



**REPUBLIC OF NORTH MACEDONIA
GOVERNMENT OF THE REPUBLIC OF NORTH MACEDONIA**

2020-2022 FISCAL STRATEGY OF THE REPUBLIC OF NORTH MACEDONIA

Skopje, May 2019

Summary of 2020-2022 Fiscal Strategy of the Republic of North Macedonia

The Fiscal Strategy is adopted for a three year period and contains the medium term directions and goals of fiscal policy, the key macroeconomic projections, the amounts of the main categories of estimated revenues and expenditures, as well as the deficit and debt projections. The Fiscal Strategy reflects the medium term fiscal goals and strategic priorities of the Government of North Macedonia.

The continuous intensification of growth during 2018 and the positive developments in the first quarter of 2019 provide the grounds for an upward revision of the projection of economic growth in 2019 to 3.5%. GDP growth is expected to strengthen to 4.2% in 2020, and then to further intensify in the following two years to 5%. Private consumption will have a considerable contribution to economic growth over the medium term, with an average real growth of 2.8% per year. The growth of private consumption is related to the increase in employment in the private sector, also supported by active employment measures, the increase of wages in the economy, as well as the measures for improvement of social protection, which will result in higher household disposable income, with an additional impulse by the rise in crediting. The projection for the growth of gross investments for 2020-22 equals an average of 6.1% per year, in real terms. The higher confidence of economic subjects, the more favourable business climate, the improved Euro-Atlantic prospects, the inflow of foreign direct investment and the government measures for investment stimulation will have a considerable effect on investment growth, whereas a positive impulse is also expected by the planned public sector investments. In this period, net exports are expected to have a positive and increased contribution to economic growth. Exports of goods and services is projected to grow by an average 9.1% per year, in real terms. The positive movements of consumption, investments and exports will result in an average real growth of imports of goods and services of 6.8% per year.

In order to strengthen fiscal discipline, the medium term Fiscal Strategy applies limits on budget expenditures, both aggregate limits and limits by budgetary users. In this direction, the annual growth rate of total expenditures of the central government budget will gradually decline from 14.2% in 2019 to 5.2% in 2022. In combination with the expected collection of revenues, this will ensure a gradual narrowing of the budget deficit from 2.5% of GDP in 2019 to 2.3% in 2020 and then to 2% of GDP in 2021 and 2022. Moreover, the limits for the budget deficit as a key indicator for the stance of fiscal policy are maintained on an almost unchanged absolute amount, as well as on an unchanged share of GDP as in the previous Fiscal Strategy. The maintenance of the path of gradual consolidation confirms the course of fiscal discipline, with unchanged projections for the budget deficit additionally strengthening the predictability of fiscal policy. The primary budget deficit will also fall from 1.2% of GDP in 2019 and 2020 to 0.8% of GDP in 2021 and further to 0.5% of GDP in 2022.

The movement of public debt in the following period will reflect the medium term budgetary framework, the implementation of capital projects as well as the repayment of maturing debt (around EUR 2.3 billion of principal in the 2019-2022 period). The realisation so far, as well as the revised projections for the economic growth and the maintained course of fiscal discipline result in a considerable downward revision of the debt projection. Namely, the Revised Fiscal Strategy was projecting a public debt of 49.8% of GDP in 2018, as opposed to the actual considerably lower public debt of 48.5% of GDP. The disciplined fiscal policy, with a gradual tightening of the overall budget deficit and almost balanced primary deficit in the medium term (2% and 0.5% of GDP in 2022, respectively), is the key factor for the downward path of general government debt, i.e. its fall from the projected 42.2% of GDP in 2019 to 39% of GDP in 2022. In addition, due to the implementation of projects mainly in the road infrastructure with loans guaranteed by the government, the guaranteed debt will increase slightly to 11.1% of GDP in 2021, and then fall to 10.1% of GDP in 2022. The downward path of general government debt and the moderate rise of guaranteed debt because of infrastructure projects and then its fall, will result in a moderate increase of the total public debt to 51.7% of GDP in 2019 and 52.3% of GDP in 2020, and then decline to 50.8% of GDP in 2021 and further to 49.1% of GDP in 2022. This is considerably below the public debt limit of 60% of GDP, implying that the public debt in the following period will not threaten the sustainability of fiscal policy. In addition, the new projections for public debt are considerably lower than before (for around 2 percentage points, on average), pointing to the effectiveness of the undertaken measures and the planned policies for stabilization and then decline of public debt over the medium term.

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Pursuant to paragraph 2, Article 16 of the Budget Law ("Official Gazette of the Republic of North Macedonia", no. 64/2005, 04/2008, 103/2008, 156/2009, 95/2010, 180/2011, 171/2012, 192/2015 and 167/2016), Government of the Republic of North Macedonia, at its session held on 28th May 2019, adopted the 2020 - 2022 Fiscal Strategy of the Republic of North Macedonia.

Introduction

The Budget Law is the basic legal act regulating the overall budget process, including the main participants in the budget process, the procedure for preparation and adoption of the Budget, execution of the Budget and Annual Budget Report, management of the budget allocations and preparation of the Medium-Term Fiscal Strategy.

The medium-term planning is reflected through the Fiscal Strategy which, in accordance with the Law, is adopted for a three-year period and it proposes the guidelines and objectives of the fiscal policy, the basic macroeconomic projections and indicators, it determines the amounts for the main categories of the estimated revenues and appropriations for that period, as well as projections for the budget deficit and the public debt.

Fiscal strategy is the crucial instrument for medium-term budget planning, including assessment of new initiatives for financing. Medium-term budget framework is the key tool to link medium-term budgetary decisions to those deficit and debt targets that have been set.

Improving public finance management, thus continuously improving the Fiscal Strategy as one of the most important strategic documents of a government, is set among the key priorities of the Government, also being a priority on the road to EU accession.

Medium-term Fiscal Strategy is in line with the medium-term fiscal goals and strategic priorities of the Government of the Republic of North Macedonia and it provides for monitoring the dynamics of revenues and expenditures in relation to the fiscal goals.

At its session held on 30th April 2019, Government of the Republic of North Macedonia identified the most important strategic priorities in the Decision on Determining Strategic Priorities, as follows:

- economic growth, increased productive employment and improved living standard of the citizens;
- Republic of North Macedonia - NATO and EU member;
- successful accession negotiations with the EU;
- decisive and non-selective fight against organized crime and corruption;
- strengthened rule of law by impartial and non-discriminatory implementation of the laws, building independent institutions and functioning local government system;
- education reforms and investments in innovations and information technology;
- judiciary reforms;
- full implementation of the Ohrid Framework Agreement and building a civic state and ethnic cohesion; and
- reduced air pollution.

Several priority goals have been determined to realize the strategic priorities of the Government, among which 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 favourable 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;
- job creation with active employment measures and increased wage level in the economy;
- developing and improving competitiveness of the industry in the country, as well as implementing active policy on FDI attraction;
- building new road sections and rehabilitating part of the existing ones, accelerating the pace of economic growth by increasing investments in science, research and innovations;

- abandoning the traditional approach in agriculture and promoting the latest technologies with increased knowledge transfer in agriculture;
- reducing the differences in development among and in the planning regions and boosting competitive ability of the planning regions;
- enhancing and strengthening the public health capacities and the health services at all levels;
- NATO integration, commencing the negotiation process and successful accession negotiations between the Republic of North Macedonia and the European Union;
- promoting gender equality in all areas of the social life and including gender perspective in policy creation and budget preparation;
- further increase of investments in environment and its protection.

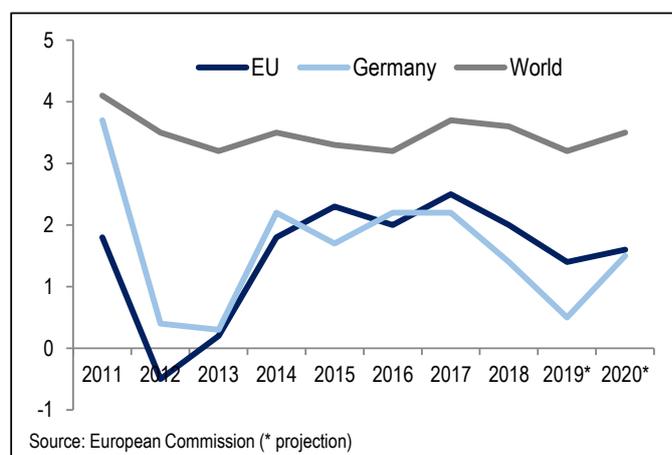
1. Macroeconomic Projections

1.1 International Economic Trends and Forecasts¹

Economic activity in the EU, as main trading partner to North Macedonia, grew by 2.0% in 2018, slowing down in the second half of 2018 as growth in the global economy and trade weakened amid tightened global financing conditions, unresolved trade tensions, high uncertainty, and as a result of weakness in the manufacturing sector in the second half of the year that extended into the start of 2019.

Global economic growth is expected to slow down to 3.2% in 2019 and to then pick up to around 3.5% in 2020 (Figure 1). Global economic activity should be supported by expansionary fiscal policies in several major emerging economies, primarily China, where significant monetary and fiscal policy stimulus is expected to stabilise economic growth.

Figure 1. Global Economic Growth (%)



EU economy is expected to experience growth of 1.4% in 2019 and 1.6% in 2020 (Figure 1). Due to the sizeable negative impact of the external environment on export-oriented sectors, the main impetus to growth in the EU is expected to continue to come from domestic demand, driven by further growth in employment and disposable income. Additional jobs, coupled with rising wages for employees, are expected to support consumption and economic activity. Investment is set to continue expanding, but far less energetically due to the impact on equipment investment of the less favourable external environment and the high prevailing levels of uncertainty.

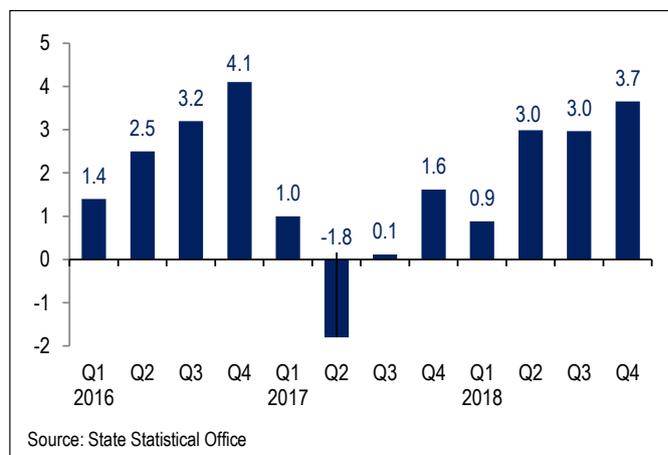
Downside risks to the outlook remain prominent. Despite easing tensions in US-China trade tensions, uncertainty remains high, and the risk of further protectionist moves in US trade policy persists. In particular, the possible imposition of US tariffs on cars and car parts imported from Europe could have knock-on effects well beyond the automobile sector. The current slowdown in world GDP growth and trade could also turn out to be more persistent than forecast, particularly if economic growth in China turns out weaker than expected.

¹ Analysis in this section is based on the Spring Report of the European Commission "European Economic Forecast", published in May 2019.

1.2 Economic Trends in the Republic of North Macedonia

Economic activity in 2018 experienced accelerated growth of 2.7%, following the 0.2% growth in the previous year. Following the weak economic growth at the beginning of the year, reflecting the trends in the construction sector, more significant positive movements are observed at the economic activity in the coming period (Figure 2), i.e. continuous acceleration of growth throughout the year.

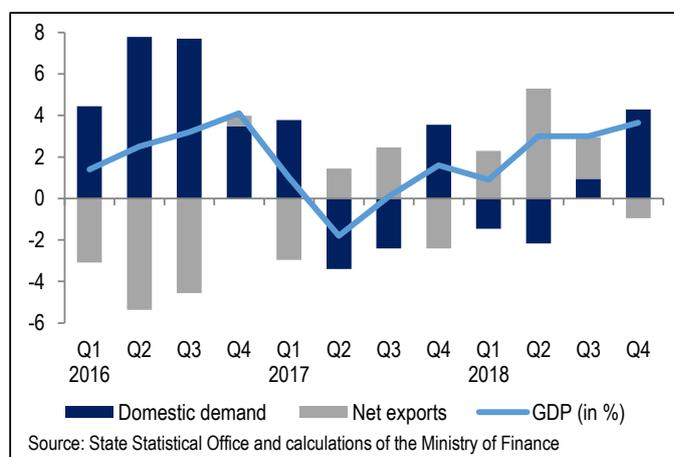
Figure 2. Year-on-Year Real GDP Growth (%)



Observed by expenditure components, growth of economic activity in 2018 was a result of increased consumption and positive contribution of net exports on the economic growth (Figure 3). Export of goods and service registered high growth of 15.3% in real terms, mainly reflecting the export activity of the new production capacities, coupled by the solid performance of part of the traditional export segments, such as metal and food industries. Imports of goods and services registered growth of 9.0% in real terms, driven by increased imports of intermediary goods.

Consumption in 2018 grew by 3.5% in real terms, with private consumption picking up by 2.9% and public consumption by 6.2%. Increase of private consumption was mainly a result of increased wages and newly created jobs in the economy, also underpinned by the increased crediting to households. Gross investments dropped by 7.2% in real terms in this period, whereby slight recovery was registered in the last quarter amid strong inflows of foreign direct investments. Hence, domestic demand in 2018 had slight positive contribution to the growth of aggregate demand.

Figure 3. Contribution by Component to the y-o-y GDP Growth (in percentage points)

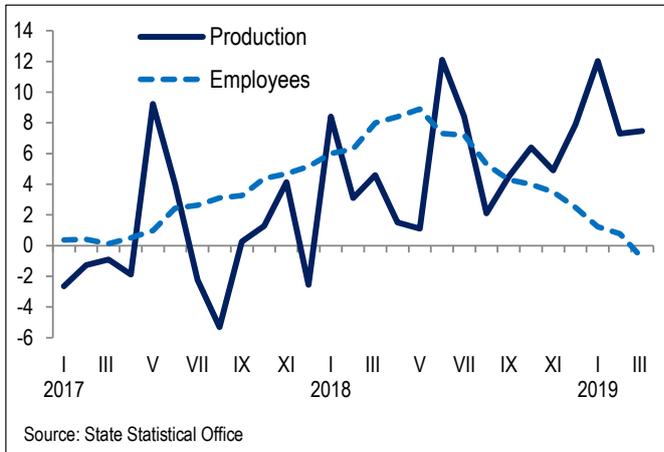


Analyzed by sectors, industry registered real growth of 3.7%, strongly underpinned by the intensified growth in manufacturing by 5.6% (Figure 4). According to high frequency data, as regards manufacturing, manufacture of machinery, equipment, motor vehicles, electrical equipment, as well as manufacture of food

products and metals, significantly contributed to growth thereto. Services sector registered real growth of 3.3%, mostly as a result of intensified growth in the trade, transportation and accommodation and food service activities by 9.2%. Growth in the construction sector moved to the positive zone in the last quarter, hence full-year growth in 2018 amounted to 0.2%, due to the intensified construction activity in the segment of buildings.

Industrial production picked up by 8.8% in the first quarter in 2019 as a result of growth in all three sectors, in particular: mining by 4.1%, manufacturing by 6.9% and electricity supply by 15.9%. Positive trends in the trade sector continued with stronger intensity in the first three months in 2019, i.e. total turnover in the country grew by almost 15% in nominal terms, amid increased turnover in all segments.

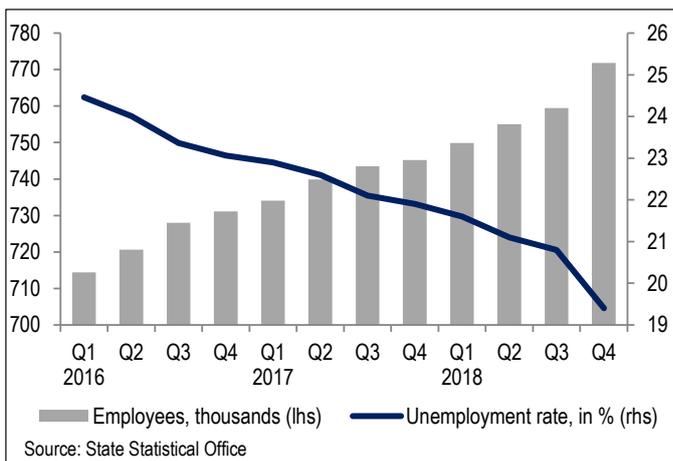
Figure 4. Year-on-Year Growth of Industrial Production (%)



Favourable trends on the labour market continued in 2018, with a stronger dynamics compared to 2017 (Figure 5). In the last quarter, the unemployment rate dropped to 19.4%, i.e. it declined by 2.5 percentage points (p.p.), compared to the same quarter in 2017, whereby youth and women unemployment also fell. Employment rate reached 45.9% in the last quarter, accounting for 1.6 p.p. annual increase. Thereby, employment growth of 3.6% y-o-y in the last quarter is the highest in the last 5 years.

In conditions of increased labour demand, supported by implemented active employment measures, number of employees in 2018 surged by 2.5% in average, i.e. by 18.4 thousand persons, compared to 2017, whereby the largest increase of employment was registered in the industrial sector, in particular manufacturing, which absorbed around 40% of the newly created jobs. Positive trends were also registered in the services sector, as a result of employment increase in several service activities. Construction had positive contribution in conditions of recovery of the activity in the last quarter in 2018. Favourable trends in the industrial and trade sector at the beginning of 2019 were coupled with increase in the number of workers in these activities.

Figure 5. Number of Employed and Unemployment Rate

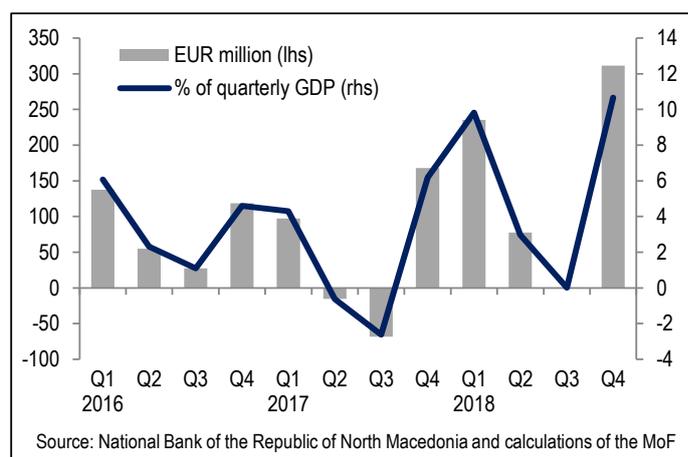


Average net wage in 2018 grew by 5.9% in nominal terms (the highest increase in the last 9 years) and by 4.4% in real terms, accelerating in relation to the previous years, amid increase of the minimum wage, the wages in part of the public sector and the wages in the private sector. Wages increased in almost all sectors, whereby the highest increase was recorded in the industry sector (Mining by 18.6% and Manufacturing by 10.8%), ICT by 14.8% and services sector by 10.6%. Positive trends continued in 2019 as well, whereby average net wage surged by 3.4% in nominal terms and by 2.21% in real terms in the first quarter.

Developments in the current account of the balance of payments in 2018 resulted in low deficit of 0.3% of GDP, being lower compared to 2017, as a result of the reduced trade deficit. Inflow of foreign direct investments (FDIs) in 2018 were realized in a record-high amount of EUR 624.5 million, accounting for 5.8% of GDP (Figure 6). Around two thirds of FDIs in this period were in the form of equity and reinvested profit, while the remaining portion was in the form of debt instruments. FDIs were mainly allocated in the industry sector, accounting for 46.4% of the total FDI inflows, in particular in the Manufacturing. FDI inflow in the services sector accounted for 15.5% of the total inflows.

Strong export of goods continued in the first three months in 2019, with a 16.8% growth, driven by the increased export of machinery, transport equipment, chemical and metal products. Imports of goods in this period surged by 11.5%, mainly as a result of the higher imports of intermediary goods. Thus, trade deficit narrowed by around 3% compared to the same period in 2018, accounting for 4% of the projected GDP for 2019.

Figure 6. FDI Inflows by Quarter

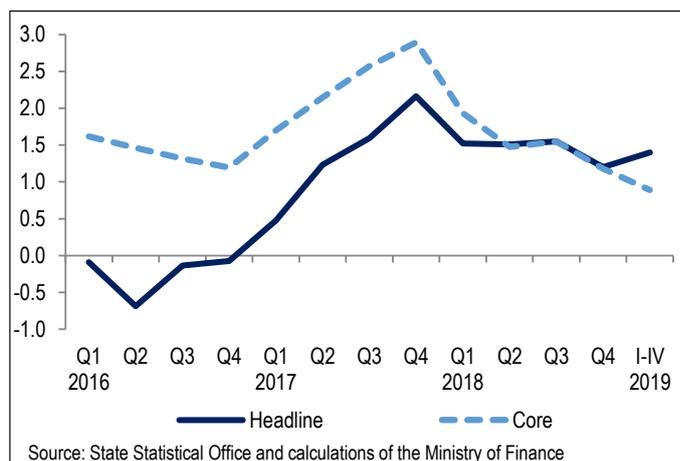


At the end of April 2019, foreign exchange reserves amounted to EUR 2.9 billion, increasing by 11.0% compared to April 2018, thus providing for four-month coverage of imports of goods and services in the next 12-month period, thus being at an adequate level to manage possible shocks.

Inflation rate in 2018 amounted to 1.5% in conditions of stable prices throughout the year (Figure 7). Consumer prices increased mostly as a result of core inflation², which amounted to 1.5%. Prices of food products rose by 0.9%, prices of energy sources increased by 2.6%, reflecting mainly the higher prices of oil derivatives, in line with the trends on the global market. In the period January - April 2019, inflation rate amounted to 1.4%, as a result of the increased prices of food (2.9%) and growth of the core inflation (0.9%), while prices of energy sources dropped.

² Inflation without the food and energy components.

Figure 7. Headline and Core Inflation (%)



In the course of 2018, monetary policy was eased by reducing the reference interest rate three times by 0.25 p.p. each, from 3.25% to 2.5%. In March 2019, the National Bank of the Republic of North Macedonia additionally reduced the reference interest rate by 0.25 p.p. to historically the lowest 2.25%, reflecting the moderate inflation and the continuous favourable trends on the foreign exchange market, in the absence of pressures in the external sector and the stable perceptions by the domestic subjects.

Banking system in 2018 maintained its stability, in conditions of solid liquidity and capital adequacy. Total deposits in the banking system in December 2018 were higher by 10.5% year-on-year, mostly due to the increased Denar deposits. In December 2018, credit activity was higher by 7.3% year-on-year, primarily as a result of the increased crediting to households. Positive trends at deposits and credits continued in 2019 as well. In March 2019, total deposits in the banking system were higher by 11.1% year-on-year, whereby Denar deposits contributed by around two thirds in the total deposit growth. Credit activity continued with stronger dynamics in March 2019, i.e. credit growth reached 9.0% year-on-year (the highest after 2015), in conditions of more significant crediting to the corporate sector (8.2% increase, the highest after April 2015) and stable household credits (9.7% increase).

1.3 Medium-Term Macroeconomic Projections

Continuous acceleration of growth in the course of 2018, especially in the last quarter, accompanied by strong FDI inflow and recovery of the investment demand, as well as the positive movements in the first quarter in 2019 observed through more intensive growth of the industrial production and of the sales in the trade activity, keeping the solid growth of the construction activity in the previous quarter, continuously strong growth of the export activity and stronger crediting to the private sector are basis for slight upward revision of the growth projection in 2019 to 3.5% (from 3.2% previously).

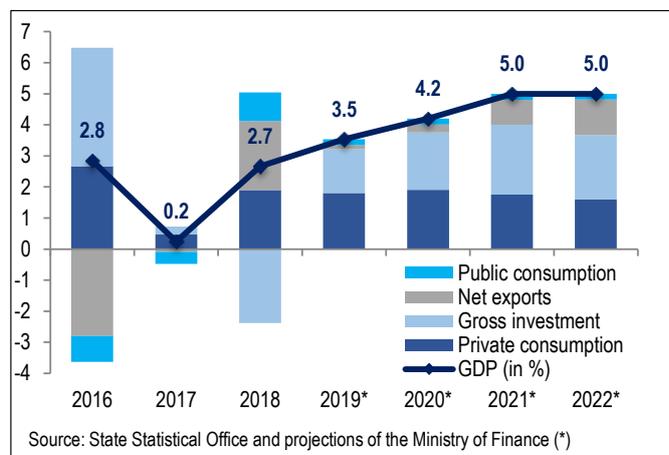
GDP growth is expected to increase to 4.2% in 2020, gaining stronger pace in the following two years, reaching 5%. Private consumption is envisaged to significantly contribute to economic growth in this medium-term period (Figure 8), i.e. it is expected to reach an average annual growth of 2.8% in real terms. Growth of private consumption is linked to the employment increase in the private sector, also underpinned by the active employment measures, increased wages in the economy, as well as the measures aimed at strengthening social protection, which will result in growth of household disposable income. Private consumption is expected to be also underpinned by the envisaged increase of credits to households. Real growth of public consumption in this period is projected at 1.3% in average.

Growth of gross investments in the period 2020-2022 is projected at 6.1% in real terms in average, with prospects for certain intensification of growth in the course of this period. Increased confidence of economic agents, more favourable business climate, better Euro-Atlantic perspectives and government measures for stimulating investments are factors envisaged to significantly contribute to growth of gross investments. Planned investments of the public sector, as well as the support to investment activity of the domestic and the foreign companies, are expected to have positive contribution to investment growth.

As regards the coming medium-term period, net export is expected to have positive and increased contribution to growth of economic activity (Figure 8). Export of goods and services is envisaged to experience

real growth of 9.1% in average, as a result of the expectations for increased activity of the existing export-oriented capacities, increased export potential in the country via FDI inflow and new capacities, further recovery of part of the traditional export sectors, in conditions of envisaged strengthening of the foreign demand in the period 2020 - 2022. Projected growth of domestic demand and export activity condition stronger import of intermediary goods, capital goods and consumer goods. Hence, import of goods and services in the analyzed period is expected to have real growth of 6.8% in average.

Figure 8. Growth of GDP (%) and Contribution by Expenditure Components (percentage points)



Projected increase of the economic activity in the coming medium-term period is expected to be accompanied by employment increase, boosted by the active employment measures and programs, the support to the domestic and the foreign companies for job creation, as well as other measures aimed at unemployment reduction.

According to the projections, number of employed persons is expected to increase by 2.4% in average annually in the period 2020 - 2022. The increase of demand in this period is expected to also reflect on the labour supply, projected to increase by 1.1% annually in average. Such trends on the labour market will provide for the average unemployment rate to drop to 16.2% in 2022 and for the average employment rate to increase to 49.2%. Increase of the average net wage in this period is expected to be around 5% annually in nominal terms (Table 1).

Table 1. Actual and Projected Main Macroeconomic Indicators for North Macedonia

	2018	2019*	2020*	2021*	2022*
GDP, real growth rate (%)	2.7	3.5	4.2	5.0	5.0
Inflation rate (average)	1.5	2.0	2.0	2.2	2.2
Export of goods (nominal growth, %)	16.8	9.2	9.8	10.5	10.3
Import of goods (nominal growth, %)	12.2	7.4	8.4	8.7	8.3
Trade balance (% of GDP)	-16.9	-16.2	-15.7	-14.9	-13.9
Current account balance (% of GDP)	-0.3	-0.9	-1.2	-1.4	-1.4
Net wage - nominal growth (%)	5.9	5.0	4.8	4.8	4.9
Unemployment rate (average)	20.7	19.3	18.2	17.2	16.2
Employment rate (average)	45.1	46.1	47.1	48.1	49.2

Source: State Statistical Office and forecast of the Ministry of Finance (*)

In the period 2020-2022, inflation rate is expected to be low and stable. Inflation dynamics will be influenced by the trends of global prices of primary products, and partially by the trends of the economic activity in the national economy. Thus, inflation rate in 2020 is expected to be 2%, while it is projected at 2.2% in 2021 and 2022.

The current account deficit is expected to remain relatively low and to be around 1.4% of GDP in the period 2020 - 2022. It will be financed with the expected FDI inflow, which will result in keeping the foreign reserves at an adequate level. Stable Denar exchange rate in relation to the euro will be retained in this period, aimed at maintaining price stability as ultimate goal of monetary policy.

Baseline macroeconomic projections are accompanied by certain risks³, which are related to both the international and the domestic environment. As regards the risks related to the international environment, they are mainly associated with the economic trends and the growth dynamics of the EU economy, as the main trading partner of North Macedonia, as well as the deteriorated prospects for growth of the global trade and of the manufacturing industry in part of the EU Member States. Volatility of base metal prices on the global market is an additional risk.

As regards the domestic environment, risks are significantly reduced in circumstances of stabilization of the political situation in the country and prospects for increased growth of the domestic economy. Related to this, the projected growth of the domestic demand over the medium term, which is expected to significantly contribute to boosting the economic activity, is related to risks that are primarily related to the increase of gross investments, i.e. the execution of public capital expenditures. On the other hand, improved Euro-Atlantic perspectives may have stronger than projected effect on the investment activity, pointing out to potential upside risks.

2. Fiscal Projections

2.1 Central Government Budget (Budget of the Republic of North Macedonia)

2.1.1 Revenues and Expenditures in the Period January - April 2019

Performance of revenues and inflows to the central government budget (Budget of the Republic of North Macedonia) is within the expectations for this period of the year, while expenditure execution is realized on regular and timely manner (Table 2). In the period January - April 2019, total revenues were collected in the amount of Denar 63,926 million or around 30.3% of the 2019 Budget, i.e. their collections was higher by 5.7% compared to the revenues collected in the same period last year. Denar 37,169 million out of this amount was tax revenues (being higher by Denar 509 million or by 1.4% compared to last year). VAT revenues (in net terms) were collected in the amount of Denar 16,977 million or by 8.8% more compared to last year, and they dominate in the structure of tax revenues with 45.7%. Personal income tax revenues were collected in the amount of Denar 5,638 million (14.2% increase), corporate income tax revenues were collected in the amount of Denar 4,818 million, while collection of excise revenues amounted to Denar 7,182 million in the first four months in 2019. Revenues collected on the basis of social contributions amounted to Denar 19,511 million. This amount was by Denar 1,759 or by 9.9% more in relation to the respective period in 2018. Denar 13,125 million was collected on the basis of pension insurance, while revenues collected on the basis of health insurance contributions amounted to Denar 5,562 million.

Non-tax revenues were collected in the amount of Denar 5,478 million in the period January - April 2019. The largest share reflects non-tax revenues of budget users on their special revenue accounts, collected in the amount of Denar 2,379 million. Capital revenues were collected in the amount of Denar 292 million, while budget users generated Denar 1,476 million on the basis of donations from international multilateral and bilateral cooperation.

In the period January - April 2019, expenditures were executed in the amount of Denar 68,091 million, i.e. accounting for 29.8% of the 2019 Budget, and execution was higher by 8.1% in relation to the same period last year. All liabilities of the budget users, legal rights of the citizens and the due liabilities towards domestic and foreign creditors were settled on time and on regular basis during this period.

Current expenditures were executed in the amount of Denar 65,538 million. During this period, Denar 9,004 million was paid for wages and allowances to the employees with the budget users, while expenditures related to goods and services were executed in the amount of 5,204 million. Transfers-related expenditures accounted for the most in the current expenditures, amounting to Denar 49,139 million in this period. Government liabilities on the basis of payments related to exercising the rights to guaranteed social protection of the citizens (pecuniary allowances to vulnerable categories of citizens, as well as child allowance and parenting payments) were settled on regular basis, accounting for Denar 2,834 million. As regards regular payment of pensions, Denar 18,645 million was allocated therefore. With respect to financing health services and benefits, Denar 10,128

³ Possible effects on macroeconomic and the other risks on the fiscal variables are shown in Chapter 7.

million was paid, while Denar 720 million was allocated for payment of unemployment benefits through the Employment Agency. Denar 5,496 million was transferred from the central government budget (Budget of the Republic of North Macedonia) to the municipalities as block grants for financing the transferred competences, as well as earmarked grants for financing the operating costs in local public institutions. In addition, Denar 764 million was transferred on the basis of VAT revenues. During this period, agricultural subsidies were paid on continuous basis and in a timely manner, aimed at improving the quality and the competitiveness of the sector. Denar 2,191 million was allocated for regular servicing of liabilities on the basis of interest, according to the repayment schedules on domestic and foreign borrowing. In the period January - April 2019, capital expenditures were executed in the amount of Denar 2,553 million.

During this period, central government budget deficit amounted to Denar 4,165 million, accounting for 0.6% of the GDP projected for 2019, i.e. around one fourth of the projected 2019 budget deficit. Inflows to the Budget provided for regular repayment of principal on the basis of incurred liabilities, amounting to Denar 5,164 million.

Table 2. 2019 Central Government Budget (Budget of the Republic of North Macedonia) and its Execution in the Period January - April 2019

	Execution January – April 2018	Budget 2019	Execution January – April 2019	Execution January – April 2019 / Budget 2019	Execution Jan – April 2019 / Jan – April 2018
	denar million			%	
Total revenues	60,453	210,848	63,926	30.3%	5.7%
Tax revenues and contributions	54,412	184,201	56,680	30.8%	4.2%
Tax revenues	36,660	121,885	37,169	30.5%	1.4%
Personal income tax	4,939	19,083	5,638	29.5%	14.2%
Corporate income tax	5,976	15,301	4,818	31.5%	-19.4%
VAT (net)	15,607	52,136	16,977	32.6%	8.8%
Excises	7,586	27,280	7,182	26.3%	-5.3%
Import duties	1,909	5,816	1,961	33.7%	2.7%
Other	643	2,269	593	26.1%	-7.8%
Social contributions	17,752	62,316	19,511	31.3%	9.9%
Non-tax revenues	4,102	18,521	5,478	29.6%	33.5%
Capital revenues	689	2,026	292	14.4%	-57.6%
Donations	1,250	6,100	1,476	24.2%	18.1%
Total expenditures	62,995	228,548	68,091	29.8%	8.1%
Current expenditures	60,360	202,577	65,538	32.4%	8.6%
Wages and allowances	8,703	28,388	9,004	31.7%	3.5%
Goods and services	4,875	19,643	5,204	26.5%	6.7%
Transfers to LGUs	5,990	19,119	6,260	32.7%	4.5%
Subsidies and transfers	6,712	18,568	7,551	40.7%	12.5%
Social transfers	32,411	107,679	35,328	32.8%	9.0%
Interests	1,669	9,180	2,191	23.9%	31.3%
Capital expenditures	2,635	25,971	2,553	9.8%	-3.1%
Deficit	-2,542	-17,700	-4,165	23.5%	63.8%
Deficit (% of GDP)	-0.4	-2.5	-0.6		
Primary deficit (% of GDP)	-0.1	-1.2	-0.3		
Deficit financing	2,542	17,700	4,165		
Inflows	22,568	34,195	9,329		
Domestic sources	8,397	19,004	4,238		
External sources	31,184	25,516	305		
Deposits (“-“ is accumulation on the account)	-17,013	-10,325	4,786		
Outflows	20,026	16,495	5,164		
Repayment upon domestic borrowing	6,654	10,320	3,653		
Repayment upon foreign borrowing	13,372	6,175	1,511		

Source: Ministry of Finance

2.1.2 Medium-Term Framework of the Central Government Budget (Budget of the Republic of North Macedonia) for 2020-2022

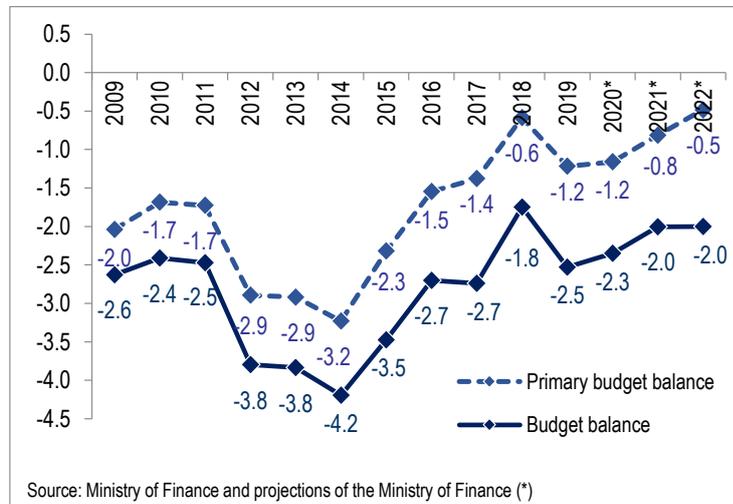
Fiscal policy in the period 2020 - 2022 features strengthened public finance and fiscal sustainability management, contributes to maintaining macroeconomic stability, further fiscal consolidation, i.e. low budget deficit (Table 3).

Medium-term priorities will focus on increasing the competitiveness of the economy and the employment, creating a favourable business climate, supporting and developing SMEs, improving social safety and protection, developing innovation activity, as well as underpinning the economy with significant investments in infrastructure projects.

Medium-Term Fiscal Strategy sets budget expenditure ceilings, both total ceilings and ceilings by budget user (Appendix 1). Related to this, the annual growth rate of total budget expenditures of the central government

(Budget of the Republic of North Macedonia) will gradually drop from 14.2% in 2019 to 5.2% in 2022. Coupled with the expected revenue collection, this will result in gradual narrowing of the overall budget deficit from 2.5% of GDP in 2019 to 2.3% in 2020, and to 2% of GDP in 2021 and 2022 each. It is important to point out that budget deficit ceilings are kept at the same level as in the 2019 - 2021 Fiscal Strategy. Primary budget deficit will also drop from 1.2% of GDP in 2019, being kept at 1.2% in 2020, and further to 0.8% and 0.5% respectively in 2021 and 2022. (Figure 9).

Figure 9. Overall and Primary Budget Deficit (% of GDP)



Total genuine revenues of the Budget of the Republic of North Macedonia (central government budget and funds) for the period 2019-2022 are projected to around 29% of GDP. Revenue projections in the coming medium-term period are based upon the revenues collected in the previous years and the effects from the tax and pension reforms.

Main objective of the tax policy is to ensure sustainable economic growth and development, thereby providing for legal safety of taxpayers and collection of tax revenues on regular basis. The main priorities are the following: fair taxation, reduction of inequality in the society, improving the quality of public services the citizens use, as well as improving the environment.

From the point of view of the planned reforms, it is important to point out the reforms for refunding part of the values added tax (VAT) to natural persons. In fact, natural persons, by collecting the fiscal bills and reporting them to the tax authority, will be entitled to refund of part of the VAT, i.e. 15% of the tax shown on the bills. This measure will ensure additional income to each household, strengthen the purchasing power and have positive effects on increased consumption and VAT collection, as well as reduce tax evasion and grey economy.

At the same time, as regards VAT, and to the end of improving the environment, it is planned for VAT rate on heat energy to be reduced from 18% to 5%.

The new draft Excise Law simplifies and improves the manner of reporting excise duty for small producers of alcohol, and strengthens the capacity to administer excise duties on excise goods by introducing the excise movement and control system. Taxation of motor vehicles will be carried out on the basis of the new Motor Vehicles Tax Law which, in addition to the basic tax parameter, also envisages introduction of an environment pollution indicator, which will contribute to improvement of environment quality.

As regards direct taxes, certain changes are made, aimed at equitable calculation of the tax base at profit tax, thus complying with the international tax practice.

The process of strengthening the capacities of the Public Revenue Office and the Customs Administration to implement the legal provisions is carried out in parallel with the process of the previously mentioned legal provisions.

Tax revenues account for 57.9% of the projected revenues, followed by revenues on the basis of social contributions accounting for 30.5%, non-tax revenues and capital revenues accounting for 8.7%, while the rest of the revenues are expected to be generated from IPA Funds and other donations. With respect to tax revenues, most revenues will be generated on the basis of VAT, personal income tax and excises.

According to the amendments to the legal regulations applied from the beginning of 2019 and the policy on stabilizing the pension system by ensuring its sustainability, 2020 projections include the increase of social

contribution rates (pension and disability insurance contribution rate increased by 0.4 percentage points and health insurance contribution rate increased by 0.1 percentage point). Positive effects from the increased contributions to the budgets of the respective funds amount to around Denar 1.1 billion.

Non-tax revenues in the next medium-term period account for around 7.8% of the total revenues, mostly reflecting revenues on the basis of administrative fees and other non-tax revenues, which the budget users generate on their own accounts.

In the coming period, budget revenue projections with regard to foreign donations include the donations the budget users will realize for specific projects, as well as disbursements from the EU pre-accession funds.

Table 3. 2018 - 2022 Central Government Budget (Budget of the Republic of North Macedonia (Denar million))

	Actual 2018	Budget 2019	2020*	2021*	2022*
Total revenues	188,513	210,848	219,720	228,688	240,271
Tax revenues and contributions	170,991	184,201	192,806	203,407	215,277
Tax revenues	114,456	121,885	126,179	132,782	140,415
Contributions	56,535	62,316	66,627	70,625	74,862
Non-tax revenues	12,271	18,521	18,088	16,555	16,268
Capital revenues	2,197	2,026	2,226	2,226	2,226
Donations	3,054	6,100	6,600	6,500	6,500
Total expenditures	200,070	228,548	237,265	244,792	257,503
Current expenditures	187,923	202,577	211,259	215,986	225,089
Wages and allowances	26,355	28,388	29,370	29,370	29,370
Goods and services	14,554	19,643	19,856	19,555	19,855
Transfers to LGUs	18,057	19,119	20,068	20,696	21,434
Subsidies and transfers	20,542	18,568	21,755	21,755	21,749
Social transfers	100,723	107,679	111,328	115,048	119,633
Interest payments	7,692	9,180	8,882	9,562	13,048
Domestic	2,820	3,055	2,857	3,217	5,966
Foreign	4,872	6,125	6,025	6,345	7,082
Capital expenditures	12,147	25,971	26,006	28,806	32,414
Budget balance	-11,557	-17,700	-17,545	-16,105	-17,231
Primary budget balance	-3,865	-8,520	-8,663	-6,543	-4,183
Total revenues, % of GDP**	28.5	30.1	29.4	28.5	27.9
Total expenditures, % of GDP**	30.3	32.7	31.8	30.5	29.9
Budget balance, % of GDP**	-1.8	-2.5	-2.3	-2.0	-2.0
Primary budget balance, % of GDP**	-0.6	-1.2	-1.2	-0.8	-0.5

Source: Ministry of Finance and projections of the Ministry of Finance (*)

** Shares to GDP for 2019 are calculated using the new GDP projection from this Fiscal Strategy

Expenditure side of the central government budget (Budget of the Republic of North Macedonia) in the next period is fully aimed at achieving the strategic priorities of the Government of the Republic of North Macedonia, i.e. accelerating the economic growth and the EU and NATO integration processes. Average share of expenditures in the central government budget in the period 2019-2022 is around 31.2% of GDP. Expenditure projections in the Budget for the next medium-term period are prepared on the basis of three key foundations:

- harmonization of the revenue projections with the planned economic activities;
- total budget expenditure projections ensure continuous fiscal consolidation, and
- projected expenditures provide for regular and smooth fulfilment of all legal obligations.

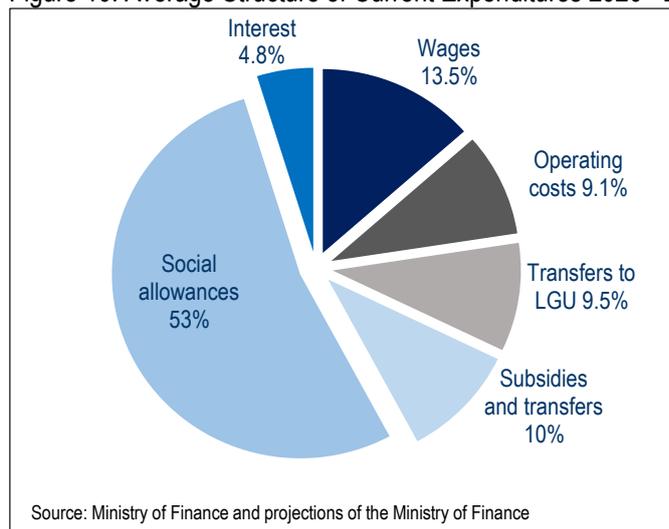
In addition to the ceilings on the total expenditures mentioned above, medium-term perspective in the budget process imposes the setting of maximum amounts of expenditures (expenditure ceilings) by budget user. Although expenditure projections give aggregate information for the coming years, setting the expenditure ceilings in line with the existing practice in the countries with successful public finance reforms means setting

spending limits for the coming years. Therefore, taking into account the legal provisions, expenditure ceilings for the period 2020 - 2022 are presented as appendix to the Fiscal Strategy, in particular by budget user: expenditures from the core budget and expenditures financed under loans from international financial institutions and bilateral creditors (Appendix 1).

When projecting the amount and the structure of the current expenditures for the next period (Figure 10), allocated for regular payment of wages to public sector employees, timely and regular payment of pensions, guaranteed minimum income and other social benefits, payment of agricultural subsidies, support to SMEs, as well as subsidies for innovation activities, following assumptions were taken into account:

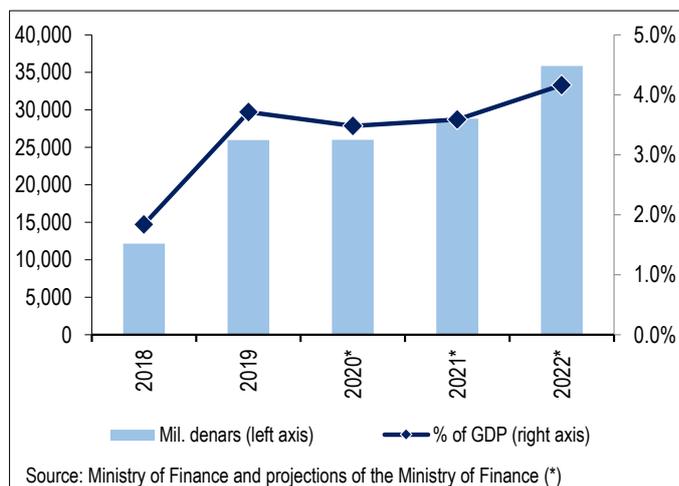
- as regards expenditures related to wages and allowances, 2020 projections reflect the effects from the 5% wage increase for the employees at the budget users in the last quarter in 2019, continuation of the strict control over new employments and gradual increase of wages in certain sectors in line with the fiscal possibilities;
- timely payment of pensions and social benefits, for the purpose of improving the well-being of the beneficiaries of these rights. Complete reform as regards the social protection system by introducing guaranteed minimum income is aimed at re-designing the types, the adequacy and the targeting of social assistance, to the end of supporting the most vulnerable categories, as well as ensuring social safety for the elderly.
- the effect from the refund of part of VAT to natural persons, as part of the tax reform, is also included.
- implementing the active employment policies and measures, which will be aimed at creating employment programs, measures and services to be carried out for the purpose of improving the functioning of the labour market, supporting job creation, as well as employing young persons - youth guarantee.
- ensuring substantial amounts of agricultural subsidies, to the end of strengthening and supporting this sector, boosting the export of Macedonian agricultural products and conquering new markets;
- stimulating the economic growth and development in the Republic of North Macedonia, by enhancing the competitiveness of the private sector via measures for new investments, measures to support the export and conquer new markets, support to job creation, SMEs, innovation activity, technological development and research, as well as encouraging foreign and domestic investments.

Figure 10. Average Structure of Current Expenditures 2020 - 2022 (%)



In the coming medium-term period, fiscal policy remains focused on ensuring substantial public investments, which are a precondition for improvement of economic perspectives, as well as better life of the citizens. Related to this, a significant amount of capital investments is projected (Figure 11) by using budget funds, including funds under loans extended from international financial institutions and bilateral creditors. Projected amounts reflect the 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.

Figure 11. Capital Expenditures of the Central Government Budget (Budget of the Republic of North Macedonia)



In addition to the Budget, substantial investments in road infrastructure are ongoing through the Public Enterprise for State Roads, such as: "Road Upgrading and Development Project (Kriva Palanka - Rankovce)", financed with a loan from the World Bank. At the same time, construction of Kicevo-Ohrid Highway, financed with loans from Export - Import Bank of China is ongoing. Activities envisaged under the National Roads Programme, funded with EBRD loan, will be intensified in the coming period, envisaging construction of road sections Stip – Kocani and Raec – Drenovo, as well as reconstruction and rehabilitation of 26 road sections in the Republic of North Macedonia, total length of which is around 400 km."Stip – Radovis Road Section Project", also funded with an EBRD loan, is in the process of realization. In the coming medium-term period, construction of Skopje-Blace highway section is expected to start, which will provide for positive effects on the economic, social and environmental aspects in the region and easier international transportation and trade in the region, particularly between the Republic of North Macedonia and the Republic of Kosovo. As regards rehabilitation and reconstruction of local roads in the country, "Local Roads Construction and Rehabilitation Project", which will be financed with a World Bank loan, will be launched this year.

As for the railway infrastructure, focus will be placed on completion of the implementation of the "Project for Improvement of the Railway Corridor X", as well as intensification of the activities within the "Project for Completion of Rail Corridor VIII", being aimed at connecting the Black Sea with the Adriatic Sea, which underlines the high strategic and economic significance of this Project.

Construction of the eastern part of Rail Corridor VIII, i.e. the part towards the Republic of Bulgaria, is carried out in 3 phases. Realisation of the first phase (Kumanovo - Beljakovce section), 30.8 km long, and second phase (Beljakovce - Kriva Palanka section), 34 km long, financed with EBRD loans and WBIF grant funds, will be intensified within the envisaged period. In addition to the WBIF grant funds for technical assistance to the Project, WBIF investment grant in the amount of EUR 68.6 million for financing the second phase has been secured. Preparation of the third phase (Kriva Palanka – Deve Bair section, border towards the Republic of Bulgaria), covering 23.4 km, financed with IPA grants, is completed, and the construction will be financed with loans from the European Investment Bank (EIB) and EBRD and grant funds within the national IPA. In parallel to the investments in railway infrastructure, implementation of the "Macedonian Railways Fleet Renewal Project", financed with EBRD loan in the amount of EUR 50 million, will continue.

As regards the transport infrastructure, significant project activities will be financed with a loan under the World Bank regional initiative "Western Balkans Trade and Transport Facilitation Project", aimed at promoting deeper economic integration within the region, reducing the trade costs and enhancing the transport efficiency in the Republic of North Macedonia.

By implementing the "Project for Construction of Gas Pipeline System in the Republic of North Macedonia", business sector, public sector and households will be provided supply with cheap and environmentally friendly energy, at the same time reducing the emission of harmful gases. Construction of the sections of the national gasification system Stip - Negotino – Bitola and Skopje – Tetovo – Gostivar, which is ongoing, is financed with a loan from Deutsche Bank and Erste Group Bank. In the coming period, the Government will focus on the realization of the new "Project on Interconnection Gas Pipeline between the Republic of North Macedonia and the Republic of Greece", which will be financed with EIB loan.

Implementation of the “Municipal Services Improvement Project”, financially supported by the World Bank, will continue in the coming period. World Bank loan proceeds are intended for financing infrastructure investment projects in the field of water supply and wastewater drainage, management of solid waste and other investments in municipal services, which have potential for generating revenues, i.e. making savings, or are of high priority for the municipalities.

Implementation of the “North Macedonia Public Sector Energy Efficiency Project”, to be financed with a World Bank loan, will commence in the next medium-term period. It will cover energy efficiency measures to be implemented by the municipalities in the Republic of North Macedonia.

In order to improve the conditions and the quality of life, especially in the rural areas in the country, by supplying clean potable water, “Water Supply and Waste Water Collection Project”, financed with EIB loan, will continue to be implemented in the coming period. The Government disburses these funds in the form of grants to municipalities, which significantly contributes to improving the living conditions of the citizens. At the same time, in order to respond to the needs and the demands of the municipalities in the Republic of North Macedonia for investments in utility infrastructure, the Government plans to secure a loan from EIB for additional financing for this Project.

Construction of the Regional Clinical Hospital in Stip, financed with a loan from the Council of Europe Development Bank (CEB), will continue in the coming period, while the Government undertakes activities for ensuring loans so as to commence the construction of a new Clinical Centre in Skopje.

As regards education, implementation of the “Project for Building Physical Education Facilities in Secondary Schools”, financed with CEB loan and contribution of the Republic of Macedonia, is expected to be completed in the coming period. The Project covers construction and procurement of the necessary equipment for 30 physical education facilities in secondary schools in different municipalities in the country, as well as reconstruction of several secondary schools. In addition, implementation of the “Project for Building Physical Education Facilities in Primary Schools and Rehabilitation of Primary and Secondary Schools”, financed with CEB loan and contribution of the Republic of North Macedonia, will continue, 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 quality of higher education, enhancing the vocational education, as well as allocating public financial support to stimulate the development of skills and innovation capacity of the Macedonian companies, implementation of “Skills Development and Innovation Support Project”, financed with a World Bank loan, will continue in 2019.

Technical documentation will commence to be prepared in the field of education, on the basis of which “Energy Efficiency Rehabilitation Programme Student Dormitories”, to be funded with a KfW loan, will be implemented.

Implementation of the second and the third phases of the “Zletovica Water Basin Utilisation Improvement Project” is planned to commence with a support by EIB. Main objective of the second phase is provision of irrigation for 4,570 ha net area in the region of Probistip and Kratovo municipalities. Implementation of the third phase, which includes construction of small hydro power plants along the flow of Zletovica River, will provide for reducing electricity shortage in the region, safe, secure and quality supply of energy for the consumers and increased energy efficiency.

Second phase of the “Irrigation Programme Southern Vardar Valley”, which will continue in 2019 as well, will be financed with KfW loan. EUR 4 million is provided for this Project as a grant from the German Federal Republic through KfW, aimed at supporting the envisaged investment activities, i.e. rehabilitation and modernisation of the irrigation systems in Valandovo region. At the same time, implementation of the third phase of this Project will commence, as well as the implementation of Lisice Hydro System - irrigation phase and electricity generation phase, which will be funded with loans from KfW.

First phase of the “Water and Sewerage Programme Macedonia”, financed with KfW loan and SECO grant funds, is expected to be completed in the coming period, providing for sustainable supply of potable water to the population in the municipalities of Gostivar, Kavadarci and Radovis. At the same time, it is expected for the second phase of this Project to commence. This phase will be financed with grant funds in the amount of EUR 5 million, awarded by the German Federal Republic through KfW, for investment activities in the municipalities of Gevgelija and Kavadarci.

“Agriculture Modernization Project” will be prepared and implemented with the support of the World Bank, which will include establishment of agriculture purchasing and distribution centers, as well as construction of system for processing of waste of animal origin.

An important priority which the Government of the Republic of North Macedonia will focus on is the preparation and the implementation of the “Project for Construction of Waste Water Treatment Plant in the City of

Skopje”, which will be finance with loans from EIB and EBRD, as well as an investment grant within the ERI instrument.

In the area of environment, activities are being undertaken for preparation and implementation of projects on establishment of integrated regional waste management systems in the Southeast, Southwest, Vardar and Pelagonija regions. These activities are of great significance, since they are aimed at construction of landfills, procurement of equipment for collection of solid waste, construction works for closure of uncontrolled dumpsites, as well as technical assistance for strengthening the capacities of public utility enterprises.

First segment of the “Project for Reconstruction of Houses of Correction” is expected to be completed in the coming period, i.e. in addition to Kumanovo Prison and the first phase of HC Idrizovo, which are put into operation, activities in the ECH for minors in Tetovo should also be completed. Preparation of project documentation for the second segment of the Project, i.e. phases 2 and 3 of HC Idrizovo, is ongoing. The Project is financed with a loan from CEB and it contributes a lot to establishing professionally and efficiently organized and managed houses of correction, which continuously ensure re-socialization and integration of the citizens in the society.

One of the important elements in the social development policy is to increase the quality of life of low-income persons and vulnerable groups by providing for their appropriate housing. Government activities and measures as regards social policy are also supported under the “Project for Housing of Vulnerable Groups”, funded with a CEB loan, encompassing construction of flats for low-income persons. Within this sector, Government of the Republic of North Macedonia implements, in cooperation with the World Bank, a new project to include implementation of reforms in the social protection area, as well as investment activities aimed at improving the social infrastructure, i.e. reconstruction and construction of early childhood development centers.

In order to provide fresh capital for small- and medium-sized enterprises, as well as support for new projects, job creation, increased liquidity of the economy and higher exports, implementation of the fifth EIB credit line for financing small- and medium-sized enterprises, in the amount of EUR 100 million, is ongoing.

2.1.3 Central Government Budget Deficit and Its Financing

During the 2020-2022 period, budget deficit is projected as follows: Denar 17.5 billion in 2020, Denar 16.1 billion in 2021 and Denar 17.3 billion in 2022. This means that gradual fiscal consolidation is projected in this medium-term period, i.e. share of budget deficit in GDP will decrease from 2.3% in 2020 to 2% in 2021 and 2021.

Financing of the projected deficit, as well as debt repayments, will be provided from domestic and foreign borrowing (Table 4). Borrowing abroad may be realised on the basis of favourable loans guaranteed by international financial institutions, disbursements of funds under favourable loans and credit lines intended for financing certain projects, as well as issuance of Eurobond on the international capital market. Related to this, the choice of a specific external financing source will be based on the ongoing and the expected developments on the international capital market. Furthermore, borrowing on the domestic government securities market will provide for additional financing under favourable terms and conditions, by using the relatively low interest rates and the high level of interest of investors on the domestic government securities market. For the purpose of optimising the payments and reducing the refinancing risk, the main commitment of the Ministry of Finance will be to lengthen the maturity of issued securities, by issuing government bonds with longer maturities. To that end, and for the purpose of efficient public debt management, Ministry of Finance will also take into account the possibility for early repayment of part of the debt, i.e. achieving more favourable debt maturity, currency and interest structure.

Table 4. Deficit and Sources for Its Financing (Denar million)

	Actual 2018	Budget 2019	2020*	2021*	2022*
Budget balance	-11,557	-17,700	-17,545	-16,105	-17,231
Deficit financing	11,557	17,700	17,545	16,105	17,231
Inflows	39,697	34,195	55,063	66,984	31,743
Domestic sources	16,556	19,004	15,819	20,037	16,793
Foreign sources	32,843	25,516	36,491	35,100	12,700
Deposits ("-" is accumulation on the account)	-9,702	-10,325	2,753	11,847	2,250
Outflows	28,140	16,495	37,518	50,879	14,512
Repayment upon domestic borrowing	12,212	10,320	8,122	11,225	7,997
Repayment upon foreign borrowing	15,928	6,175	29,396	39,654	6,515
Memorandum:					
Net domestic borrowing	4,344	8,684	7,697	8,812	8,796
Net foreign borrowing	16,915	19,341	7,095	-4,554	6,185

Source: Ministry of Finance and projections of the Ministry of Finance (*)

2.2 Local Government Budget

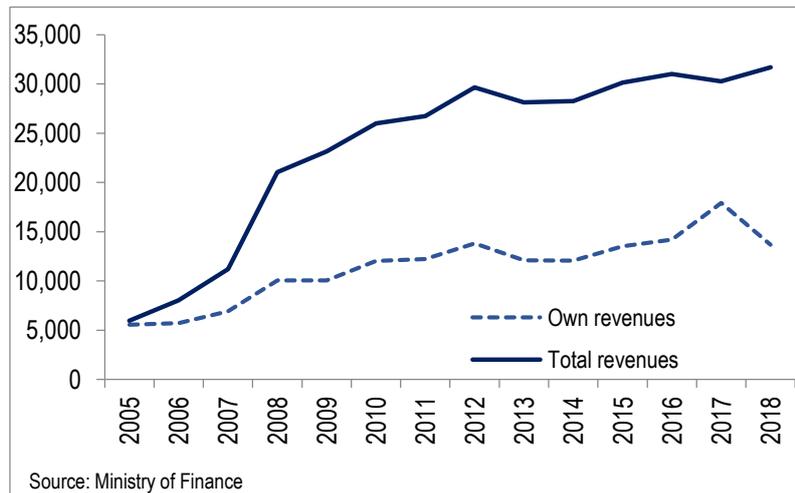
Decentralization of the competences to local government and strengthening its capacity is one of the priorities arising from the Accession Partnership of the Republic of North Macedonia with the EU and the Framework Agreement. Since 2012, all municipalities (except for Plasnica) finance the transferred competence with block grants, when the phased approach ended for transferring and managing the operating and financial resources for the transferred powers in the field of education, culture, child care and social protection.

Powers in several sectors assumed by the municipalities increased both the administrative and the fiscal capacities and strengthened the capacities for managing larger amount of funds. Successful administration and collection of own revenues contributes to the process of increased own revenues of municipalities and the strengthened capacities for fund management, performance of the transferred powers and management of financial and other resources necessary for their realisation. In addition, municipalities successfully administer new powers related to managing construction land, dealing with illegally built facilities with respective revenue collection. Successful implementation of fiscal decentralisation, with fully established legal and institutional framework for local government, provides for developed, responsible and functional local government units and level of local democracy, bringing the citizens closer to the local government institutions. Progress in achieving the decentralisation-related goals is assessed as successful by many international institutions, which assisted with several projects towards improvements in the public financial management system, control, transparency and coordination in managing local government reforms.

At the same time, access to the capital market has been easier, under more liberal and transparent requirements for borrowing, by which, interest of the municipalities for financing investment projects on the basis of borrowing increased. To that end, the Government has provided credit lines from international financial institutions (World Bank, EIB, KfW and EBRD), which have provided for substantial investments, especially in: reconstruction and rehabilitation of local streets, roads and bridges, construction and reconstruction of water supply and atmospheric water networks, improvement of public hygiene and increasing energy efficiency in municipal public facilities and local spatial landscaping.

As regards the level of decentralisation, Republic of North Macedonia, according to the data on 2018 expenditure execution (around 4.6% of GDP), belongs to the group of countries with medium decentralisation. Compared to 2005, when the process of transferring the powers and fiscal decentralization commenced, today, municipal revenues have increased by more than five times (Denar 5.9 billion in 2005, more than Denar 31 billion in 2018). Tax revenues, which the municipalities are authorised to collect, have increased by more than twice during the same period (Figure 12).

Figure 12. Own and Total Revenues in the period 2005 - 2018 (Denar million)



Municipalities in the Republic of North Macedonia are financed from own sources of revenues, grants from the central government budget (Budget of the Republic of North Macedonia) for the competences transferred in the field of education, culture, social protection and fire fighting, revenues determined in separate laws, tax revenues collected at central level, transfers from the state Budget and other institutions, revenues collected on the basis of grants, loans and other revenues.

Own revenues of the municipalities are local taxes (tax on real estate, inheritance and gift tax, tax on sales of real estate), local fees prescribed by law (utility fees, administrative fees and other fees stipulated by law), local fees (fee for landscaping of construction land, fees for utility activities, fees for spatial and urban plans), revenues on the basis of ownership and other revenues stipulated by law. Municipalities also receive transferred revenues in the amount of 3% of the collected PIT on the basis of personal earnings from salaries of individuals with a permanent address in the respective municipality and 100% of the PIT collected from individuals engaged in craftsmanship activity, registered in the area of the municipality.

Additional revenues are also transferred as grants from the Budget of the Republic of North Macedonia as follows: revenues on the basis of VAT grants (4.5% of collected VAT in the previous fiscal year), earmarked and block grants for the transferred powers in the field of education, culture, social protection and fire fighting, and capital grants. Funds from these grants are distributed on the basis of criteria determined in decrees adopted by the Government of the Republic of North Macedonia.

In order to strengthen the fiscal capacity of the local government units, the servicing of the debts and the settlement of the unpaid obligations towards the business sector, in November 2018 the Parliament adopted the Law on Financial Support to Local Government Units and Spending Units Established by Local Government Units for Financing of Unpaid Obligations that Are Due for Payment. The Law provided for financial support for the local government units and spending units established by the local government units, for the purpose of servicing some of the reported unpaid obligations that are due for payment in the Electronic System for Reporting and Recording of Obligations, as of September 2018 inclusive.

In order to implement this law, according to the Modifications and amendments to the Budget of the Republic of North Macedonia for 2018 (supplement budget), funds amounting to Denar 3,032 million were provided, and transferred to the special accounts of the municipalities in November 2018. With these funds allocated as financial support, it is planned for the municipalities and the spending units to settle 51% of their total unpaid obligations that are due for payment reported as of September 2018 inclusive. As of April 2019, 48 municipalities have used these funds in the amount of Denar 1,475 million or 48.6% of the allocated funds. The funds allocated to the local government units as a financial support pursuant to law are strictly earmarked and non-repayable.

Unreal projecting of the budgets of the local government units, i.e. the too optimistic projecting of revenues is one of the reasons due to which the local government units accrued unpaid obligations in the previous years. In order to overcome this situation, under the amendments to the Law on Financing the Local Government Units as of November 2018, fiscal rule has been set out for planning the own revenues of the core budget of local government units, i.e. the planning of own revenues of the core municipal budget is limited with the performance of the collected revenues. According to the amendments to the Law, the own revenues of the

municipal core budget in the future will be projected with an increase of maximum 10% of average collected revenues in the last three years, according to the data from the Treasury records. At the same time, exceptions have been envisaged only if the municipality has provided confirmation of a transfer of funds from a respective institution. Consequently, with the proposed legal solutions, the revenues of the 2019 municipal budgets are planned in a significantly more realistically, thus also improving the fiscal position of the municipalities.

2.2.1 Revenue Performance and Expenditure Execution in the Period January – April 2019

Revenue collection and inflows in the budgets of local government units in this period were within the expectations, i.e. total revenues in the period January - April 2019 were collected in the amount of Denar 10,740 million and they slightly grew by 0.5% compared to the same period last year. Denar 2,663 million out of this amount was tax revenues, being lower by 1.7% more compared to last year. Revenues collected on the basis of property taxes in this period of 2019 amounted to Denar 958.7 million, being a decrease of 6.5%. As regards income taxes, 11.7% increase was recorded, while the revenues on the basis of utility fees were at almost the same level, increasing by 1%, while fees for usage or licenses for performing an activity experienced significant growth of 38.2%.

During the analyzed period this year, non-tax revenues were collected in the amount of Denar 541 million and, when compared to the same period in 2018, they were higher by 24.9%, i.e. by around Denar 108 million. With respect to non-tax revenues, inflows on the basis of fees and charges (61.9%) predominated, amounting to Denar 335.5 million, being at the same level as in the previous year. The other non-tax revenues participate with 31.9% or Denar 173 million, whereby significant 170.5% increase was registered.

In the period January - April 2019, capital revenues were collected in the amount of Denar 543 million, being significantly lower by 40.8% compared to those collected in the previous year. As for capital revenues, revenues collected on the basis of sale of land and intangible investments predominated on the whole. In the analyzed period of 2019, revenues collected on the basis of grants amounted to Denar 5,495 million, experienced an annual increase of 4.6%. Revenues collected on the basis of transfers in the period January – April 2019 amounted to Denar 945.6 million, being by 14.2% less compared to the revenues collected in the analyzed period last year. In the period January – April 2019, revenues collected on the basis of donations amounted to Denar 314.7 million, i.e. they higher by 15.5% compared to last year. During the same period, revenues on the basis of loans were collected in the amount of Denar 177.9 million, i.e. they increased by 77% compared to the same period last year. During this period, revenues on the basis of sale of securities were also collected, amounting to Denar 60 million.

In the period January – April 2019, expenditures were executed in the amount of Denar 11.335 million, i.e. execution was higher by 21.1% in relation to the same period last year. These expenditures provided for regular settling of liabilities arising from the transferred powers to the municipalities, necessary for their ongoing operations, implementation of capital projects and principal repayment for the previously taken loans.

Expenditures related to wages and allowances accounted for the most of the expenditures with 46.2%, i.e. Denar 5,242 million. Most of the wages, i.e. 85.2% or Denar 4,468 million was intended for the employees in the institutions at local level, such as primary and secondary education, culture, kindergartens and old people's homes and fire fighting, financed with 9% with block grants. Expenditures related to goods and services amounted to Denar 2,858 million, accounting for 25.2% of total expenditures. Capital expenditures accounted for 20.2%, amounting to Denar 2,288 million, being mostly financed, i.e. 81.6% with municipal own funds, while 9.4% was funds on the basis of donations and 7.3% was funds on the basis of loans. Expenditures related to subsidies and transfers amounted to Denar 682 million, accounting for 6%, while principal repayment amounted to Denar 233 million, i.e. 2.1% of total expenditures. Expenditures executed on the basis of reserves, social benefits and interest payments accounted for around 0.3%.

2.2.2 Medium-Term Framework of Local Government Budget

In the course of 2019, as well as in the medium run, municipalities are expected to continue the trend of improved collection of own revenues, strengthening the capacities for development of policies for financing the municipalities and enhancing the capacities for financial management. For the purpose of realising the strategic commitments, strong commitment to encouraging sustainable local development, good local governance and creating conditions for more active, more effective and more innovative role of the local authorities in implementing national objectives for growth and development will continue in the next period as well.

Stable revenues are allocated to the municipalities from the central government budget (Budget of the Republic of North Macedonia) on the basis of the VAT grant (general grant), in the amount of 4.5% of VAT collected in the previous year. As regards the grants for transferred powers, criteria for distribution of funds allocated for the transferred powers in the field of primary and secondary education, culture, child care and protection of elderly people and fire fighting will be defined in the following period. Therefore, the Government has established an inter-ministerial working group, which is to prepare a detailed analysis on the situation in these areas in which block and earmarked grants are transferred, redefining the manner and the determining of the distribution criteria.

New revenues are provided by allocating funds from lease of state-owned agricultural land to the municipalities, the proportion of which is 50% for the Budget of the Republic of North Macedonia and 50% for the municipalities and the municipalities in the City of Skopje, to be distributed from 2018, depending on the location of the agricultural land under lease, provided that collection of revenues on the basis of tax on real estate exceeds 80% in relation to the ones projected in the previous year. Municipalities also have higher revenues from the fee collected by issuing concession for usage of water resources for electricity generation (50% for the central government budget and 50% for the local authorities), depending on which area the concession activity is performed.

Increased own revenues of the municipalities, in particular revenues collected on the basis of taxes on real estate, as a result of better inclusion of the real estate of natural persons and legal entities and re-assessment of the value of real estate, will continue in the next medium-term period. At the same time, part of the municipalities generate higher revenues on the basis of property taxes as a result of the higher rate of calculation and collection of property tax within the margin set by to the Law on Property Taxes. Higher revenues are also expected by applying the improved elements of calculation in the Methodology on Determining Market Value of Real Estate, as well as the improved quality of the assessment of the value of real estate with the legal possibility to employ an expert – an evaluator or to use the services of licensed evaluators.

In the coming period, higher revenues are expected to be generated by determining the real market value of the real estate after completing the procedure related to illegally built facilities on construction and agricultural land. Further on, municipalities will continue performing the transferred competences for management of construction land and treatment of illegally built facilities and agricultural land, the respective sources of revenues therefore being determined in the municipal budget.

Government of the Republic of North Macedonia will continue to carry out the activities aimed at equal regional development and enhancement of all regions in the country in the next period as well. Implementation of the 2009-2019 Strategy for Equal Regional Development of the Republic of North Macedonia in the eight planning regions (Vardar, East, Southwest, Southeast, Pelagonija, Polog, Northeast and Skopje regions), by better vertical and horizontal coordination of both the national and the local policies and the integrated development projects adjusted to the local needs and conditions, will provide for more balanced local development throughout the country. The Council for Equal Regional Development will continue to play a significant role as promoter of partnership between the regions/the municipalities and the Government, and within it the usage of funds will be coordinated from all sectoral programmes intended for the planning regions and the municipalities. Special efforts will be put in supporting the municipalities by encouraging the local development via supporting the local projects and harmonizing them with the national ones.

The 2015 - 2020 Programme on Sustainable Local Development and Decentralisation in the Republic of North Macedonia, as well as the 2018 - 2020 Action Plan have been revised envisaging specific activities and projects to be implemented by the relevant institutions.

In the course of March 2019, Working Sectoral Group for Regional and Local Development was established, being obliged to carry out tasks at expert level, related to the formulating and implementation of the national sectoral policies, including those related to the EU integration and the donors' aid generally, as well as the IPA Program.

Implementation of a series of infrastructure projects related to the improvement of the quality of life will accordingly improve the regional development and the active integration in the economy. Related to this, projects will be implemented aimed at improving the overall road infrastructure, bridges, local streets and roads, utility infrastructure (water supply, sewage systems, wastewater treatment station collectors, pedestrian crossings, horticulture landscaping, public hygiene), as well as improving the infrastructure of villages through urbanisation, connection of inhabited areas and construction of local roads, pedestrian crossings and lighting, development and support of rural tourism and recreational centers.

As mentioned above, implementation of the "Municipal Services Improvement Project", financially supported by the World Bank, as well as of the "Water Supply and Waste Water Collection Project", financed with EIB (European Investment Bank) loan, will continue in the coming period.. At the same time, pursuant to the legal

regulations, in the coming period, municipalities that fulfil the legal criteria to borrow, will be able to finance their projects by borrowing on the basis of concluding loan agreements with domestic or foreign creditors or on the basis of issuing municipal bonds.

Table 5. Medium-Term Projection of Local Government Budget (denar million)

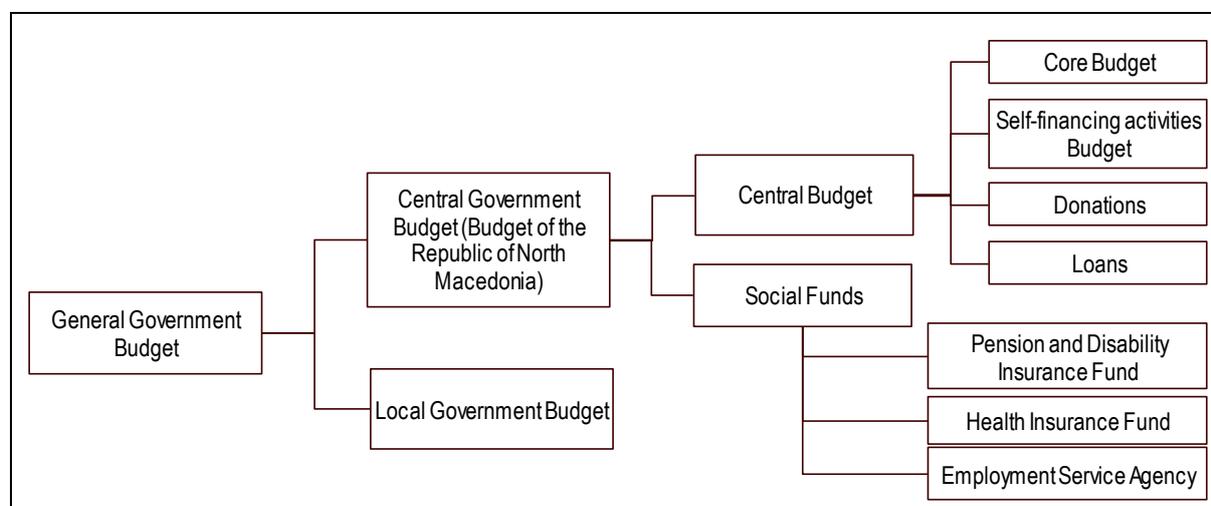
	Actual 2018	2019	2020*	2021*	2022*
Total revenues	34,384	36,314	37,273	37,801	38,539
Tax revenues	8,383	9,393	9,290	9,190	9,190
Non-tax revenues	1,467	1,721	1,815	1,815	1,815
Capital revenues	1,680	2,280	2,250	2,250	2,250
Transfers	22,004	22,120	23,068	23,696	24,434
Other transfers	3,628	2,701	2,700	2,700	2,700
Donations	850	800	850	850	850
Total expenditures	29,940	39,745	37,273	37,801	38,539
Wages and allowances	15,034	16,452	16,680	16,701	16,781
Goods and services	7,754	10,626	9,625	10,091	10,598
Interest payments	45	65	65	65	65
Subsidies and transfers	1,746	2,776	2,070	2,070	2,070
Social transfers	46	54	55	55	55
Capital expenditures	5,315	9,772	8,778	8,819	8,970
Balance	4,444	-3,431	0	0	0

Source: Projections of the Ministry of Finance (*)

2.3 General Government Budget (Consolidated central and local government budget)

The General Government Budget includes consolidated data of the central government budget (Budget of the Republic of North Macedonia) and the local government budget (budgets of the municipalities). The central government budget comprises the central budget (core budget, self-financing activities budget, donation funds and loan funds) and the budgets of the Pension Insurance Fund, the Health Insurance Fund and the Employment Agency (Figure 13).

Figure 13. Structure of the General Government Budget



In the following 3-year period, revenues projected in the General Government Budget will relatively decline as share of GDP, from 32.2% of GDP in 2019 to 29.6% in 2022 (Table 7). As a result of continuous disciplined budget policy and strengthened control over the public spending, total expenditures in the

consolidated budget will also experience a decline in the 2019 - 2022 period, from 35.2% in 2019 to 31.6% in 2022. Subsequently, and in line with the gradual fiscal consolidation, the General Government Budget deficit will reduce from 3% of GDP in 2019 to 2.3% of GDP in 2020, and further on to 2% of GDP in 2021 and 2022.

Table 6. General Government Budget

	Denar million					% of GDP				
	Actual 2018	2019	2020*	2021*	2022*	2018	2019	2020	2021	2022
Central Budget										
Revenues	108,245	124,255	128,195	132,517	139,101	16.4	17.8	17.2	16.5	16.1
Expenditures	120,009	141,576	145,337	148,619	156,330	18.2	20.2	19.5	18.5	18.1
Budget balance	-11,764	-17,321	-17,142	-16,102	-17,228	-1.8	-2.5	-2.3	-2.0	-2.0
Social Funds										
Revenues	58,583	64,773	68,757	72,775	77,036	8.9	9.3	9.2	9.1	8.9
Expenditures	58,376	65,152	69,160	72,777	77,039	8.8	9.3	9.3	9.1	8.9
Budget balance	206	-379	-403	-3	-3	0.0	-0.1	-0.1	0.0	0.0
Central Government (Budget of the Republic of North Macedonia)										
Revenues	166,828	189,028	196,952	205,292	216,137	25.3	27.0	26.4	25.6	25.1
Expenditures	178,385	206,728	214,497	221,396	233,369	27.0	29.5	28.7	27.6	27.1
Budget balance	-11,557	-17,700	-17,545	-16,105	-17,231	-1.8	-2.5	-2.3	-2.0	-2.0
Local Government Budget										
Revenues	34,384	36,314	37,273	37,801	38,539	5.2	5.2	5.0	4.7	4.5
Expenditures	29,940	39,745	37,273	37,801	38,539	4.5	5.7	5.0	4.7	4.5
Budget balance	4,444	-3,431	0	0	0	0.7	-0.5	0.0	0.0	0.0
General Government Budget (Consolidated Central and Local Government)										
Revenues	201,212	225,342	234,225	243,093	254,676	30.5	32.2	31.4	30.3	29.6
Expenditures	208,325	246,473	251,770	259,197	271,908	31.5	35.2	33.7	32.3	31.6
Budget balance	-7,113	-21,131	-17,545	-16,105	-17,231	-1.1	-3.0	-2.3	-2.0	-2.0

Source: Ministry of Finance and projections of the Ministry of Finance (*)

3. Other Aspects of the Improvement of Public Financial Management

3.1. 2018-2021 Public Financial Management Reform Program

Maintenance of the overall fiscal discipline on the medium run is one of the priorities in the projecting and budgeting process, which will result in: a) medium-term fiscal consolidation; b) distribution of resources based upon the programs and the included program indicators; and c) medium-term budget framework that serves as a reliable guidebook for the future distribution of the budget funds for each budget user.

Measures planned within the 2018-2021 Public Financial Management Reform Program (within the priorities for Improved Fiscal Framework, Projecting and Budgeting, Budget Execution and Transparent Government Reporting) are aimed at establishing fiscal rules and fiscal council, strengthening and upgrading the programme budgeting, providing improved information on the projects, continuation of the process of introducing comprehensive medium-term budget framework (MBF), establishing integrated public finance management IT system, as well as enhancing transparency.

Activities planned within the above-mentioned priorities and their successful implementation should be solidly based upon the new Law on Budgets. This law should provide for the framework which defines the public finance management system in North Macedonia.

The Ministry of Finance, in cooperation with foreign experts (from the IMF and the World Bank), in the past period, i.e. in the course of 2018, intensively worked on thorough and comprehensive determination of the areas for further improvement of the public finance management, preparation of the structure, the contents and the scope of the new Law on Budgets, as well as preparation of proposals for certain areas included in the Law (Medium-Term Fiscal Strategy, structure of the budget documents, organizational structure, registry of public sector entities, fiscal rules, enhancement of the transparency).

The activities during 2018 are based upon the draft law and the overall documentation (manuals and guidelines) prepared by experts engaged through the 2-year Twinning Project "Strengthening Medium-Term Budgeting for Effective Public Finance Management" (completed in November 2017), financed with IPA funds.

The new law, which is in the final preparatory stage, is in line with the improvements of the public finance management system, for the purpose of providing a framework for conducting sound, predictable and sustainable fiscal policy and increasing the budget discipline and responsibility. New mechanism of the law includes:

- establishment of fiscal rules and institutionalization of the Fiscal Council;
- publication of a registry of public sector entities;
- improvement of the medium-term fiscal strategy process, preparation of baseline scenario and new initiatives;
- enhancement of transparency (submitting data on public enterprises, local government units); and
- establishment of integrated public finance management IT system.

In the following period, the Ministry of Finance, in cooperation with the World Bank and the Government of the United Kingdom, as well as through sectoral budget support from the EU, will continue to work on preparing by-laws, instructions, manuals, etc., aimed at operationalizing the new Law on Budgets, further improvement of the PFM system, developing a detailed plan for all working process in the Ministry of Finance and their mapping, as well as preparation of detailed technical specification for integrated public finance management IT system.

3.2. Report on the Recorded Obligations pursuant to the Law on Reporting and Recording the Obligations

In 2018, Law on Reporting and Recording Obligations was adopted, regulating the reporting and the recording of undertaken obligations not yet due for payment and unpaid obligations that are due for payment, in order to ensure and maintain transparency and accountability and strengthen the responsibility when managing/using public funds.

Such legal solution establishes a legal obligation for reporting the obligations (liabilities) in the electronic system on monthly basis by the following:

- government bodies,
- local government units,
- institutions performing activities in the field of culture, education, health, child care and social protection, as well as other activities of public interest determined by law, established by the Republic of North Macedonia or the local government units,
- public enterprises, state-owned companies and
- other legal entities established by the Republic of North Macedonia or the local government units.

On the basis of the recorded data on reported liabilities, and for the purpose of informing the public and greater transparency, since September 2018, the Ministry of Finance started publishing on its website summary reports on the basis of the data reported by the above-mentioned entities.

In line with the data recorded in the Electronic System for Reporting and Recording Obligations, as for the data reported in May 2019, referring to obligations as of April 2019, the Report on Reported Obligations by groups of entities is shown in Table 7.

Table 7. Report on Reported Obligations by groups of entities for 2019 (denar million)

Nr.	Entities	Unpaid liabilities due for payment, 2019	Liabilities not due for payment, 2019	Liabilities not due for payment, 2020	Liabilities not due for payment, 2021
1	First-line budget users	1,033	896	87	29
2	Second line budget users - insitutions on national level	344	88	40	4
3	Municipalities	4,078	563	430	446
4	Second line budget users - local institutions financed by bloc-grants	905	66	2	0
5	Public health institutions	2,784	1,041	5	4
6	Public enterprises / Companies established by the Republic of North Macedonia	4,851	3,058	1,810	5,041
7	Local enterprises established by municipalities	3,447	510	105	105
8	Regulatory bodies	2	28	9	0
9	Plan regions	7	1	0	0
10	Other entities	38	1,303	2,059	1,244
Total (1+2+3+4+5+6+7+8+9+10)		17,489	7,552	4,547	6,874

Source: Ministry of Finance - Electronic System for Reporting and Recording of Obligations

3.2. Public Enterprises and State-Owned Companies

Operations of public enterprises and state-owned companies is regulated in the Law on Public Enterprises, the Company Law, as well as sub-sector laws defining the operations in specific areas (Law on Energy, Law on Railway System, Law on Public Roads, etc.)

Total revenues of public enterprises and state-owned companies in 2018, according to the data from the annual reports, amount to Denar 39.2 billion, total expenditures were executed in the amount of Denar 35.1 billion, whereby as a final result in 2018, gross profit in the amount of Denar 4.1 billion was realized (Table 8).

Financial indicators from the financial operations of public enterprises and state-owned companies are shown on accrual basis, in line with the stipulated accounting methodology, differing from the accounting methodology of budget users, where financial data are shown on cash basis.

Positive performance recorded in the overall operations of public enterprises and state-owned companies in 2018 will be a basis for further improvement of financial performance of these enterprises, along with the efficient improvement of public services they provided to the citizens and business sector.

Table 8. Main financial indicators for public enterprises and state-owned companies for 2018 and plan for 2019 (Denar million)

Nr.	Public enterprise/State owned company	Total	Total	Loss/profit before	Plan	Plan	Loss/profit before
		revenues	expenditures	tax	revenues	expenditures	tax
		2018			Plan 2019		
1	Power plants of North Macedonia ESM, JSC	13,740.7	11,906.4	1,834.4	14,855.2	14,323.2	532.0
2	Electricity Transmission System Operator of the Republic of North Macedonia, JSC	6,147.8	5,700.0	447.8	3,824.4	3,476.1	348.4
3	Public Enterprise for State Roads	7,653.8	5,154.5	2,499.3	17,805.3	17,805.3	0.0
4	Railways of the Republic of North Macedonia Transport JSC	1,214.1	1,695.6	-481.5	1,287.1	2,031.0	-744.0
5	Public enterprise for managing forests "National Forests"	1,679.0	1,660.8	18.3	2,252.2	2,130.4	121.8
6	State - owned Joint - Stock company for postal Traffic "Posts of North Macedonia"	1,184.8	1,351.6	-166.8	1,198.9	1,350.9	-152.0
7	Public Enterprise for Railway Infrastructure Railways of Republic of North Macedonia	920.7	1,296.6	-375.8	1,149.7	1,556.2	-406.5
8	Public Enterprise for the maintenance and protection of national and regional roads	1,134.7	1,107.6	27.0	1,200.0	1,198.0	2.0
9	Public Enterprise "National Television - MRT"	949.9	971.0	-21.1	932.5	932.5	0.0
10	Joint stock company for construction and management of residential properties and commercial properties with significance for for the Republic	880.2	913.2	-33.0	958.7	1,005.9	-47.2
11	„M-NAV“ Air Navigation service Provider of the Republic of North Macedonia, GOJSC	1,054.5	876.7	177.8	988.7	988.6	0.1
12	Joint Stock Company for water management of the Republic of North Macedonia	657.7	646.3	11.4	529.1	521.7	7.4
13	Public Enterprise for water supply "Strezevo"	212.1	447.8	-235.7	223.5	461.7	-238.2
14	Joint stock company "TEC Negotino"	195.0	187.0	8.1	223.1	223.1	0.0
15	Joint stock company "State Lottery of North Macedonia"	396.5	186.6	209.8	530.0	303.6	226.4
16	Public Enterprise Hydro system "Zletovica"	14.5	164.1	-149.6	27.4	27.4	0.0
17	Public Enterprise "National Broadcasting"	302.4	155.9	146.5	308.7	308.7	0.0
18	Joint Stock Company for airport services "Airports of the Republic of North Macedonia"	20.1	134.4	-114.3	19.8	127.5	-107.7
19	Company for construction, management and issuance of multipurpose hall "Boris Trajkovski", state owned limited liability company established by one person	117.9	129.5	-11.6	147.5	187.0	-39.5
20	Public Enterprise for water supply "Lisice"	46.2	81.8	-35.6	19.6	19.6	0.0
21	Joint stock company for Management of state-owned business premises	78.7	76.6	2.1	85.3	83.5	1.8
22	Public Enterprise "Official Gazette of Republic of North Macedonia"	76.1	60.5	15.7	68.3	66.8	1.5
23	Public Enterprise for water supply "Studencica"	60.9	55.6	5.3	65.4	65.3	0.1
24	Media Information Agency - Skopje, a state owned joint - stock company	55.4	47.4	8.0	67.0	66.9	0.1
25	Public enterprise for managing and protection of the multipurpose area "Jasen"	41.4	43.6	-2.2	64.1	63.1	0.9
26	Public Enterprise for pastures management	25.8	31.8	-6.0	45.5	35.6	9.9
27	Joint Stock Company for performing energy activities "National Energy Resources" in State Ownership	360.0	22.1	337.9	50.0	30.2	19.8
28	Public Enterprise "Agro - Berza"	9.8	11.5	-1.6	12.9	12.9	0.0
29	State owned limited liability company established by one person „Naftovod“	8.5	8.4	0.1	7.4	7.4	0.0
Total:		39,239	35,125	4,115	48,947	49,410	-463

Source: Annual reports and financial plans of state-owned public enterprises and companies

Some of the public enterprises and state-owned companies receive revenues from the central government budget (Budget of the Republic of North Macedonia) through subsidies for certain purposes, capital transfers, equity, or through respective programmes and activities financed from the Budget (Table 9).

Table 9. Transferred funds from the central government budget (Budget of the Republic of North Macedonia) to the public enterprises and state-owned enterprises (Denar million)

	Execution 2018	Plan 2019
On the basis of Subsidies and transfers	1,971	2,442
Participation in the company capital	397	129
Total:	2,368	2,571

Source: Ministry of Finance

Payments on the basis of profit and dividend from public enterprises and state-owned companies are part of non-tax revenues of the Budget (Table 10).

Table 10. Paid profits and dividends in the Budget of RNM in 2018 (Denar million)

Nr.	Public enterprise/JSC in state ownership	amount
1	Public Enterprise "Official Gazette of the Republic of North Macedonia"	130.0
2	Joint Stock Company "State lottery of Macedonia"	77.0
3	Joint Stock Company GA-MA	65.0
4	„M-NAV“ Air Navigation service Provider of the Republic of North Macedonia, GOJSC	17.7
5	Joint Stock Company for management of state-owned business premises	2.9
Total		293

Source: Ministry of Finance

In order to enhance transparency, pursuant to the amendments to the Law on Public Enterprises as of April 2018, public enterprises are obliged to submit annual and quarterly reports on their websites, thus providing for timely and transparent monitoring of the financial operations of these entities, which ultimately provides an opportunity for more realistic forecasts of the fiscal risk in this domain and timely reaction and undertaking of appropriate measures.

4. Use of EU Pre-Accession Assistance

The Republic of North Macedonia, as a candidate country for EU membership, has funds under the EU Pre-Accession Assistance (IPA) Instrument available through two financial perspectives: IPA 2007 - 2013 Financial Perspective (IPA 1) and IPA 2014 - 2020 Financial Perspective (IPA 2).

This section of the document presents only the part of EU Pre-Accession Assistance which is implemented under the decentralised/indirect management method. IPA decentralised/indirect management method is a management method within which the European Commission (EC) entrusts tasks for implementation of certain IPA programmes to the accredited structure in the Republic of North Macedonia, such as tender procedures, contracting, project monitoring and execution of payments. On the other hand, when it is a matter of centralised management, these are responsibilities of the EC.

Funds for national co-financing intended for projects implemented under the decentralised/indirect management are planned within the budget of the Ministry of Finance, organisational code 09002 - Functions of the State, except for the national co-financing necessary for financing the IPARD projects, which is planned within the budget of the Agency for Financial Support in Agriculture and Rural Development, organisational code 14004, as well as the national co-financing for payment of financial contribution to EC for participation in the Union Programmes, which is planned in the line ministries.

4.1 IPA 1 - 2007 - 2013 Financial Perspective

Within IPA 1 - 2007 - 2013 Financial Perspective, Republic of North Macedonia has available, through the five IPA Components, funds in the amount of EUR 614 million (Denar 37.8 billion), around EUR 467 million (Denar 28.7 billion) out of which or around 76% of the total allocations are employed through the decentralised management method (through structures that are accredited by the EC services so as for indirect management of the European funds). As regards IPA 1 program period 2007-2013, national structures responsible for implementation of the projects are accredited for decentralised management of the following components: IPA Component I - Транзициска помош и институционална надградба (TAIB); IPA Component III - Regional Development; IPA Component IV - Human Resources Development and IPA Component V - Rural Development.

Implementation of most of the programmes within IPA 1 finished at the end of 2018. Programs within IPA 1 which remain to be implemented include the projects planned within Annual National Program TAIB 2012 and Annual National Program TAIB 2013.

These IPA Component I Programs generally provide support to the state administration in order to enhance its capacities at both central and local level, undertake reforms, as well as fulfill the obligations under the membership more quickly and more efficiently.

As per National Program TAIB 2012, contracting rate accounts for around 75%, i.e. total of 46 contracts are concluded, the implementation of which is to be completed by October 2018, while the deadline to complete the final payments per the contracts expires in October 2019.

With respect to National Program TAIB 2013, contracting rate accounts for 93%, i.e. total of 52 contracts are concluded, the implementation of which is started in December 2017. In line with the requirements in the Financing Agreement, contract implementation should be completed by December 2019, i.e. final payments under the contracts are to be made by 21st December 2020 at the latest.

Under these two programmes, projects are financed in the field of public administration reform, consolidation of the local government system by ensuring strong link between the decentralisation process and the inclusive processes for sustainable development with the two support processes, fiscal decentralisation and equal regional development. Improved implementation of both standards and recommendations of the international community and the European Union in the areas such as border control, fight against organised and serious crime, financial crime, strengthening of the CARM and meeting of the EU measures on implementing the acquis in the field of customs, upgrading the customs clearance capacities at Tabanovce road border crossing.

Significant portion of the funds is also intended for intensifying the cooperation of the Government of the Republic of North Macedonia with the NGO sector and strengthening the capacities of the NGO sector. In fact, total of 25 grant contracts are concluded with the NGO sector under the National Programme TAIB 2013 alone.

4.2 IPA 2 - 2014- 2020 Financial Perspective

Under IPA 2 2014 - 2020 Financial Perspective, Republic of North Macedonia has EUR 664 million (Denar 40.9 billion) available. With respect to the manner of implementation, around 50% of the total allocations under IPA 2 will be earmarked for projects planned to be implemented through indirect management system, i.e. through accredited IPA structures.

Awarded assistance will be used for financing projects in the following areas: justice and home affairs, road and railway infrastructure, environment protection, education, employment, promotion of gender equality, human resources development and agriculture and rural development

IPA funds that will be employed through indirect management are the following annual and multi-annual programmes:

- 2014 Action Program for financing projects in the following areas:
 - judiciary,
 - disaster recovery system and ensuring business continuity,
 - further development of capacities for crime scene investigations,
 - entry tickets for the Union Programmes,
 - local and regional competitiveness, focusing on tourism, and
 - support to EU integration (SEA)
- 2015 Action Programme, 2016 Action Programme, 2018 Action Programme and 2019 Action Programme for financing the entry tickets for EU Programmes;
- 2017 Action Programme for financing projects in the following areas:
 - labour and education,
 - entry tickets for the Union Programmes,
- Multi-Annual Sectoral Operational Programme for Transport 2014 – 2020;
- Multi-Annual Sectoral Operational Programme of the Republic of North Macedonia for Environment and Climate Action 2014 – 2020;
- IPARD 2 Programme.

Around 15 contracts are envisaged to be financed within the 2014 Action Programme. As regards the financing of the projects within this Programme, IPA funds in the amount of around EUR 20 million are made available to the Republic of North Macedonia. Among the more significant projects envisaged to be financed under the Programme are the following:

- construction works for rehabilitation of prisons in Bitola and Skopje,
- construction works for rehabilitation of Public Prosecutor's Office regional offices,
- grant scheme for support to NGO in the area of law,

- service contracts to support judiciary reforms,
- contract for procurement of IT equipment for the needs of the Ministry of Internal Affairs - Disaster Recovery Data Center, etc.

Contracting deadline was 23rd December 2018, by when 26 contracts have been concluded in the amount of EUR 14.63 million. As regards the remaining projects, tender procedures are ongoing.

Financing of projects in the field of road and rail transport, as well as projects for construction of waste water treatment plants, sewerage networks and waste management and climate changes is envisaged within the Multi-Annual Sectoral Operational Programme of the Republic of North Macedonia for Environment and Climate Action and Multi-Annual Sectoral Operational Programme of the Republic of North Macedonia for Transport.

It is envisaged for around 40 contracts to be financed with EUR 86 million as IPA funds within the environment and climate action sector in the period 2014 - 2020. Among the more significant projects envisaged to be financed under the Programme are the following: contracts for construction works related to water treatment stations in Bitola and Tetovo, contracts for construction works related to upgrading the sewerage network in Bitola, Tetovo and Kicevo, contract for construction of wastewater collection infrastructure in Skopje, etc.

It is envisaged for around 17 contracts to be financed within the transport sector in the period 2014 - 2020. IPA funds in the amount of EUR 108 million is allocated to the transport sector in the period 2014 - 2019. Among the more significant projects envisaged to be financed under the Programme are the following: contracts for construction of the rail section from Kriva Palanka to the Republic of Bulgaria, construction of Gradsko – Drenovo road section, reconstruction of Raec – Prilep road section, reconstruction of Kumanovo – Rankovce road section, etc.

As of December 2018 inclusive, 4 contracts were concluded in the amount of EUR 30.24 million. As regards the remaining projects, tender procedures are ongoing.

With respect to 2015, 2016, 2018 and 2019 Action Programmes, under which the entry tickets for the Union Programmes are financed, payment of entry tickets for participation in the respective programmes and agencies for the 2014 - 2020 Financial Perspective will be made in a decentralised manner through the National Fund within the Ministry of Finance, whereby, IPA contribution is planned within the budget of the Ministry of Finance, while the planning of the national contribution is an obligation of the competent institutions within their budget.

Union Programmes cover almost every area of the social and the economic life of European citizens: education, culture, youth, media, social affairs, development of small- and medium-sized enterprises, environment, transport, public health, legal cooperation, fight against violence, crime, terrorism, information society, customs duties and taxes. All legal entities may participate in the Programmes and, in certain cases, natural persons (individuals) from the participating countries may also participate therein.

Projects in the field of labour and education are financed within 2017 Action Programme, the aim of which is to reduce high unemployment rate, increase share on the labour market, in particular the one of young people and women, increase the access to quality education and training, improve the results and the skills and establish a modern and flexible social protection system. In order to achieve the general objective, several projects are envisaged in the following areas:

- institutional strengthening of the capacities for sustainable sectoral reforms;
- improving the quality of education and training;
- promoting the development of skills, employment and working conditions;
- social protection, social inclusion and equal share on the labour market and in the society.
-

IPARD 2 Programme supports projects that will provide for attaining EU standards introduced in the field of agricultural production, food processing and rural development. In the period 2014-2020, total IPA funds in the amount of EUR 60 million are made available to the Republic of North Macedonia under this Programme.

2014 - 2020 IPARD Programme implementation is launched with 4 measures (Investments in physical assets of agricultural holdings, Investments in physical assets concerning processing and marketing of agricultural and fishery products, Farm diversification and business development and Technical assistance to Programme implementation), while preparation for accreditation of one more measure (Investments in rural public infrastructure) is commenced.

During 2018, 939 contracts were concluded upon the first public call, amounting to EUR 13.3 million (IPA part).

In December 2018, two public calls were announced for measure 1 and measure 3 and there is ongoing processing of applications.

5. Public Debt

General government debt comprises financial liabilities incurred on the basis of borrowing by the Republic of North Macedonia, the public institutions established by the Republic of North Macedonia and the municipalities, the municipalities within the City of Skopje and the City of Skopje. General government debt is defined as such according to the national methodology envisaged in the Law on Public Debt. Central government debt accounted for 99.7% of the total general government debt at the end of the first quarter of 2019 and it is managed directly by the Ministry of Finance. As regards the other levels of debt, such as debt of municipalities and debt of public enterprises and state-owned companies, guaranteed by the state, the Ministry of Finance participates in the process of borrowing, however, it cannot influence the intensity of withdrawing the funds under the concluded loan agreements.

General government debt of the Republic of North Macedonia amounted to EUR 4,343.0 million, i.e. it accounted for 38.3% of GDP on 31st March 2019. Central government debt accounts for the most in the general government debt, amounting to EUR 4,329.8 million, while the debt of the municipalities amounts to EUR 13.3 million.

Pursuant to the Law on Public Debt, public debt is broader definition of the debt, including the general government debt and the guaranteed debt of public enterprises and companies fully or dominantly owned by the state or municipalities. Unlike the period 2008-2016 when the debt experienced more intensive growth, as of 2017 already, it was stabilized. In line with the data on the first quarter of 2019, public debt amounted to EUR 5,242.3 million i.e. it accounted for 46.2% of GDP.

Compared to the EU countries, Republic of North Macedonia remains moderately indebted country. In fact, according to Eurostat Press Release dated 24th April 2019, average general government debt to GDP ratio in the EU 28 was 80% at the end of the fourth quarter in 2018.

From the point of view of interest structure, fixed - variable interest rate ratio was 77:23 respectively at the end of the first quarter of 2019. As regards currency composition, debt denominated in domestic currency accounted for 21.3% in the total general government debt portfolio, while share of foreign currency denominated debt was 78.7% (including government securities with FX clause issued on the domestic market), whereby euro-denominated debt accounted for the most with 72.5%, share of SDR was 4.9%, Japanese Yen-denominated debt accounted for 1% and US dollar-denominated debt accounted for 0.2%.

Special emphasis in the past period was put on developing the domestic government securities market by issuing government bonds with longer maturity. This has contributed to its deepening and extending the average time to maturity of the domestic debt portfolio. In fact, average time to maturity of the domestic debt portfolio of the central government, which includes continuous government securities and structural bonds, at the end of 2012 was 1.3 years, while at the end of the first quarter of 2019, this indicator was 6.4 years. In addition, the Ministry of Finance has continued its policy of lower auction frequency, whereby the auction calendar for the first and the second quarter in 2019 envisages two auctions per month. Hence, the Ministry of Finance expects for secondary trading with government securities to be encouraged, where investors, needing liquid funds with shorter maturities than the ones offered at the regular auctions, will participate. In order to additionally encourage the secondary trading, at the beginning of 2019, government bonds were listed on Macedonian Stock Exchange, thus becoming available for bigger number of foreign and domestic investors. In addition, in conditions of stable market trends and continuously relatively high demand for government securities, interest rates on government securities have dropped since the beginning of 2019, thus providing for lower borrowing costs. As an illustration, interest rate on 12-month treasury bills, which dominates in the structure, has been reduced by around three times, i.e. from 2.4% and 2.3% at the beginning of 2017 (without and with foreign currency clause) to 0.8% and 0.5% as of the beginning of 2019, respectively. Furthermore, interest rate on 15-year government bonds was reduced from 4.3% and 4.1% at the beginning of 2017 (without and with foreign currency clause) to 3.2% and 2.7% as of the beginning of 2019, respectively. In addition, in line with the Denarisation Strategy prepared by the Ministry of Finance and the National Bank, the spread of interest rates on government securities with and without foreign exchange clause was increased. Thus, at the beginning of 2017, this spread was minimal, ranging between 0.1 p.p. and 0.2 p.p., while at the beginning of 2019, the spread between the government securities with and without foreign exchange clause ranges between 0.3 p.p. and 0.5 p.p.

5.1. Public Debt Management Policy

Efficient public debt management is of essential importance, encompassing reduced risks when designing the debt structure and debt management policy, all to the end of avoiding the possible inability to service the debt on regular basis and in a timely manner. The main objective is to ensure the funds necessary to finance the budget deficit and repay the due debt liabilities, as well as funds for project financing, thereby not increasing the debt to a level that can jeopardise the stability of the economy and the economic growth of the country. Quality debt management, among other things, is determined on the basis of the institutional framework and the capacity to set and implement the public debt management policy. This implies clear definition of public debt management goals and measures.

The Public Debt Management Policy sets the framework for the Government of the Republic of North Macedonia to act towards prudent public debt management in the medium term. Objectives of public debt management policy set in the Law on Public Debt are the following:

- financing the needs of the state with the lowest cost possible, in the medium and the long run, with sustainable level of risk;
- identifying, monitoring and managing the risks which public debt portfolio is susceptible to; and
- developing and maintaining efficient domestic financial market.

By adopting this Strategy, the Ministry of Finance is given the framework to act towards prudent public debt management in the medium term, i.e. in the next three years. Above-mentioned goals of the public debt management policy will be attained by defining short- and medium-term limits of certain debt portfolio indicators, in accordance with the Law on Public Debt.

5.1.1 Medium-Term Limits

Medium-term limits are used to compile the framework for the movement of public debt in the 2020-2022 period. Such limits define the maximum sustainable level of total public debt in relation to GDP and the level of guaranteed public debt in relation to GDP. In addition, in order to reduce the risk factors affecting the total public debt portfolio, medium-term limits on currency and interest structure of the general government debt are also determined.

The public debt level is considered sustainable if it enables a timely servicing of the debt liabilities coming due in the longer run, which depends on several factors such as: the level of development of the domestic financial market, the liquidity of the international capital market, the rate of economic growth, the inflation rate, the level of budget deficit/surplus, etc. In order to keep a sustainable level of public debt, without disrupting the fiscal sustainability, the limit on the total public debt level in the medium and long run is set to 60% of GDP.

Issued sovereign guarantees are a contingent liability for the state budget, i.e. there is a risk of increased costs related to servicing in case the guarantees are activated. Therefore, the sustainable level of issued guarantees in the medium term is of great importance for the Ministry of Finance. In addition, when selecting the projects for which a sovereign guarantee will be issued, special emphasis is put on self-sustaining projects, which generate revenues, support the economic growth and will provide for boosted competitiveness of the national economy in the medium term, which are in line with the strategic priorities of the Government of the Republic of North Macedonia, and justify the purpose which the funds are used for. In accordance with this, the limit on the level of guaranteed public debt in the 2020 -2022 period is defined at 13% of GDP.

Changes in the exchange rate could largely affect, i.e. increase the envisaged costs for repayment of debt denominated in foreign currency. However, taking into account the fact that since 1995 the Republic of North Macedonia applies a de facto fixed exchange rate regime of the Denar in relation to the German Mark, and since 2002 onwards in relation to the euro, and that this policy will continue in the future, the exposure to such a risk would be measured as a share of the euro in the total debt portfolio. Consequently, in the period 2020-2022, the limit on the currency structure of the general government debt - the minimum threshold of euro-denominated debt in the total general government debt portfolio denominated in foreign currency is defined to be 85%.

In order to protect the general government debt portfolio against possible future market shocks, i.e. unfavourable changes of interest rates that directly lead to increase of the costs to the Budget of the Republic of North Macedonia, maintaining optimal interest rate structure of general government debt portfolio is one of the objectives debt managers aim at. Therefore, for the period 2020 -2022, the limit on the interest rate structure of general government debt - the minimum threshold of debt with fixed interest rate is determined to be 60%.

5.1.2 Short-Term Limits

In line with the medium-term targets on determining the optimal level and the structure of public debt portfolio, short-term limits, i.e. limits pertaining only to 2020, are also defined. These limits help to determine the maximum amount of net borrowing on the basis of general government debt in 2020, as well as the maximum amount of net borrowing on the basis of guarantees issued in the course of the same year.

Net borrowing in 2020 includes the planned borrowing within the general government debt, reduced by its repayments. Related to this, sources of financing secured through the borrowing in 2019 will also be dedicated for partial financing of the repayments falling due in the first quarter of 2020. Short-term maximum limit on net borrowing (domestic and external) on the basis of general government debt in 2020 is set at EUR 400 million.

In order to reduce the risk of contingent liabilities in the public debt portfolio, the annual amount of net borrowing on the basis of guaranteed debt of public enterprises is defined. Investments in road infrastructure, implemented with loans for which a sovereign guarantee is issued, are expected to intensify in the period 2019-2021. Therefore, the guaranteed debt stock is expected to increase, and the limit on maximum net borrowing on the basis of guaranteed debt in 2020 is set to EUR 250 million.

Limits on the indicators related to the risk of debt refinancing are calculated within this Strategy - the indicator on the average time for debt re-financing and the indicator showing the share of the central government debt portfolio that falls due in the next year. In addition, the limit on the indicator for measuring the interest rate change risk (showing the average time in which the interest rates of the debt portfolio are being re-set) is also calculated. More precisely, in order to protect the central government debt portfolio against the re-financing risk, the limit on re-financing risk - the minimum threshold of "average time to maturity" indicator in 2020 is determined to be 4 years. In addition, maximum limit on the share of debt falling due in 2020 out of the total central government debt is set at 35%⁴. Further on, in order to protect the central government debt portfolio against the interest rate risk, the limit on the risk for interest rate changes - the minimum threshold of the "average time to re-fixing" indicator in 2020 is determined to be 3 years⁵.

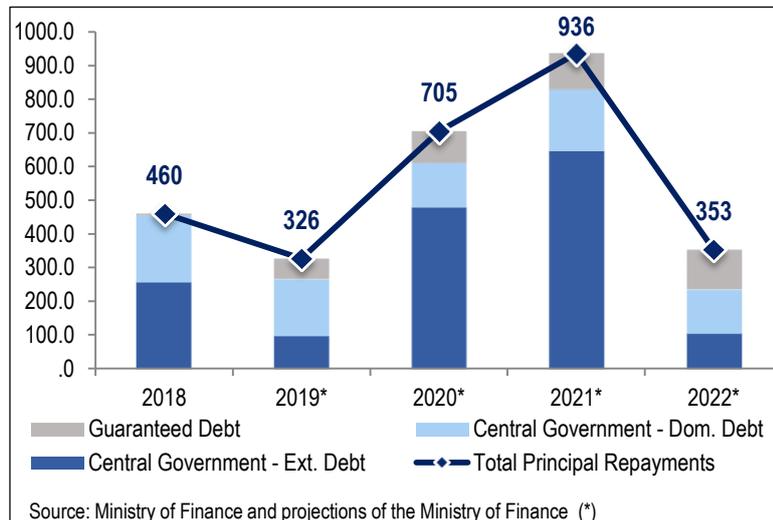
5.2 Projections of General Government and Public Debt Structure

Investments launched in the past period as well as new investments in the field of road and rail infrastructure, water supply and sewerage, sports facilities, education, health, energy, construction of the National Gasification System, reforms in the agricultural and social sectors, the pension system, municipal development, as well as other projects that are in line with the Programme of the Government of the Republic of North Macedonia, are expected to continue in the period 2020-2022. Projects will be implemented by the state administration bodies, municipalities, public enterprises and companies predominantly owned by the state. These projects will be co-financed with foreign loans, but with a strong commitment not to jeopardize the long-term sustainability of the debt level of the country. In addition to the investment projects, part of the borrowing is aimed at covering the budget deficit, i.e. providing for smooth Budget execution. In addition, part of the borrowing will also be intended for repayment of previously undertaken debt. More precisely, in the period to come, substantial amount of previously taken loans fall due for repayment (Figure 14), i.e. in the period 2019-2022, a total of EUR 2.3 billion should be repaid on the basis of principal of central government and guaranteed debt. Thereby, in 2020 and 2021, around EUR 835 million will need to be repaid only on the basis of three sizable prior borrowings (second tranche of PBG loan concluded in 2013 amounting to EUR 155 million, Eurobond of EUR 500 million issued in 2014 and the outstanding amount of EUR 180 million of the Eurobond issued in 2015), as well as other repayments of debt on the domestic and foreign market.

⁴ This indicator includes the repayments of treasury bills with a maturity lower than 1 year, but not include a potential early debt buy-back.

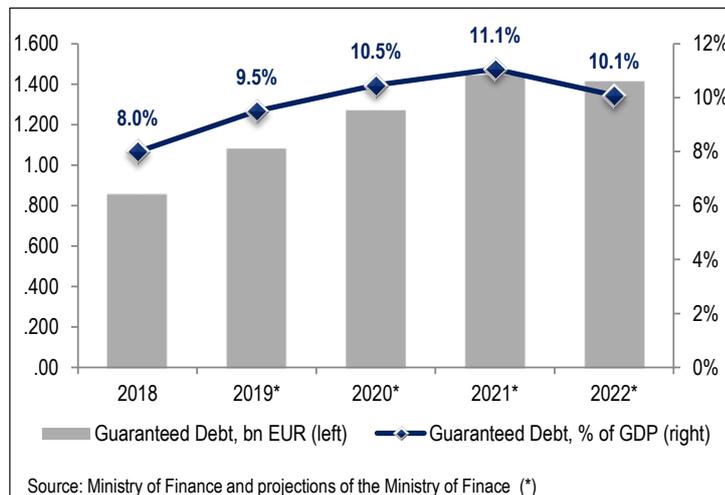
⁵ The debt refinancing risk, as well as the interest rate risk, are presented in more details in Chapter 5.3.

Figure 14. Repayment of Principal of Central Government Debt and Guaranteed Debt (EUR million)



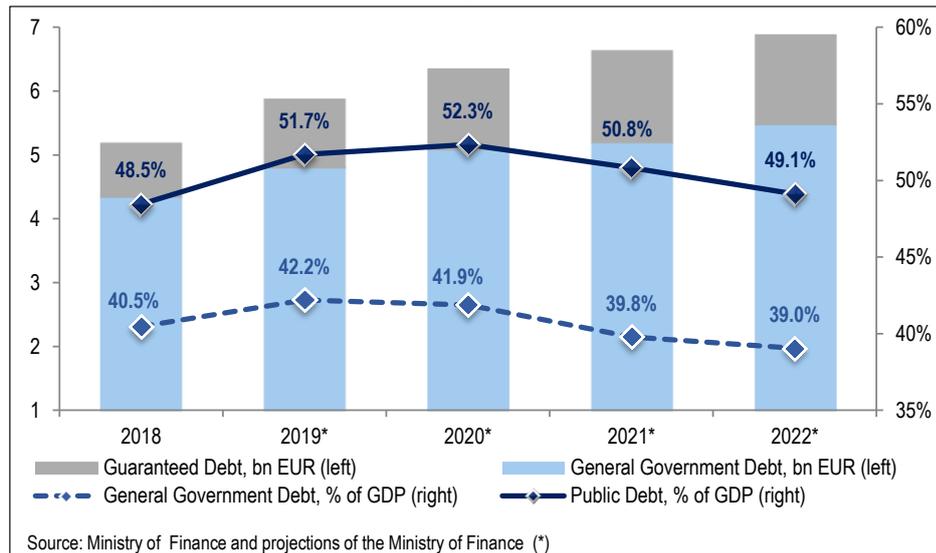
On the basis of the analyses made on the movement of the projected guaranteed public debt in the 2020-2022 period (Figure 15), it is expected to moderately increase by 2021 as a result of the disbursement of loan proceeds under the projects mainly in the road infrastructure, implemented with loans for which sovereign guarantee is issued, after which it is expected that the guaranteed debt will decrease to 10.1% of GDP in 2022. Thereby, the level of guaranteed public debt throughout the whole period is below the set maximum limit.

Figure 15. Guaranteed Public Debt



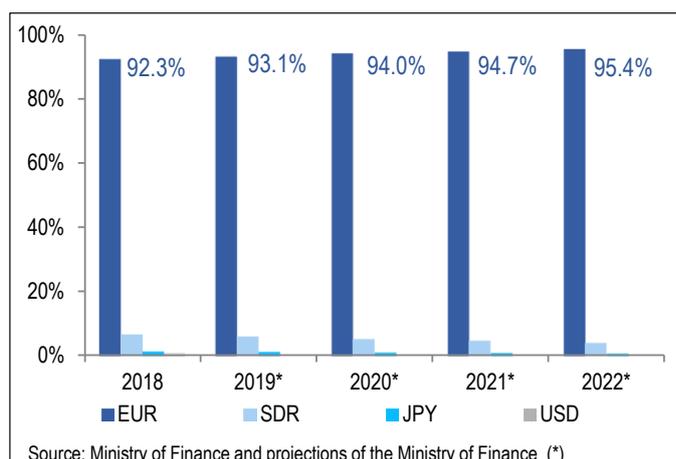
The movement of the public debt in the next period will reflect the medium-term budget framework and implementation of capital projects. The disciplined fiscal policy, with a projected narrowing of total budget deficit and approximate balancing of primary budget deficit in the medium run (2% and 0.5%, respectively, in 2022), will contribute to gradual reduction of government debt from the projected 42.2% of GDP in 2019 to 39% of GDP in 2022. In conditions of gradual increase of the guaranteed debt until 2021, for the purpose of implementing the projects mainly in the road infrastructure with loans guaranteed by the government and its reduction in 2022, a moderate increase of the total public debt up to 52.3% in 2020 is expected, to be followed by a reduction to 50.8% of GDP in 2021 and 49.1% of GDP in 2022. This is significantly lower than the determined limit on the medium-term and long-term public debt level, i.e. the public debt in the coming period will not jeopardise the fiscal policy sustainability (Figure 16). In addition, the projected movement of the debt is in line with the fiscal policy target of the Government to stabilize and then reduce the public debt in the medium run - at the end of the medium-term period, in 2022, the public debt will be at the similar level as a percentage of GDP as in 2018.

Figure 16. Projections of Total Public Debt (General Government Debt and Guaranteed Debt)



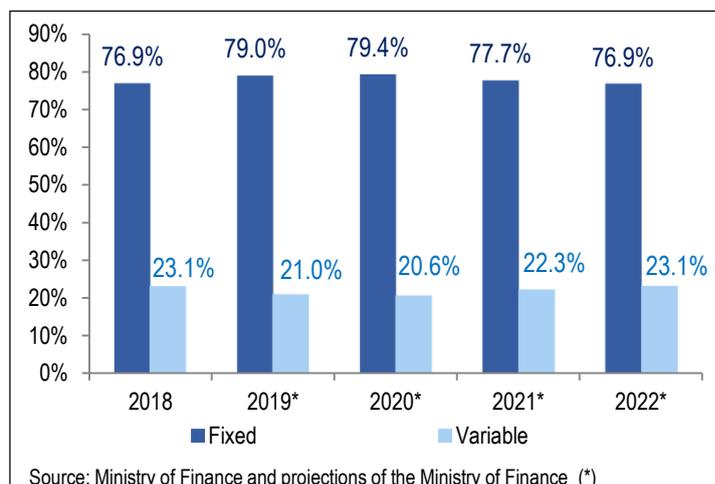
A dominant share of euro-denominated debt is evident in the currency structure projections, experiencing moderate increase in the medium term as a result of the commitment of the Ministry of Finance for the new external borrowing to be denominated in euros (Figure 17). In the 2020-2022 period, the share of euro-denominated debt in the total general government debt portfolio denominated in foreign currency is significantly above the minimum threshold. The small share of other currencies (lower than 10% of the total general government debt denominated in foreign currency) is related to loans denominated in US dollars, Japanese Yen and Special Drawing Rights for credit lines. These loans were mainly concluded in the past and they are repaid in the period to which the projection refers.

Figure 17. Currency Structure of the General Government Debt Denominated in Foreign Currency



Taking into account the current structure of the general government debt portfolio, as well as the medium-term projections, in the 2020-2022 period, the fixed interest rate debt is significantly higher than the defined minimum threshold (Figure 18). This reflects the commitment of the Ministry of Finance to issue long-term securities on the domestic market, as well as the commitment to borrow using instruments with fixed interest rate on the international capital market.

Figure 18. Interest Rate Structure of the General Government Debt



5.3 Public Debt Risk Management

In conditions of large oscillations of economic variables, the need arises to actively manage risks to which the public debt portfolio in the Republic of North Macedonia is exposed. The risk management policy is of crucial importance for public debt management, being the main link between the proposing, designing, adopting and implementing the public debt management policy. The development of this policy is a challenge for the debt management and it comprises identifying, measuring and managing the risks, taking into account the trade off between risks and costs.

The main objective of public debt management is to ensure that government financing needs and liabilities are covered with the lowest costs in the medium and long run with an acceptable risk level. From the point of view of the risks the debt portfolio of the general government debt of the Republic of North Macedonia faces, certain improvement in indicators on the re-financing risk and the interest rate risk can be observed. In fact, as a result of the commitment of the Ministry of Finance to develop the domestic government securities market, the process of restructuring the government securities portfolio has been underway since 2012, with newly issued securities with longer maturity, while the issue of short-term instruments has been gradually reduced. Such a strategy resulted in significant improvement in terms of re-financing risk and interest rate risk regarding the domestic debt portfolio. As regards the other risks, debt management in the medium term will be focused on maintaining the lowest cost possible under a sustainable level of risk.

The following appear as the main risks identified at managing the debt portfolio of the Republic of North Macedonia:

1. Debt re-financing risk;
2. Market risk, involving the following risks:
 - o Interest rate risk and
 - o Exchange rate risk;
3. Risk associated with the contingent liabilities and
4. Operational risk.

1. The refinancing risk is managed by preventing a considerable part of the liabilities to fall due at once at any one time and providing an evenly distributed maturity of debt-related liabilities. The exposure of public debt portfolio to re-financing risk is measured by the debt repayment profile and the “average time to maturity” (ATM) indicator. The higher the value of this indicator, the lower the uncertainty, i.e. the re-financing risk.

Average time of maturity as regards the central government debt is expected to increase in the 2020-2022 period, from 5.2 years at the end of 2020, to 5.6 years in 2021, and to reach the level of around 5.2 years again in 2022 (Table 11). As regards the domestic debt, the maturity is extended as a result of the commitment of the Ministry of Finance to focus on deepening the domestic securities market. In fact, particular emphasis was put on increased issuance of long-term securities, as well as extending the maturity and increasing the volume of the existing government securities portfolio by issuing 2-, 3-, 5-, 10- and 30-year treasury bonds. The re-financing risk is expected to drop in the period 2020-2022 as a result of the extended maturity of the external debt portfolio.

These projections point out that average time to maturity in the period 2020-2022 is significantly above the defined limit for the minimum threshold for 2020.

Table 11. Average Time to Maturity - ATM (years)

	2020	2021	2022
Central Government Debt	5.2	5.6	5.2
Domestic Debt	6.7	6.9	6.9
External Debt	4.3	4.8	4.0

Source: Simulations of the Ministry of Finance

Taking into consideration the projections for the repayment profile in the coming years (Figure 14), one can see that the liabilities on the basis of repayment of the external and the domestic general government debt increase by 2021, while in 2022 no significant repayments are projected. A particular challenge for efficient management of the re-financing risk is expected in 2020 and 2021, when the Eurobonds issued in 2014 and 2015 (in the total amount of EUR 678 million), as well as the second instalment on the basis of the loan secured under Policy Based Guarantee (PBG) from the World Bank (in the amount of EUR 155 million), fall due for repayment. In order to reduce the re-financing risk in 2020, in January 2018 Ministry of Finance made early repayment of part of the previously issued Eurobond with interest rate of 4.875%, falling due in 2020 in the amount of EUR 91.7 million in nominal terms. The early repayment reduced the refinancing amount in 2020, while also generating savings on interest costs from the Budget of the Republic of North Macedonia given that the new Eurobond was issued with historically the lowest interest of 2.75%. In order to further smoothen the redemption profile and reduce the re-financing risk, as well as generate additional savings, the Ministry of Finance will continue to consider the possibility for debt restructuring in the coming period by actively managing the debt portfolio through liability management activities.

2. The market risk is determined by the exposure of debt portfolio to economic variables, especially the changes of interest rates on the domestic and the international capital markets and the movements in foreign exchange rates. Identifying and managing market risks in the Republic of North Macedonia is crucial for the public debt portfolio since these risks are determined mainly by external factors, i.e. variations in interest rates on the international financial markets where, due to their constant oscillations, medium- and long-term trend is very difficult to project.

Measuring and managing the interest rate risk is especially important in the countries in which domestic financial markets are underdeveloped and the financing needs are covered from external sources under non-concessional terms, where exposure to interest rate risk is greater. Changes of interest rates in the domestic and international markets affect the debt-related costs, especially when fixed interest rate debt should be refinanced or when the interest is re-set for variable interest rate debt. Therefore, there is a close connection between the interest rate risk and the debt re-financing risk.

The ATR (average time to re-fixing) indicator measures the average time to interest rate change. A higher value of this indicator shows that a larger portion of the debt portfolio will not be subject to a significant interest rate change and that such a portfolio is a lower-risk portfolio. In the 2020-2022 period, it is expected for the interest rate risk to slightly increase due to the decrease in the average time to re-fixing indicator (Table 12). Decrease in the average time to re-fixing is due to the drop at this indicator at the external debt. In fact, the increase of the ATR indicator at the domestic debt is in line with the commitment to borrow on the basis of long-term fixed-interest instruments on the domestic securities market in the coming period. These projections point out that average time to re-fixing in the 2020-2022 period is significantly above the set limit on the minimum threshold for 2020.

Table 12. Average Time to Re-Fixing (years)

	2020	2021	2022
Central Government Debt	4.8	5.1	4.6
Domestic Debt	6.7	6.9	6.9
External Debt	3.6	4.0	3.1

Source: Simulations of the Ministry of Finance

Exchange rate risk refers to debt indexed or denominated in foreign currency. A higher share of the debt denominated in foreign currency points out to a higher exchange rate risk. This risk is crucial for the developing countries where external debt is fully indexed and also where a higher share of the domestic debt is denominated in foreign currency.

Changes in the exchange rate may largely affect, i.e. increase the envisaged costs for repayment of public debt denominated in foreign currency. However, taking into account that the Republic of North Macedonia applies a de facto fixed exchange rate of the Denar to the Euro, the exposure to such a risk would also be measured as a share of the euro in the total general government debt portfolio, which was actually dominant currency with a 72.5% share in the total debt structure during the first quarter of 2019.

3. The risk related to contingent liabilities - as a result of the projected investments, which are exceptionally important for the further development of the infrastructure and the energy sector, a moderate but controlled increase of the level of the guaranteed public debt is projected in the following period. In order to ensure more favourable financing terms and conditions by the creditors, the government issues a sovereign guarantee, after carrying out analyses of the borrower and its ability to independently service its future liabilities.

Liabilities on the basis of guaranteed debt in relation to GDP falling due in the period 2019-2022 have a moderately upward trend, but borrowers will independently service such liabilities. In order for the Budget of the Republic of North Macedonia not to be exposed to a risk of calling-up guarantees, the process of issuance of new guarantees is strictly regulated and is subject to certain criteria the entities using guarantees should meet.

4. The operational risk includes the settlement risk and the error risk. The settlement risk occurs if numerous non-automated activities are used during data processing, while error risk is closely related to the manner of segregating the tasks related to the execution of transactions and their settlement across the units within the institution in charge of debt management. Public debt management is carried out with an IT system and adequate software platform, thus significantly reducing the risk of human errors. In addition, measures to apply the "four eyes" principle (at least two executors of each operation) are also undertaken in a timely manner, in order to avoid the risk from untimely performance of the tasks in case the responsible person is prevented from fulfilling the working tasks.

5.4 Development of the Government Securities Market

The development and maintenance of an efficient and liquid domestic government securities market is an additional goal in public debt management in most of the developed economies and economies in transition. In order to ensure a stable and reliable source of financing of the budget needs, it is necessary for the domestic financial market to be deep enough so as to respond to the needs of the country in conditions of external shocks. In that way, budget needs are met without causing any crowding out effect. In addition, a developed domestic financial market enables a growing number of investors and a creation of a reference yield curve for the overall economy.

The Ministry of Finance will continue to regularly issue government securities on the domestic market in the coming period. The purpose is, by regular issuance of government securities, to provide for more efficient financing of budget needs in the short and the long run, reducing the financing costs, as well as encouraging further development of the financial market in the Republic of North Macedonia.

In the upcoming period, Ministry of Finance will intend to retain regular issuance of treasury bills, as well as stay focused on expanding the maturity structure of the portfolio of government securities with longer maturities. Thus, particular emphasis will be put on extending the maturity of the existing government securities portfolio. In addition, measures will be undertaken in the line with the Denarisation Strategy prepared by the Ministry of Finance and the National Bank.

These goals will be realised through the following activities:

- issuance of government bonds with 30-year maturity, on quarterly basis and in a standardised amount;
- issuance of government bonds with 15-year maturity at least 4 times a year;
- issuance of government bonds with 10-year maturity at least 4 times a year;
- issuance of government bonds with 2-, 3- or 5-year maturity on regular basis;
- reduction of the share of government securities with FX clause in the total issued government securities.
- increase of the spread of interest rates on government securities with and without FX clause.

Pension funds, as well as commercial banks and insurance companies, are expected to show particular interest in investing in long-term securities issued by the Republic of North Macedonia. In order to improve and further develop the government securities market, activities aimed at expanding the investor base will be continued, by considering the possibility to introduce new financial instruments adequate to the needs of the market participants, as well as carrying out marketing campaign in front of different target groups of investors and maintaining regular dialogue with all participants on the government securities market.

6. Comparative Analysis of Macroeconomic and Fiscal Projections for 2020-2022

6.1. Comparison with the Revised 2019-2021 Fiscal Strategy

Comparatively analysed in relation to the revised 2019-2021 Fiscal Strategy of the RNM, the 2020-2022 Fiscal Strategy of RNM does not indicate significant deviations in relation to the medium-term projections of the macro-fiscal parameters. Thereby, the relatively slight revisions of the macroeconomic parameters projections, key budget indicators and public debt indicators are in a positive direction.

Continuous intensification of the growth in the course of 2018, accompanied by strong inflow of FDIs and recovery of investment demand, increase of wages and the employment, growth of export and crediting, resulted in GDP growth of 2.7%, which was closest to the autumn projection of 2.8% growth under the Revised Fiscal Strategy (unlike most of the other institutions which projected lower growth). These trends in 2018, as well as the positive changes in the first quarter of 2019 evident through more intensive growth of industrial production and the sales in the trade activity, continuous strong growth of export activity and intensified credits to the private sector, are the basis for a slight upward revision of the growth projection. Consequently, the new economic growth projections are slightly revised upwards for 2019 and 2020 by 0.3 p.p. and 0.2 p.p., respectively (from the previous 3.2% to 3.5% in 2019, and from the previous 4% to 4.2% in 2020) while the economic growth projection in 2021 is unchanged at 5% (Table 13). Thereby, this growth revision is in line with the latest revisions of some of the international financial institutions. In fact, the most recent projections of the International Monetary Fund and the European Commission as regards the GDP growth in North Macedonia in 2019 and 2020 (Table 15) are revised upward by 0.2 p.p. and 0.1 p.p., respectively.

As in the previous Fiscal Strategy, domestic demand and net export are envisaged to positively contribute to the economic activity growth. Contribution of domestic demand is more significant in relation to the previous projections, reflecting the more favourable expectations on the labour market, i.e. stronger drop of unemployment and higher growth of wages, as well as the improved Euroatlantic perspectives. Net export is expected to have somewhat lower contribution to growth compared to the previous projections, in conditions of projected slower growth dynamics of both foreign demand and global trade.

In average, in the 2019-2021 period, unemployment rate projection is lower by 0.9 p.p., employment rate is expected to be higher by 0.3 p.p., while growth of wages is expected to be higher by 0.7 p.p. annually compared to the previous projections.

Projections of the inflation rate are unchanged compared to the previous Fiscal Strategy.

Table 13. Comparison of Macroeconomic Projections with the Revised 2019-2021 Fiscal Strategy

Indicators	Revised Fiscal Strategy 2019-2021			Fiscal Strategy 2020-2022			Deviation (in p.p.)		
	2019*	2020*	2021*	2019*	2020*	2021*	2019	2020	2021
GDP, real growth rate (%)	3.2	4.0	5.0	3.5	4.2	5.0	0.3	0.2	0.0
Inflation rate (average)	2.0	2.0	2.2	2.0	2.0	2.2	0.0	0.0	0.0
Export of goods (nominal growth, %)	9.5	10.1	10.8	9.2	9.8	10.5	-0.3	-0.3	-0.3
Import of goods (nominal growth, %)	8.1	8.7	9.0	7.4	8.4	8.7	-0.7	-0.3	-0.3
Net wage - nominal growth (%)	4.5	4.4	3.7	5.0	4.8	4.8	0.5	0.4	1.1
Unemployment rate (average)	20.1	19.1	18.1	19.3	18.2	17.2	-0.8	-0.9	-0.9
Employment rate (average)	45.8	46.7	47.8	46.1	47.1	48.1	0.3	0.4	0.3

Source: Ministry of Finance and projections of the Ministry of Finance (*)

As far as the projections of the central government budget (Budget of the Republic of North Macedonia) are concerned, the 2020-2022 Fiscal Strategy of RNM does not indicate any significant deviations in relation to the revised 2019-2021 Fiscal Strategy (Table 14). In fact, the budget deficit as the main indicator of fiscal policy is retained at almost the same level in absolute terms, as well as at the same level as a percentage of GDP, as follows: 2.5% in 2019, 2.3% in 2020 and 2% in 2021. Retaining the trajectory of gradual fiscal consolidation confirms the direction of fiscal discipline. In addition, the retaining of the budget deficit rates set in previous Strategy confirms the predictability of fiscal policy as one of the main indicators in planning the economic activity.

In relation to the revenue and expenditure projections, under the 2020-2022 Fiscal Strategy of RNM, they are changed minimally compared to the projections under the 2019-2021 Fiscal Strategy of RNM. In 2020, there is no deviation on the revenue side, while in 2021 it is insignificant (lower by 0.3%). Expenditures are projected at higher by 0.2% in 2020, and by 0.2% lower in 2021. As a percentage of GDP, the share of revenues and expenditures are minimally lower, reflecting the upward GDP revision.

As regards the revenues, the main revisions are in projections of tax revenues and contributions, with further retaining of the trend of conservative fiscal projections and inclusion of the effects from the implemented amendments in the regulations in the tax area and social contributions. Furthermore, as for the expenditures, biggest deviations pertain to subsidies and transfers (as regards current expenditures) as a result of the inclusion of the effect from the refund of part of the Value Added Tax to natural entities, as part of the reforms in the tax area, as well as capital expenditures for the purpose of revising the dynamics of projects financed with loans from international and financial institutions and bilateral creditors.

Table 14. Comparison of the Medium-Term Projections for the Budget of RNM with the Revised 2019-2021 Fiscal Strategy (million denar)

	Revised Fiscal Strategy 2019-2021			Fiscal Strategy 2020-2022			Deviation 2020-2022/2019-2021			% of deviation (shares of GDP in p.p.)		
	Budget 2019*	2020*	2021*	Budget 2019	2020*	2021*	2019	2020	2021	2019	2020*	2021*
Central Government (Budget of the Republic of North Macedonia)												
Total revenues	210,848	219,726	229,276	210,848	219,720	228,688	0	-6	-588	0.0	0.0	-0.3
Tax revenues and contributions	184,201	193,587	203,776	184,201	192,806	203,407	0	-781	-369	0.0	-0.4	-0.2
Tax revenues	121,885	127,852	134,092	121,885	126,179	132,782	0	-1,673	-1,310	0.0	-1.3	-1.0
Social contributions	62,316	65,735	69,684	62,316	66,627	70,625	0	892	941	0.0	1.4	1.3
Non-tax revenues	18,521	18,014	17,375	18,521	18,088	16,555	0	74	-820	0.0	0.4	-4.7
Capital revenues	2,026	2,025	2,025	2,026	2,226	2,226	0	201	201	0.0	9.9	9.9
Donations	6,100	6,100	6,100	6,100	6,600	6,500	0	500	400	0.0	8.2	6.6
Total expenditures	228,548	236,888	245,381	228,548	237,265	244,792	0	377	-589	0.0	0.2	-0.2
Current expenditures	202,577	208,955	215,278	202,577	211,259	215,986	0	2,304	708	0.0	1.1	0.3
Wages and allowances	28,388	29,473	29,473	28,388	29,370	29,370	0	-103	-103	0.0	-0.3	-0.3
Goods and services	19,643	19,712	19,722	19,643	19,856	19,555	0	144	-167	0.0	0.7	-0.8
Transfers to LGUs	19,119	20,051	21,107	19,119	20,068	20,696	0	17	-411	0.0	0.1	-1.9
Subsidies and transfers	18,568	18,983	19,683	18,568	21,755	21,755	0	2,772	2,072	0.0	14.6	10.5
Social transfers	107,679	111,152	115,109	107,679	111,328	115,048	0	176	-61	0.0	0.2	-0.1
Interest payments	9,180	9,584	10,184	9,180	8,882	9,562	0	-702	-622	0.0	-7.3	-6.1
Capital expenditures	25,971	27,933	30,103	25,971	26,006	28,806	0	-1,927	-1,297	0.0	-6.9	-4.3
Budget balance	-17,700	-17,162	-16,105	-17,700	-17,545	-16,105	0	-383	0	0.0	2.2	0.0
Primary budget balance	-8,520	-7,578	-5,921	-8,520	-8,663	-6,543	0	-1,085	-622	0.0	14.3	10.5
Total revenues, % of GDP	30.3	29.7	28.8	30.1	29.4	28.5				-0.2	-0.2	-0.3
Total expenditures, % of GDP	32.9	32.0	30.8	32.7	31.8	30.5				-0.2	-0.2	-0.3
Budget balance, % of GDP	-2.5	-2.3	-2.0	-2.5	-2.3	-2.0				0.0	0.0	0.0
Primary budget balance, % of GDP	-1.2	-1.0	-0.7	-1.2	-1.2	-0.8				0.0	-0.1	-0.1

Source: Ministry of Finance and projections of the Ministry of Finance (*)

The realisation to date, as well as the revised economic growth projections and the retained fiscal discipline result in significant downward revision of the government and the public debt projections in relation to the revised 2019-2021 Fiscal Strategy of RNM (Figure 19). In fact, the Revised Strategy assumed a public debt of 49.8% of GDP in 2018, compared to the significantly lower actual public debt of 48.5% of GDP. Furthermore, under this Fiscal Strategy, the fiscal discipline is retained, with moderate decrease of the total budget deficits, as well as the primary budget deficit as a main input in the debt trajectory. As for the budget deficit financing, the projection of the net issuance of domestic securities remains unchanged compared to the previous Fiscal Strategy, while projection of foreign borrowing is reduced in 2019 and 2021. In addition, a revision of disbursements with respect to projects financed with foreign creditors has been made.

Given these factors, the government debt projections were reduced by 1.1 p.p. in 2019, 1.3 p.p. in 2020 and 1.6 p.p. in 2021. There is also a downward revision of the guaranteed debt by 0.5 p.p. in 2019, 0.8 p.p., in 2020 and 0.7 p.p. in 2021. This results in a significant downward revision of the projected total public debt, by 1.6 p.p. in 2019, 2.1 p.p. in 2020 and 2.3 p.p. in 2021 (Figure 19). Thereby, these downward revisions not only reflect the above-mentioned factors, but they are also in line with magnitude of the revisions by some of the international institutions. In fact, the last April projections of the International Monetary Fund, as regards the general government debt ratio to GDP for North Macedonia in 2019 - 2021 (Table 16) are revised downwards by 2 percentage points on average.

Figure 19. Comparison of the Government and Public Debt Projections with the Revised 2019-2021 Fiscal Strategy (as % of GDP)



Source: Ministry of Finance and projections of the Ministry of Finance (in FS 2020-22, 2018 is realisation)

6.2. Comparison with the Projections of Other National and International Institutions

Medium-term economic projections are based on certain assumptions, primarily on the macroeconomic environment, designing of economic policies and their implementation, as well as the absence of greater shocks. This also refers to medium-term macroeconomic and fiscal projections discussed so far as baseline medium-term projection. Thereby, different assumptions on input variables may also result in variations at the projections of the key variables of fiscal policy. However, the economic growth projections (particularly in 2019 and 2020), as well as the inflation rates from the relevant national and international institutions are similar to those included in this Fiscal Strategy (Table 15).

Table 15. Comparison of GDP Growth and Inflation Projections for North Macedonia

Institution	Real GDP growth (%)				Inflation rate (%)			
	2019	2020	2021	2022	2019	2020	2021	2022
IMF	3.0	3.1	3.2	3.3	1.8	2.0	2.2	2.2
World Bank	2.9	3.2	/	/	1.8	1.9	/	/
European Commission	3.0	3.2	/	/	1.7	2.0	/	/
EBRD	3.0	3.0	/	/	/	/	/	/
Vienna Institute for International Economic Studies	3.0	3.0	3.0	/	2.0	2.0	2.0	/
NBRNM	3.5	3.8	4.0	/	1.5	2.0	2.0	/
Ministry of Finance	3.5	4.2	5.0	5.0	2.0	2.0	2.2	2.2

Source: IMF (World Economic Outlook, April 2019), World Bank (Western Balkans Regular Economic Report No. 15, April 2019), European Commission (European Economic Forecast, May 2019), EBRD (Regional Economic Prospects, May 2019), WIIW The Vienna Institute for International Economic Studies (Forecast Report, March 2019) and NBRNM (May 2019).

Furthermore, projections on the deficit and the general government debt in North Macedonia from the relevant international institutions (Table 16) are similar to the ones contained in this Fiscal Strategy.

Table 16. Comparison of Projections on Budget Deficit and General Government Debt in North Macedonia

Institution	Budget balance (% of GDP)				General government debt (% of GDP)			
	2019	2020	2021	2022	2019	2020	2021	2022
IMF	-2.6	-2.5	-2.4	-2.2	40.5	41.3	41.8	42.1
World Bank	-3.0	-2.4	/	/	44.2	45.3	/	/
European Commission	-3.0	-2.5	/	/	43.2	44.0	/	/
Ministry of Finance	-2.5	-2.3	-2.0	-2.0	42.2	41.9	39.8	39.0

Source: IMF (World Economic Outlook, April 2019), World Bank (Western Balkans Regular Economic Report No. 15, April 2019) and European Commission (European Economic Forecast, May 2019).

7. Fiscal Risks and Sensitivity Analysis

Medium-term economic and fiscal projections are always accompanied by certain level of uncertainty and risks. Possible occurrence of these risks, reflecting conditions other than those taken as basis for the medium-term projections mentioned above, would result in deviations from the baseline medium-term projection, i.e. different movements of the key fiscal variables. Hence, this section of the Fiscal Strategy analyses the potential effects from the possible occurrence of several main macro-fiscal risks on the budget deficit and the general government debt. In addition, this section also analyses the exposure of the external general government

debt to the market risk, as well as the effect of various financing strategies on the debt level, the debt servicing costs and the portfolio structure.

7.1 Macro-Fiscal Risks and Sensitivity of Deficit and General Government Debt

This part of the Fiscal Strategy provides review of the results from the sensitivity analyses on sensitivity of budget deficit and level of general government debt to the possible effects of the possible realisation of the four main identified risks to fiscal policy in the medium term. Thereby, all risks are analysed separately and all scenarios assume absence of other deviations from the baseline projection and the effects only of certain risks:

- Scenario 1 - lower economic growth,
- Scenario 2 - lower tax revenues by 5%,
- Scenario 3 - lower execution of capital expenditures by 25% and
- Scenario 4 - servicing the liabilities on the basis of issued guarantees from the central government budget.

Taking into account that baseline medium-term fiscal projection is based on certain macroeconomic assumptions, they are considered to be a primary factor with a potential effect on the fiscal developments. Therefore, effects of downward risks regarding the external environment are used as the first risk scenario. This would deteriorate both the foreign trade and the financial flows, as well as increase uncertainty and deteriorate the expectations among the domestic economic agents, which would further result in a lower economic growth of the country. According to this scenario, the projection of the average real GDP growth between 2019 and 2022 is by 1.1 percentage points lower than in the baseline projection. Further, the possible lower economic growth would also imply lower performance of the cyclical component of budget revenues. Therefore, in relation to the baseline projection, this scenario would result in a higher budget deficit by 0.6 percentage points of GDP on average in the period 2019-2022, while the general government debt would be higher by 3.5 percentage points of GDP at the end of 2022.

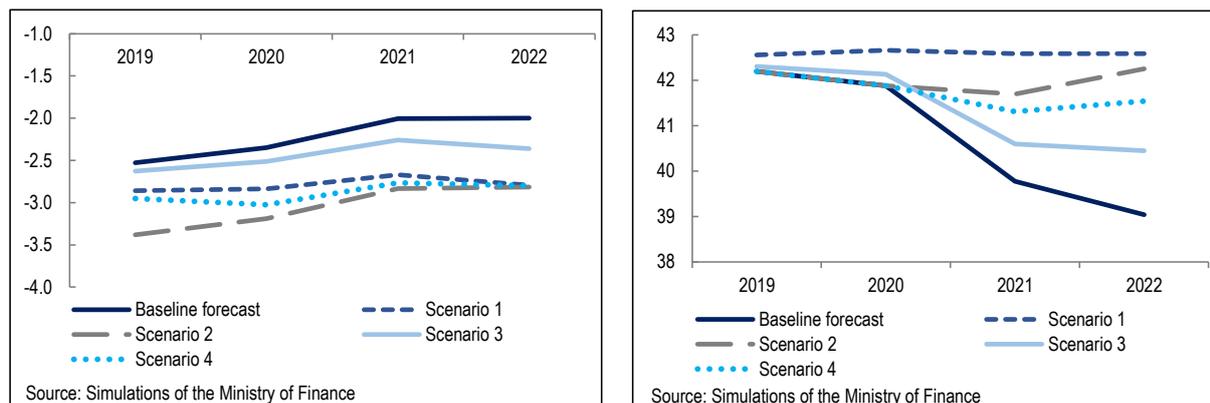
The second scenario assumes lower collection of tax revenues by 5% annually compared to the baseline projection. In conditions of unchanged level of budget expenditures and unchanged economic growth, lower tax revenues would lead to a higher budget deficit by 0.8 p.p. of GDP on average during the analysed period compared to the baseline projection, while the general government debt would be higher by 3.2 p.p. of GDP at the end of 2022 in relation to the baseline projection.

The third scenario assumes lower execution of capital expenditures, i.e. their execution at the level of 75% of the levels projected in the baseline projection, which is similar to the execution in the past. The lower execution of capital expenditures would slow down the growth of gross investments and accordingly lead to a lower GDP growth rate in relation to the baseline projection on average by around 0.5 percentage points annually. This scenario would adversely affect tax revenues as well, which would overcome the effect of reduced expenditures. Therefore, according to this scenario, the budget deficit would be higher by 0.2 p.p. of GDP on average annually in the projection period compared to the baseline projection, while the general government debt would be higher by 1.4 p.p. of GDP at the end of 2022 compared to the baseline projection.

The fourth scenario assumes that the liabilities falling due on the basis of principal and interest on loans guaranteed by the state to be fully serviced from the central government budget (Budget of the Republic of North Macedonia), which is an extreme assumption bearing on mind that, in the past period, the guaranteed loans were not a burden on the budget and they were regularly and timely serviced by the appropriate public enterprises and state-owned companies. The possible realisation of this extreme scenario would lead to higher budget expenditures in the period to come. In conditions of unchanged level of budget revenues and unchanged economic growth, this would lead to higher budget deficit by 0.7 p.p. of GDP on average annually in the period 2019-2022 compared to the baseline projection, while the general government debt at the end of 2022 would be higher by 2.5 p.p. compared to the baseline projection. Thereby, the effect of this scenario on debt would be present in 2021 and 2022.

In summary, the realisation of any of the four risk scenarios, which reflect the main identified macro-fiscal risks in the coming period, would mostly result in relatively limited effects on the budget deficit and the general government debt (Figure 20). More precisely, the sustainability of fiscal policy in the medium run is in no case jeopardised.

Figure 20: Sensitivity Analysis of Budget Deficit (left) and General Government Debt (right) of Main Macro-Fiscal Risks (% of GDP)



7.2. Scenario Analysis of the Effects of Interest Rate Risk and Currency Risk on the External General Government Debt

In order to analyse the exposure of the debt portfolio of the Republic of North Macedonia to the market risk, a short simulation is prepared on the effects of the interest rate changes and the foreign exchange rate on the costs related to servicing of the external general government debt (Table 17). The sensitivity analysis of the movements of the servicing-related costs on the basis of external debt in the Budget of Republic of North Macedonia, is based on the following assumptions:

- by changing one variable, all other variables remain the same, i.e. ceteris paribus;
- in conditions of possible currency movements in relation to the euro, the Denar exchange rate in relation to the euro remains stable;
- non-correlation between interest rate movements and exchange rate movements.

Table 17. Sensitivity Analysis of Costs Related To Servicing the External General Government Debt in Cases of Changes of Interest Rates and of Foreign Exchange Rates

	2020	2021	2022
Baseline scenario	100.0	100.0	100.0
Scenario 1 - increase of corresponding interest rates by 1 percentage point	105.0	105.5	106.9
Scenario 2 - appreciation of other currencies in the portfolio in relation to the euro by 10%	100.6	100.4	101.3

Source: Simulations of the Ministry of Finance

Main conclusions that may arise from this analysis are as follows:

1. Servicing-related costs on the basis of external general government debt are sensitive to the interest rate movements. Should interest rates in 2020 surge by 1 percentage point in relation to the baseline projection, this would cause interest-related costs to increase by 5.0%, i.e. by EUR 4.8 million, with similar effects in 2021 and 2022. Such sensitivity could be explained as exposure of debt portfolio to interest rate risk.

2. Possible euro depreciation in relation to the other currencies in the portfolio (US dollar, Japanese Yen and Special Drawing Rights) by 10% will cause an increase of servicing-related costs by 0.6% in 2020, i.e. by EUR 3 million. Given the obtained results, it may be concluded that possible unfavourable trends at exchange rates of other currencies in relation to the euro will not cause any significant increase of the servicing-related costs, as a result of the fact that most of the external general government debt is euro-denominated.

7.3 Alternative Financing Strategies

In order to improve the decision-making process related to financing the Budget needs, aimed at successful fulfilment of the goals set in the public debt management policy, quantitative analysis is prepared in

this Strategy by applying the Medium-Term Debt Strategy (MTDS) This tool is developed by the World Bank and the IMF, aimed at determining the costs and risks related to the potential financing strategies.

The MTDS model uses the following as an input data:

- principal and interest flows on the existing debt portfolio,
- projections of macroeconomic and financial variables,
- financial variables shocks (interest rate and exchange rate) and
- alternative strategies on financing the budget needs.

Alternatives that could be used as source of financing the budget needs are the following:

1. treasury bills and government bonds on the domestic government securities (GS) market;
2. Eurobond on the international capital market;
3. funds from the World Bank as budget support in the form of development policy loan (DPL) or policy-based guarantee (PBG) loan.
4. funds for project financing from international financial institutions and private creditors.

MTDS model analyses three alternative financing strategies, elaborated below. Timeframe to which the analysis refers is a 4-year period (2019-2022).

Alternative manners of financing differ among themselves in the financing structure in relation to the domestic or the external financing, as well as in the instrument structure.

The first alternative envisages covering the financing needs through the domestic government securities market, the international capital market, World Bank funds for budget support, as well as withdrawal of funds for project financing by the international financing institutions. Within the domestic financing (GS with and without FX clause), most of the net financing is realised on the basis of long-term instruments, i.e. government bonds. This strategy is aimed at retaining regular issuance of treasury bills, as well as staying focused on expanding the maturity structure of the portfolio of government securities with longer maturities. This Strategy is distinguished mainly as a result of the lower exposure to the re-financing risk. The value of ATM indicator at the end of 2022 is increasing, indicating lower refinancing risk, and the interest rate risk is lowest at this Strategy. This Strategy is insignificantly more expensive option compared to the other alternatives.

Second alternative has the same ratio between domestic and foreign financing as the first alternative and unchanged structure of the foreign financing, the main difference being higher financing by issuing treasury bills, and less net financing through long-term instruments. This Strategy is aimed at reducing the financing costs by issuing higher amount of short-term Denar instruments, having lower interest rate than the long-term instruments on the domestic GS market. From the point of view of costs, this alternative is insignificantly cheaper compared to the other strategies, but is accompanied with far higher portfolio riskiness. In this strategy, the highest levels are recorded for the indicators: debt that falls due in 1 year and debt that is re-fixed in 1 year, while the currency risk is lowest seen through the share of debt denominated in foreign currency in the total debt.

The third alternative largely relies on external financing and lower net borrowing on GS domestic market. Greater focus is placed on the borrowing on the international capital market through the Eurobond, while as for the domestic market, securities that fall due are expected to be rolled over, as well as low net borrowing at all maturities. Re-financing risk and currency risk are most evident at this alternative due to the greater financing from foreign sources.

Objective of the MTDS tool is to quantify the costs and the risks and to find out the optimal ratio between them. The tool enables comparison of the potential debt management strategy, by analyzing the costs and risks that are result of the different debt portfolios and cash flows. In addition, enables observing the different structure of the debt portfolio at each of the alternatives, thereby taking into account the effects of the shocks on the financial variables. According to the analysis of the results from the application of the alternative approaches, the first alternative is considered to be the most favourable in terms of the debt portfolio riskiness (as per the refinancing risk and the interest rate risk indicators), because of the greater focus on the instruments with longer maturities on the domestic market, although it is a slightly more expensive option than the others alternatives. Second and third alternative from the aspect of costs generate better performance, but are less favourable in relation to the refinancing risk and the interest rate risk indicators. In addition, the first strategy further provides for developing and maintaining efficient and liquid domestic government securities market, being deepened so as to be able to respond to the budget needs in conditions of external shocks.

Appendix 1. Maximum Amounts of Expenditures by Budget Users, 2020-2022

Table A1. Maximum Amounts of Expenditures of the Core Budget (637 Account), Denar

BUDGET USER	2020	2021	2022
PRESIDENT OF THE REPUBLIC OF NORTH MACEDONIA	75,500,000	74,503,000	74,312,000
INTELLIGENCE AGENCY	239,000,000	235,844,000	235,238,000
ASSEMBLY OF THE REPUBLIC OF NORTH MACEDONIA	540,442,000	523,438,000	522,093,000
STATE AUDIT OFFICE	96,179,000	94,909,000	94,665,000
STATE COMMISSION FOR PREVENTION OF CORRUPTION	35,000,000	34,538,000	34,449,000
STATE ELECTION COMMISSION	471,171,000	371,670,000	78,440,000
COMMISSION FOR PROTECTION OF COMPETITION	22,827,000	22,526,000	22,468,000
DIRECTORATE FOR PERSONAL DATA PROTECTION	17,094,000	16,868,000	16,825,000
STATE APPEALS COMMISSION FOR PUBLIC PROCUREMENT	19,550,000	19,292,000	19,242,000
REGULATORY COMMISSION FOR HOUSING	9,503,000	9,378,000	9,353,000
COUNCIL FOR ADVANCEMENT AND OVERSIGHT OF AUDIT	6,829,000	6,739,000	6,722,000
COMMISSION FOR PROTECTION AGAINST DISCRIMINATION	15,000,000	14,802,000	14,764,000
STATE SECOND LEVEL COMMISSION FOR ADMINISTRATIVE AND LABOR RELATION PROCEDURE	54,633,000	53,912,000	53,773,000
AUDIT AUTHORITY FOR AUDIT OF INSTRUMENT FOR PRE-ACCESSION ASSISTANCE	41,909,000	41,418,000	41,039,000
STATE SECOND LEVEL COMMISSION FOR INSPECTION SUPERVISION	27,700,000	27,334,000	27,264,000
OPERATIONAL TECHNICAL AGENCY	134,000,000	132,231,000	112,206,000
CONSTITUTIONAL COURT OF THE REPUBLIC OF NORTH MACEDONIA	40,676,000	40,139,000	40,036,000
GOVERNMENT OF THE REPUBLIC OF NORTH MACEDONIA	2,950,000,000	2,960,385,000	3,149,631,000
SERVICE FOR GENERAL AND COMMON AFFAIRS OF THE GOVERNMENT OF THE REPUBLIC OF NORTH MACEDONIA	1,138,781,000	1,108,942,000	909,437,000
SECRETARIAT FOR LEGISLATION	19,726,000	19,466,000	19,416,000
PUBLIC ATTORNEY OF THE REPUBLIC OF NORTH MACEDONIA	81,000,000	79,930,000	79,725,000
AGENCY FOR ADMINISTRATION	45,227,000	44,630,000	44,515,000
SECRETARIAT FOR EUROPEAN AFFAIRS	137,000,000	135,191,000	134,844,000
SECRETARIAT FOR IMPLEMENTATION OF OHRID AGREEMENT	625,400,000	602,537,000	591,097,000
AGENCY FOR COMMUNITY RIGHTS REALIZATION	11,469,000	11,318,000	11,288,000
AGENCY FOR MANAGEMENT OF CONFISCATED PROPERTY	22,738,000	22,566,000	22,479,000
INSPECTION COUNCIL	23,136,000	22,830,000	22,772,000
AGENCY FOR USE OF LANGUAGE	8,656,000	8,542,000	8,520,000
MINISTRY OF DEFENCE	9,673,000,000	12,115,000,000	14,875,000,000
DIRECTORATE OF SECURITY OF CLASSIFIED INFORMATION	34,503,000	34,936,000	34,846,000
PROTECTION AND RESCUE DIRECTORATE	250,690,000	247,380,000	246,744,000
CRISIS MANAGEMENT CENTER	166,807,000	164,604,000	161,295,000
MINISTRY OF INTERIOR	10,242,658,000	10,138,982,000	10,164,114,000
MINISTRY OF JUSTICE	470,127,000	463,919,000	462,727,000
DIRECTORATE FOR EXECUTION OF SANCTIONS	880,233,000	878,543,000	886,274,000
OFFICE FOR MANAGEMENT OF REGISTERS OF BIRTHS, MARRIAGES AND DEATHS	232,041,000	203,485,000	202,962,000
THE BUREAU FOR REPRESENTATION OF THE REPUBLIC OF MACEDONIA BEFORE THE EUROPEAN COURT OF HUMAN RIGHTS	5,383,000	5,312,000	5,298,000
INSPECTORATE FOR USE OF LANGUAGES	7,616,000	7,515,000	7,496,000
MINISTRY OF FOREIGN AFFAIRS	1,277,760,000	1,260,887,000	1,257,648,000
MINISTRY OF FINANCE	764,828,000	758,075,000	786,593,000
CUSTOMS ADMINISTRATION OF THE REPUBLIC OF NORTH MACEDONIA	844,063,000	849,397,000	850,207,000
COMMODITY RESERVES AGENCY	74,884,000	74,426,000	74,272,000
PUBLIC REVENUE OFFICE	2,760,902,000	2,728,392,000	2,721,382,000
FINANCIAL POLICE	53,416,000	52,711,000	52,575,000
STATE FOREIGN EXCHANGE INSPECTORATE	7,879,000	7,775,000	7,755,000

MINISTRY OF ECONOMY	445,538,000	439,414,000	438,624,000
AGENCY FOR FOREIGN INVESTMENTS AND EXPORT PROMOTION	60,643,000	59,842,000	59,688,000
AGENCY FOR PROMOTION AND SUPPORT OF TOURISM	130,000,000	128,283,000	127,954,000
DIRECTORATE FOR TECHNOLOGICAL INDUSTRIAL DEVELOPMENT ZONES	953,521,000	842,250,000	840,086,000
STATE MARKET INSPECTORATE	177,433,000	175,534,000	175,083,000
STATE INSPECTORATE FOR TECHNICAL INSPECTION	20,782,000	20,557,000	20,504,000
MINISTRY OF ENVIRONMENT AND PHYSICAL PLANNING	468,676,000	462,487,000	461,299,000
STATE INSPECTORATE OF ENVIRONMENT	26,320,000	25,972,000	25,906,000
MINISTRY OF TRANSPORT AND COMMUNICATIONS	1,708,209,000	1,667,745,000	1,378,038,000
STATE TRANSPORT INSPECTORATE	29,760,000	29,268,000	29,193,000
STATE INSPECTORATE FOR CONSTRUCTION AND URBAN PLANNING	15,984,000	15,773,000	15,732,000
STATE COMMUNAL INSPECTORATE	12,553,000	12,387,000	12,355,000
MINISTRY OF AGRICULTURE, FORESTRY AND WATER ECONOMY	835,352,000	717,013,000	674,351,000
AGENCY FOR ENCOURAGING THE DEVELOPMENT OF AGRICULTURE – BITOLA	68,206,000	67,305,000	67,132,000
NATIONAL HYDRO-METEOROLOGICAL SERVICE	95,838,000	94,627,000	94,384,000
AGENCY FOR FINANCIAL SUPPORT IN AGRICULTURE AND THE RURAL DEVELOPMENT	8,234,624,000	8,224,566,000	8,203,435,000
FOOD AND VETERINARY AGENCY OF THE REPUBLIC OF NORTH MACEDONIA	540,000,000	532,869,000	531,500,000
STATE INSPECTORATE FOR AGRICULTURE	89,726,000	88,541,000	88,314,000
STATE INSPECTORATE FOR FORESTRY AND HUNTING	19,035,000	18,784,000	18,735,000
MINISTRY OF LABOR AND SOCIAL POLICY	43,611,544,000	43,207,761,000	43,529,409,000
STATE LABOR INSPECTORATE	104,000,000	102,627,000	102,363,000
MINISTRY OF EDUCATION AND SCIENCE	21,690,961,000	21,417,702,000	21,653,715,000
OFFICE FOR DEVELOPMENT OF EDUCATION	178,245,000	175,891,000	175,439,000
NATIONAL AGENCY FOR EUROPEAN EDUCATION PROGRAMS AND MOBILITY	27,440,000	27,078,000	27,008,000
STATE EDUCATION INSPECTORATE	59,278,000	58,495,000	58,345,000
AGENCY FOR YOUTH AND SPORT	351,287,000	307,176,000	306,387,000
MINISTRY OF INFORMATION SOCIETY AND ADMINISTRATION	1,838,370,000	1,901,310,000	1,896,425,000
STATE ADMINISTRATIVE INSPECTORATE	25,993,000	25,650,000	25,584,000
MINISTRY OF CULTURE	3,120,734,000	2,830,061,000	2,797,177,000
MINISTRY OF HEALTH	4,955,272,000	4,889,838,000	4,872,154,000
STATE SANITARY AND HEALTH INSPECTORATE	38,887,000	38,374,000	38,275,000
MINISTRY OF LOCAL SELF-GOVERNMENT	400,000,000	394,718,000	405,130,000
STATE INSPECTORATE FOR LOCAL SELF-GOVERNMENT	8,215,000	8,107,000	8,086,000
EMIGRATION AGENCY	21,612,000	21,327,000	21,272,000
COMMISSION FOR PROTECTION OF THE RIGHT TO FREE ACCESS TO PUBLIC INFORMATION	17,264,000	17,036,000	16,992,000
COMMISSION ON RELATIONS WITH RELIGIOUS COMMUNITIES AND RELIGIOUS GROUPS	13,573,000	13,394,000	13,359,000
AGENCY FOR REAL ESTATE CADASTRE	210,202,000	207,426,000	206,893,000
STATE STATISTICAL OFFICE	511,171,000	182,809,000	182,510,000
STATE ARCHIVES OF THE REPUBLIC OF NORTH MACEDONIA	139,609,000	137,765,000	137,412,000
BUREAU FOR COURT EXPERTISE	20,287,000	20,019,000	19,968,000
MACEDONIAN ACADEMY OF SCIENCE AND ARTS OF THE REPUBLIC OF NORTH MACEDONIA	111,248,000	109,779,000	109,497,000
BUREAU FOR REGIONAL DEVELOPMENT	139,437,000	137,596,000	137,242,000
COURT COUNCIL OF REPUBLIC OF NORTH MACEDONIA	2,102,807,000	2,075,040,000	2,069,708,000
PUBLIC PROSECUTION OF THE REPUBLIC OF NORTH MACEDONIA	780,463,000	770,157,000	768,178,000
OMBUDSPERSON	88,333,000	87,167,000	86,943,000

Table A2. Maximum Amounts of Expenditures Financed with Loans, Denar

BUDGET USER	2020	2021	2022
Government of the Republic of North Macedonia/Fund for innovations and technology development	324,290,000	0	0
Directorate for execution of sanctions	369,000,000	430,500,000	553,500,000
Ministry of Finance	1,032,685,000	768,750,000	430,500,000
Ministry of economy	1,200,200,000	0	0
Ministry of transport and communications	3,582,829,000	4,611,398,000	6,285,300,000
Ministry of environment and physical planning	123,000,000	984,000,000	1,906,500,000
Ministry of agriculture, forestry and water economy	728,353,000	959,400,000	1,141,139,000
Ministry of labor and social policy	532,537,000	696,074,000	392,898,000
Ministry of education and science	587,032,000	350,550,000	237,670,000
Ministry of information society and administration	0	30,750,000	61,500,000
Ministry of health	1,502,904,000	4,369,449,000	4,120,500,000

Table A3. Maximum Amounts of Expenditures of the Core Budget (660 Account), Denar

SOCIAL FUNDS	2020	2021	2022
Pension and Disability Insurance Fund of the Republic of North Macedonia	74,018,000,000	76,820,000,000	80,010,000,000
Health Insurance Fund of the Republic of North Macedonia	33,017,000,000	34,405,000,000	35,909,000,000
Employment Service Agency of the Republic of North Macedonia	3,171,000,000	2,938,000,000	3,114,000,000