

2020 BUDGET OF THE REPUBLIC OF NORTH MACEDONIA

I. GENERAL SECTION

Article 1

2020 Budget of the Republic of Macedonia consists of the following:

Denar thousand

I Total Revenues 222.308.000

- source revenues 214,484,000
- capital revenues 2,183,000
- donations

II Total expenditures

- determined purposes
- reserves 200,000

III Deficit 17.385.000

Inflows 60.598.000

Outflows 43,213,000

MACROECONOMIC PROJECTIONS

Global economic activity grew with weaker intensity in the first half of 2019. Growth of Manufacturing was significantly slowed down during this period, and the increased trade and geopolitical tensions, which increased the uncertainty regarding the global trade system and the international cooperation in general, negatively affected the global trade, as well as the confidence of investors and their decisions. Thereby, the tendency to apply monetary policy in order to incentivize lending activity through low interest rates mitigated the effects of these tensions on the financial market and the economic activity, and the resilience of the services sector provided for underpinning the employment growth.

Growth of global economy in 2019 was projected at 3.0%, which is expected to accelerate in 2020, being projected at 3.4%. With respect to developed economies, growth of the economic activity is expected to be kept at 1.7% in 2020, by which the growth in the Eurozone is projected at 1.4%, and 1.6% in the EU in 2020. In 2019, Germany, as the most significant trading partner in the country, was strongly affected by the significant slowdown of the global demand of cars, by which growth of economic activity in 2019 is expected to amount to 0.5%, whereby growth is expected to intensify in 2020, projected at 1.2%, however being lower by 0.5 percentage points compared to the previous projections.

Risks with respect to the projected global economy growth rates, are significant. Further escalation of trade tensions, accompanied with increased uncertainty with respect to economic policies, as well as the increased geopolitical tensions, could adversely affect global trade, investments and economic activity, respectively.

As for domestic economy, growth of economic activity in the first nine months of 2019 accounted for 3.6%, being a result of the positive performance at all activities. Construction activity and industrial sector picked up by 5.6% each, in real terms. Services sector registered 2.2% growth, mostly as a result of intensified activity in the trade and transport sectors, while agriculture surged by 4.2%. Strong contribution of private consumption on the economic growth continued in the first nine months of 2019, underpinned by the increase of wages and employment in the country. Gross investment recorded significant positive movements, while growth of export activity continued with high intensity, coupled with high growth of the import as well. Inflation rate in the period January – October 2019 amounted to 0.9%.

Real GDP growth is expected to account for 3.8% in 2020, driven by domestic demand, while net export is expected to have negative contribution to growth.

Solid growth dynamics of consumption is expected to continue in 2020 as well. Growth of private consumption is projected at 3.3%, driven by the expected increase of household disposable income, supported by the envisaged growth of crediting to households. Income growth originates from the expected increase of wages and employment in the country, underpinned by the government measures for wage increase, unemployment reduction, as well as activation and strengthening of the social protection of vulnerable categories. Public consumption growth is projected at 2.0% in real terms in 2020.

Chart 1. Real GDP growth and inflation rate

Gross investments are projected to increase by 8.0% in real terms in 2020. Planned investments in the public sector, as well as the continuous support to investment activity of the domestic and the foreign companies, are expected to have positive contribution to investment growth. Main preconditions for achieving the projected growth of investments are retaining the political stability in the country and the confidence of economic entities. Thereby, the efforts for continuous improvement of business climate and the road infrastructure are significant factors for sustainable growth of investments.

High growth of export is expected to continue in 2020 as well, however with somewhat weaker dynamics compared to the growth in 2019, amid deteriorated prospects for foreign demand growth. Real growth of export of goods and services is projected at 8.3%, driven by the export of the new export-oriented industrial capacities. Projected growth of domestic demand and export activity provide for increase of import of goods and services, which is expected to account for 8.7% in real terms in 2020.

Inflation rate in 2020 is expected to remain at low level, accounting for 1.7%, whereby the inflation pace will be mostly under the influence of the trends of global prices of primary commodities, as well as the growth pace of domestic demand to a lesser extent.

Envisaged increase of the economic activity is expected to be accompanied by employment increase, boosted by the active employment measures and programs, support to the domestic and the foreign companies for job creation, as well as other measures aimed at unemployment reduction. Hence, the increase in the number of employees in 2020 is projected at 2.1%, thus contributing for average unemployment rate to decrease to around 16%. Increase of the average net-wage in this period is expected to be 6.3% in nominal terms, i.e. 4.6% in real terms.

BOP current account deficit is expected to remain low, accounting for 1.2% of GDP, having tendency for slight widening compared to 2019, amid anticipated deterioration of the trade deficit. Current account deficit will be financed with the expected FDI inflow, which will result in keeping the reserve assets at an adequate level. Stable Denar exchange rate in relation to the euro will be kept in 2020 as well, to the end of maintaining price stability as ultimate goal of monetary policy.

2020 BUDGET OF THE REPUBLIC OF NORTH MACEDONIA

2020 fiscal policy is aimed at achieving the key objectives determined under the strategic priorities of the Government of the Republic of North Macedonia for 2020, those being the following:

- implementing macroeconomic policy aimed at maintaining macroeconomic stability, boosting competitiveness and job creation;

- implementing fiscal policy aimed at contributing to fiscal sustainability and gradual consolidation of public finances, underpinning the economy with significant investments in infrastructure projects and increased transparency;
- ensuring social safety and protection;
- creating favorable business climate with policies on cooperation with the business sector, the social partners, protection of workers' rights, non-discrimination, increased efficiency, as well as support to and development of SMEs;
- support for job creation with active employment measures and increased wage level in the economy;
- NATO integration, commencing the negotiation process and successful accession negotiations between the Republic of North Macedonia and the European Union and other;

Total revenues of the 2020 Budget of the Republic of North Macedonia are projected at Denar 222.3 billion, whereby expenditures are projected at Denar 239.7 billion.

Such projected revenues and expenditures result in reducing the budget deficit to 2.3% of GDP or Denar 17,385 million in absolute terms. Projected deficit is in line with the previous 2020-2022 Fiscal Strategy, confirming the strong commitment to fiscal consolidation, accompanied by further budget discipline and provided significant fiscal room to support domestic economy and citizens and infrastructure projects.

Table 6p.1. Budget of the Republic of North Macedonia (Denar million)

Source: Ministry of Finance

2020 Budget revenue projections are based upon:

- revenue collection in the current 2019,
- expectations for economic performance in the next year,
- projected effect from the increase of social contributions,
- slight easing of tax policy, at the same adjusting certain tax rates, which is expected to cause multiple effect, i.e. - it is envisaged to provide greater tax coverage, fair and streamlined administrative procedures, as well as support to the private sector, which would result in reducing the tax evasion, as well as

- strengthening the mechanisms for reducing the informal economy.

2020 tax revenues are projected at Denar 130.1 billion on the basis of the above-mentioned assumptions. VAT accounted for the most of the projected tax revenues, accounting for 42.8%, while excise duties accounted for 22.2%.

Under 2020 Budget, Denar 17.3 billion is projected to be generated on the basis of non-tax revenues (administrative fees, concessions and other non-tax revenues) and Denar 2.2 billion such as capital revenues (on the basis of sale of social flats and land and on the basis of planned dividend by AD Macedonian Telecom).

Social contributions, as genuine revenues of the Pension and Disability Insurance Fund and the Employment Agency, are projected at Denar 67 billion. This projection includes the effects from the increase of social contribution rates by 0.5 percentage points, estimated at around Denar 1.1 billion within the budgets of the respective social funds.

During 2020, on the basis of donations, Denar 5.6 billion is envisaged, which are planned for the budget users to realize through special revenue accounts for specific projects, as well as disbursements under the EU pre-accession funds.

Total 2020 budget revenues, projected in the amount of Denar 239.7 billion, are aimed at regular and timely fulfilment of all legal obligations, as well as support to domestic economy, strong support to the private sector and the citizens, investments in human potentials, accelerated realization of infrastructure projects, encouragement of future investments and innovation of domestic companies, support to the policies for economic growth and higher living standard of the population, as well as the priority for the integration processes of the Republic of North Macedonia in the EU, and the obligations arising from the NATO membership. Thus, significant amounts of funds has been provided for the Ministry of Defense as the leader of the reform activities of the Republic of North Macedonia in achieving the country's strategic goal - NATO membership. Projected amount of funds will contribute to defence sector reforms in line with the NATO standards, modernizing and equipping ARNM, professional training of ARNM soldiers and long-term development of the defence.

Chart no.2 Expenditures of RNM for 2020 by functional areas (as% of total expenditures)

Source: Ministry of Finance

2020 current expenditures are projected in the amount of Denar 215.9 billion, intended for regular payment of the already increased wages of the public sector employees, timely and regular payment of increased pensions, guaranteed minimum income and other social allowances, payment of agricultural subsidies, intensified support to small- and medium-sized enterprises, support and subsidizing of innovation activities, as well as measures for increasing wages and subsidizing of

mandatory social insurance contributions, i.e. financial support to employers, which will provide for increasing the wage of employees up to EUR 100.

Hence:

- Expenditures for payment of wages are projected at Denar 30.6 billion. As regards these funds, the effect from the already realized 5% wage increase for the employees at the budget users in the last quarter in 2019 has been already projected, aimed at raising the living standard of employees and increasing the incentive for professional, quality and fulfillment of the working tasks, as well as the effect from the 10% wage increase for the employees in the educational institutions at central level.
- Expenditures related to goods and services are projected 20.6 billion, thus providing for regular and timely settlement of the expenditures of budget users, as well as providing funds for parliamentary elections in 2020.
- Current transfers and subsidies projected at Denar 156.4 billion in 2020, refer to the following:
 - Social transfers are projected at Denar 116 billion. During 2020, Denar 60.7 billion are intended for payment of higher pensions as appropriate provided funds for this category of population. Pension increase is projected under the 2020 Budget by around Denar 700, starting with the pension in January. This increase was envisaged as additional indexation, above the regular indexation of costs of living, in order to provide for appropriate level of higher living standard at the elderly as well, followed by the improved living standard of employees. Denar 1.6 billion is projected for payment of unemployment benefit.
 - Denar 1.3 billion is projected for implementation of active employment policies and measures, which will be focused on creating employment programs, measures and services, which will be implemented so as to improve the functioning of the labor market, support the job creation, employ young people, support for employment of disabled persons, activation of the users of guarantee minimum assistance, in a way that the working-able members of the household will be included in the active employment programs and measures for the purpose of increasing their employability and employment.
 - Funds in the amount of Denar 33.7 billion is projected for health protection. This level of projected funds for health protection, which will be realized through the Health Insurance Fund, is higher by around Denar 2.8 billion compared to 2019, mostly intended to finance health services and measures undertaken in this area as increase in capititation, availability of medicines throughout the month, increase of wages of medical specialists, as well as increase of the wages of medical staff in public health institutions. Under 2020 Budget, starting with the wage in February, increase of wages was planned for the doctors and the medical staff from 5 to 25 percent.

- Ensuring adequate level of social protection for the most vulnerable is of special importance for reaching higher level of social justice. Hence, budget funds, on this basis, have been projected in the amount of Denar 10.5 billion, within which the already commenced reform of the social protection system is covered, by introducing guaranteed minimum income. 2019 social protection reform provided for re-designing the types and targeting of the social welfare, to the end of supporting the most vulnerable categories, as well as ensuring social safety for the elderly.
- Agricultural subsidies and funds under IPART Program, will provide for strengthening and supporting this sector for the purpose of boosting export of Macedonian agricultural products and conquering new markets.
- In addition, around Denar 3 billion is allocated for enhancing the private sector competitiveness through measures for new investments, measures aimed at supporting the export and conquering new markets, supporting job creation, SMEs support, innovative activity, technological development and research, as well as foreign investments in the technological industrial development zones.
- Transfers to LGUs amounting to Denar 21.4 billion, aimed at financing the transferred competences to the municipalities and the revenues collected on the basis of VAT. Compared to 2019, these funds increased by Denar 2.2 billion, Denar 130 million out of which on the basis of VAT grant, while block grant surged by Denar 2.1 billion. Hence, funds have been provided for the already increased wages for the employees in the institutions from the transferred competences to LGUs by 5% in 2019, i.e. wages of the employees in the schools, kindergartens, elderly homes, cultural institutions and fire workers. In addition, for the purpose of motivating the teachers, being crucial for building more productive future generations, funds have been provided for increasing the wages of education workers by 10%, starting as of January 2020.

Capital investments projected at Denar 23.8 billion, have been provided from budget funds, IPA funds and loans. They are intended for intensification of the infrastructure projects, i.e. investments in road and railway infrastructure, energy and utilities infrastructure, as well as capital investments aimed at improving the conditions in the health, education and social systems, agriculture, culture, sports, environment protection and judiciary. More precisely, funds for 2020 have been projected, as follows:

- Capital expenditures related to road and railway infrastructure in the amount of Denar 3.4 billion. With respect to modernization of the existing railroad infrastructure, reconstruction of railroad tracks on Corridor X, financed with EBRD loan, will continue. These activities will provide for improving the flow of passengers and goods along this section, reducing the costs for railroad track maintenance, and ensuring safer and more efficient transportation. During 2020, funds have been projected for continuing the realization of the first and second stage of the Rail Corridor VIII Project- Kumanovo Beljakovce-

Kriva Palanka-section, financed with EBRD. At the same time, activities related to the Beljakovce-Kriva Palanka railway section, which will be, in addition to the EBDR loan, financed with grant funds under the Western Balkans Investment Framework. Under the Project, activities have been envisaged for improving the technical features of the railway line, construction and rehabilitation of bridges, railway stations, stops, underpasses and overpasses. During 2020, activities for realizing the Local Roads Connectivity Project will commence with a World Bank loan, by which the road infrastructure in the municipalities in the Republic of North Macedonia will be improved. At the same time, the activities for realizing the Project for the Western Balkans Trade and Transport Facilitation Project will also continue in 2020, being part of the new World Bank Regional Initiative, wherefrom funds for its financing have been provided. IPA funds will be used for implementing projects for Construction of Road Section Gradsko - Interchange Drenovo as part of Road Corridor Xd, Rehabilitation of the State Road A2, Kumanovo-Stracin Section (Phase 1), as well as Reconstruction and Upgrading of the Existing Road from Prilep - Bridge on Leniska River and Construction of Third Lane of the Road Section from the Village of Belovodica - Mavrovo Quarry.

- Around 5 billion is projected as capital investments in energy and utilities infrastructure, as well as waste management. What is also envisaged is continuation of the activities aimed at constructing the first phase of the National Gasification System, Stip-Negotino-Bitola Section and Skopje-Tetovo-Gostivar Section, being financed with a loan from Deutsche Bank and Erste Group Bank. Intensive activities will continue to be undertaken, being aimed at constructing water supply and sewerage systems in the municipalities financed from own resources and loans from EIB and KfW. At the same time, The World Bank's Municipal Services Improvement Project will provide for enabling the municipalities and public utility enterprises to finance investment operations in line with their priorities in the field of water supply and wastewater drainage, solid waste management, as well as other investments in the municipal services, having potential to generate revenues, i.e. make savings, or being of high priority for the municipalities. IPA funds will be aimed at supporting the Rehabilitation and Upgrading of Sewerage Network in the City of Skopje, Rehabilitation and Upgrading of the Sewerage Network and Construction of the Wastewater Treatment Station in Kicevo, Bitola and Tetovo, as well as Establishing Regional Waste Management System and Closure of Landfills in East and North-East Regions.
- Arrangement of technological industrial development zones through construction of the necessary infrastructure and facilities, as well as by carrying out the necessary geo-mechanical research works, for which purpose Denar 529 million has been projected.
- In the field of health sector, investments in the amount of Denar 1.5 billion have been intended for construction and reconstruction of public health institutions, procurement of medical equipment, reconstruction of the General Hospital in Kicevo. In 2020, the Project for Construction of the New Clinical Center in

Skopje is planned to commence, whereby the implementation of the Regional Clinical Hospital in Stip, financed with CEB loan will continue.

- In the field of education, child protection and sports, capital investments in the amount of Denar 2.1 billion have been projected, being intended for construction and reconstruction of primary and secondary schools, kindergartens, construction of schools and sports halls, reconstruction of pupils' and students' dormitories, equipping and reconstruction of universities and investments in sports infrastructure. In the field of education, Project for Reconstruction of Student Dormitories will also commence, with KfW loan, and the realization of the Project for Construction of Physical Education Facilities in Primary Schools and the Project for Construction of Physical Education Facilities in Secondary Schools in the Republic of North Macedonia, financed with CEB loan and contribution by the Republic of North Macedonia will also continue, being aimed at improving the physical education, as well as the overall learning conditions in the primary and the secondary schools. To the end of improving the access to social rights and services, as well as extending the capacities for pre-school care and education, by constructing new facilities and transforming/upgrading the existing infrastructure of pre-school institutions, the realization of the Social Protection Project, financed with World Bank loan, continues in 2020. In the coming period, the Skills Development and Innovation Support Project, financed with World Bank loan will continue, by which, among the other, the operations of the Fund for Innovation and Technological Development is underpinned.
- To the end of supporting the agricultural sector, substantial capital investments is envisaged in the amount of around Denar 1.6 billion, intended for rural development, construction of hydro systems and investments aimed at improving the competitiveness and modernization of agricultural holdings. Agricultural Modernization Project will be launched with a World Bank loan, whereby construction of purchasing and distribution centers throughout the country, is envisaged. Thus, the realization of the second and third phase of the Zletovica Water Basin Utilization Improvement Project is expected to start with EIB support in 2020, thus providing for irrigation of 4,750 ha net area in the region of Probistip and Kratovo municipalities, as well as construction of small hydropower plants along the flow of Zletovica River. In addition, what is planned in 2020 is a construction of the irrigation systems in Valandovo region, being financed with KfW loan and grants by implementing the second phase of the Irrigation Program Southern Vardar Valley.
- Denar 509 million is planned in the field of judiciary, while in 2020, implementation of the Prisons Reconstruction Project will continue, financed with a loan from the Council of Europe Development Bank.
- For the purpose of improving the conditions for socially vulnerable groups, the Project of Housing of Vulnerable Groups, funded with a loan from the Council of Europe Development Bank, will continue to be implemented.

2020 projected deficit in the amount of Denar 17.4 billion, repayment of foreign debt principal in the amount of Denar 26.9 billion and domestic debt repayment in the

amount of Denar 16.3 billion, will be financed by external borrowing and borrowing on the domestic government securities market. Repayment of foreign debt principal includes the regular servicing of liabilities on the basis of foreign debt, while domestic debt repayment covers: early repayment of domestic loan in the amount of Denar 8.2 billion, repayments of government bonds in the amount of Denar 6.6 billion and repayment of structural bonds in the amount of Denar 1.5 billion.

Domestic borrowing is projected at Denar 27.1 billion, which will be provided from short-term loan from domestic commercial banks, and it will be intended for refinancing the second installment of the PBG loan extended in 2013, as well as by borrowing with government securities. Borrowing on the domestic market will provide for financing under favorable conditions, using the favorable interest rates. For the purpose of optimizing the payments, reducing the refinancing risk, as well as using the low interest rates, the main commitment of the Ministry of Finance will be portfolio optimization and lengthening maturity of the issued securities.

Foreign borrowing may be realized through issuance of Eurobond on the international capital market and by disbursement of funds under favorable loans from foreign financial institutions and credit lines intended for financing certain projects. Thereby, the choice of a financing source will be based on the favorable ongoing developments on the international capital market. For the purpose of prudent public finance management, Ministry of Finance will consider the possibility for active debt portfolio management through liability management activities.

General government debt of the Republic of Macedonia amounted to EUR 4,445.0 million, i.e. 39.2% of GDP on 30th September 2019, while public debt amounted to EUR 5,405.2 million, i.e. 47.7% of GDP on 30th September 2019. According to the revised 2020-2022 Fiscal Strategy, the general government debt at the end of 2020 accounted for 40.9%, while public debt will account for 50.4% of GDP, by which Republic of North Macedonia will further remain in the group of moderately indebted countries.