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A conventional 2017 budget

The “no surprises” spending plan

The 2017 draft budget is dramatically different from what we’re used to seeing during the last two years. It includes no large-scale changes in taxation rules, no quasi-fiscal outlays, an identical spending structure as a year ago and a deficit budgeted at a normal level of 3.0% of GDP. Against this refreshing backdrop, the main target for criticism appeared to be its macro forecast of 3% GDP growth in 2017. Still, the overly optimistic real growth forecast is compensated by underestimated inflation in what amounts to quite a realistic 2017 tax base estimate (nominal GDP).

Realistic macro forecast

The Finance Ministry developed a 2017 draft budget anticipating 3% yoy GDP growth in 2017, 8.1% consumer inflation and a UAH 27.2/USD average hryvnia exchange rate. Nominal GDP was estimated at UAH 2,585 bln. Though our estimate for real GDP growth in 2017 is more pessimistic (we expect a 2.1% yoy increase), we have a higher inflation forecast (8.9% yoy CPI increase) and lower average hryvnia exchange rate estimate at UAH 28.0/USD. As a result, the tax base (nominal GDP) appeared to be about the same as officials estimated at UAH 2,597 bln. So we see the basic macro-parameters that the budget was developed upon as quite realistic.

Revenues: cancelled special regime for agri-producers and higher excise duties

State budget revenues are projected to rise to 27.3% of GDP (UAH 706.3 bln) compared to 26.6% of GDP (UAH 601.9 bln) as planned in 2016. The main sources for growing tax collections are increased excise duties (growing to 4.2% of GDP from 3.6% of GDP in 2016) and cancelled residuals of a special tax regime for agri-producers (general VAT revenues will grow to 10.9% of GDP from 10.3% of GDP a year ago). Remarkably, the authorities plan to reduce rent for natural gas extraction (from deposits at a depth of more than 5,000 meters) to 29% from 50% currently, which will translate into falling rent on mineral extraction collections (to 2.0% of GDP from 2.8% of GDP). Also important, the Finance Ministry plans substantial revenues from National Bank “profits” in 2017, with the draft budget earmarking a UAH 41.0 bln wire from the bank compared to UAH 38.1 bln budgeted for 2016.

Spending: defence and housing subsidies

On the spending side, significant defense spending has been preserved at UAH 64.0 bln, or 2.48% of GDP (compared to UAH 55.6 bln in 2016, or 2.46% of GDP), as well as increasing outlays on housing subsidies at UAH 53.2 bln, or 2.1% of GDP (compared to UAH 41.5 bln in 2016, or 1.8% of GDP). At the same time, spending on education is planned to decline to UAH 70.5 bln (2.7% of GDP) from UAH 70.9 bln (3.1% of GDP). Subsidies for the pension fund grew to UAH 157.4 bln (UAH 145.5 bln in 2016), but in relative terms the subsidy decreased to 6.1% of GDP (compared to 6.4% of GDP). Debt servicing was reported at UAH 111.3 bln (4.3% of GDP) compared to UAH 99.1 bln (4.4% of GDP in 2016).

Deficit targeted at 3.0% of GDP

The state budget deficit was defined at 3.0% of GDP (UAH 77.5 bln), which is lower than 3.7% of GDP (UAH 83.7 bln) outlined for 2016. Similar to the last three years, a large part of the deficit is expected to be covered by UAH 17.1 bln from privatization proceeds. We do not know the IMF requirement for the 2017 deficit, but the number is close to the projections for the general budget deficit (3.1% of GDP) released with the August 2015 IMF memorandum.

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State budget stats, UAH bln

	2016 plan	2017 plan	yoy
Revenues	601.9	706.3	17.3%
Spending	674.5	775.3	14.9%
Deficit	83.7	77.5	-7.3%
% of GDP	3.7%	3.0%	-0.7pp

Source: Verkhovna Rada, Concorde Capital estimates

Key budget stats

State budget revenues and expenditures, UAH bln

	Target 2016	Target 2017	Target 2017 / 2016
State budget revenues	601.9	706.3	17.3%
% of GDP	26.61%	27.32%	0.7pp
State budget spending	674.5	775.3	14.9%
% of GDP	29.82%	29.99%	0.2pp
State budget deficit	83.7	77.5	-7.3%
% of GDP	3.70%	3.00%	-0.7pp
Budget revenues:			
Tax revenues	501.3	588.0	17.3%
% of GDP	22.16%	22.75%	0.6pp
Personal income tax	55.3	63.2	14.2%
% of GDP	2.45%	2.44%	0.0pp
Enterprise profit tax	48.2	57.3	18.9%
% of GDP	2.13%	2.22%	0.1pp
VAT	232.7	281.7	21.1%
% of GDP	10.29%	10.90%	0.6pp
Rent on mineral extraction	62.5	52.1	-16.6%
% of GDP	2.76%	2.02%	-0.7pp
Import duties	19.3	22.4	16.0%
% of GDP	0.85%	0.86%	0.0pp
Excise duties	81.9	109.6	33.8%
% of GDP	3.62%	4.24%	0.6pp
Non-tax revenues	82.8	101.6	22.7%
% of GDP	3.66%	3.93%	0.3pp
Transfer from the NBU	38	41	7.9%
% of GDP	1.68%	1.59%	-0.1pp
Budget spending:			
Defense Ministry	55.6	64.0	15.1%
% of GDP	2.46%	2.48%	0.0pp
Internal affairs (police)	41.2	46.1	0.0%
% of GDP	1.82%	1.78%	0.0pp
Ministry of education	70.9	70.5	-0.5%
% of GDP	3.14%	2.73%	-0.4pp
Ministry of healthcare	56.9	62.0	9.0%
% of GDP	2.52%	2.40%	-0.1pp
Ministry of social policy	154.8	166.7	7.7%
% of GDP	6.84%	6.45%	-0.4pp
-- Incl. pension fund subsidy	145.5	157.4	8.2%
% of GDP	6.43%	6.09%	-0.3pp
State road agency	18.8	14.2	-24.1%
% of GDP	0.83%	0.55%	-0.3pp
Finance Ministry	207.7	254.3	22.4%
% of GDP	9.18%	9.84%	0.7pp
-- Incl. housing subsidies	41.5	53.2	28.2%
% of GDP	1.83%	2.06%	0.2pp
-- Incl. debt servicing	99.1	111.3	12.4%
% of GDP	4.38%	4.31%	-0.1pp
-- Incl. social assistance	45.5	53.9	18.6%
% of GDP	2.01%	2.09%	0.1pp

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

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