April 1, 2014

Revised state budget 2014

Austerity reaches Ukraine

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On March 27, Ukraine's parliament approved a revised 2014 state budget. The new spending plan marked a considerable adjustment to Ukraine's new reality, with more than UAH 25 bln in spending cut. Nearly 80K dismissed policemen, frozen pensions and wages, and tax hikes for the wealthy are among the most remarkable measures. At the same time, the targeted deficit remained almost unchanged at 4.2% of GDP, with the only difference being that the revenue target is now quite realistic. Naftogaz funding was increased to 2.2% of GDP despite the announced 50% natural gas rate hike for the population as hryvnia devaluation, higher Russian gas prices and considerable external payments are accounted for.

The realistic budget, coupled with macro support promised by the IMF and other Western sources, significantly raises the chance that Ukraine will remain solvent this year. We anticipate state debt to reach 43.6% of GDP by the end of 2014.

State budget stats, UAH bln

	2013	2014 revised	yoy
Revenues	339.2	372.9	10.0%
Spending	403.4	436.8	8.3%
Deficit	64.2	63.8	-0.6%
% of GDP	4.41%	4.19%	-0.2pp

State debt, year end, UAH bln*

	2013	2014 revised	yoy
Total	584.4	664.7	13.7%
% of GDP	40.16%	43.61%	4.1pp
External	300.3	344.1	14.6%
Internal	284.1	320.5	12.8%

Source: Verkhovna Rada, Concorde Capital estimates

Tax base lowered by more than UAH 100 bln

In contrast to the December spending plan for 2014, this time the authorities have approved quite realistic macro parameters with an attainable tax base. In particular, real GDP was projected to decline 3.0% in 2014 (our projection is -3.7% yoy) and CPI was estimated to speed up 8.5% yoy (our estimate is 7.1% yoy). The 2014 nominal GDP is projected at UAH 1,524 bln (our estimate is UAH 1,511 bln), which is 7.8% less than the target offered in December 2013 (UAH 1,653 bln).

Cabinet slices spending by 6%

State budget spending, as well as revenue, has been reduced by 5.5% and 5.7%, respectively. In particular, the revenue target was lowered by UAH 22.4 bln (down to UAH 372.9 bln) while the spending plan was cut by UAH 25.4 bln (down to UAH 436.8 bln). As a result, the state deficit remained almost unchanged compared to the December plan (UAH 63.8 bln vs. UAH 66.9 bln initially); but now it looks much more legitimate.

Tough decisions

The authorities touched many sensitive areas when revising the spending plan. Among the most impressive points we can mention are police force cuts (estimated at up to 80K); civil servant layoffs (nearly 24K); taxation of large pensions (exceeding UAH 10,000 per month); cuts in remuneration for top officials, judges and prosecutors; freezing the minimum wage and minimum subsistence level; and no indexation of pensions and social spending. Though quite painful and not popular, these moves are very positive for improving fiscal health.

Taxing the rich

Though the authorities reduced the spending side substantially, the weak economic situation has put under risk the execution of the revised budget. Against this backdrop, the authorities could not resist raising taxes (with an additional law, “About preventing financial disaster, and creating conditions for economic growth in Ukraine”). In our opinion, the decision is quite disputable; however, no discussion was held on it. In particular, the Cabinet approved an increase in mineral extraction royalties, hiked excise duties, resurrected charges on foreign currency operations (the IMF previously was against this move), resurrected the progressive income tax, and returned imposing VAT on pharmaceuticals and grain trading. In general, the revised tax legislation secured an extra UAH 24.7 bln in revenue for the 2014 budget, the Cabinet estimated.

State debt to exceed 43% of GDP

The state budget deficit was approved at 4.2% of GDP (UAH 63.8 bln), the same level as the initial state budget approved three months ago (UAH 66.9 bln). The structure of deficit funding is also very similar to the previous one, with UAH 17 bln targeted to be raised from privatization. The main difference is in the heavy reliance on external funding. Effectively, the Yanukovych administration also expected to make ends meet only at the expense of the Russian dollar loan; however, for some reason it was not reflected in the budget. Now it is clearly stated that net external funding will be UAH 48.9 bln vs. UAH 6.9 bln previously. So by the end of the year, the general state debt is expected to reach 43.6% of GDP. The good news is the government is set to service its debt smoothly in 2014.

Naftogaz funding approved at 2.2% of GDP

The revised budget approved UAH 33.3 bln in Naftogaz refunding through the year. Initially in the December plan, UAH 11.1 bln was earmarked and the sum was already provided to Naftogaz in February. Apparently, the interim government determined that sum was not enough in light of the approaching Russian gas price hikes and the need to make USD 1.6 bln in payments on Naftogaz Eurobonds. We estimate that Naftogaz’s deficit from low gas rates for heating utility companies will reach UAH 16-17 bln in 2014. The remainder of the subsidy should be directed either to repay Naftogaz debt to Gazprom (amounting to USD 1.7 bln at the moment), or repayment of USD 1.6 bln in Eurobonds.

Frozen pensions

As mentioned, pensions were frozen for 2014. As a result, the total State Pension Fund deficit will remain flat in nominal terms (UAH 83.8 bln vs. UAH 83.2 bln in 2013) and even reduced in relative terms (5.5% of GDP vs. 5.7% of GDP a year ago). Merely freezing the pension fund growth has already been beneficial for the budget. In particular, the Pension Fund subsidy was reduced UAH 3.6 bln (0.2% of GDP) compared to the initial plan approved in December 2013.

Fiscal independence for Crimea

Despite official claims about full-fledged financial support planned for annexed Crimea, the revised budget makes it clear that mainland Ukraine will allow Crimea to become self-sustainable financially. In essence, the Ukraine government has committed itself to paying Crimea all the money that will be wired from the peninsular to the central budget. Therefore, the deficits of both the local budget and pension fund should be covered from the budget of the Crimean Republic. In this context it is important to mention that in 2011, Crimea’s pension fund deficit was close to UAH 4.0 bln. At the same time, donations to the central budget on VAT only reached UAH 2.6 bln for the same period. In other words, it looks like the Ukrainian budget will save some money. Kyiv’s total 2011 subsidy to Crimea was nearly UAH 9.0 bln (0.7% of GDP), according to official statistics.

Key budget stats

Revenues and expenditures, UAH bln

	2013	Initial 2014	Revised 2014	Revised 2014 / 2013
State budget revenues	339.2	395.3	372.9	10.0%
% of GDP	23.31%	23.91%	24.47%	1.2pp
State budget spending	403.4	462.2	436.8	8.3%
% of GDP	27.73%	27.96%	28.66%	0.9pp
State budget deficit	64.2	66.9	63.8	-0.6%
% of GDP	4.41%	4.05%	4.19%	-0.2pp
Pension Fund subsidy	83.2	87.4	83.8	0.7%
% of GDP	5.72%	5.28%	5.50%	-0.2pp
Incl. Pension Fund deficit coverage	21.8	22.1	18.1	-16.8%
% of GDP	1.50%	1.34%	1.19%	-0.3pp

Source: Verkhovna Rada, MinFin, UkrStat, Concorde Capital estimates

Deficit financing, UAH bln

	2013	Initial 2014	Revised 2014	Revised 2014 / 2013
State budget deficit	64.2	66.9	63.8	-0.6%
% of GDP	4.41%	4.05%	4.19%	-0.2pp
External funding (net)	10.0	6.9	48.9	389.0%
- New loans	48.0	43.2	90.3	88.4%
- Repayments	38.0	36.3	41.5	9.3%
Internal funding (net)	67.2	55.7	41.4	-38.4%
- New loans	109.0	114.9	109.1	0.1%
- Repayments	41.7	59.2	67.7	62.1%
Other funding	-13.0	4.3	-26.5	103.4%
Privatization proceeds	1.5	17.0	17.0	11.0x
State debt, year end	584.4	647.0	664.7	13.7%
% of GDP	40.16%	39.14%	43.61%	4.1pp
External debt, year-end	300.3	307.2	344.1	14.6%
% of GDP	20.64%	18.58%	22.58%	2.3pp
Internal debt, year-end	284.1	339.8	320.5	12.8%
% of GDP	19.53%	20.56%	21.03%	1.8pp

Source: Verkhovna Rada, MinFin, UkrStat, Concorde Capital estimates

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