

## Ukraine's Financing Requirements and Sources in 2009

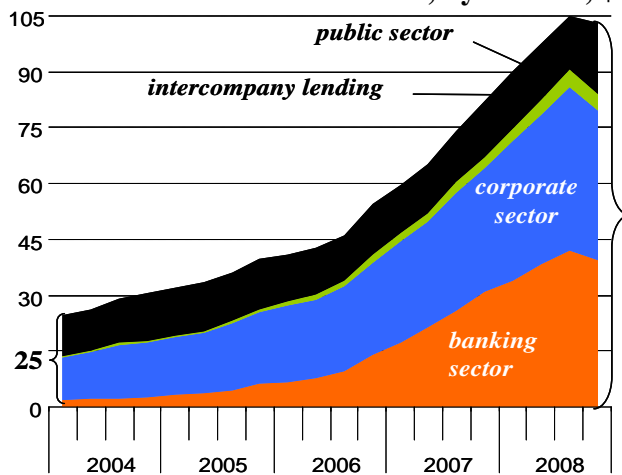
*E. Segura and O. Pogarska*

Ukraine's external financing requirements in 2009 are caused by the following: (i) a gap in the current account of the balance of payments, (ii) external private debt service obligations and (iii) external financing required to cover the 2009 fiscal budget deficit and serve public external debt obligations. These financing requirements are discussed below.

### (i) Current Account Balance

We forecast that Ukraine's current account gap could be reduced from a record high of \$13 billion (7.2% of GDP) in 2008 to \$3.6 billion (3.0% of GDP) in 2009. We expect exports to decline by 30% yoy due to low world commodity prices and the current economic downturn in Ukraine's main trading partners. At the same time, imports are expected to fall at a faster pace by about 35% yoy, due to lower domestic demand (caused by weaker economic activity in Ukraine, less credit availability and the Hryvnia depreciation). This decline in imports will occur despite an almost 30% average increase in imported natural gas prices.

**Chart 1. Gross External Debt, by Sectors, \$ billion**



Source: NBU, The Bleyzer Foundation

### (ii) External Private Debt.

In the last two years, Ukraine's total external debt more than doubled, reaching \$103.2 billion at the end of 2008. Its short-term component with a maturity of less than one year is reported by the NBU at \$22 billion (see table 1 for details).

However, the actual amount of private foreign debt to be repaid in 2009 is higher. Essentially, the NBU classifies external borrowings based on their original maturity, ignoring the current portion of medium-term debt.

**Table 1. Private Sector External Debt, \$ billion (by original maturity)**

	2006	2007	2008
<b>Total private sector debt</b>	<b>40.7</b>	<b>67.1</b>	<b>83.9</b>
<b>Banks</b>	14.1	30.9	39.4
Short-term	6.5	11.7	9.3
Long-term	7.6	19.2	30.1
<b>Corporate sector</b>	24.7	33.0	40.2
Short-term	8.7	10.3	12.7
Long-term			
<i>o/w trade credit</i>	7.3	8.8	10.6
<i>o/w trade credit</i>	2.4	2.1	0.6
<b>Direct Investment: Intercompany Lending</b>	1.9	3.1	4.2

Source: NBU

Despite limited data on the terms of private external debt (debt that was raised mainly through private placements and loans), the average maturity of medium term debt is estimated at about 4 years. Based on this estimate, the short-term component of medium- and long-term private debt due in 2009 may amount to \$14 billion.<sup>1</sup> Thus, the total amount of external private debt to be repaid or refinanced in 2009 may be as high as \$36 billion. In private meetings, the NBU told us that this estimate is consistent with its own estimate.

We also estimate that about 50% of the amount due in 2009 is likely be refinanced or rolled-over, as it constitutes commercial banks' borrowings from their parent foreign banks and trade credit operations. In fact, at the beginning of 2009, many foreign banks announced capital support for their Ukrainian subsidiaries. Preliminary balance of payments statistics for January-April 2009 also supports this assumption. According to the NBU, long-term private sector debt obligations due in February-March 2009 were fully rolled-over, while in January and April the debt roll-over ratio was about 53%. Given this assumption, we believe that the roll-over of external private debt in 2009 may amount to \$20 billion.

### (iii) Public Finances and External Public Debt.

Except in 2004, the Ukrainian government has maintained fiscal deficits below 2% of GDP since 2002. Prudent fiscal policy allowed it to reduce total public sector debt from about 45% of GDP in 2000 to 12% of GDP in 2007. In 2008, Ukraine, severely hit by the world financial crisis, was among the first countries that applied for IMF financing. The first tranche of the IMF stand-by loan to Ukraine in the amount of \$4.2 billion was disbursed in November 2008. This, coupled with sharp Hryvnia depreciation in the fall of 2008, resulted in total public debt in Hryvnia equivalent growing to 20% of GDP. At the same time, this level of public debt is quite low compared with countries of similar risk.

**Table 2. Public Sector External Debt, \$ billion**

	2006	2007	2008
<b>Total public sector external debt</b>	<b>13.8</b>	<b>15.1</b>	<b>19.3</b>
<b>General Government</b>	12.9	14.7	14.6
<i>Short-term</i>	0	0	0
<i>Long-term, o/w</i>	12.9	14.7	14.6
Bonds and Notes	6.4	7.5	7.1
Loans	6.5	7.2	7.5
<b>Monetary Authorities (mainly IMF)</b>	0.9	0.5	4.7
<i>Short-term</i>	0	0	0
<i>Long-term, o/w</i>	0.9	0.5	4.7
Loans	0.9	0.5	4.7

Source: NBU

For 2009, the Ukrainian authorities had originally targeted a fiscal deficit of 3% of GDP, but based on optimistic macroeconomic forecasts. The revision of the macroeconomic assumptions was one of the main reasons for the delays in the IMF program in February 2009. Due to a sharp economic downturn, the IMF Board relaxed its original fiscal deficit requirements for Ukraine from a balanced budget to a deficit of UAH 40 billion (about \$5.2 billion), or 4% of GDP (excluding expenditures on bank recapitalization). This larger deficit was accepted considering the relatively small public debt ratio and the past record of low deficits.

<sup>1</sup> The estimates of the short-term component of medium- and long-term debt vary from about \$12 billion in the recent IMF report on Ukraine (June 2009) to \$17.5 billion in the JP Morgan report at the end of 2008.

Initially, the targeted fiscal deficit of 3% of GDP was expected to be financed by domestic financial sources. According to the 2009 state budget law, funds from issuance of domestic debt securities, privatization proceeds and accumulated cash balances on the unified treasury account should have been sufficient to cover almost 80% of the budget gap. The 20% remaining was planned to be raised from external markets. But given the sluggish privatization process and weak domestic borrowing market, these plans were revised in favour of external borrowed resources. According to the IMF revised program, about 60% of the state budget financing need would be raised from external sources.

**Table 3. State Budget Financing Needs in 2009 ( as % of GDP)**

	2009 Budget Law	Revised IMF program
<b>Targeted Fiscal Budget Deficit (excluding bank recapitalization)</b>	<b>-3.0</b>	<b>-4.0</b>
<b>Debt Repayment</b>	<b>-2.7</b>	<b>-2.7</b>
External	-1.3	-1.3
Domestic	-1.4	-1.4
<b>Budget financing need</b>	<b>-5.7</b>	<b>-6.7</b>
<b>Sources of financing</b>	<b>5.7</b>	<b>6.7</b>
Privatization	0.8	0.1
Available Deposits	0.6	0.6
Public Sector Borrowings	4.3	3.4
Domestic	2.5	1.6
External	1.8	1.8
Other financing	0	2.6
IMF	0	1.2
Other prospective external financing	0	1.4

*Source: 2009 State Budget Law, IMF report on Ukraine (June 2009), The Bleyzer Foundation*

Following the resumption of the IMF program in May 2009, we assume that the total planned IMF funds of \$9.8 billion will be disbursed in 2009. According to the revised IMF program, about \$1.5 billion from the second IMF tranche (1.2% of GDP) will be directed to finance the fiscal budget deficit. The Ukrainian authorities have been working to secure external financing from other international financing institutions (mainly the World Bank, EBRD) as well as bilateral financing. According to the above table, these institutions were expected to provide \$2 billion (or about 1.4% of GDP). This fiscal budget gap is listed as “External Financing for Fiscal Budget Gap” in the table below.

### **Ukraine’s Overall External Financing Needs and Sources**

Given all the above, Ukraine’s total external financing needs as well as projected resources to cover them are summarized in table 4.

**Table 4. Ukraine’s External Financing Needs and Sources in 2009 (in US\$ bn)**

<b>External Financing Needs</b>	
Current account balance	-4
External debt repayments	-38
Private sector	-36
Short-term debt	-22
ST portion of M&LT debt	-14
Public sector	-2
External financing for fiscal budget gap	-2
<b>Total external financing needs</b>	<b>-44</b>

<b>External Financing Sources</b>	<b>36</b>
FDI	4
Rollover of private debt	20
IMF	10
Other International Financial Institutions	2
<b>Net Financing Gap</b>	<b>-8</b>
Available NBU reserves, end of 2008	32

The above numbers suggest that Ukraine's financing needs for 2009 are manageable given the current level of international reserves, provided that financing from the IMF and other international institutions materialize as currently expected.