

December 23, 2011

# 2012 State Budget

## Conservative, but deficit financing is highly dependent on debt markets

Yesterday Ukraine's parliament approved the 2012 state budget. Our first take is positive – both revenues and expenditures are projected to considerably lag nominal GDP growth. Meanwhile, our biggest concern is that Naftogaz' financing needs are underestimated given the budget's import gas price assumption of USD 416/tcm. Deficit financing and debt rollover remain the key challenges for 2012. Overall, budget parameters are broadly in line with market expectations and the document should have a minor impact on Ukrainian debt quotations.

### Key budget parameters & assumptions

- In 2012, budget revenues are projected to grow 10% yoy to UAH 333 bln (USD 42 bln), with the NBU contributing UAH 9.6 bln of its income or 2.9% of the total. Expenditures are to rise by a moderate 5% yoy to UAH 385 bln (USD 48 bln). The central budget deficit is planned at UAH 38 bln or 2.6% of 2012E GDP, if Naftogaz' capitalization costs are accounted for, broadly in line with IMF requirements.
- The government plans to borrow UAH 61 bln (USD 7.6 bln) on the domestic market and UAH 38 bln (USD 4.7 bln) on the external market next year. Key external debt repayments in 2012 include USD 2.0 bln to Russia's VTB, USD 1.1 bln to the IMF and USD 0.5 bln in Eurobonds.
- There seems to be progress in alleviating the pension fund's deficit, with transfers to it halved yoy to UAH 9.0 bln in 2012.

### We see several execution and deficit financing risks

- Raising/rolling over debt, both domestically and externally, is going to be a challenge next year given difficult global debt markets and weak liquidity in the domestic banking sector. In terms of foreign obligations, we believe rollover of the VTB loan is almost certain, but raising the other USD 2.7 bln is dependant on Ukraine regaining access to international public debt markets.
- The government likely underestimated Naftogaz' financing needs at UAH 12 bln (vs. our estimate of UAH 16 bln in 2011), while the import gas price is expected to rise 32% yoy to USD 416/tcm for 2012. We think the IMF will bring this issue back up when talks resume on unfreezing Ukraine's USD 15.5 bln loan.
- The minimum wage is expected to increase 13% yoy next year, slightly above our 2012 CPI forecast of 9.0% eop. We do not rule out, however, that the government increases salaries more ahead of the October parliamentary election.

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### Budget (planned)

	2011	2012
Revenues, USD bln	37.8	41.1
% of GDP	23.6%	22.8%
Expenditures, USD bln	-42.7	-44.2
% of GDP	-26.7%	-24.6%
Net budget lending, USD bln	0.4	0.0
% of GDP	0.0%	0.0%
Deficit, USD bln	-4.4	-4.7
incl. Naftogaz capitaliz.	0.0	-1.6
% of GDP	-2.8%	-2.6%

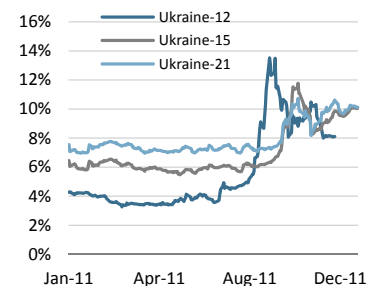
Sources: State budgets for 2011, 2012; Concorde Capital

### Budget deficit financing

	USD bln	% of GDP
Cash leftovers from 2011	0.0	0.0%
External borrowings	4.7	2.6%
External redemptions	-3.9	-2.2%
incl. VTB loan	-2.0	-1.1%
incl. IMF debt	-1.1	-0.6%
incl. Eurobond	-0.5	-0.3%
Net external borrowing	0.8	0.4%
Domestic borrowings	7.6	4.2%
Domestic redemptions	-4.3	-2.4%
Net domestic borrowing	3.3	1.8%
Privatization revenues	1.3	0.7%
Total financing	5.3	2.9%
Total needs	4.7	2.6%
incl. Naftogaz capitaliz.	1.6	0.9%
Cash leftovers for 2013	0.6	0.3%

Sources: State budget for 2012, Concorde Capital

### Ukrainian Eurobond yields



Source: Bloomberg

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