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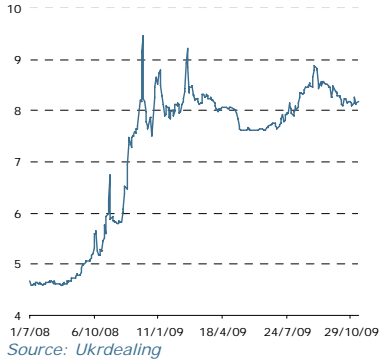
# IMF cooperation in 2009 in doubt

## Hardest hit would be public finance

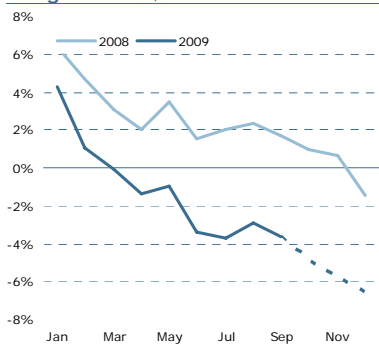
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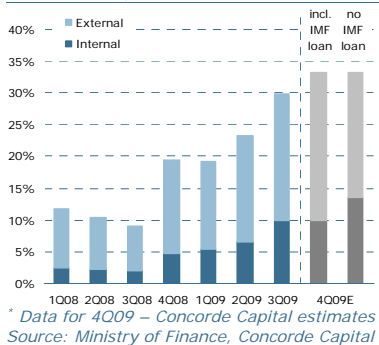
### USD/UAH rate, mid-market



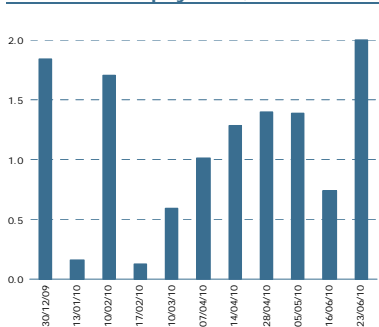
### Budget deficit, % of GDP\*



### Public debt, % of GDP\*



### UAH T-bills repayment, UAH bln



**The allocation of the fourth, USD 4 bln, tranche from the IMF to Ukraine, originally slated to take place this month, looks unlikely. While, foremost, this complicates financing of the budget deficit, in our view, the situation is not critical. Ukraine has already received ~USD 10 bln from the IMF and the domestic economic situation has stabilized recently.**

Statements from International Monetary Fund officials, including chief Dominique Strauss-Kahn over the weekend, have suggested that work with the Ukrainian government until after the presidential elections in January is in doubt. On Monday, a representative from the IMF's office in Kyiv clarified to the local mass-media that the IMF is ready to resume cooperation with Ukraine if there is consensus among leading politicians on sticky issues, though they did not expect this to happen.

In our view, possible implications of not receiving the tranche in end-2009 – beg-2010 include:

- More difficult and expensive financing of the budget deficit
- Higher risk of short-term public domestic debt refinancing
- No risk as to sovereign external debt payments
- No significant UAH depreciation, although negative sentiment and increased volatility might prevail

### Hardest hit to be borne by public finance

The fourth tranche from the IMF, most likely, would have gone directly to the government, as did the previous tranche in July. Hence, an allocation delay would make it harder to cover the budget deficit, which might amount to as much as UAH 25-30 bln (USD 3.0-3.7 bln) in 4Q09, but no less than UAH 20 bln (USD 2.4 bln) (accounting for possible outlay cuts, higher excise rates and increased discipline by corporate taxpayers). The consolidated budget deficit could reach as much as UAH 68 bln (USD 8.3 bln) or 7.4% of GDP in 2009 under our pessimistic scenario (incl. covering Naftogaz' payments for gas).

Total public debt equaled ~30% of GDP as of end-3Q09 and the government still has some leeway to cover budget deficit by attracting new debt. Without the next IMF tranche, the government will have no other recourse but to turn to the domestic debt market, a venue more expensive and not terribly liquid.

### Scarce domestic liquidity will be aggravated by gov't demand

Increased demand from the government on the domestic debt market should push interest rates up and delay the return of overall liquidity in the banking system. Ultimately, the burden will likely end up on the NBU, which may have to refinance or buy out new government UAH debt securities from banks.

Low liquidity among banks this year stems from the NBU's withdrawal of hryvnias via FX interventions (USD 9.8 bln in 10M09) and high risk aversion across the system. Recently the tendency was aggravated by stricter NBU monetary policy: balance on banks' correspondent accounts at the NBU dropped to UAH 14.8 bln in October, down from UAH 16.8 bln in September and UAH 18.7 bln in August.

Amid the dearth of liquidity, the government sold UAH 16.1 bln in domestic T-bills at an average YTM of 19.3% and time to maturity of 1.3 years during 10M09. Interest rates ran as high as 28% for half-year papers in a recent placement. The liquidity shortage will be aggravated by the concentrated redemption schedule of previously issued domestic T-bills: UAH 1.9 bln in December 2009, UAH 1.8 bln in February 2010, and UAH 3.7 in April 2010.

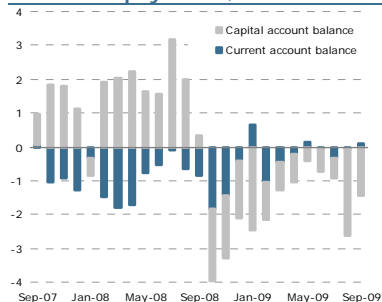
If the government restructures the UAH bonds at maturity, it might also have a negative spillover effect on Ukrainian Eurobonds and the exchange rate around the aforementioned dates.

### No risks to external sovereign debt payments

Ukraine has no sovereign or quasi-sovereign external debt repayments until end-2010. The government redeemed its Eurobonds in August-September for ~USD 1.25 bln in total and state-owned Ukreximbank repaid its Eurobonds for USD 250 mln in September. Naftogaz of Ukraine recently completed the restructuring of its USD 500 mln Eurobonds, prolonging their maturity to 2014.

The Ministry of Finance has ~USD 1.5 bln of USD 2 bln in NBU reserves from IMF SDR allocations in August-September. This will cover at least 60% of the Naftogaz' payments to Gazprom for imported natural gas during the next two months (it already spent ~USD 0.5 bln to pay the October bill).

Balance of payments, USD bln



Source: NBU

### USD/UAH: no chance for end-2008 scenario again

In terms of the exchange rate, regardless the source of budget deficit financing, excessive social spending before the elections is bound to increase pressure on the UAH exchange rate. The absence of additional IMF money deprives the NBU of alternative sources for FX reserves and creates additional negative sentiment toward the hryvnya.

Nonetheless, we do not expect repetition of 4Q08's abrupt hryvnya depreciation (-55%), and see the national currency depreciating by some 10-15% ahead of the elections.

Firstly, the NBU has sufficient reserves (USD 27.7 bln vs. potential demand on the retail market from social budget outlays of ~USD 3.5 bln in 4Q09 and up to USD 1 bln for Naftogaz' needs). The reserves are supported by previous IMF tranches (about USD 10 bln since the program began), while the NBU spent USD 20.2 bln on interventions since September 2008.

Secondly, supply-demand in the domestic FX market is more balanced now, compared to end-2008, thanks to improvements in the BoP. In September 2009, the current account turned positive to USD 97 mln vs. the deficit of USD 83 mln in August. The capital account deficit narrowed to USD 1.4 bln from USD 2.5 bln in August. In 4Q09, the double BoP deficit is expected to be not more than USD 4.5 bln vs. USD 9.5 bln in 4Q08.

Neither do we expect direct pressure on the exchange rate from the domestic debt market, as it is primarily domestic investors who invest in UAH-nominated T-bills (only 0.3% of all outstanding UAH T-bills were owned by foreigners as of end-October 2009).

### 2010: measured stabilization ahead

We foresee renewal of cooperation with the IMF by the beginning of 2Q10. The government is also likely to revise the budget after the elections to decrease the deficit through smaller social spending (provided the next parliamentary elections are not rescheduled from 2012 to an earlier date).

The negative gap between supply and demand on the domestic FX market is expected to narrow by mid-2010 through balancing of the BoP and improving sentiment toward the UAH from the population. Exchange rate stability is also expected to ensue. Nonetheless, it will take longer for the real economy to fully recover, because of low corporate spending on investment (-57.8% yoy in 2Q09) and lagging resumption in consumer demand and banking activities.

## Yearly economic indicators and Concorde Capital forecasts

	2001	2002	2003	2004	2005	2006	2007	2008	2009E	2010F
<b>Business cycle indicators</b>										
Real GDP, % chg yoy	9.2	5.2	9.6	12.1	2.7	7.3	7.6	2.1	-14.1	4.0
Nominal GDP, UAH bln	204	226	267	345	441	538	713	950	914	1017
Nominal GDP, USD bln	38.0	42.4	50.1	65.0	86.1	106.5	141.2	180.3	110.1	111.8
GDP per capita, UAH	4195	4685	5591	7273	9372	11630	15372	20600	19926	22275
GDP per capita, USD	781	880	1048	1371	1829	2303	3044	3909	2401	2448
Consumption, % chg yoy	9.6	9.5	11.5	13.1	20.6	15.9	17.1	11.8	-10.0	4.0
Investment, % chg yoy	17.9	-1.5	24.3	5.5	14.0	18.5	22.1	5.1	-35.0	5.0
Industrial output, % chg yoy	14.2	7.0	15.8	12.5	3.1	6.2	10.2	-3.1	-23.1	7.5
CPI (eop), % chg yoy	6.1	-0.6	8.2	12.3	10.3	11.6	16.6	22.3	15.0	9.0
PPI (eop), % chg yoy	0.9	5.7	11.1	24.1	9.5	14.1	23.3	23.0	10.0	10.0
<b>External indicators</b>										
Current account balance, USD bln	1.4	3.2	2.9	6.9	2.5	-1.6	-5.9	-12.5	-1.4	2.3
Current account balance, % GDP	3.7	7.5	5.8	10.6	2.9	-1.5	-4.2	-7.0	-1.3	2.0
Trade balance, USD bln	0.6	1.9	1.3	5.0	0.7	-3.1	-7.9	-13.7	-1.9	1.3
Trade balance, % GDP	1.6	4.4	2.6	7.7	0.8	-2.9	-5.6	-7.6	-1.7	1.2
Exports, USD bln	21.1	23.4	29.0	41.3	44.4	50.2	64.0	85.7	57.9	68.0
Exports, % chg yoy	8.0	10.7	24.0	42.6	7.5	13.2	27.4	34.0	-32.5	17.5
Imports, USD bln	20.5	21.5	27.7	36.3	43.7	53.3	71.9	99.4	59.8	66.7
Imports, % chg yoy	14.1	5.0	28.7	31.3	20.4	22.0	34.8	38.3	-39.9	11.6
Capital account balance, USD bln	0.4	-1.2	0.1	-4.6	7.7	3.7	15.3	13.9	-7.8	-4.0
Capital account balance, % GDP	1.1	-2.9	0.2	-7.1	9.0	3.5	10.9	7.7	-7.1	-3.6
FDI net, USD bln	0.8	0.7	1.4	1.7	7.5	5.7	9.2	9.7	3.5	5.0
NBU reserves (eop), USD bln	n/a	4.4	5.1	9.5	19.4	22.3	32.5	31.5	26.3	24.6
<b>Debt indicators</b>										
Public debt, USD bln	12.5	13.8	14.5	16.0	15.5	15.9	17.6	24.6	39.9	50.0
Public debt, % GDP	33.0	32.5	29.0	24.7	18.0	15.0	12.4	13.6	36.2	44.7
Corporate external debt, USD bln	n/a	n/a	13.0	17.8	25.5	42.7	67.6	85.0	72.5	68.0
Corporate external debt, % GDP	n/a	n/a	25.9	27.3	29.6	40.1	47.9	47.1	65.8	60.8
Gross external debt, USD bln	n/a	n/a	23.8	30.6	38.9	54.5	80.0	101.7	102.4	100.2
Gross external debt, % GDP	n/a	n/a	47.5	47.1	45.2	51.2	56.6	56.4	92.9	89.6
<b>Monetary indicators</b>										
Monetary base, UAH bln	23.0	30.7	40.1	53.8	82.8	97.2	141.9	186.7	186.7	210.9
Monetary base, % chg yoy	37.4	33.6	30.5	34.1	53.9	17.5	46.0	31.6	0.0	13.0
Money supply (M3), UAH bln	45.8	64.9	95.0	125.8	194.1	261.1	396.2	514.7	466.7	569.5
Money supply, % chg yoy	41.9	41.8	46.5	32.4	54.3	34.5	51.7	29.9	-9.3	22.0
Monetary multiplier (eop MB/M3)	2.0	2.1	2.4	2.3	2.3	2.7	2.8	2.8	2.5	2.7
Monetization (avg M3/GDP), %	19.2	24.9	30.3	32.0	36.7	42.3	46.4	47.5	53.7	50.9
<b>Exchange rate</b>										
Interbank UAH/USD (avg)	5.38	5.33	5.33	5.32	5.10	5.04	5.03	5.27	8.30	9.10
<b>State budget</b>										
Revenues, UAH bln	n/a	n/a	55.1	70.3	105.2	133.5	165.9	231.7	182.3	213.6
Expenses, UAH bln	n/a	n/a	55.8	79.5	112.8	137.1	174.2	241.5	238.9	259.4
Balance, % GDP	n/a	n/a	-0.4	-3.0	-1.8	-0.7	-1.4	-1.3	-6.2	-4.5
<b>Social indicators</b>										
Population, mln (eop)	48.5	48.0	47.6	47.3	46.9	46.6	46.4	46.1	45.9	45.7
Unemployment (ILO methodology, avg), %	10.9	9.6	9.1	8.6	7.2	6.8	6.4	6.4	11.0	8.0
Average monthly salary, UAH	n/a	376	463	591	806	1,043	1,351	1,806	1,896	2,129
Real disposable income, % chg yoy	10.0	18.0	5.8	16.8	20.1	16.1	12.8	10.3	-10.0	5.0

Source: State Statistics Committee, National Bank of Ukraine, Ministry of Finance, Bloomberg, Concorde Capital estimates

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