welcome the rebound in economic activity in 2018, as well as improved growth prospects over the medium term. Carefully calibrated policy mix and growth-enhancing structural reforms are needed to mitigate risks and build policy buffers in line with staff's recommendations.

Growth rates in FYR Macedonia have significantly fallen short of staff's expectations in 2017. During the 2017 Article IV consultations staff projected growth to be 1.9 percent, while the authorities' projections were more pessimistic, between 0.5 percent (NBRM) and 1.6 percent (MoF). Could staff elaborate on the key factors that led to their substantial forecast error? The process of changing the country's name creates additional uncertainty to the outlook, presenting both downside and upside risks going forward. This may contribute to the divergence between the authorities' and staff's growth assumptions for 2018-19. Could staff elaborate on how this uncertainty is reflected in their baseline scenario? Could staff comment on potential implications for growth and public finances from possible further delays in investment recovery?

Bold and credible fiscal consolidation is necessary to preserve debt sustainability and to create additional fiscal space for priority capital spending and structural reforms. Indeed, public debt has doubled since 2008, reaching 48 percent in 2017. Moreover, the DSA indicates that in the baseline scenario public debt will continue to rise to around 55 percent of GDP by 2023. In this context, we support staff's recommendations to implement a relatively ambitious fiscal consolidation with the objective to reach a zero-primary balance by 2023. Could staff share their interest rates and growth assumptions in the recommendations-based scenario (see the text chart on page 18 of the report)?

Against this background, we welcome the authorities' recent measures to reduce the pension deficit and improve targeting of social assistance spending. These measures should be complemented by broadening the tax base, improving compliance, rationalizing subsidies, and enhancing fiscal transparency. We support staff's recommendation to develop an accrual-based fiscal reporting to prevent accumulation of arrears and strengthen budget execution.

The current accommodative monetary stance is appropriate, given the negative output gap and benign inflation outlook. At the same time, external risks to the outlook require the authorities' close attention. Continued efforts to boost foreign exchange reserves are needed to mitigate risks stemming from euroization and the rise in global risk aversion.

We welcome the recent FSAP findings that supervision and regulations in the financial sector have been strengthened over the recent years. The banking sector remains well capitalized, profitable, and liquid. At the same time, the authorities should continue to closely monitor structural vulnerabilities, such as an indirect credits risk from unhedged borrowers' large FX exposures and high corporate portfolio concentrations. The authorities are well advised to continue their efforts aimed at strengthening further the financial regulation and macroprudential frameworks, as well as crisis management and resolution (table 1, FSSA report). Among staff's recommendations we would highlight the need to enhance the NBRM's independence and governance arrangements.

Given high long-term unemployment and informality in the economy, we welcome the authorities' focus on improving labor market and education policies. Addressing skill mismatches, improving the vocational training system, and promoting internships and apprenticeships would be instrumental on this front. At the same time, staff's analysis would benefit from a more detailed description of already implemented reforms. As Mr. Doornbosch pointed out, FYR Macedonia has moved to the 10^{th} place in the highly regarded Doing Business ranking of economies. Moreover, as was highlighted in the report, FYR Macedonia's export shares in key markets are rising, while wage growth remains in line with productivity. We would appreciate staff's elaboration on FDI developments over the recent years. Like Mr. Fachada, we remain puzzled by the disconnect between FYR Macedonia's ranking in the World Bank Doing Business and staff's judgment on the business environment in the report.

We welcome the authorities' efforts aimed at strengthening governance and fighting corruption. Several indicators in the report, such as C-efficiency, scores in the Fund's Fiscal Transparency Evaluation, and PEFA point to potential governance vulnerabilities in FYR Macedonia that may lead to corruption. For example, as suggested by the recent data compiled by the IMF for 108 countries, there is a strong correlation between a C-efficiency and corruption. Based on the Fund's Fiscal Transparency Assessment staff mentioned that only 30 percent of FYR Macedonia's fiscal transparency practices are "advanced" or "good".

At the same time, staff widely used less reliable third-party indicators and other external sources of information to highlight corruption and institutional weaknesses in FYR Macedonia (see Figure 7, page 12 and Annex 1, page 40-43). For example, staff's judgment on the judicial weaknesses and the rule of law are primarily based on the Worldwide governance indicators, the Venice Commission, and the GRECO's recommendations. It could be attributed to the lack of staff's expertise in this area, since the procedures for appointing judges seem to be out of the Fund's mandate perimeter. The report should have included a disclaimer about the existing shortcomings.

Mr. Gokarn and Ms. Dhillon submitted the following statement:

We thank staff for their informative Article IV report on the Former Yugoslav Republic of Macedonia and Mr. Doornbosch and Mr. Tolici for their helpful buff statement. We agree with the thrust of the staff's appraisal and would like to make the following comments for emphasis.

After an extended political crisis, we welcome the recent developments and the growth rebound, driven by exports and private consumption. We note that downside risks, domestically of investment recovery and externally of protectionism and tightening global financial conditions may impact growth. Nevertheless, the authorities have expressed optimism about growth picking up. We are encouraged by the authorities' overall assurances and, going forward, urge steady implementation of the FYR Macedonia ambitious reform agenda for addressing labor market weaknesses, reducing inequality and achieving inclusive growth.

Fiscal Policy. Fiscal consolidation is required to create fiscal space and support the structural reform agenda. We welcome the efforts of the authorities to achieve gradual consolidation by reducing the pension system deficit and improving targeting of social assistance spending. Further, introduction of a more progressive personal taxation, better monitoring of government arrears and the 2018-2021 Public Financial Management Reform Program are welcome measures to target revenues, rationalize expenditure and improve efficiency of spending. We join staff in recommending a zero-primary balance over the medium term to put public debt on a firm downward trajectory, improve tax compliance and rationalize subsidies.

Monetary and Financial Policies: We note that the monetary stance has been appropriate and supportive of the economic recovery while keeping inflation expectations stable. Significantly, the banking sector is well-capitalized, liquid, and profitable. We join staff in urging for effective measures to bolster the financial stability framework in line with the recently concluded FSAP mission, including on the macroprudential policy framework, supervision, crisis management resolution mechanism and addressing AML/CFT deficiencies.

Structural Policy: Structural reforms will be instrumental for economic activity and growth per se. Like staff, we urge for policies that optimize use of the labor force, address skill shortages, while strengthening governance and reducing corruption. We welcome the authority's actions on this agenda and the progress on judicial reform. The buff mentions that in the latest World Bank 2019 Doing Business Report, Macedonia has moved up by one place, to 10th best country in the world for doing business and we see this as a positive affirmation of the business environment, while noting the investment constraints highlighted in Figure 8. Continued efforts on the reform agenda would signal confidence, attract high-quality investments, and address unemployment. Could staff comment on how the high doing business ranking can be leveraged into growth-stimulating investment?

With these comments, we wish the authorities the best in their endeavors.

Ms. Levonian, Ms. McKiernan and Mr. Hart submitted the following statement:

We thank staff for their Article IV and Financial System Stability Assessment, and Mr. Doornbosch and Mr. Tolici for their helpful buff. We welcome indications that the economy is recovering following a difficult 2017, further supported by positive developments in several key macro indicators. We are encouraged by the renewed political support for structural reforms, which could receive a further boost if EU accession negotiations get underway. In the interim, ongoing reform efforts suggest that the authorities are moving in the right direction, including with regard to the pension system, governance and corruption, and financial oversight and stability. With risks to the outlook tilted to the downside, we would emphasize the importance of effective and steadfast implementation.

We welcome the focus of this assessment on the structural obstacles to sustainable growth, given FYR Macedonia's high level of informality, unemployment, and skills shortages. We welcome staff's recommendations to strengthen the labor market, including services that would help bring more women into the labor force. In addition, the low levels of public trust points to the need to strengthen public institutions and enhance transparency. In that spirit, we encourage timely implementation of the new AML/CFT law, judicial reforms, and anti-corruption measures, with a particular focus on achieving results.

We support staff's recommendation for a gradual fiscal consolidation to help reduce fiscal risks and create policy space to respond to shocks. We welcome the introduction of pension reforms in the 2019 budget alongside efforts to better target social assistance benefits and make the personal income tax more progressive. However, weak public spending execution suggests an urgent need to strengthen public financial management, building on Fund TA recommendations, as appropriate. The fiscal outlook could be further strengthened by expanding VAT coverage and compliance.

We note the FSSA's conclusion that financial sector supervision and regulation has improved considerably over the last decade, but that gaps remain. Despite progress in recent years, FX vulnerabilities remain high for banks, corporates, and households. Among the many constructive recommendations, we would highlight the importance of: carefully managing the banking sector's FX and concentration risks; strengthening the central bank's operational autonomy and macroprudential mandate; developing domestic capital markets; and supporting financial inclusion. Can staff elaborate on how the Fund intends to support the authorities in implementing the FSSA's reform recommendations in a risk-based and well-sequenced manner?

Mr. Kaya and Mr. Bayar submitted the following statement:

We thank staff for the comprehensive set of reports, and Messrs. Doornbosch and Tolici for their helpful buff statement. We welcome that FYR Macedonia has overcome prolonged political uncertainties to reenergize the country's bid to join the European Union and NATO. This improvement in the political landscape could help boost the rebound of the economy through better expectations and market sentiment. Nevertheless, accelerating FYR Macedonia's income convergence to the EU averages critically hinges on the success of the authorities' efforts to address vulnerabilities and structural bottlenecks in the economy. We share the thrust of staff's assessment and policy recommendations and would like to provide the following comments for emphasis.

The implementation of a well-paced and growth-friendly fiscal consolidation is essential to put debt on a downward trajectory. While FYR Macedonia's public debt stock – at 48 percent of the GDP – is not very high in peer comparison, directionally, it has increased significantly in the last decade. Replenishing fiscal buffers, therefore, is critical for not only buttressing the economy's resilience against future bouts of stress, but also for preserving the authorities' policy flexibility in support of their comprehensive structural reform agenda. We appreciate, in this regard, the measures undertaken by the authorities, including those in the 2019 budget, and underscore the crucial importance of attaining fiscal targets. We note the rather sizable divergence between the authorities' and staff's fiscal projections, including for 2018 and would appreciate more elaboration by staff on the underlying reasons. We acknowledge the political difficulty of recalibrating the parameters of the pension system and welcome the authorities' strides in this regard. In line with the staff recommendations, we see timely implementation of the social assistance reform as a critical step to rendering public support for the reform momentum. We welcome the authorities' efforts to improve public financial management, particularly through the focus on institutional capacity and fiscal transparency.

With low inflation and a negative output gap, maintaining an accommodative policy stance is warranted provided that inflation expectations remain well-anchored and risks to financial stability are contained. We welcome that the authorities' stand ready to tighten the policy stance as needed. Considering that the impact of monetary easing on credit has been modest, we welcome the authorities' implementation of the de-euroization strategy. We concur with staff that the use of macroprudential tools can be considered to expedite the denarization process while carefully managing the impact on financial intermediation, and liquidity.

The banking system remains well-capitalized, liquid, and profitable, while close monitoring of structural vulnerabilities is warranted. We appreciate the detailed analyses and findings of the Financial System Stability Assessment (FSSA) as well as the authorities' determination to implement the key policy recommendations, including through strengthening the macroprudential framework, safeguarding the operational independence of the central bank, and introducing an effective crisis management and resolution framework. We also encourage the authorities to closely monitor the indirect credit risks emanating from unhedged borrowers' FX exposures and widespread use of adjustable-rate and bullet loans. Continued vigilance on cross-border linkages against risks of deleveraging is also warranted.

Reviving the pace and depth of structural reforms are essential to boost investment and potential growth. The current political landscape presents a unique window of opportunity to advance the structural reform agenda in FYR Macedonia. In line with staff recommendations, the authorities' efforts should particularly focus on addressing the labor market weaknesses through a comprehensive action plan comprising education, labor market, and wage policies. Amidst mounting demographic pressures, increasing female labor force participation through the provision of affordable childcare and proper family leave policies are essential. We positively note the progress on the judicial reform and look forward to the Parliamentary discussions on the legislative amendments that would address remaining gaps. We appreciate the depth of staff's assessment on governance issues that are clearly macro-critical for FYR Macedonia's economy. We, nevertheless, would like staff to exercise more caution in the use and communication of third-party indicators, particularly pertaining to sensitive governance issues, and believe that the respective discussion in the staff report could have benefitted more from the inclusion of the authorities' views.

The representative from the European Central Bank submitted the following statement:

We would like to thank Mr Doornbosch and Mr Tolici for their buff statement and Staff for their report.

We share Staff's assessment on the economic outlook for FYR Macedonia. The economy appears to be recovering after the political tensions in 2015-2016, with a further growth pick-up expected in the near-term. This is supported by a rebound in investment, following the rather pronounced weakness in recent years. However, risks to the outlook are tilted to the downside, in light of the slowdown in the global, and European, economy and a likely tighter global financing environment going forward. On the domestic front, the financing structure of public debt, the high level of euroisation and rising external indebtedness are significant domestic risks.

An accommodative monetary policy appears appropriate at present. The central bank met its intermediary monetary policy objective of maintaining a stable exchange rate of the denar against the euro. Against the background of moderate inflation, and a negative output gap, the central bank has steadily accumulated reserve assets in the course of 2018, facilitating further reductions in its policy rate and supporting credit growth in the private sector, notably in household loans.

We concur with Staff that the financial sector appears resilient, with risks being relatively muted. The banking sector is well positioned in terms of capital and liquidity. Despite subdued economic activity in recent years the banking systems' capital adequacy ratio has stayed comfortably above the

Basel III requirements adopted in early 2017. Ample liquidity, with banks retaining considerable excess reserves at the central bank, progress with the write-off of non-performing assets and solid profitability metrics are complementing the picture of a resilient banking sector. Against this background, financial sector risks appear muted.

Nevertheless, we share Staff's assessment that structural vulnerabilities remain high, with key challenges being the considerable degree of euroisation in the economy and the resolution of non-performing debt. Banks remain vulnerable to large and unexpected fluctuations in the denar's exchange rate, as progress with further strengthening the use of the domestic currency has levelled off in recent years. This applies specifically to foreign currency lending to borrowers who are unlikely to be hedged against currency risk. Staff appropriately acknowledges this risk in the report, but could emphasize more the importance of addressing this issue. In our view the associated benefits from additional actions towards de-euroization are likely to outweigh any potential negative side effects on the financial system. In this regard, we would like to stress the importance of continued efforts to reduce the still considerable degree of euroisation in the economy. Moreover, we would like to highlight that some unresolved issues with borrower debt restructuring may offset some of the positive economic effects from reducing non-performing exposures on banks' balance sheets. We believe that the authorities would benefit from a more comprehensive resolution of non-performing exposures including both, the borrower and the lender side.

We concur with Staff that in light of mounting fiscal risks and shrinking fiscal policy space, more ambitious fiscal consolidation appears warranted. Whereas weak economic activity as a consequence of the protracted political crisis warranted the maintenance of a supportive fiscal stance, the rapidly improving economic outlook should provide an opportunity to rebuild fiscal buffers. This suggestion appears appropriate also given the rather challenging financing structure of public debt. Reliance on foreign financing is high (about two thirds of the total) and the average maturity of public debt (at slightly more than 4 years) is relatively short, entailing significant repayment obligations in the coming years. This may pose challenges, especially in the face of a likely tighter external financing environment going forward. Furthermore, re-orienting sovereign financing towards domestic markets may mitigate the susceptibility to external shocks and contribute to local capital market development, thereby also supporting the efforts to foster denar use. In addition, the introduction of a credible and effective rules-based fiscal framework might be considered in order to cement the medium-term orientation of fiscal policy.

The Acting Chair (Mr. Zhang) made the following statement:

With the prospect of opening accession negotiations with the European Union (EU), Directors have underscored the importance of pursuing an ambitious structural reform agenda to try to lift productivity and accelerate income convergence. These are the main themes of the Article IV consultation. Directors have highlighted a range of policy challenges and urged the authorities to try to rebuild the fiscal policy space and external buffers. I can see that the Article IV consultation already has in-depth coverage on all of these issues.

Another point I want to make is that Directors have seen this Financial System Stability Assessment (FSSA) report that has been circulated to the Board before this meeting, which has provided background for this Article IV consultation report.

Mr. Doornbosch made the following statement:

I have two remarks at the opening of our discussion. First, there is no news on the name issue. The vote in the Greek Parliament is still expected tomorrow, so that will be exciting.

Second, on the publication of the Article IV report, the authorities have given their consent for publication of the Article IV report, but they have not yet given their consent to the publication of the FSSA. They need a bit more time to consider the pros and cons because they consider some small parts to be market sensitive. They might come back to the staff with a request for a few small deletions in line with the transparency policy. That is something to be decided after the Board meeting.

Ms. Pollard made the following statement:

I thank the staff for the comprehensive Article IV and FSSA report. We broadly agree with the staff’s appraisal, so I will just make a few points.

We are pleased to see the rebound in economic activity in 2018 and the continued decline in unemployment, including structural unemployment. The results of the Financial Sector Assessment Program (FSAP) were also largely positive, with banks deemed to be well capitalized, liquid, and profitable.

However, still high structural unemployment and low labor market participation rates continue to hold back potential growth and median income. In this regard, we support the staff's call for a combination of labor market and wage policies, as well as measures to expand education and vocational training. The staff estimates that these policies will cost about 0.6 percent of GDP. Could the staff elaborate on how the implementation of this package would affect the balance of fiscal risks, given the staff's call for a larger fiscal consolidation to reach the zero-primary balance by 2023?

We also share the staff's concerns on the near doubling of public debt since 2008 but are pleased to see improvements in the debt structure, particularly the significant lengthening of average maturities. We encourage growth-friendly fiscal consolidation to rebuild fiscal space.

Finally, we thank staff for the useful annex on judicial reform and anti-corruption efforts. This annex and the report point to weak judicial independence, property rights protection, and public institutions as major impediments to growth. While recent and planned reforms to the judiciary are encouraging, we urge the authorities to take greater steps to improve governance and the rule of law, which are critical to boosting investment, reducing informality, and raising median incomes.

Mr. Tan made the following statement:

It is encouraging to see that the ongoing policy and reform efforts seem to be paying dividends for the country. Notwithstanding the downside risks noted in the staff report, there are some reasons to be optimistic about the country's future, one of which pertains to the recent developments with respect to its intent for EU accession.

The coming year will be a crucial one, partly but not just because of the targeted integration, which is first and foremost a political process. Much will be premised on further tangible and sustained reform results. It will not be an easy task by any standard, with or without the accession and equalization in the background.

In this context, I have one clarification for the staff, building on the questions raised by other Directors on the topic of accession, including the one regarding the priority reforms to be implemented before EU accession negotiations could begin. Specifically, we would appreciate if the staff could shed some light for our discussion today on the EU accession negotiations from an additional angle in terms of how the negotiations might impact the ongoing reform processes in Macedonia. A particular focus would be on the specific challenges that the authorities could face as policymakers, how the accession negotiations may support, and perhaps at the same time benefit from, the authorities' efforts and the staff's recommendations arising from this consultation.

Comments would be especially meaningful if the staff could draw from the experience of other peer countries that have gone through or are going to go through the same process, such as how integration may help to boost and shape reforms for these countries, assuming it does so. Any insights shared will be relevant for these countries, including the next agenda item on Albania, with the aim of better realizing the benefits of the expected negotiations which, as noted in the staff report, could boost capital inflows, the investment climate, and confidence, thereby unlocking further growth potential.

On that note, I would like to wish the authorities well in the coming months.

Mr. Palei made the following statement:

I thank the staff for the report and for reflecting on some of the questions Directors raised in their gray statements. In particular, there was a question related to the use of the Doing Business indicators and third-party indicators (TPIs) in the report, and the understanding of governance and corruption in the country.

What we felt when we read the report was that the staff placed excessive emphasis on the perception-based indicators, including Worldwide Governance Indicators, World Economic Forum, various surveys, and so on. It seems that the staff tended to discount the importance of the Doing Business indicators, where the country has a very high ranking. To us, it seems to be rather controversial because it is difficult to accept that the implementation of simple and straightforward procedures is hard to understand for the population and businesses, as the staff seem to imply. If the procedures are simple and straightforward, then it is relatively easier to use various arbitration mechanisms and the courts as well.

We would have preferred to see more balance between the emphasis on Doing Business indicators and also the purely perception-based indicators, which were favored by staff. In addition, we found in the report many interesting indicators and a significant information related to the structure of taxation—for example, the C-efficiency of the VAT collection. But somehow, the staff did not make this link explicit between the structure of taxation, various exemptions, fiscal transparency, and the issues of governance and corruption. In the future, we call on the staff to have a more balanced approach and to revisit the guidelines the Board approved last year and also the digest on TPIs that was provided to the staff.

Mr. Saito made the following statement:

We would like to make comments on two issues. First, on the business environment, like Mr. Fachada and Mr. Palei, we take note of the sharp contrast between the high rankings in the Doing Business indicators and the staff's assessment of the business environment, as well as the actual development of private investments and productivity. In this relation, we appreciate the staff's detailed written response on the background and differences and the reforms needed to leverage the success reflected in the rankings. Going forward, like Mr. Palei, we would encourage the staff to assess the business environment in a more balanced manner in the staff report, taking account of the positive side, as reflected in the Doing Business indicators, as well as the factors holding back investments and productivity in future Article IV consultations.

Second, on de-euroization, we noticed that loan and deposit de-euroization has stopped recently. In this situation, we support the staff's view that the central bank should continue with policies to ensure a gradual de-euroization. At the same time, as the staff mentioned in the answers to our technical questions, the process of de-euroization is constrained by the deposit-driven nature, reflecting depositors' concerns about domestic stability. In this context, we welcome that the authorities adopted a national strategy for de-euroization. We would like to ask the staff to what extent the strategy would help to change the perception of depositors by anchoring the expectations for the process of de-euroization in light of the other countries' experience?

Mr. Castets made the following statement:

We welcome the renewed growth momentum in the country in 2018 after the more tepid performance in 2017. We also feel that the country is at an important juncture for many reasons. We see it as a high priority to sustain investors' confidence by maintaining the reforms' impetus. I have three points to highlight since we share staff's assessment and recommendations.

First, the key issues for the country are the structural deficiencies in the job market, which need to be addressed as a matter of priority by increasing the participation rates, including the female participation rate. Also, a point well highlighted in the report and that we share is the skills mismatch, which should also be addressed through adequate initial and vocational training.

Our second issue regards the need to pursue growth-friendly fiscal consolidation, as was also mentioned by Ms. Pollard, given the increasing burden of the public debt. We know that the structure of the public debt has recently improved, which is welcome. We encourage the authorities to re-create some fiscal space through enhanced revenue collection and the implementation of the pension reform, as was also recommended by staff.

The third key issue regards enhancing public governance and fighting corruption. We understand that some progress has been made in the rule of law and the functioning of the institutions, which we also see as a key priority. But more can be done to ensure the efficiency of the public administration and to further fight corruption. In this regard, we share the staff's assessment and also the caution taken when dealing with the Doing Business rankings. That is something we have mentioned several times in the Board room. The staff is doing a great job in this regard, trying to look at the different indicators—both perception-based indicators, because we need to rely on them accordingly with our policy, but also the indicators that are more focused on the business environment.

As mentioned on page 15 of the Doing Business report, it does not assess corruption levels in countries. Like Mr. Saito, I encourage the staff to be even more granular when using the Doing Business indicators. What does this ranking tell us? Macedonia now is at the tenth rank in the Doing Business indicators when, for example, Finland is 17, Canada is 22, and France is 32. Maybe we have to take this ranking with some distance and try to understand exactly where there has been some progress and where progress has been more limited, and more importantly, what the impact on investors' confidence can be.

Mr. Meyer made the following statement:

We have issued a gray statement together with Mr. Trabinski and Mr. Djokovic would, therefore, only like to emphasize the following points.

First, we welcome the political progress that has been made, which has resulted in renewed confidence, improved investor sentiment, and a pickup in economic activity. At the same time, we agree with the staff, that there is a need for a sustained fiscal consolidation to reverse the trend of rising public debt, ensure debt sustainability, and build buffers.

The implementation of structural reforms should be accelerated to address bottlenecks to growth and improve the business environment. In particular, and also given the prospect of joining the EU, we strongly encourage the authorities to strengthen governance, the rule of law, and the fight against corruption on all levels. We appreciate the candid and diligent analysis conducted in the staff report and the ongoing technical assistance (TA) by the Fund to boost state capacity. We welcome the steps that the authorities have already taken in this direction, as outlined in the buff by Mr. Doornbosch and Mr. Tolici, and we encourage them to step up their efforts.

Let me end by thanking Mr. Doornbosch for informing us about the consent to publish the Article IV report. We would hope that the FSSA can also be published. With that, I wish all the best to the authorities. With regard to the longstanding name issue, I hope that we can change what we all put in our gray statements in the next Article IV round.

Mr. Palei made the following statement:

This is in reaction to what Mr. Castets said about the interpretation of the guidance and the policy approved by the Fund on governance and corruption. Our call was clear. We want the staff to adhere to the existing policies. The Board was debating this policy for a long time, and the views were not initially well aligned. We found the appropriate balance in this document. It is important for the staff to try to adhere to these guidelines.

There are many reports where we found the balance was right. In this particular case, there is room for improvement in terms of balance; but this is new practice. The guidelines, themselves, are a living document. Maybe the Strategy, Policy, and Review Department (SPR) could say a few words on it and also tell us how easy is it to find these guidelines in the digest itself? The other day, I tried to check some of the definitions in the digest, and it was difficult for me to find it on the website.

Mr. Castets encouraged the authorities to consent to the publication of the FSSA.

The staff representative from the European Department (Ms. Rahman), in response to questions and comments from Executive Directors, made the following statement:[1]

> We thank Directors for their supportive statements. We have provided written responses to all technical questions. I will address a few non-technical questions raised in the gray statements, as well as a few questions that came up in the Board.
>
> There was a question on the prospect for an approval of the name change agreement in the Greek Parliament. The staff is not well positioned to assess such prospects. We are following developments closely, and here is what we know.
>
> The agreement passed the Greek Parliament's Committee for National Defense and Foreign Affairs yesterday. The Greek Parliament started discussions today. A vote is expected to take place tomorrow. Most analysts expect the agreement to be ratified by the Greek Parliament. The ruling party has 145 seats, and analysts expect that support from independent and smaller parties is likely to secure the remaining vote needed to reach the 151 votes for the deal to be ratified. However, we should mention that this is a divisive issue. Recent polls show that nearly 70 percent of the people oppose the name deal, and their protests intensified over the weekend. Opposing views on the deal have also caused the breakup of the government coalition and the resignation of two ministers. If the deal is ratified tomorrow in the Greek Parliament, the constitutional name change will not be immediate. That will happen after the government ratifies the NATO membership protocol for Macedonia, which effectively lifts the veto for accession. This is expected to take place in early February. That is all we know.
>
> There was a question about the priority reforms to open EU accession negotiations. Following the successful ratification of the name change agreement, the opening up the EU accession negotiations will be based on the European Commission's (EC) assessment, as well as at the discretion of the European Council. The most important are the urgent reform priorities, which are in the areas of governance, rule of law, and public administration. There is no magic list of priority actions. The staff's understanding from their discussions with commission colleagues is that they are looking for tangible progress with respect to the implementation of recent judiciary reforms to clearly signal judiciary independence; adequate progress with ongoing

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[1] Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes.

corruption investigations that are under the purview of the special prosecutor's office in order to demonstrate a determination to tackle corruption; and progress is also needed in public administration to ensure merit-based recruitment.

There is a large subjective element here. In essence, what the EC is looking for is not about the passage of a particular law or a change in regulation, but implementation that builds trust in public institutions. Weak trust in public institutions and policymaking is at the root of high informality, euroization, and brain drain in this country. These reforms are important not just for EU accession but also to ensure high productivity and a brighter future.

There was a question about the experiences of countries that have become members of the EU, and what challenges the authorities face. We do believe that the authorities' focus is in the right place. They are putting great emphasis and energy on tackling things in public financial management (PFM), the judiciary, rule of law, and media freedom. The focus is absolutely right. What we have advised is to prioritize these reforms—given that it is a small country with limited capacity—to make sure that implementation happens in order to create the right expectations.

It is also important to coordinate TA. The authorities are receiving TA from the Fund, from the EC, from the World Bank. It would be important to make sure there is a good division of labor, as well as coordination. We are heavily involved in tax policy, tax administration, PFM, and strengthening statistics, which is an issue in Macedonia. The World Bank is involved in pension reforms, arrears, and labor market issues. The EC is heavily involved in all kinds of governance issues. It is important to keep the division of labor and coordination and manage expectations.

In terms of the experience of other countries, in terms of starting EU accession negotiations in the years running up to actual membership, experience shows that these are crucial years for members. If the reforms are implemented, this can be a huge magnet for FDI and other things. Our regional unit has done some analysis on what impact it has on institutional reforms and the growth benefits, and the results show a very positive payoff.

There was a question on Doing Business and TPIs. In our technical responses, we have tried to address the differences between Doing Business indicators and all the other TPIs. Essentially, it is largely due to methodology. Doing Business focuses on a very narrow set of issues, which are directly related to opening and closing business, construction permits, and other issues in 10 areas. The reason we focused on these other TPIs' assessment is that, in this consultation, the focus was to assess governance and corruption vulnerabilities. These are the things that are not directly addressed by Doing Business, as Mr. Castets mentioned. That was the reason why we focused on this broad set of assessments and indicators. I believe our guidance says that we are supposed to ensure the robustness of our assessment. We need to look at a broader range of inputs, as well as apply knowledge of the country context, staff judgment, and assessments done by other international financial institutions (IFIs) in pertinent areas.

The staff representative from the Strategy, Policy, and Review Department (Ms. Goodman), in response to questions and comments from Executive Directors, made the following statement:

I will pick up on these more general points on the use of TPIs specifically in the report and also on the approach taken in the evaluation of governance and corruption risks. I will also address the more general points about the application of the policy on governance and corruption more and come back to the questions that were raised on the digest.

Some of the limitations of the Doing Business indicators are evident, and the staff had to tackle them with the approach that they took to the evaluation for this consultation. This includes that they are limited in scope. The Doing Business indicators do not measure all aspects of the business environment that matter to firms to investors. This point is specifically highlighted in the TPI digest, which has been shared with the Board. Under the existing guidance on the use of TPIs, it is recommended that the staff consider a broader range of inputs, including other TPIs—in other words, not to rely on any single indicator in making an assessment but also to bring to bear the knowledge of the country context, to exercise staff's judgment, and to rely on information gleaned from the dialogue with the authorities. As a policy matter, teams are encouraged to consider this broader range of factors to ensure the robustness of their assessment and not to base it on a single indicator.

The indicators that were drawn for staff's broader assessment do include perception-based measures. The staff's written answers explain the reasons why the team considered these as particularly relevant in assessing the business environment in this case. We take note of the points raised about the importance of understanding the limitations of perception-based indicators.

With respect to the evaluation of governance and corruption, in line with the policies that were recently endorsed by the Board with respect to assessing governance and corruption vulnerabilities, the staff's evaluation has also included an assessment of the rule of law. For this assessment, the staff has relied on third-party surveys, like the Worldwide Governance Indicators, and also on qualitative assessments that are undertaken by multilateral bodies, including the EC.

The reliance on the work of other institutions is specifically anticipated under our existing guidance for when staff lacks the expertise in that particular area. As was noted by Mr. Palei in his gray statement, this is a case where this expertise is not part of the staff's core competency, and so the reliance has been on the work of outside parties.

More generally, we take note of the points on the importance of conveying clearly the issues and rationale by which the staff comes to the conclusions from the use of TPIs and also in the governance and corruption work. We do consider the TPI Digest to be a living document. As we continue to gain experience, we will be revisiting and reflecting the things that we learn in our updates of that document.

I take note of the points that were made on the approaches. We do move forward in the evaluations of corruption and governance. We are progressively conducting these evaluations. For each team, it is a new exercise, but that exercise is supported by a structured process that brings to bear the expertise that has been developed within the functional departments in support of the teams as they make these evaluations. We continue to learn as we go along with that process.

Mr. Palei made the following statement:

On the guidelines, we have a policy that we agreed upon. In this particular case, we felt that the policy was not entirely adhered to. I understand there could be different points of view on it. What bothered us was that there is this general attitude that the Doing Business indicators are somehow limited. They do not show this and they do not show that. They have many shortcomings. This general attitude to Doing Business indicators is different from the one reflected in the general policy adopted by the Board. I encourage the staff to look at it once again, and I reiterate my point for the record.

> Another point is that there are many indicators that are not TPIs. They are produced by the Fund itself, and staff do have expertise in this area. In our gray statement, we specifically mentioned the Fiscal Transparency Evaluation and a number of practices that are good or excellent. The C-efficiency indicator is also produced by the Fund. There are many areas where the Fund has specific expertise. This expertise has to have implications for understanding governance and corruption as well.

Ms. Pollard asked how the package of reforms to the labor market fit with the staff's overall fiscal recommendations.

The staff representative from the European Department (Ms. Rahman), in response to further questions and comments from Executive Directors, made the following additional statement:

> The cost of the recommended structural reform measures that are shown here is cumulative; 0.6 percent of GDP. We believe this is not too onerous given the expected growth benefits that could come from that. If one looks at our recommended fiscal measures, we are not taking all that into account in our recommended path. There is scope to pay these from additional fiscal measures.
>
> More importantly, if this country does embark on an EU accession path, there is a significant amount of EU money that can be used for precisely these things. We believe these are important reforms, growth-enhancing reforms, and they do not jeopardize fiscal sustainability.

Mr. Saito asked the staff to comment on the de-euroization strategy's impact on the perception of depositors and the credibility of domestic financial institutions.

The staff representative from the Monetary and Capital Markets Department (Mr. Verkoren), in response to further questions and comments from Executive Directors, made the following additional statement:

> I can comment on that because we looked at that issue in the context of the FSAP.
>
> From an overarching perspective, what we believe is that continued efforts to maintain macroeconomic stability and financial stability will be absolutely critical in this process. The authorities have already made quite a bit of progress in fostering denarization of the system, as we noted in our response to the technical questions.

Going forward, additional measures to try to reduce the pricing differential will certainly help to stimulate more savings in denar. That is clearly also acknowledged in the denarization strategy that the authorities have meanwhile finalized.

The other point that will be quite important going forward is additional financial education, and in the long term, further efforts to foster market development in denar. We do acknowledge, though, that these processes will take quite a bit of time, so it is not likely that one would see sharp changes in the near future.

Mr. Doornbosch made the following concluding statement:

Let me start by thanking Directors for their written statements and their participation in the discussion.

Macedonia is a small country. It is very encouraging to see in the gray statements and in the interventions how much interest and engagement there is in Macedonia. That is greatly appreciated by the authorities, because these are exciting times for Macedonia. Tomorrow, the Greek Parliament is expected to vote on the bilateral agreement between the two countries that was reached at the edge of Lake Prespa, which is the lake that is at the border of Albania, Macedonia, and Greece. I imagine that these have also been nerve-racking times and weeks for the authorities because, from all sides, so much effort, work, consideration, discussions, goodwill, reputations, drafting, and redrafting have gone into this. We are now going to see whether it has been enough. My authorities are convinced it is, though I am sure they will heave a sigh of relief when the agreement is actually passed. Immediately after that, and with renewed energy, they will continue and step up their efforts to ready the country through the opening of EU negotiations, because they are fully aware that successful EU accession is conditional on the progress in key areas that were pointed out this morning: judiciary framework, public administration, but also further safeguards for free and fair elections.

To conclude our discussion, I would like to comment on two critical issues for the authorities. One is inclusive growth and the other is financial stability.

On inclusive growth, many Directors rightly emphasized the need to boost productivity in order to speed up convergence to EU income levels, and he staff stressed this rightfully in their assessment. The staff focused on structural weaknesses in labor markets and public institutions that are holding back growth in the country. The authorities strongly agree with this, but they also believe that productivity enhancements should go hand-in-hand with the reduction of inequality and have made inclusive growth a priority from the start of taking office in May 2017.

The reforms undertaken by the authorities have focused on strengthening institutions, supporting employment, and reducing informality. To quote the Prime Minister, Mr. Zoran Zaev, who is a monetary economist: "We believe in solidarity, and it is only fair that people who have more help people who have less. Only by helping each other can we build a society that provides everyone with equal rights and opportunities." But at the same time, the reform will need to improve competitiveness. In the rule of law, transparent governance and a better functioning labor market are important prerequisites for Doing Business, or are complementary, as the staff points out, but I do not want to redo the discussions on TPIs.

The focus on inclusiveness does have implications for the debt and the speed of some of the reforms that are being undertaken. The pension reform, more progressive taxation of personal incomes, and a better targeting of social assistance spending are crucial steps for achieving long-term fiscal sustainability. But these are introduced in a gradual and carefully calibrated manner to maintain public support for the structural reform agenda of the government.

Second, turning to the Macedonian financial sector and the excellent FSSA, the authorities are grateful that the progress made since the last FSAP has been widely recognized in the gray statements and that their compliance with the Basel Core Principles and the 2008 FSAP recommendations have been well acknowledged. In this context, I would like to stress that the authorities see financial stability as something that requires constant alertness and continuous work to upgrade the legislative, regulatory, and supervisory frameworks.

I want to repeat a few conclusions in the FSSA to support this point. The National Bank of the Republic of Macedonia has developed a systematic risk monetary framework that allowed them to successfully use macroprudential measures to address vulnerabilities, including the high degree of euroization. Financial market infrastructure has considerably improved by the adoption of EU requirements on payment system operations and oversight, statistics, and reporting standards, and settlement risk mitigation. The Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) framework has been strengthened by enhancing the legal framework and by improving coordination across supervisory authorities. The Macedonian authorities recognize that further efforts will be needed to increase the financial system's resilience and have indicated that they will implement the key FSAP recommendations.

On behalf of our Macedonian authorities, I thank the mission chiefs, Ms. Rahman and Mr. Verkoren, and their teams for the excellent reports. Just this morning, I received another email from the authorities, stressing the excellent cooperation and communication with both teams, both for the Article IV and FSAP process. The insights and recommendations that the staff gave are much valued and will guide future work and the sequencing of reforms.

I hope the name issue will pass in early February, and I hope we can publish before that because, otherwise, we will have to go through the document again.

The Acting Chair (Mr. Zhang) noted that the Former Yugoslav Republic of Macedonia is an Article VIII member, and no decision was proposed.

The following summing up was issued:

Executive Directors agreed with the thrust of the staff appraisal. They welcomed the revival of reforms following the restoration of political stability, which has resulted in renewed confidence and a pickup in economic activity. With the prospect of opening accession negotiations with the European Union, Directors underscored the importance of pursuing an ambitious structural reform agenda to lift productivity growth and accelerate income convergence, while also rebuilding fiscal policy space and external buffers.

Directors noted that fiscal developments in the past decade have reduced policy space. They agreed that a gradual and steady fiscal consolidation toward a zero primary balance in the medium term is needed to put public debt on a firm downward trajectory. They welcomed recent measures aimed at reducing the pension deficit and improving the targeting of social assistance benefits. They emphasized the need for steadfast implementation of the CPI-only pension indexation and recommended additional measures to improve tax efficiency and compliance, rationalize agricultural subsidies, and reduce the scope for early retirement. Directors also encouraged further efforts to strengthen public financial management and increase fiscal transparency.

Directors agreed that monetary policy has been appropriately accommodative against a background of moderate economic activity, low inflation, and favorable foreign exchange markets. Directors welcomed the authorities' readiness to tighten the monetary stance if reserves accumulation falls below baseline projections or global financial conditions tighten.

Directors noted that the banking system remains well-capitalized, liquid, and profitable but that there are risks that should be closely monitored. They underscored that further efforts to gradually increase deposit denarization, coupled with carefully calibrated macroprudential measures to reduce foreign currency lending to households, would help strengthen financial system resilience.

Directors commended the authorities for the considerable improvement in financial sector regulation and supervision over the past decade. However, they agreed on the need to further strengthen the financial stability framework along the lines identified in the recent Financial Sector Assessment Program. Directors noted that the macroprudential policy framework would benefit from additional capacity building for systemic risk monitoring and enhanced inter-agency coordination. They also stressed the importance of addressing residual gaps in supervision and promptly finalizing the modernization of the crisis management and bank resolution regime.

Directors called for a multi-pronged strategy to address labor market weaknesses that hinder growth. To reduce skill shortages and mismatches, Directors recommended enhancing the quality of secondary and vocational education and realigning tertiary education toward delivering the skills demanded by the economy. They noted that active labor market policies should continue to target youth and the long-term unemployed but with a greater emphasis on building skills and facilitating education-to-work transition. Directors also welcomed ongoing efforts to raise female labor force participation.

Directors urged the authorities to maintain an unwavering commitment to implementing key institutional reforms that strengthen governance, reduce corruption, and ensure an effective rule of law. These will prove instrumental to improving the investment climate and reducing widespread informality, as well as unlocking EU accession negotiations.

It is expected that the next Article IV consultation with FYR Macedonia will be held on the standard 12-month cycle.

APPROVAL: April 20, 2020

JIANHAI LIN
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Outlook/Risks

1. ***Could the staff comment on whether the source of revision in 2017 and 2018 was only the length and intensity of the political crisis, or were there other relevant factors?***
2. ***Could staff elaborate on the key factors that led to their substantial forecast error?***

- The source of staff's growth revision in 2018 is mostly due to investment developments driven by lingering political uncertainties, one-off factors and procurement weaknesses.

- With the formation of the new government and the return of stability, staff had anticipated a turnaround in confidence and recovery in investment in 2018. In reality, weak confidence lingered much longer (something that staff had anticipated as a downside risk in the 2017 staff report) with a slim-majority governing coalition, a highly divisive political context, municipal elections in late 2017, and the name change referendum in 2018.

- There were also one-off factors that contributed to a large contraction in investment in 2018 and related downward adjustment/revisions in staff's growth projections. The one-off factors include postponement of large infrastructure projects, scrutiny of existing projects and stricter issuance of building permits in some large municipalities. In addition, weaknesses in procurement contributed to under-execution of public spending.

- For 2017, preliminary data indicates real GDP growth to be much lower compared to staff's projections at the time of the 2017 article IV consultation (0.2 percent compared to 1.9 percent). Reflecting 2017H1 data available at the time of the 2017 Article IV mission and based on the discussions with the authorities, staff projected an overall drop in investment of 3½ percent (preliminary 2017H1 data showed a large drop owing to intensifying political crisis in Q2) but anticipated private consumption and net exports to remain solid as they had been throughout the political crisis supporting overall growth. However, subsequent data revisions show much weaker private consumption growth and no contraction in investment in 2017H1. For 2017 as a whole, private consumption experienced a historically low growth of 0.7 percent while investment grew by 0.8 percent. Staff has reached out to the authorities on the reasons for these revisions which are somewhat inconsistent with other developments:

strong employment, wage and household credit growth in 2017 do not sit well with historically low private consumption growth, while large capital underspending, falling construction and weak imports growth are somewhat inconsistent with increasing investment. The authorities are looking into it and do not rule out further revisions to 2017 (data for 2017 will be finalized in September 2019). Frequent and large data revisions continue to complicate staff's macroeconomic forecasting.

3. The process of changing the country's name creates additional uncertainty to the outlook, presenting both downside and upside risks going forward. This may contribute to the divergence between the authorities' and staff's growth assumptions for 2018-19. Could staff elaborate on how this uncertainty is reflected in their baseline scenario? Could staff comment on potential implications for growth and public finances from possible further delays in investment recovery?

- Staff's baseline projections show a pick-up in investment assuming a resumption in investment. There are uncertainties around these projections, both upside and downside, arising from the name change agreement. On the upside, the successful name resolution can unblock EU accession and a period of higher investment if priority reforms are implemented. On the downside, a failure could trigger political turmoil/early elections and delays in investment recovery. A hypothetical downside scenario constructed by staff shows that further delays in investment (assuming a contraction of 1 percent in 2019 in investment from it already depressed 2018 level instead of the 4 percent increase assumed in the current baseline) could reduce growth to 1 percent in 2019.

- Should downside risks materialize from a lack of investment recovery, near-term pressures on the headline fiscal deficit would be contained. The deficit will likely undershoot staff's projection due to lower execution of goods and services and capital expenditures for 2019.

Fiscal Policy

4. Regarding the divergence of views between authorities and staff on the 2019 deficit projections, staff mentioned the difference of GDP and wage growth projections. Could the staff elaborate more on these differences?

5. We note the rather sizable divergence between the authorities' and staff's fiscal projections, including for 2018 and would appreciate more elaboration by staff on the underlying reasons.

6. As the authorities' and Staff's 2019 deficit projections diverge, could Staff elaborate a bit on this divergence?

- The difference of about 0.4 percent of GDP between staff's and the authorities' projection for the overall 2019 deficit primarily reflects staff's lower projections for tax and social contribution revenues. This can largely be attributed to staff's more conservative macroeconomic outlook (the 2019 budget proposal was underpinned by a real growth projection of 3.2 percent versus staff's projection of 2.8 percent for 2019). Staff also expects slightly higher transfer spending based on overall assessment of the expansionary elements in the 2019 budget. The lower capital spending projections of staff is largely offset by lower non-tax revenue projections, which alongside grants is the main source of capital expenditure financing.

7. Could staff provide more details on the decision to scrutinize the existing portfolio of construction projects and assess the associated delays (paragraph 5 of the report)?Given the infrastructure needs of the country, we would like staff to further elaborate on the under execution of public capital expenditure observed in 2018.

- The decision to scrutinize investment portfolio was related to project design flaws that were discovered and weaknesses in project documentation, as well as taking a step back to reassess urban development needs, where in the past there has been a high emphasis on investment in administrative buildings. Large public investments on buildings, statues and monuments to highlight FYR Macedonia's heritage have come under widespread criticism. Much of this spending came to a halt under the new government. The weak capital expenditure execution can also be partially attributed to delays in tendering procedures as well as factors associated with the political uncertainty earlier in the year. Infrastructure spending is carried out by an SOE (Public Enterprise for State Roads) and is not part of budgetary capital spending.

8. Could staff share their interest rates and growth assumptions in the recommendations-based scenario (see the text chart on page 18 of the report)?

- The recommended scenario presented in the text chart is an illustrative presentation of the staff's recommended consolidation path building on the measures listed in paragraph 25 of the report. The scenario does not attempt to assess any associated second-round effects on growth. That said, staff does not expect the pace or magnitude of the recommended gradual consolidation path to have a significant impact on growth or interest rate in a small open economy like FYR Macedonia where fiscal multipliers are expected to be small.

Structural Policies

9. Do staff view reforms to education and institutions as the most urgent and pressing to achieve authorities' goal of lifting potential growth and therefore real incomes?

- Lifting productivity and potential growth will require raising skills, improving institutions and building better infrastructure. At this juncture, both staff and authorities feel that skill shortages and weak institutions constitute the most binding constraints. While FYR Macedonia has received notable FDI in recent years that has boosted exports and links to global value chains, a lack of trained technicians and tertiary graduates in relevant fields currently preclude the inflow of investments (and the subsequent technological transfer) in industries that are higher up in the value chain, holding FYR Macedonia in a low-income trap.

- Most reforms will take time to bear fruit. Meanwhile, the government has, in the short term, adopted policies to support the development of skills demanded by employers, including through on-the-job training and apprenticeships, and minimize skill erosion by offering incentives for the employment of fresh graduates.

10. Does this (Figure 8) suggest that additional fiscal space created by staff's suggested measures should be directed towards an expansion in public spending on infrastructure alongside fostering private investment by addressing labor market and institutional weaknesses?

- Better infrastructure is a high priority for FYR Macedonia, a land-locked country aspiring to pursue higher growth through exports. While better than most Western Balkan peers, significant gaps in transport and energy infrastructure do exist in FYR Macedonia compared to other CESEE countries and the EU average (see Atoyan and Others (2018), "Public Infrastructure in the Western Balkans: Opportunities and Challenges). The RHS chart in Figure 8 of the staff report, which reflects empirical results from an upcoming cross-country study that looks at factors contributing to strengthening links to global value chains, also emphasizes the need for good infrastructure and connectivity along with higher skills and better governance.

- Notwithstanding the medium-term fiscal consolidation needs, staff's baseline projection provides room for increasing capital expenditure, including in infrastructure development. Moreover, FYR Macedonia is rightly scaling up investment in transport infrastructure significantly through its public enterprise for state roads (with financing by EBRD, China Exim Bank and other multilateral organizations, see IMF country report no. 16/357; Selected Issues), where previously incurred execution delays are now being addressed.

11. We would appreciate staff's elaboration on FDI developments over the recent years. Like Mr. Fachada, we remain puzzled by the disconnect between Macedonia's ranking in the World Bank Doing Business and staff's judgment on the business environment in the report.

- FDI inflows have averaged around EUR 225 million per year in the last 5 years (2.5 percent of GDP). These flows are notable but have been quite volatile with an increasing part financed through inter-company debt. Overall, the stock of per capita FDI in FYR Macedonia, at little over USD 2,000, remains below the Western Balkans average and represents about a third of EU New Member States average (see WP/18/187). These inflows have been increasingly targeted towards sectors such as automotive components, glass, manufacturing, and food processing. They were buoyed by an attractive tax regime and financial incentives given to foreign firms in the technological and investment zones.

- The disconnect between ranking in Doing Business (DB) and other TPI is not unique to FYR Macedonia, although the difference is striking. The discrepancy relates to the DB methodology, which is primarily based on the assessment of business regulations in the legal code, as opposed to implementation, and is focused on a narrow set of replicable benchmarks for a standardized case scenario. This approach may have its advantages but also its limitations, particularly for FYR Macedonia where implementation of regulation is uneven and unpredictable, and micro enterprises—constituting about 90 percent of businesses—struggle to understand and comply with applicable regulations. To ensure robustness of staff's assessment, existing guidance on the use of TPIs recommends considering a broader range of inputs including other TPIs, but also knowledge of the country context, staff judgment, and dialogue with the authorities. To have a more comprehensive picture and also fulfill the requirements for assessing governance and corruption vulnerabilities under Article IV consultation, staff considered third-party surveys (like the worldwide governance indicators) and qualitative assessments undertaken by multilateral bodies, like the EC, and by the WEF, which better reflect perception of corruption, rule of law and other governance issues. These factors have a strong impact on the business climate but may not be reflected in legal codes; hence, the disconnect observed between the DB ranking and staff's assessment.

12. Could staff comment on how the high doing business ranking can be leveraged into growth-stimulating investment?

- While major regulatory reforms have made it easier to start and expand a business and propelled FYR Macedonia up in the Doing Business rankings, to fully leverage this success, complementary reforms are needed to ensure even and predictable implementation of regulations, rooting out corruption to increase public trust in regulations, and removing labor market constraints, notably providing a more skilled workforce.

Financial Sector Issues

13. We would like to hear staff's view on the desirable modalities of the emergency liquidity assistance of euro, including the funding source for NBRM.

- In case of idiosyncratic funding pressures, the NBRM can acquire foreign currency (euros in particular) as needed and engage in transactions (spot sales and/or currency swaps) with Macedonian banks. However, additional arrangements are needed to enable the provision of foreign currency liquidity in case of broader market dislocations, with sufficient safeguards that seek to protect the NBRM's foreign currency reserves. Options include requiring commercial banks with substantial euro funding needs to establish (as part of their recovery plans, as noted in para. 51 of the FSSA) contingency funding arrangements that may involve euro area parent banks or third parties, as well as the establishment of swap arrangements between central banks that can be relied on at times of stress. The Vienna Initiative platform may provide a suitable forum for exploring the feasibility of the latter.

14. As we learn from the excellent selected issues paper on Republic of Belarus the importance of developing de-dollarization strategy to anchor expectation, we would like to ask staff' view on the merit of creating a national strategy for de-euroization in FYR Macedonia and authorities' intention for this initiative.

- The process of de-euroization in FYR Macedonia has come a long way, with the share of FX deposits declining substantially to about 40 percent of total deposits in 2018, down from about 60 percent during the global financial crisis. It has been supported by the policies aimed at raising the relative costs of banks' FX intermediation, including differentiated reserve requirements. IMF staff advised the authorities on the need to continue further the course of de-euroization but recognized that the process is inherently constrained by the deposit-driven nature of euroization in FYR Macedonia and the public's preference for euro deposits, given deep-rooted apprehension about domestic stability.

- The authorities last month adopted a national strategy for de-euroization, which will be made public soon. Staff welcomes the adoption of the strategy, an earlier draft of which was discussed during the FSAP mission.

15. The authorities point to the exchange rate peg to the euro as a key mitigating factor to (euroization-related) risks. Do staff view the exchange peg as a sufficient risk mitigating factor? Are there remaining risks to be managed? Further, how does advice to pursue policies to support de-euroization reconcile with the authorities' medium-term goal of EU accession?

- FYR Macedonia's fixed exchange rate regime has served the country well in terms of ensuring macroeconomic and price stability. The long-standing peg, supported by strong and adequate actions by the NBRM when needed, does provide a strong cushion against euroization-related risks.

- What staff has stressed in both the AIV Staff Report and in the FSSA though is that the authorities should ensure that the banking system is sufficiently well-poised to withstand any euro outflows or indirect credit risks from highly-unlikely but also highly detrimental exchange-rate variability, given nontrivial euroization levels in the country.

- We do not find that there is an inherent conflict between medium-term EU accession goal and de-euroization since the exchange rate peg should continue to maintain the needed stability relative to the euro. In this respect, one can point to the experience of other countries that have either successfully pursued (Croatia) or are currently pursuing (Serbia) EU accession while having a financial sector with sizable euroization.

16. Could staff elaborate on the households' distrust in financial institutions?

- Past episodes of considerable domestic instability have accounted for public distrust in domestic institutions, including financial institutions, which has been persistent but improving. This process is found to have accounted for marked preference for euro-denominated deposits (which has declined in recent years) and aversion to placing savings with local banks among segments of the population—a key barrier for financial inclusion. Distrust in formal financial institutions is cited as a key barrier to account ownership and financial inclusion by unbanked individuals covered by the WBG Global Findex and the 2016 OeNB-Euro Survey (which collects information from private individuals in 10 CESEE countries about (euro) cash holdings, saving behavior and debt, and seeks respondents' views on economic opinions, expectations and experiences).
- Policy steps to enhance public trust can include the adoption of a comprehensive financial consumer protection framework (colleagues from the World Bank has provided specific suggestions), increase awareness of deposit insurance, and strengthen the deposit insurance scheme itself (as outlined in the FSSA).

17. Can staff elaborate on how the Fund intends to support the authorities in implementing the FSSA's reform recommendations in a risk-based and well-sequenced manner?

- Staff welcomes the authorities' commitment to implementing the FSAP's key recommendations and notes that key reform initiatives (e.g. the introduction of a modern resolution regime) are already in train. As discussed with the authorities, priority should be placed on developing the macroprudential and crisis management frameworks, the former including further refinements of the authorities' systemic risk monitoring tools. Staff is available to provide follow-up technical assistance, based on the authorities' sequencing preferences.

- Staff will respond to these questions during the Board meeting:

18. Could staff elaborate on the prospects that the Greek Parliament approve this agreement?

19. Assuming ratification of the agreement, we would welcome staff elaboration on the priority reforms to be implemented before EU accession negotiations could begin?