КОМЕНТАР
COMMENT

Бр./No.34

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On the Budget Supplement 2022
27 May 2022

The Government of North Macedonia adopted **the Budget Supplement for 2022.** The Supplement is adopted in completely changed macroeconomic conditions, mainly as a result of the military invasion of the Russian Federation onto Ukraine, which caused lower growth prospects for the European continent, and hence for North Macedonia, as well as a significant increase in energy and primary commodity prices, while further transferred to the wider consumer basket.

In that sense, the Budget Supplement revises the macroeconomic projections, namely 3.2% GDP growth for 2022 and 7.2% growth in the cost of living. **Finance Think estimates that these projections are optimistic, ie the projected growth rate is at the upper bound with significant prospects to be lower, while the projected inflation rate is at the lower bound with significant prospects to be higher.** In nominal terms, combining real GDP growth and price growth, which serves as a basis for estimating budget revenues, the projection for latter’s growth is currently appropriate and is mainly a result of the prices increase which contribute the most to VAT revenue growth.

The Budget Supplement envisages **widening the budget deficit to 5.3% of GDP**, and in conditions of further slowdown in GDP growth, it will be exceeded. Although crisis circumstances may be a justification for higher budget spending and increased public debt, the current context is quite different from that in the pandemic 2020.

Namely, presently the slowdown in the GDP growth is accompanied by **pronounced price pressures**, mainly determined by global developments. In the past, Finance Think estimated that so far there have been no domestic factors for inflation, ie price pressures on the demand side.

The supplementary budget envisages increase of expenditures for salaries by 1.7%, goods and services by 11.4% and block grants (containing payments of salaries at the municipal level) by 4.7% compared to the initial projection, while in terms of 2021 realization - the growth is even greater. **These increases, especially in goods and services, do not reflect (or obscure) the stated intention to cut unnecessary and unproductive expenditures, and expenditures that may be deferred**, although part of the increase is intended to cover public sector energy costs.

However, **the increase of expenditures for subsidies and transfers in the amount of 40.5% compared to the initial projection is particularly worrying**, of which a significant part is justified by the subsidization of energy consumption. However, most subsidies remain under-targeted and do not address structural weaknesses, including support for an accelerated green transition. The second important part that generates this increase is setting funds to subsidize crop production in order to reduce the possible occurrence and consequences of the food crisis. However, additional clarifications are needed on how these subsidies focus on yields, ie output from production (yield per hectare) instead of inputs in production (unit of sown area).

In the reminder, the growth of the item subsidies and transfers is due to the subsidizing of the increase of wages and the minimum wage in the amount of 44% compared to the initial projection, **which in the current circumstances may support additional pressure on prices from the side of consumption**, and at the expense of the budget deficit and public debt.

The reduction of the planned capital investments is an expected move and a pattern of adjusting the Budget with each rebalance in the previous decade. It is not related to the crisis and the changed circumstances, but to the unrealistic initial planning of capital expenditures. **In the current circumstances, it is important that these reduced capital expenditures are fully realized**, albeit according to previous experiences this is unlikely to happen, because the average realization of capital expenditures compared to the last Supplement in previous years was about 75%-80%.

Finance Think appeals to the need for funds in this Budget of about 900 million euros, of which about 700 million euros current deficit, **to be met predominantly from external sources**, in order to better support foreign exchange reserves, **primarily from concession creditors.** The latter would have two key objectives: *first*, to reduce the cost of borrowing amid tightening conditions in private markets, and *second*, to **adopt a certain external mechanism to ensure further consolidation of public finances and to control the further price pressures that the Budget can exert through current spending.**

In conclusion, the Budget Supplement is a response to the crisis, but **greater consolidation of current spending is needed so that it does not have a pro-inflationary effect.**