

CONCEPT

of liquidity management for 2020-2023

Problems that require solutions

There could be short-term gaps between the inflow and outflow of cash resources when making payments by the order of budget entities and other clients of the Treasury. As a result, this leads to the temporarily free cash balances or lack of cash to commit payments.

To balance the inflow and outflow of cash, it is important to manage liquidity, in particular to make short-term borrowings and / or place temporarily free cash balances, through active operations with public debt.

Since 2002, Ukraine has introduced a treasury single account (hereinafter - STA). It consolidates cash balances of state and local budgets, cash balances of budget entities, extra budget social security funds and other Treasury clients, advances in the accounts of electronic tax administration, deposit accounts of customs authorities, as well as other cash balances in accordance with the legislation in the national currency.

In addition to the cash in the national currency, Treasury accounts accumulate cash balances in foreign currency, which are mostly used to make repayments of government debt principal and interest in foreign currency.

Consolidation of cash balances in the STA as well as foreign currency accounts of the Treasury provides the operational information about the status and movement of cash balances of the general government sector. This is a necessary yet insufficient condition for effective liquidity management.

The primary prerequisite for effective liquidity management is the availability of accurate cash flow forecasts in regards to the STA. Namely daily forecasts for the upcoming three months and monthly forecasts for the upcoming six months. Their absence leads to the idle cash balances, or to a temporary lack of cash to make payment on time.

Lack of a developed and liquid domestic capital market as well as inconsistent access to world capital markets also affect balances on the Treasury accounts.

Additionally, other factors further complicate liquidity management.

Relatively low activity of the spending units in the first half of the year and uneven use of budget allocations for the capital expenditures leads to the need of

accumulating significant amounts of temporarily free cash balances during August - November to make significant payments at the end of the budget period. In particular, the ratio between the volumes of consolidated budget expenditures in December to January for 2017-2019 averages 3-4 times.

The cyclical nature of processes in respect to the accumulation of cash balances in the STA and their use affect the liquidity of the banking system and inflation.

Lack of agreed upon dates of receipts of the main types of income and the spread of expenditures throughout the calendar month also lead to the accumulation of excess liquidity in the Treasury accounts.

These factors can lead to the following consequences:

- delays or incomplete execution of expenditures;
- accumulation of significant amounts of temporarily free cash balances in the STA and cash balances in foreign currency accounts, as a result of the imbalance between the periods of incomes and expenditures;
- unstable liquidity in the government securities market;
- acceleration of inflation during significant expenditures at the end of the year, cyclical impact on the liquidity of the banking system.

Given the above, the following elements of the liquidity management system need improvement:

- forecasting the movement of cash balances on the STA and foreign currency accounts of the Treasury:
 - approval of the methodology for forecasting the movement of cash balances on the STA and foreign currency accounts of the Treasury;
 - improving coordination between stakeholders, introduction of automatic necessary data exchanges;
 - ensuring the collection of short-term forecasts of expenditures from budget administrators (payment calendar);
 - introduction of a forecasting information system that will increase the accuracy of forecasts;
- planning procedures by administrators and recipients of budget cash balances the terms and amounts of expenditures, drawing up a schedule of payments, as well as the introduction of early notification by them about the expected one-time payments for unsecured expenditures for the amounts above 100 million UAH;
- instruments for managing temporarily free cash balances, in particular by conducting active operations with public debt;
- mechanism for balancing the inflows and outflows of the STA provided that the projected balances on the STA fall below the minimum balance required to fully comply the obligations of Treasury clients.

The purpose of the concept

The purpose of the Concept is to introduce an effective mechanism for managing the liquidity of the STA and foreign currency accounts of the Treasury, and allow timely fulfillment of Treasury clients' obligations of at the lowest possible cost, in particular by improving the quality of cash flow forecasting.

Stakeholders

In order to achieve this goal it is necessary to involve the National Bank, the Ministry for Development of Economy, Trade and Agriculture, the Treasury, the Ministry of Health, the Ministry of Social Policy, the State Tax Service, the State Customs Service, the NSSMC, compulsory state social and pension insurance cash balances, and other central executive bodies with significant (above 100 million UAH) and / or irregular expenses, local governmental bodies, administrators and recipients of budget cash balances to the processes of forecasting of the movement of cash balances on the STA and foreign currency accounts of the Treasury.

The beneficiaries of the results of the Concept will be the general population of Ukraine, the Cabinet of Ministers of Ukraine, local governmental bodies, administrators and recipients of budget cash balances and the National Bank.

In order to coordinate and agree upon practical measures of the Concept implementation with all the stakeholders, it is necessary to ensure regular work of the subgroup on fiscal risks, liquidity and debt management, established in accordance with the order of the Ministry of Finance dated December 22, 2018 № 1124. Primary objectives of the subgroup are related to solving questions in regards to the cash balances forecasting (analysis of deviations of forecast indicators from actual ones, development and improvement of forecasting methods, operative data exchange), development and use of liquidity management tools.

Concept implementation strategy

Effective liquidity management mechanism starts with implementation of specific measures split into two stages.

The first stage focuses on the quality improvement of the forecast as well as an increase of the forecasting period of the cash balances movement, in particular:

- approval of the forecasting methodology for the movement of cash balances on the STA and foreign currency accounts of the Treasury with the establishment of:
 - forecasting period of three months – for the daily indicators and six months - for the monthly ones;
 - procedures for calculating the daily optimal amount of cash balances on the STA, which will take into account the volumes of inflows and

outflows while ensuring the fulfillment of payment obligations of the Treasury clients without excess liquidity;

- introduction of automation tools for real-time data exchange between the Treasury, the Ministry of Finance and other entities responsible for the movement of cash balances, the main of which are the State Tax Service, the State Customs Service and the Pension Fund, including:
 - current figures used to forecast the movement of cash balances on the single treasury account and foreign currency accounts of the Treasury, as well as for the operational calculation of balances;
 - expected daily figures of state and local budget revenues incoming from taxes and other collections grouped by their types, inflows on the deposit accounts of customs authorities, as well as inflows of a unified social tax in respect to the obligatory state social insurance;
 - expected daily inflows of cash from privatization of state property (including other cash balances directly related to the privatization process) and proceeds from the alienation of communally owned property;
 - monitoring of registered budget commitments and budget financial commitment with amounts exceeding UAH 100 million;
- creation and implementation of an information system for forecasting the movement of the STA and foreign currency accounts of the Treasury;
- extending the cash movement forecasting methodology with cases when external economic conditions in commodity and financial markets affect the inflows on the STA.

Second stage focuses on the improvement of the instruments for liquidity management, in particular:

- introduction of an automated procedure for determining the amounts of temporarily free cash balances of the STA and foreign currency accounts of the Treasury that can be used, in particular for carrying out active operations with public debt;
- creation by the Ministry of Finance together with the National Commission on Securities and Stock Market and the National Bank preconditions for further increase of the capacity and liquidity of the domestic market of government securities;
- reaching legislative settlement of the issue of using temporarily free cash balances of the STA to cover temporary cash imbalances of the general fund of the state budget within the budget period and classifying temporarily free cash balances of the STA as sources of budget financing;
- introduction of liquidity management tools for the STA and foreign currency accounts of the Treasury (in case of temporarily free cash balances, as well as insufficient cash balances).

Consistency with strategic documents

Necessity to improve the cash management mechanism is consistency with the following documents:

- Strategy for reforming the public financial management system for 2017-2020, approved by the order of the Cabinet of Ministers of Ukraine on February 8, 2017 № 142 (Official Gazette of Ukraine, 2017, № 23, p. 659);
- Action plan for the implementation of the Strategy for reforming the public financial management system for 2017-2020, approved by the order of the Cabinet of Ministers of Ukraine dated May 24, 2017 № 415;
- The program of activities of the Cabinet of Ministers of Ukraine, approved by the resolution of the Cabinet of Ministers of Ukraine on June 12, 2020 № 471 (Official Gazette of Ukraine, 2020, № 50, p. 1571);
- Plan of priority actions of the Government for 2020, approved by the order of the Cabinet of Ministers of Ukraine on September 9, 2020 № 1133;
- Medium-term public debt management strategy for 2019-2022, approved by the Resolution of the Cabinet of Ministers of Ukraine on June 5, 2019 № 473 (Official Gazette of Ukraine, 2019, № 47, p. 1610).

Expected results

Concept implementation should ensure effective liquidity management, in particular through making reliable forecasts of cash flows on the STA and foreign currency accounts of the Treasury, development and the increase of the liquidity of the government securities domestic market.

- the ratio of the sum of the absolute values of monthly forecasts errors to the volume of STA' outflows - up to 5 percent;
- the ratio of the average daily cash balances on the STA to the volume of STA' outflows - up to 200 percent;
- commitment payment of budget entities as well as other clients of the Treasury in time;
- increasing the efficiency of the use of budget cash balances as a result of reducing the excessive amount of temporarily free cash balances on the STA.

Financial and technical resources requirements

Implementation of the action plan for the implementation of the Concept does not require additional costs from the state budget.

Concept implementation may involve resources of programs, international technical assistance projects, as well as other sources not prohibited by law.

ACTION PLAN
for the implementation of the Concept of liquidity management for 2020-2023

Action name	Responsible	Deadline	Performance indicator
Improving the quality of the cash balances movement forecast and increasing its period			
1. Development of methods for forecasting cash flows, liquidity status on the single treasury account (hereinafter - STA) and foreign currency accounts of the Treasury	Ministry of Finance Treasury	IV quarter of 2020	an order was issued by the Ministry of Finance approving the methodology for forecasting the movement of cash balances on the Treasury accounts
2. Implementation of the payment calendar project that will detail expenses by administrators and recipients of budgetary cash balances with payments exceeding UAH 100 million	Ministry of Finance Ministry of Defense State Road Agency of Ukraine Ministry of Health Ministry of Social Policy individual administrators and recipients of budget cash balances	—“—	Implemented collection procedure for the information about payments exceeding UAH 100 million from individual administrators and recipients of budgetary cash balances

Action name	Responsible	Deadline	Performance indicator
3. Introduction of the procedures for exchanging information between the Treasury, the Ministry of Finance and other entities responsible for the movement of cash balances through the STA for the purposes of liquidity management	Ministry of Finance Treasury National Bank State Tax Service State Customs Service Pension fund State Property Fund individual administrators and recipients of budget cash balances	I quarter of 2021	Information exchange procedure between the subjects of the liquidity management system was approved Database for the collection of cash flow forecasting data is created
4. Introduction of the information system for forecasting the cash flow on the STA and foreign currency accounts of the Treasury	Ministry of Finance Debt agency Treasury	II quarter of 2021	An automated decision-making system for liquidity management has been introduced
5. Monitoring of budget commitments and budget financial commitments in order to track the expenditures of administrators and recipients of budget cash balances exceeding UAH 100 million	Ministry of Finance Treasury	—“—	A system for collecting information on expected payments exceeding UAH 100 million has been introduced

Action name	Responsible	Deadline	Performance indicator
	Ministry of Economy Debt agency individual administrators and recipients of budget cash balances		
Improving liquidity management tools			
6. Improving legislation on active public debt transactions	Ministry of Finance National Bank NSSMC	I quarter of 2021	Drafts of relevant regulations submitted for approval
7. Carrying out active operations with government debt, in particular repurchase, exchange and repo transactions with government securities	Ministry of Finance Debt agency National Bank NSSMC	II quarter of 2021	The schedule of active operations with government securities has been published
8. Development of domestic stock market and capital market infrastructure	NSSMC National Bank Ministry of Finance Debt agency	IV quarter of 2021	Legal conclusions on the compliance of Ukrainian legislation with the terms of general agreements: GMRA (Global Master Repurchase Agreement) and ISDA (International

Action name	Responsible	Deadline	Performance indicator
9. Legislative regulation of the use of temporarily free cash balances of the STA to cover temporary cash imbalances of the general fund of the state budget within the budget period and the assignment of temporarily free cash balances of the STA to the sources of budget funding	Ministry of Finance Treasury	IV quarter of 2020	Swaps and Derivatives Association) were obtained A draft act on amendments to the Budget Code of Ukraine was prepared and submitted for approval
10. Introduction of liquidity management tools aimed to ensure successful payments by administrators to recipients of budget cash balances, as well as other clients served by the Treasury, in case of insufficient cash balances in the STA	Ministry of Finance Debt agency	IV quarter of 2021	Appropriate operations are provided
11. Analysis and preparation of proposals on matching significant inflow and outflow of cash of the state budget	Ministry of Finance	IV quarter of 2023	Drafts of relevant regulations submitted for approval