

**FOR
AGENDA**

EBS/14/47

April 22, 2014

To: Members of the Executive Board

From: The Secretary

Subject: **Ukraine—Request for a Stand-By Arrangement**

Attached for consideration by the Executive Directors is a paper on Ukraine's request for a Stand-By Arrangement, which will be brought to the agenda for discussion on **a date to be announced**. A draft decision appears on page 35. The authorities of Ukraine have indicated that they consent to the Fund's publication of this paper. Any requests for modifications for publication are expected to be received two days before the Board concludes its consideration.

Questions may be referred to Mr. Gueorguiev (ext. 30024), Mr. Gorbanyov (ext. 34980), Ms. Jajko (ext. 36656), and Ms. Kaltani (ext. 39414) in EUR.

Unless the Documents Section (ext. 36760) is otherwise notified, the document will be transmitted, in accordance with the procedures approved by the Executive Board and with the appropriate deletions, to the WTO Secretariat forthwith; and to the European Bank for Reconstruction and Development, the European Commission, and the Organisation for Economic Cooperation and Development, following its consideration by the Executive Board.

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UKRAINE

REQUEST FOR A STAND-BY ARRANGEMENT

April 22, 2014

EXECUTIVE SUMMARY

Stand-By Arrangement. In the attached letter, the Ukrainian authorities describe their economic and financial policies for which they request a 24-month SDR 10.976 billion (800 percent of quota, about US\$17.1 billion) Stand-By Arrangement involving exceptional access. An initial purchase of SDR 2.058 billion will become available on approval, with SDR 1.290 billion being allocated to budget support. The second and third purchases will be based on bi-monthly reviews and performance criteria, and the remainder will be subject to quarterly reviews.

Policies. Key objectives of the authorities' program are to restore macroeconomic stability, strengthen economic governance and transparency, and lay the foundation for robust and balanced economic growth. To achieve this, the government will implement immediate measures aimed at securing stability, combined with deeper reforms to achieve and sustain external sustainability, ensure financial stability, restore sound public finances, rationalize the energy sector, and improve the business environment. Successful and timely implementation of these policies will unlock sizable official financing already committed to Ukraine and catalyze private inflows. To underscore their commitment to program policies and objectives, the authorities have adopted a number of key measures as prior actions.

Discussions. During March 4–26, 2014, staff met with Acting President Turchinov, Prime Minister Yatseniuk, Governor of the National Bank of Ukraine Kubiv, Minister of Finance Shlapak, Minister of Economy Sheremeta, Minister of Energy Prodan, Minister of Labor and Social Policies Denissova, other senior officials, ambassadors, and representatives of the trade unions, banking, and business community. The mission also met with presidential candidates, the Maidan Council, and other politicians.

Political assurances. Staff met three leading presidential candidates and representatives of several key political parties and civil society organizations, who expressed their agreement with key program objectives and policies.

Publication. The Ukrainian authorities authorized the Fund to publish the staff report and the LOI/MEFP.

Approved By
**Poul M. Thomsen and
 Mark Flanagan**

Discussions were held in Kyiv during March 4–26, 2014. The IMF team comprised Nikolay Gueorguiev (head), Peter Dohlman, Michael Gorbanyov, Beata Jajko, Linda Kaltani (EUR); Olga Stankova (COM); Tigran Poghosyan (FAD); Luis Cortavarría, Elias Kazarian (MCM); Karim Youssef (SPR); and Jerome Vacher, Resident Representative. Reza Moghadam (Director, EUR), Menno Snel (ED), and Olexander Petryk (Alternative ED) joined some of the policy discussions. Nikita Kannekanti and Dilcia Noren provided support from headquarters.

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CONTEXT

1. Ukraine is experiencing its second major economic crisis in six years. As detailed in the staff report for the 2013 Article IV consultation (EBS/13/150), an overvalued exchange rate, a substantial budget deficit, and sizable losses in the energy sector had put Ukraine on a highly unsustainable course with a large and rising current account deficit and a rapid loss of foreign exchange reserves. Intermittent discussions between the previous Government and the Fund on a package of corrective policies that could be supported by a stand-by arrangement were unsuccessful. In a first important break with past policies, with significant external and public sector payments falling due, mounting pressures on the hryvnia and reserves at critical levels, the NBU allowed the exchange rate to float in February 2014. This change in the exchange rate regime, along with other stabilization measures, has eased reserve pressures, but large depreciation, heightened uncertainties, and geopolitical risks have weakened bank and corporate balance sheets, triggered bank deposit withdrawals, and fueled capital flight. Economic activity is contracting, and international debt markets are closed. The fiscal situation is challenging, as government revenues have fallen on the back of political uncertainty and weak economic performance. The political situation in some regions of the country remains tense after the change in government in Kyiv was followed by a secessionist movement in Crimea and tensions in the East.

2. To overcome the crisis and restart growth, the authorities have requested a Stand-By Arrangement. The new government that took office in late February after intensive political turmoil has quickly taken steps to secure macroeconomic and financial stability and to concentrate resources on critical spending needs. It has also embarked on a comprehensive and ambitious reform program designed to address Ukraine's long-standing macroeconomic imbalances and structural weaknesses. Specifically, the program aims to restore external solvency, replenish international reserves, improve governance, and lay a firm foundation for sustainable growth. In support of these objectives, the authorities have requested Fund assistance under a two-year SBA.

3. The authorities are confident that Fund support would lend credibility to their program and help unlock official and private financing. They see their program as a historical break with the past of crony capitalism, pervasive corruption, and poor governance that weighed heavily on the economy. They believe that the political regime change has given them a mandate to launch bold and ambitious reform aimed at transforming Ukraine into a dynamic and competitive emerging market economy with transparent government and vibrant business environment and they are keen to take advantage of the political momentum for change by front-loading critical measures. They believe that a Fund arrangement would lend credibility to these plans and help unlock sizable official bilateral and multilateral—and eventually private—financing. Strong program implementation is expected to restore access to international capital markets and facilitate private capital inflows for a much needed resumption of robust private investment.

4. The success of the program depends critically on the authorities' unwavering commitment to macroeconomic adjustment and reforms. Two previous Fund-supported

programs in the past six years went off track relatively early on. Ex-post evaluations highlighted lack of ownership and weak governance as the main reasons for the poor program performance. By implementing a set of strong and comprehensive prior actions, the authorities have demonstrated their ability to conduct reform-based policy adjustments. Their staunch commitment to economic transformation despite resistance from entrenched vested interests will be key for the program's ultimate success.

BUILD UP OF IMBALANCES AND VULNERABILITIES BEFORE THE CRISIS

5. Inconsistent macroeconomic policies pursued in 2012–13 aggravated deep-seated vulnerabilities and eventually generated a balance of payment crisis. Ukraine had long relied on an effectively pegged exchange rate as a nominal anchor. However, this was accompanied by loose fiscal policy and sizable losses in the state-owned gas company Naftogaz ultimately covered by the budget (and monetized by the NBU, which holds about 60 percent of domestic government debt). This policy mix had resulted in overvalued exchange rate, large twin deficits, a steady rise in indebtedness, recurrent difficulties with external financing, and depletion of international reserves. Such vulnerabilities made the economy especially susceptible to shocks of economic and political nature that eventually led to the current crisis.

6. Facing persistent devaluation pressures, the authorities tightened monetary policy and intervened in foreign exchange market (Figures 2, 5). Devaluation expectations rose from late 2011, when the first signs of currency overvaluation appeared. Defending the pegged exchange rate, the NBU intervened heavily, intensified foreign exchange controls, and squeezed bank liquidity. This prompted banks to raise deposit and lending rates and tighten credit conditions, exacerbating the recession in 2012–13. Persistent devaluation expectations and tight monetary policy pushed real hryvnia interest rates into double digits in 2013, despite zero consumer price inflation. The high rates prompted a 50 percent increase of hryvnia deposits during 2012–13. The banks used deposit inflows mainly to buy government securities and repay loans to the NBU, while credit to the economy expanded only by 14 percent over two years.



7. The economy had been in recession since mid-2012 (Figure 1). Generous wage and pensions hikes supported private consumption and domestic demand (text chart). However, overvalued exchange rate and poor business climate weighed on industrial production and investments. In late 2013, a bumper harvest gave a boost to GDP and briefly lifted the economy out of recession.

8. A ballooning fiscal deficit and rising quasi-fiscal losses in the energy sector contributed to the buildup of vulnerabilities. Large pension and wage increases and generous energy subsidies widened the general government deficit to 4¾ percent of GDP by 2013.

Disregarding rising gas import prices, the authorities kept domestic retail gas and heating prices fixed at the lowest levels in Europe. As a result of price disparities and persistent governance problems, the operating deficit of Naftogaz reached 1.9 percent of GDP in 2013, sapping public resources and leading to the accumulation of gas payment arrears to Gazprom.

9. Amid deepening economic imbalances, Ukraine lost market access (Figures 3 and 4).

Renewal of program discussions with the Fund helped the authorities place two Eurobond issues in early 2013 and raise US\$2.25 billion at yields of about 7½ percent. After the program discussions stalled in May 2013, the international debt markets effectively closed for Ukraine. As the current account deficit was on course to its print of 9.2 percent of GDP and reserves declined to a critically low level, sovereign debt yields went into double digits and CDS spreads widened sharply.

International rating agencies downgraded Ukraine to pre-default levels by end-2013. At the same time, private external debt roll-over rates remained high, as a large part of this debt reflected inter-company lending.

10. Short-lived assistance from Russia was not put to good use. In mid-December, the authorities signed a set of economic agreements with Russia and received assurances of financial assistance amounting to US\$15 billion in two-year loans and a gas price discount of about 30 percent. The first tranche of US\$3 billion arrived in late 2013 and the gas price was reduced in 2014:Q1. However, with no fundamental change in policy, the authorities continued to defend the *de facto* exchange rate peg. This policy, together with external sovereign debt service and partial clearance of gas payment arrears by Naftogaz, quickly depleted reserves. The cut in the price of imported gas was passed through to industrial and budget energy consumers, even though Naftogaz was well behind on payments to Russia's Gazprom. Following the government resignation in January, Russia put its financial assistance on hold and in April Gazprom steeply raised its demanded import price (Box 1).

RECENT DEVELOPMENTS AND CHALLENGES

11. By late February, the NBU could no longer defend the exchange rate. The NBU's international reserves dropped to US\$15½ billion, covering only about two months of imports and equivalent to 28 percent of the remaining external debt service in 2014. In response, the NBU abandoned its *de facto* exchange rate peg and switched to a flexible exchange rate regime. After significant volatility in thin trading, by early April the exchange rate had depreciated by over 35 percent from its end-2013 level, hovering around UAH 11–11.5/US\$1.

Box 1. Ukraine's Dire Energy Finances

Overall energy subsidies in Ukraine, on- and off-budget, amounted to 7½ percent of GDP in 2012 with relatively well-off households capturing the larger share of the benefits. Ukraine is one of the most energy-intensive countries in Europe, with use of energy per unit of GDP 10 times above the OECD average (IEA (2012), "Energy Balances of Non-OECD Countries", (Paris, OECD/IEA).

Extremely low prices on sales of gas to households and district heating companies—a small fraction of prices in other energy-importing countries in the region—strongly contributed to large Naftogaz cash deficits and inability to pay for imported gas. By end-March 2014, Naftogaz had built up arrears of about US\$2.2 billion (1½ percent of GDP) to Gazprom and significantly depleted its stored gas reserves. Despite the ongoing build-up of arrears, Gazprom has continued gas deliveries so far, but is warning that supplies may be cut if arrears are not cleared soon.

The government, as the sole owner, frequently raises Naftogaz's capital by issuing bonds, which places a large burden on the budget. Moreover, the lack of funds deters maintenance of the existing infrastructure—which in turn generates large technical losses—as well as needed investment in extraction of domestic gas. Another complicating factor for Naftogaz finances in 2014 is the fact that gas transit fees are currently very low because of pre-payment by Gazprom in 2012–13.

In April 2014, Gazprom cancelled the gas price discount provided under the December 2013 agreements, citing the build-up of arrears and reverting to the 10-year gas supply contract signed in 2009 (which neither Russia nor Ukraine has published). This has raised the gas import price to US\$385.5 per thousand cubic meters (tcm), a level envisaged in the program framework. However, Gazprom later also announced the cancellation of another US\$100 discount linked to the 2010 agreement on the Russian naval base in Sevastopol, recently cancelled by Russia following events in Crimea. As a result, Gazprom is now asking Naftogaz to pay as much as US\$485/tcm from April 2014. The Ukrainian authorities dispute this price and have indicated they will appeal to arbitration.

12. Fiscal balances have deteriorated. The 2014 budget approved in January allowed for increases in wages and social spending that are unaffordable, being based on highly unrealistic revenue assumptions. In fact, tax revenues are down 8½ percent y-o-y in January–February, on account of sharp deterioration of compliance amid the political turmoil. While the resulting gap has been partly filled up with profit transfers from the central bank, the Single Treasury Account has experienced intermittent payment difficulties. Meanwhile, local market financing has become limited to a handful of banks, including the state-owned financial institutions.

13. The financial sector is under significant stress. The banking system lost about 12½ percent of deposits in the two months to end-March. Reduced bank liquidity has made several banks vulnerable and dependent on emergency liquidity support from the NBU. Facing liquidity shortages, many banks have imposed ATM withdrawal limits. Exchange rate depreciation and economic contraction has hit banks with negative open foreign exchange positions and put loan portfolios at risk. The system's capital adequacy ratio (CAR) dropped to 14.4 percent at end-March, 3.5 percentage points less than at end-2013, while the NPL ratio inched up to

13.3 percent. In March, four banks accounting for about 3 percent of the system deposits disclosed capital shortfalls and—after their owners refused to provide extra capital—were moved under temporary administration by the Deposit Guarantee Fund (DGF). The 22 largest banks (accounting for over 70 percent of the system deposits) reported meeting the minimum of 10 percent CAR as of mid-March. Adjusted for exchange rate movements, credit to the economy still grew by 3 percent in real terms in March relative to a year ago.

14. In these crisis circumstances, the NBU has taken a number of extraordinary measures.

In addition to floating the exchange rate, it has adjusted monetary policy to accommodate emergency financing to the budget and the banking system. Thus, the NBU accelerated its profit transfers to the budget and back-stopped government T-bond placements by purchasing similar bonds from the secondary market. The NBU also introduced new facilities for providing liquidity to banks, allowing them to pledge as collateral not only government debt securities, but also loans to companies, at a sizable discount. Specifically, the NBU introduced (i) a special facility at a penalty rate, with access limited to the size of deposit outflows; and (ii) an emergency liquidity assistance (ELA) facility that lends at a high penalty rate against nonstandard collateral (corporate and household loans) at a 65–75 percent haircut. In late February, the NBU limited households' FX deposit withdrawals from banks to an equivalent of UAH 15,000 per day—but allowed households to withdraw all deposited amount if converted into hryvnia.

15. The near-term economic situation is challenging. The economy is in recession. Industrial production continues to contract (-5 percent y-o-y in Q1) on the back of declining manufacturing, in particular export-oriented industries. Retail trade growth so far remains relatively strong (7.7 percent up in real terms in Q1 y-o-y), driven by still positive, if decelerating, wage growth (in real terms, 3.6 percent in February y-o-y). Consumer price inflation is only moderately picking up (3.4 percent y-o-y in March) from low levels as the effect of the exchange rate depreciation is likely to start feeding into domestic prices with a lag. In January-February exports of goods contracted by 9½ percent y-o-y driven by a drop in exports in chemicals and machinery and equipment, as well as intermittent customs restrictions imposed by Russia. Imports of goods declined by 16 percent y-o-y, reflecting mainly a drop in gas and machinery imports.

16. Crimea accounts for a relatively minor share of Ukraine's economy. Crimea, which is included in the data for Ukraine, accounts for relatively modest 3.7 percent of Ukraine's GDP, while its 2.3 million residents represent some 5 percent of the country's population. The exposure of the banking sector in the region is limited to 2.3 percent in terms of deposits and 1.9 percent of the issued loans, and recently the majority of Ukrainian banks are winding up or selling their branches. One state-owned domestic gas extraction company, accounting for 14 percent of Naftogaz output is in Crimea, but its output is broadly equal to the region's gas consumption. The effect for the budget is likely to be essentially neutral as well, as Crimea is a slight net recipient of fiscal transfers from the central government.

POLICY DISCUSSIONS

A. Program Objectives and Strategy

17. Ukraine—and the authorities’ program—is facing unprecedented risks (¶¶46–49).

Traditionally, policy implementation risks have been significant in Ukraine, and the issue may resurface with the coming presidential elections in May 2014. In the same vein, vested interests could be expected to resist governance reforms. The program is addressing these risks by seeking upfront implementation of a critical set of prior actions, balancing decisive policy action with measures to sustain public support for the reforms, and securing broad political support for program objectives and policies. In addition—and perhaps more prominently—the unfolding developments in the East and tense relations with Russia could severely disrupt bilateral trade and depress investment confidence for a considerable period of time, thus worsening the economic outlook. Should the central government lose effective control over the East, the program will need to be re-designed.

18. Notwithstanding these significant risks, the authorities’ policy package deserves strong support. In the midst of severe economic, financial, and geopolitical risks, the authorities have shown an unprecedented resolve to put Ukraine’s economic policies on firm ground and decisively break with controversial past governance practices. If this momentum is harnessed and appropriately supported by the Fund, other IFIs, and bilateral contributions, the authorities’ success could mark a watershed moment in transforming Ukraine into a dynamic economy with rising living standards. However, if strong support is not delivered and reform momentum is lost, the full force of the current crisis could devastate Ukraine, perpetuating the vicious dynamic of bad policies followed by catastrophic crises. Thus, notwithstanding the significant risks, Ukraine is in urgent need of Fund support, which would unlock additional assistance from Ukraine’s other international partners.

19. In this context, the program aims to restore macroeconomic stability, strengthen economic governance and transparency, and on this basis lay the foundation for robust and balanced economic growth. This will be achieved by restoring competitiveness while maintaining financial stability, and resolving the remaining balance of payments needs by unlocking external financing. In parallel, deep-reaching structural reforms will aim to reduce imbalances durably, improve governance and the business climate—Ukraine’s long-standing weaknesses—and lead to resumption of balanced growth driven by consumption, investment, and exports. Given the difficult context Ukraine finds itself in, careful attention has been paid to the pace of adjustment, protection of the most vulnerable, and to flexibility in program design (in the form of adjustors to the performance criteria). Moreover, the program strategy includes a focus on capacity building with the aim of addressing the legacy of ad hoc policy design and implementation in Ukraine.

20. The main policies of the proposed program are as follows:

- **Maintain a flexible exchange rate and focus monetary policy on domestic price stability.** Adopt initially a money-based monetary policy framework, with strict targets for the NBU’s net

domestic assets (NDA) and net international reserves (NIR). Introduce inflation targeting within the course of the program.

- **Stabilize the financial system.** The program will help maintain confidence in banks and develop a plan for strengthening balance sheets and financial infrastructure.
- **Meet near-term fiscal obligations and gradually reduce the structural fiscal deficit.** Stabilize budget revenues and embark on an expenditure-led medium-term fiscal adjustment path that distributes the burden of adjustment equitably.
- **Modernize and restructure the energy sector to increase its efficiency and reduce its fiscal drag.** Begin staged increases in end-user energy prices, while enhancing the social safety net, and follow with deep-reaching structural and governance reforms in Naftogaz and the broader energy sector.
- **Implement comprehensive structural reforms** to help reduce imbalances, reduce corruption, improve the business climate, and achieve high and sustainable growth.

B. Macroeconomic Framework

21. Under the program baseline, policies and reforms are expected to support higher and more durable growth, keep inflation under control, and reduce vulnerabilities.

- **Real GDP is expected to contract by 5 percent in 2014, modestly rebound by 2 percent in 2015, and grow by 4–4½ percent in the medium term.** This projection is broadly consistent with GDP indicators in the past emerging market crises over the last 25 years (Figure 6). In 2014, growth is being hindered by a weak banking sector that constrains credit for the economy, subdued investor and consumer confidence, restricted wage growth, and fiscal tightening. All these factors will result in a significant contraction in domestic demand, led by dropping private consumption and investment declining to historically low levels (Table 1). Net exports' positive contribution to growth only stems from a sharp contraction in imports (driven by the exchange rate adjustment and restrained domestic demand), and a less pronounced drop in exports (as the positive effect of the exchange rate depreciation will take time to materialize). In 2015, after the economy has stabilized, a moderate investment- and export-driven recovery should ensue. In the medium term, successful implementation of program policies to improve governance and the business climate should lead to a rapid investment rebound, restored competitiveness should enable robust export growth, and—on the basis of these two effects—rising incomes will support a recovery in private consumption.
- **In 2014–15 inflation will remain elevated, driven by the depreciation of the hryvnia and hikes in energy tariffs.** On the other hand, the sharp demand contraction in 2014 and a slow rebound in 2015 should cap the price increases. Supported by prudent macroeconomic policies, price growth is expected to fall within the authorities' inflation target range in the medium term.

- **The current account deficit is expected to fall to more sustainable levels in 2014 and decline further over the medium term (Table 3).** The exchange rate adjustment and subdued domestic demand will result in sharp reduction of the current account deficit to 4½ percent of GDP in 2014, while the decline of the economy's net interest bill owing to both low-interest official financing, and a smaller debt burden for the private sector will reduce it further over the medium term. At the same time, an expected deterioration in Ukraine's terms of trade (over the near term) will keep current account improvements relatively muted. Official financing, augmented over time by private capital inflows, will cover the external financing needs in 2014 and create preconditions for replenishing the NBU's international reserves from 2015 onwards.

22. However, the economic outlook is subject to significant risks (¶46). While the Fund-supported program aims to stabilize Ukraine, and in this context to maintain strong economic relations with both Russia and Central/Western Europe, there is nonetheless a risk that the political, trade, and gas frictions with Russia could lead to strong deterioration in economic relations between the two countries, with a significant drop in Ukraine's exports to and imports from Russia. This would likely lead to deeper and longer recession, and—to the extent that trade imbalances deepen—the REER may need to depreciate further and the financial sector may take a larger hit than under the baseline. In the event of such an outcome, the program's macroeconomic framework would need to be significantly recalibrated, and policies may need adjustment.

C. Monetary and Exchange Rate Policy

23. The float of the hryvnia marks an important breakthrough that must be preserved (MEFP ¶8). Maintaining a flexible exchange rate will restore competitiveness, help protect scarce reserves and provide an important shock absorber. To this end, the achieved REER adjustment should be preserved and, in this context, the minimum wage and public wage growth should not push economy-wide wage dynamics above productivity growth. The authorities passed a regulation specifying that the official exchange rate is calculated as the weighted average of same-day interbank transaction rates, thus institutionalizing the flexible exchange rate regime. Staff analysis suggests that an exchange rate in the UAH 10–13/US\$1 range is consistent with Ukraine's fundamentals over the medium term, with the rapid economic shifts underway accounting for the uncertainty in these estimates. Should the hryvnia trade within the UAH 10–11/US\$1 range, the impact would be manageable for banks, firms, and households; balance sheets would take a stronger hit if the exchange rate settled in the UAH 12–13/US\$1 range (Box 2). Appropriately designed NIR floor targets back the commitment to a flexible exchange rate and support gradual rebuilding of reserves to adequate levels by the end of the program (Box 3).

24. In support of Ukraine's move to a flexible exchange rate, the authorities have agreed to gradually unwind existing restrictions and controls on the FX market. They have committed to identify and assess the existing foreign exchange restrictions by end-May 2014, and to formulate and begin implementing a plan for their removal by end-July. Meanwhile, they agreed not to impose any new restrictions affecting foreign exchange operations, nor intensify existing

restrictions.¹ In light of the significant increase in exchange rate volatility amid decline in market volumes staff recommended a condition-based approach to unwinding foreign exchange market controls with an eye on safeguarding macro-financial stability, while also seeking to limit the negative effects of existing controls on the FX market (for example by suggesting that the more distortionary controls be eliminated first).

25. The NBU will focus on achieving domestic price stability through targeting monetary aggregates in the early stages of the program (MEFP ¶12). The program sets a money supply path consistent with inflation objectives for 2014. This path will be achieved by controlling credit to government and commercial banks, while also providing sufficient liquidity to meet the needs of solvent but illiquid banks during the current period of funding stress. The monetary policy stance will tighten in 2014:H2, which will bring inflation down in 2015, after an initial increase during 2014—driven largely by significant pass-through from the exchange rate depreciation and energy tariff adjustments. Effective policy interest rates are expected to stay positive in real terms throughout the program.

Box 2. Ukraine: Balance Sheet Impact of Currency Depreciation

Staff conducted, jointly with the NBU, stress tests of the Ukrainian banking system. The results below should be taken as indicative in light of questions about the quality of the underlying data. A more comprehensive analysis of banks' assets will be completed in the context of the coming program reviews.

A sustained exchange rate around UAH10.5/US\$1 would appear to be manageable for the balance sheets of banks, firms, and households. Recapitalization needs of the largest 22 banks would amount to about 1½ percent of GDP or 9½ percent of the system's regulatory capital, emanating from asset quality deterioration and large FX open positions. A separate analysis indicates that corporate balance sheets would lose on average about 2 percent of their end-2012 equity and their debt service would increase by the equivalent of 4 percent of their liquid assets as of December 2013. A number of corporations and households will likely experience difficulties servicing their loans and banks would need to be proactive in restructuring loans to troubled but viable borrowers where applicable. Households as a group would be net winners from exchange rate depreciation, as their FX assets significantly exceed their FX liabilities (the FX loan to deposit ratio for households was about 0.4 at end-2013). However, their disposable income will be affected by the increasing burden of servicing foreign currency denominated loans.

A larger exchange rate move would affect bank balance sheets more substantially. An exchange rate around UAH12.5/US\$1 (a 50 percent depreciation from end-December) would require a total capital injection of up to 5 percent of GDP in the largest 22 banks. This is a conservative estimate, as the 2008–09 crisis—when bank balance sheets were larger relative to the economy and more exposed to exchange rate moves—saw a bank recapitalization of 4 percent of GDP for the same group. The adverse effect would be concentrated in domestic private banks, while public banks and most foreign owned banks would remain adequately capitalized. Bank recapitalization modalities are discussed in Section D.

¹ As per the most recent Article IV consultation report (EBS/13/150, Sup. 1), Ukraine maintained two multiple currency practices (MCPs). Recently the authorities introduced a number of changes to its exchange system that may have had an impact on these MCPs, and which may have introduced additional exchange restrictions and MCPs subject to the Article VIII of the Fund's Articles of Agreement. Staff is currently analyzing the jurisdictional implications of these measures.

Box 3. Ukraine: Exchange Rate and Reserve Adequacy Assessment

Under the baseline, standard quantitative methods suggest the hryvnia is broadly aligned with fundamentals. The real effective exchange rate can be assessed based on standard CGER-type methodologies. Under the program baseline, the macroeconomic balance method identifies a negligible gap between the current account norm and the underlying current account deficit of around 0.7 percentage point. To close this gap, the REER would need to depreciate by about 2.6 percent. On the other hand, the external sustainability method indicates a 1 percentage point negative gap between the norm and the underlying current account deficit, implying a slight undervaluation. To close the gap implied by the external sustainability approach, the REER would need to appreciate by about 3.6 percent to reach the current account balance that would stabilize Ukraine's NFA position. The reduced-form equilibrium real exchange rate method points to a larger undervaluation of over 14 percent, mainly on account of highly volatile variables such as terms of trade, relative productivity, relative government consumption, and initial net foreign assets. The results of the three approaches imply that at UAH 10.5–11/US\$1, the hryvnia is in close alignment with fundamentals.

However, new external shocks, including changes in prices of imported gas or trade relations with Russia and the EU could change the underlying current account deficit and push estimates toward UAH 12–13/US\$1.

Exchange Rate Assessment 1/
(Percent deviation from equilibrium REER)

	Sep-11	Dec-12	Nov-13	Apr-14
Macroeconomic balance 2/	8.5	13.5	14.0	2.6
External sustainability 3/	5.5	14.4	16.3	-3.6
Equilibrium real exchange rate	-9.3	-3.8	-1.8	-14.1

Source: IMF Exchange Rate Assessment Toolkit.

1/ Based on Staff Projections

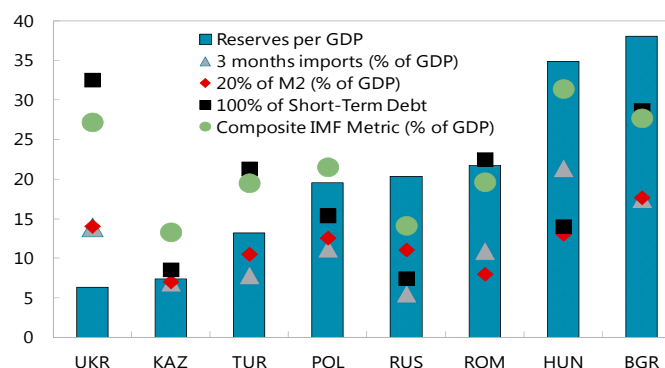
2/ REER adjustment needed to bring underlying current account to the level of the norm.

3/ REER adjustment needed to stabilize NFA position.

In early 2014, Ukraine's foreign exchange reserves fell to a critically low level by a number of metrics. The authorities' program would restore reserves to adequate levels.

- As of end-March 2014, NBU international reserves dropped to US\$15.1 billion, covering only two months of Ukraine's imports of goods and services. The program builds reserves up to 3.9 months of import coverage by end-2016, above the standard sufficiency threshold of three months.
- Current level of reserves covers about 28 percent of short-term debt by remaining maturity basis. This ratio is projected to reach 59 percent at end-2016.
- Finally, the reserves amounted to less than 50 percent of the IMF composite metric, calculated as a weighted sum of short-term debt, other portfolio liabilities, broad money, and exports in percent of GDP. Official reserves would exceed 100 percent of this metric by end-2016.

Reserve Metrics in Selected Countries, 2014
(Percent)



Sources: National authorities and IMF staff estimates.

26. By mid-2015, the authorities will aim to adopt inflation targeting as Ukraine's new monetary policy anchor (MEFP ¶10). Building on the extensive amount of technical work in the past several years, the NBU plans to complete its preparations within this timeframe and make the formal switch to the new regime in a period of relative economic stability. With technical assistance from the IMF, the NBU will prepare by end-June 2014 a clear timetable for completing the remaining preparations for adoption of inflation targeting. This transition will be facilitated by the planned fiscal consolidation (to reduce fiscal dominance) and steps to strengthen NBU independence, accountability and policy communications (MEFP ¶11). Under the new anchor, the NBU will target 3–5 percent inflation over the medium-term.

D. Financial Sector Policy

27. Rebuilding public confidence in the banking system requires a broad strategy with near- and medium-term actions and reforms. In this context, the program aims to strengthen financial stability through actions in five priority areas: (i) monitoring and supporting bank liquidity; (ii) assessing banks' financial resilience; (iii) restructuring and recapitalizing banks in need; (iv) reviewing and upgrading the regulatory and supervisory framework; and (v) removing impediments and upgrading banks' capacity to resolve NPLs.

Monitoring and supporting bank liquidity

28. The authorities will facilitate bank liquidity management and enhance supervisory monitoring (MEFP ¶14). In the near-term, the NBU should continue providing liquidity to solvent banks in need. To provide banks with more flexibility to manage their liquidity needs, the NBU will allow averaging of the minimum obligatory reserve requirements over the monthly maintenance period. To be able to gauge liquidity pressures in the system in advance, the NBU will require the largest banks to share their weekly cash flow projections prepared on the basis of best estimates of loan repayments and deposit withdrawals. The NBU will also ensure its liquidity policy is implemented in a transparent and expeditious manner.

Assessing bank resilience

29. The strategy in this area includes actions to identify banks in need of recapitalization and restructuring (MEFP ¶15). The authorities and staff agreed that this is a critical step towards rebuilding confidence in banks and ensuring financial stability. To this end:

- **The largest 35 banks accounting for about 82 percent of the system's assets will be subjected to independent asset diagnostics and business viability studies.** The authorities and staff view this as important for gauging the strength of bank balance sheets, and for charting the best course of action to address any weaknesses. In particular, the asset valuation exercise aims to ensure that loan provisions reflect rigorous implementation of NBU loan classification and provisioning rules, so their true financial condition and capitalization is not distorted. As a first step, the NBU has instructed the participant banks to launch the diagnostic studies (*prior action*). The diagnostic studies for the 15 largest banks will be completed by end-July 2014 (*structural benchmark*), and for the 20 next largest banks by end-September 2014.

- **To ensure banks' viability, the NBU will require banks to submit business plans that demonstrate they have sufficient capital through 2016.** To allow sufficient cushion in the current uncertain environment, banks will be asked to meet a main Tier 1 capital ("T1"), defined as paid-up capital, disclosed reserves, share premiums, additional contributions of shareholders, and general risk provisioning fund, metric of 7 percent—within an overall capital requirement of 10 percent—under the main program scenario, and 4.5 percent T1 under adverse macroeconomic scenarios agreed with Fund staff.²
- **In the event of capital shortfalls, the current bank shareholders will be the first line of defense.** Capital-deficient banks will be required to submit recapitalization and restructuring plans. The deadlines for compliance are end-December 2014 for the 15 largest banks and end-February 2015 for the 20 next largest banks. Private owners of banks will be asked to make up any capital shortfall through cash injection.
- **If private recapitalization efforts fail, public funds could be made available under strict conditions.** The authorities are confident that private shareholders will cover the recapitalization needs of their banks, but have nevertheless agreed to seek authorization in a supplementary budget for funds amounting to about 1 percent of GDP to support banks with the view to increase it in case of larger needs. These funds will be injected on the basis of strict criteria to be agreed with IMF and WB staff by mid-May 2014 (*structural benchmark*).
- **The authorities will ensure proper governance in the use of public funds.** For this purpose, the authorities will appoint a high level committee by end-March 2014 (MEFP ¶15). Management of potential state ownership of bank shares will be handled by a specialized unit at the Ministry of Finance by end-September 2014 (*structural benchmark*). The DGF will continue its role as the resolution agency to resolve banks, and steps will be taken to ensure it has adequate resources and is well staffed and trained.
- **A high level committee will be formed to ensure proper oversight of banks' resilience assessments.** The NBU will appoint a Steering Committee to oversee the diagnostic process to ensure consistency and implementation meeting the goals and modalities of the overall exercise. Staff of the IMF and the World Bank will be involved in the process.

Upgrading the regulatory and supervisory framework

30. The authorities are planning a number of steps to bring Ukraine's regulatory and supervisory framework in line with international best practice (MEFP ¶16). Measures will target distortions in the calculation of economic foreign exchange positions (from Resolution 109), possible deficiencies in accounting standards and the application of Basel Core Principles, and improvements in providing credit information on borrowers. Specifically:

²As a result of the 2008 financial crisis, regulators and markets shifted their focus to bank Tier 1 capital as a better metric for bank's capital strength.

- **As a prior action, NBU has repealed Resolution 109**, which forces the banks to maintain a large negative open foreign exchange position.³ The NBU will now allow banks to gradually add provisions in foreign exchange in the calculation of their foreign currency position over a period of 20 months, ending in December 2015. As this would generate some demand for foreign exchange from banks to stay within the statutory open position limits, the gradual approach would reduce the likelihood of sharp spikes in the exchange rate.
- **With technical assistance from the IMF, the NBU will compare Ukraine's IFRS implementing practices against international best practice.** If this assessment were to find material room to enhance IFRS implementation, then after consultation with IMF and World Bank staff, the NBU will issue guidelines to correct current practices by end-November 2014;
- **The NBU will invite IMF and WB staff to assess Ukraine's compliance with Basel Core Principles for Effective Supervision.** This will aim to identify gaps between the current supervisory and regulatory framework regarding international best practices and prepare an action plan to address them in the following 12–24 months;
- **To help monitor large exposures and troubled borrowers, the NBU has agreed to establish a centralized credit risk register.** Additionally, this credit register should share information with all market participants to enhance credit standards in the country. To this end, the existing legal framework for the credit register will be revised by end-August 2014 with the aim to become operational no later than August 2015.

Facilitating banks' capacity to resolve NPLs

31. A critical step in restoring bank balance sheet health and reviving lending will be to resolve high NPLs. As of end-March 2014, banks' NPLs (13.3 percent by the NBU definition) are about 80 percent covered by specific provisions. However, NBU's NPL definition does not include restructured or rescheduled loans. Should these be included in NPLs, in line with best practices, the level of NPLs would rise to about 23 percent, suggesting a notable risk to banks' capital asset ratios. In addition, two factors add to this risk: (i) as the recession unfolds, NPLs are expected to rise further; (ii) the upcoming bank diagnostics may uncover additional loan provisioning needs, in particular for banks that have granted FX loans to non exporters. The framework for debt workouts will thus be strengthened to facilitate the resolution of NPLs (MEFP ¶17). Later this year (by end-September), the NBU will assess the level of banks' preparedness to effectively deal with troubled borrowers while minimizing moral hazard. The authorities have decided to request Fund TA on strengthening the legal framework for NPL resolution, including for out-of-court restructuring and in-court processes. In this regard, the authorities will complete a review of the existing framework by end-October 2014.

³ NBU's Resolution 109 excludes provisions in foreign currencies from the calculation of banks' foreign exchange position. This artificially inflates the value of the banks' reported foreign currency loans and forces them to keep their other foreign currency assets low in order to comply with the NBU regulation on open foreign exchange positions. However, this policy amounts to requiring the banks to run a structural negative (short) economic open position, as their foreign currency assets net of provisions fall well short of their foreign currency liabilities.

As part of the diagnostic studies, the NBU will ask the auditing firms to assess the quality of bank debt restructuring policies and procedures to ensure effective debt restructuring. This report will be completed by end-October 2014.

E. Fiscal Policy

32. Recent turmoil has significantly exacerbated an already weak fiscal position. Starting from 6¾ percent of GDP in 2013, the combined general government-Naftogaz deficit in 2014 would have exceeded 12 percent of GDP without adjustment (8½ percent for the budget alone), as the effects of the political turmoil and the weak economy on budget revenues would have combined with the unaffordable spending plans of the previous government. Such a deficit would have been impossible to finance without recourse to large-scale monetization, not to mention its destabilizing effect on public debt sustainability and confidence in public solvency.

33. Discussions focused on urgent measures to maintain priority spending and initiate durable medium-term fiscal adjustment. Staff and authorities agreed that revenue shortfalls produced by large macroeconomic and political disruptions warranted an immediate policy response involving a mix of revenue and expenditure measures. Over the medium-term, the authorities will emphasize expenditure-led consolidation and benchmark their progress against the structural fiscal deficit indicator.

34. To mobilize financing for priority spending, the government is stepping up revenue collection efforts (MEFP ¶18). This is being done through measures to break tax evasion schemes that reportedly proliferated until recently. While these measures did help strengthen budget revenue in March, additional efforts are needed to counter the weakness observed in early April. On the expenditure side, it has given priority to timely payments of wages, pensions, and debt service obligations. At end-March, unpaid bills amounted to UAH 6.4 billion (0.4 percent of GDP), down from 9.9 billion at end-January. The program has budgeted adequate resources for their elimination.

35. Against this background, the program targets a moderate structural fiscal adjustment of 2 percent of GDP from the 2013 levels over 2014–16, or 3 percent including Naftogaz (table). Given the difficulty in reducing Naftogaz's losses quickly (see Section F), the onus of the adjustment in 2014

will need to fall on the budget deficit, with a structural cut of 1 percent of GDP in that year. This pace aims to balance between containing the rise in public debt and bringing the deficit in line with

Fiscal Balances Under the Program, 2013–16
(percent of GDP)

	2013	2014	2015	2016
	Estimated	Program		
General government balance 1/	-4.8	-5.2	-4.2	-3.1
Overall balance including Naftogaz operational deficit	-6.7	-8.5	-6.1	-4.4
Structural general government balance	-4.6	-3.6	-3.1	-2.6
Structural general government and Naftogaz balance	-6.1	-4.9	-3.9	-3.1

Sources: Ukrainian authorities; and IMF staff estimates.

1/ The general government includes the central and local governments and the social funds.

available non-inflationary financing, on the one hand, and minimizing the adjustment costs for the

fragile economy, on the other hand. For 2014, this approach translates into a headline budget deficit of 5¼ percent of GDP and a Naftogaz deficit of 3¼ percent of GDP. Even as the structural deficit improves, the combined general government and Naftogaz deficit of 8½ percent of GDP is going to widen by 1¾ percent of GDP relative to 2013.

36. To help achieve this adjustment, the authorities have decided to restrain expenditure and raise additional revenue. Given the very high budget expenditure (nearly 50 percent of GDP), the breakdown of expenditure/revenue efforts is about 2:1 in favor of the former. Excluding measures preventing further unaffordable fiscal expansion, savings amount to about 2 percent of GDP.

- **The government will restrain the public sector wage bill growth by canceling the discretionary wage increases planned for July and October 2014.** Alongside, the government will maintain a hiring freeze to reduce employment through attrition and staff optimization. The existing scheme for indexing wages with inflation remains in place.
- **The authorities will also limit the growth of pension expenditure by canceling the discretionary increase in pensions and pension-linked benefits previously planned for July and October 2014.** They will also suspend indexation of pensions with part of the average economy-wide wage growth. As for public wages, inflation indexation of pensions remains intact.
- **As a *prior action* for the program, Parliament has adopted a new public procurement law**—which has benefitted from advice from the World Bank—to strengthen governance and reduce exemptions from regular competitive procedures, which would allow substantial savings on government purchases.
- **To limit fiscal risks and foster transparency, the new loan guarantees issued by the central government will not exceed UAH 25 billion in 2014 (*quantitative performance criterion*).** The authorities will focus these guarantees on high priority projects, including where such guarantees are required to unlock complementary external financing.
- **On the revenue side, decisive efforts to improve revenue collection have already led to breaking two major fraudulent tax evasion schemes concerning fake exports of fuel and illegal alcohol production.** Together with the ongoing reorganization of state tax and customs services, this will bring considerable additional revenues.

- **Moreover, as a *prior action*, Parliament has reversed the already introduced VAT rate reduction in 2015 and kept the rate at 20 percent.** Pending a reform of the VAT regime in agriculture planned for late 2014, Parliament has extended until October 1, 2014 the recently expired VAT exemption regime for grain exporters.

- **The government will apply a single higher excise tax rate for diesel fuel** instead of the current differentiation of rates—which is prone to abuse—and will hike excises for other products.

- **A reduced 7 percent VAT rate will be applied to supplies of pharmaceutical and medical products** (currently exempt from VAT).

In addition to the revenue effect, this will also help level the playing field between importers and domestic producers.

Fiscal Adjustment Measures, 2014

(percent of GDP)

<i>Expenditure measures</i>	<i>Yield</i>
Wage and hiring freeze in the public sector	0.5
Cancel discretionary hikes and wage indexation of pensions	0.2
Savings in non-pension social funds	0.3
Rationalization of social assistance	0.2
Prioritization of capital expenditures	0.5
Rationalization of subsidies to enterprises	0.1
Public procurement and other savings	0.2
Total expenditure measures	2.0
<i>Revenue measures</i>	
Elimination of zero VAT rate for grain and crops export	0.3
Increase of mineral resources fees	0.1
Increase in excises, and indexation of land prices	0.3
Reduction of VAT exemptions on medical products	0.1
Elimination of tax frauds	0.4
Total revenue measures	1.3

37. To address the build-up of overdue VAT refund claims that deprives companies of working capital, the government will securitize the accumulated VAT refund arrears by end-2013 (MEFP ¶21). This will be a one-time bond issuance of up to UAH 16.7 billion (1.1 percent of GDP). The bonds will be fully marketable and issued at market interest rates. Going forward, the authorities have pledged to make every effort to provide VAT refunds on time and using conventional methods. To address long-standing problems in this area, the authorities will increase transparency in granting VAT refunds, widen application of automatic VAT refund systems, and prohibit the practice of requesting CIT advance payments in exchange for VAT refunds (MEFP ¶27).

38. The government will help finance Naftogaz by issuing recapitalization bonds (MEFP ¶23). Naftogaz's operational deficit is projected at 3¼ percent of GDP in 2014. Taking into account previously accumulated arrears and the US\$1.6 billion Eurobond maturing in September 2014, Naftogaz's actual financing needs could reach 4.1 percent of GDP in 2014. To help cover this gap, government has already recapitalized Naftogaz by UAH 11 billion in 2014:Q1, and another UAH 22 billion is allocated in the recently adopted supplementary budget. To fill the remaining gap, including repayment of its large arrears to Gazprom in a timely manner, Naftogaz will need to develop a plan based on cost rationalization and improved revenue collection that could eventually include further financial backing from the budget as well.⁴

⁴ The arrears between Naftogaz and Gazprom are classified as commercial, since Naftogaz is an autonomous state-owned enterprise and not a part of Ukraine's budgetary process in a legal sense. Thus the IMF's lending into arrears policy does not apply.

39. Fiscal consolidation will continue in 2015–16 (MEFP ¶20). Over this period, the emphasis will be on a gradual expenditure-led fiscal consolidation, combined with measures to enhance public sector efficiency. An upcoming FAD technical assistance mission in May 2014 will help identify specific measures in this regard. This approach will place public debt firmly on a declining path.

F. Energy Sector Reforms

40. Naftogaz's fiscal position is precarious. Without adjustment, Naftogaz's deficit would have doubled in 2014, pushed by the rise in its costs stemming from the exchange rate depreciation and the need to replenish stored gas that was depleted past winter. Moreover, Naftogaz needs to clear its 2013 arrears to Gazprom and remain current on its 2014 bills. The retail gas and heating tariffs remain the lowest in Europe, only 11–25 percent of the levels in other gas-importing countries in the region and significantly below even the levels in Russia. Last but not least, the low and differentiated tariffs breed governance problems and stimulate overconsumption of energy, making Ukraine one of the most energy-intensive countries in Europe.

41. The authorities' program aims to gradually eliminate Naftogaz losses by 2018 by implementing staged tariff hikes over 2014–17 and reducing Naftogaz's costs (MEFP ¶23 and Box 4). In 2014, the objective will be to contain Naftogaz's deficit to 3¼ percent of GDP and clear its arrears. Subsequently, the authorities aim to reduce Naftogaz's deficit to 1.9 percent of GDP in 2015 and eliminate it completely by 2018. The strategy for achieving this will depend critically on gradual increases in retail gas and heating tariffs (56 and 40 percent in 2014, respectively, and 20–40 percent in 2015–17), along with strengthening payment discipline and restructuring of Naftogaz to reduce its costs. Increases in retail tariffs will be accompanied by enhanced social assistance from the budget to cover the most vulnerable.

42. Such price hikes should be viewed in a broader context:

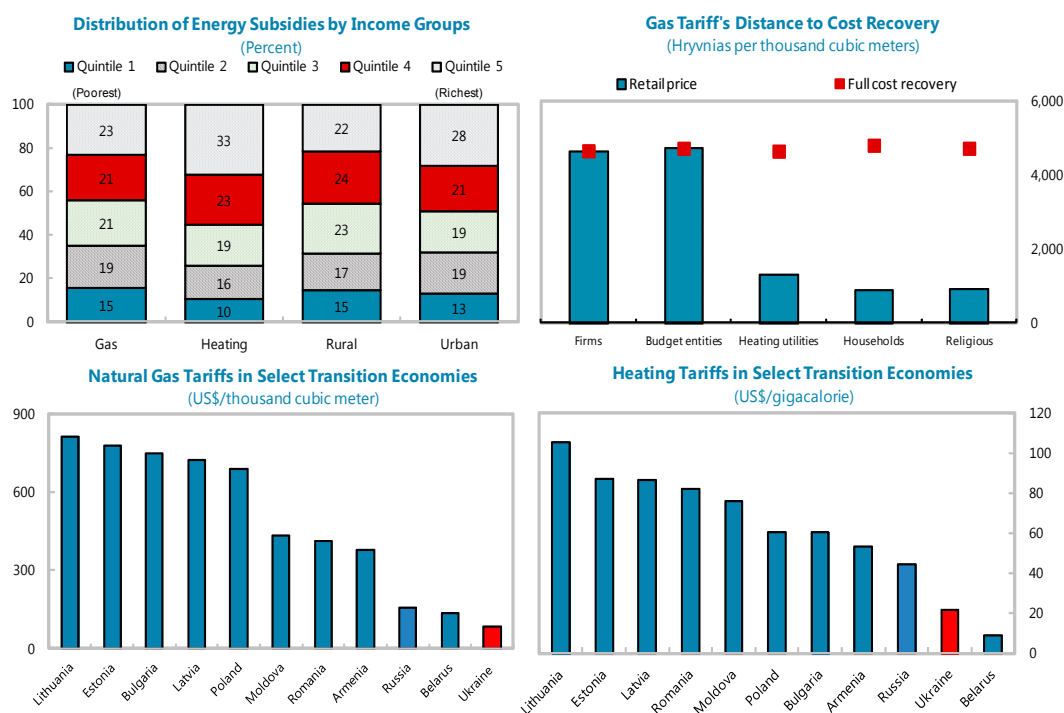
- **Currently, gas and heating spending account for 3–7 percent of household budgets.** Increasing gas and heating prices by 40–56 percent would raise this share to 5–11 percent. This is moderate by the standards in the neighboring countries, especially given that nearly 30 percent of the population will be shielded from the increase (see below). Even after the programmed increases in 2014, the price of gas and heating for the population will remain several times less than in other gas-importing European countries.
- **The tariff increase will be fully offset for the most vulnerable 25–30 percent of the population.** To this end, the authorities will increase several-fold the coverage of vulnerable households, from about 810,000 today on average to 4.5 million next fall. Specifically, the existing housing utility subsidy scheme that pays the bills in excess of 10/15 percent of the income of eligible households' would expand to cover about 1 million households. Moreover, a new scheme will be introduced from July 1, with the assistance of the World Bank, which would cover additional 3.5 million households and aim to provide a benefit equal to the difference between pre-and post-increase gas and heating bills. The Cabinet decision to introduce the new scheme was a *prior action*.

- **Further enhancements in social assistance are possible by improving the targeting of the existing schemes.** As present, the majority of social assistance is captured by higher-income households who consume the largest share of gas and heat. For instance, the top quintile in the income distribution gets subsidy benefits that are, as a rule, double those of the bottom quintile (chart below). For a fraction of the cost of the existing utility subsidies, the government could fund additional social assistance programs that would substantially reduce poverty.

Box 4. Energy Sector Reforms

The program aims to take immediate actions on several fronts. For this purpose the government will first and foremost motivate the need for reform through an extensive campaign that will inform the population why tariff hikes are necessary. The campaign will also lay out the government's approach to increased social assistance. The main reform objectives will be:

- **Gradually bring domestic tariffs to cost recovery levels.** As *prior actions* for the program, Ukraine's national energy and utility price regulators NERC and NURC will adopt decisions to raise retail gas tariffs by 56 percent on average from May 1, and retail heating tariffs by 40 percent on average from July 1. The government also announced the decision and schedule for tariff increases, entailing end-user gas and heating tariff increases of 40 percent in 2015 and 20 percent in 2016 and 2017, respectively. To ensure de-politicization of tariff setting, Parliament passed legislation to vest the communal services regulator with the exclusive authority to set heating tariffs in the country. Gas prices to industrial and budget consumers were adjusted in early April taking into account new gas import prices and exchange rate movements.
- **Protect the most vulnerable from the impact of gas and heating tariff increases.** The existing Housing and Utility Subsidy program that covers the utility bills above 10/15 percent of the enrolled households' income will remain in place and will fully shield current beneficiaries from the increase in gas and heating prices as well as cover new entrants who have fallen on hard times. In addition, to protect vulnerable households not covered by the existing subsidy, the government will introduce a new social assistance scheme that will compensate for the average utility bill increase families earning incomes below subsistence levels. In total, 4.5 million families—about 27 percent of the total—will be receiving government support to shield them from tariff increases.
- **Strengthen payment discipline.** The authorities intend to address the low compliance rates of district heating companies by (i) passing legislation that will create distribution accounts into which all utility payments are made, and from which payments to Naftogaz are automatically drafted (*structural benchmark for end-June, 2014*); (ii) raise building-level heating meter coverage from 36 to 45 percent by end-2014; and (iii) move to consumption based utility bills rather than current use of norms.
- **Improve energy efficiency in the heating sector.** In close cooperation with the World Bank, the authorities will continue their efforts to improve the efficiency of the residential heating sector (building efficiency, consumption-based billing), utilities (production efficiency, transmission of heat and distribution efficiency) and the public sector (public buildings).
- **Conduct quarterly audits of Naftogaz operations to improve transparency.** A tender has been launched and an auditor will be in place within 60 days. The results of the audits will help enhance Naftogaz's transparency and support progress toward improved finances.
- **Restructure Naftogaz.** The authorities will start to identify strategic priorities, including restructuring, for Naftogaz, relying also on advice from the World Bank.



Source: Ukrainian authorities; WB and IMF staff estimates; www.energy.eu; www.euroheat.org.

G. Reforms for Better Governance and Transparency

43. Weak governance, transparency, and a very difficult business climate have long hindered Ukraine's ability to achieve greater efficiency, higher growth and trust in government. In discussions, staff emphasized the importance of a comprehensive approach with strong leadership and ownership from top to bottom, including government and local administration, and the NBU. In response, the authorities have committed to address governance issues in state-owned companies, strengthen transparency of public procurement procedures to substantially reduce room for misuse of public resources, build capacity to more effectively conduct anti-money laundering (AML) activities and anti-corruption actions, seek recovery of stolen assets, and enhance the effectiveness of the judiciary and tax administration (MEFP ¶25).

44. Actions will be guided by a diagnostic study aiming at identifying the core of the problems and proposing specific remedial measures (MEFP ¶26). Concrete reforms in this area will be informed by an in-depth diagnostic analysis and develop as one of the main priorities of the coming program reviews. To this end, the authorities requested a comprehensive diagnostic study to be completed in close consultation with IMF staff prior to the first program review that will cover the anti-corruption framework, the design and implementation of key laws and regulations that may have impact on the business climate, the effectiveness of the judiciary, and tax administration (*structural benchmark*). Specifically, the diagnostic study will: (i) assess the current governance arrangements and frameworks in place, identifying areas for strengthening and reform; (ii) judge the relative importance of the issues flowing from the diagnostic findings; and (iii) propose specific remedial measures and time frames for their implementation.

45. In parallel, a number of policies aimed at combating and reversing the legacy of corruption in Ukraine will be implemented in the coming months (MEFP 127):

- **The authorities have committed to strengthen their AML framework and revise the relevant laws in line with international standards.** In particular, banks should be required to conduct enhanced due diligence on business relationships with domestic politically exposed persons, and NBU is going to properly assess the fit and proper requirement, including requirements to check the source of wealth/funds of owners of qualifying holdings of banks.
- **In the context of the Stolen Asset Recovery (“STAR”) Initiative, the authorities will work with the World Bank and other international partners** to develop a strategy and action plan for pursuing and recovering assets stolen by corrupt former officials.
- **The government plans to develop new measures to simplify the regulatory environment and reduce compliance costs for the business,** which would improve the business climate and facilitate higher growth in Ukraine.

RISKS TO THE PROGRAM

A. Risks to Macroeconomic Outlook

46. Downside risks to the economic outlook are significant:

- **Disruption of non-energy trade with Russia.** Tensions with Russia, if not eased quickly, could lead to significant reduction in most non-energy bilateral trade. Given that Ukraine ships about a quarter of its exports to Russia, most of it exempt from customs duties (see Box 5), this could result in a highly disruptive negative economic shock similar in nature to, but likely smaller than, the post-transition period in the 1990s. Ukraine’s expected move towards deeper integration with other international markets, which include plans to sign free trade and association agreements with the EU later this year, will support exports, but is not a substitute for maintaining established trade relations with Russia. In this context, it is important that both Russia and Ukraine refrain from imposing restrictions on their bilateral trade.
- **Disruption of energy trade or pricing with Russia.** A significant increase in the price of imported gas above the baseline level of US\$386/tcm could cause additional burden to external balances and the economy. Staff estimates that an increase to the price of US\$485/tcm sought by Gazprom, if it were to materialize, would raise Ukraine’s current account deficit by an additional US\$1½–2 billion a year (1 percent of GDP) and Naftogaz’s deficit by about ½ percent of GDP assuming full pass-through to industrial and budget users as currently legislated. On the other hand, the planned expansion of reverse-flow gas imports from European countries at prices below US\$400/tcm could mitigate these effects. In the absence of agreement between the parties, this dispute can lead to interruption of gas supply from Gazprom to Ukraine. Speedy resolution of the dispute with both sides showing good faith is thus crucial. In light of the uncertainty created by the absence of agreement on this issue, the review scheduled to be

completed by end-September will take stock of the progress in reaching agreement between the parties, including implications for the program's objectives, key policies, and adequacy of financing.

Box 5. Ukraine's Connectedness with Russia

Ukraine's close economic links with Russia were discussed in the 2012 and 2013 Article IV consultation staff reports (see Country Report No. 12/315 and EBS/13/150, respectively). Some key facts are:

- Russia accounts for about a quarter of Ukrainian exports (equivalent to about 10 percent of GDP), mainly base metals and machinery. Most of these exports have been exempt from Russian customs duties under CIS and bilateral agreements. About 30 percent of Ukraine's 2013 imports were sourced from Russia.
 - Ukraine imports about half of its gas consumption from Russia. In addition, about 12–15 percent of gas consumed by European Union countries passes through the territory of Ukraine.
 - Russian banks account for about 12 percent of Ukraine's banking system assets.
 - Russian FDI accounts for about 2.4 percent of GDP, though more may be sourced through Cyprus.
 - In 2013, Ukraine received about US\$2.7 billion annually in workers' remittances sourced from Russia.
- **Geopolitical risks relating to Crimea.** It is acknowledged that at this stage the authorities do not have effective control with respect to Crimea for purposes of implementing their economic policies in that territory. However, while this might lead to Ukraine being deprived of significant energy assets in the medium term, the small economic size of Crimea and other available information (¶16) suggests that such lack of control would not impair the authorities' ability to meet program targets and objectives. Staff will take stock of future developments on this matter that might affect the need and feasibility of presenting Ukraine's data with or without Crimea.
 - **Broader geopolitical risks and escalation of internal tensions.** There are also risks that tensions remain high in Eastern Ukraine, a highly-industrialized region. The scale of the impact will depend on the duration and intensity of the unrest and is difficult to quantify at this point. The conflict could weaken budget revenue, as well as significantly damage prospects for investment. As a result, the budget deficit could widen above the program ceilings, necessitating corrective measures or offsetting increases in donor financing. Moreover, this would likely lead to significant deterioration in the trade balance, given the outsized role of the eastern regions of Ukraine in the production of machinery and equipment.⁵
 - **Financial sector risks.** Diagnostic studies could identify more severe bank weaknesses than expected. Deposit withdrawals and loan portfolio deterioration could accelerate, perhaps triggered by further political and economic upheaval, producing a deeper negative impact on

⁵ In 2013 the provinces of Donetsk, Luhansk, and Kharkiv accounted for about 21½ percent of GDP and 30 percent of Ukraine's total industrial production. The region also accounted for about 28 percent of Ukraine's exports of goods and 11 percent of imports. In 2013, the three provinces' net contribution to the central budget amounted to 1.3 percent of GDP.

the banking system than currently expected. This could mean as much as 5 percent of GDP or more in bank recapitalization costs (Box 2). Such developments would further restrain access to financing for the economy and could require channeling additional public funds to bank recapitalization and possibly to cover insured deposit losses. The NBU may be called on to provide additional liquidity injections.

- **Other risks.** Sharp increase in military spending may make it difficult to adhere to the program fiscal envelope. Political and economic uncertainty could linger longer than anticipated, with significant negative implications for investment, and could possibly drive economic activity underground. Currently unreported governance issues may disrupt the implementation of the program as well.

47. On the positive side, quick rebound and diversification of exports, higher international steel or grain prices, or faster recovery in investor sentiment would provide for upside potential. Stronger global growth could improve the current account outlook and boost growth in Ukraine. Decisive program implementation could lead to a stronger and faster than anticipated FDI pick-up and international capital markets could reopen faster for Ukraine, creating preconditions for stronger investment growth and faster reserves accumulation. Stepped up efforts by EU countries to increase the volume of reverse flows of gas to Ukraine could alleviate the heavy burden of the gas bill on Ukraine and help with the current account adjustment. Finally, Ukrainian exports to a broad range of international markets could rise faster than envisaged, providing for more robust export-led growth than currently projected. In addition, rapid investment and technology transfer can result in a beneficial change in the structure of exports towards higher value-added products.

B. Risks to Program Implementation

48. Coming in a very difficult moment for Ukraine, the program faces considerable risks and uncertainties. These risks could weaken program implementation and performance and hinder prospects for regaining access to international capital markets within the timeframe when the Fund has significant financial exposure to Ukraine. The political commitment and public support to comprehensive reforms could falter once the initial adjustments are accomplished. Vested interests are likely to resist governance reforms. With presidential elections scheduled for May 25, and a likely run-off on June 15, political pressures could result in incomplete program implementation in the months ahead. Moreover—should a new government be formed following the presidential or possible later parliamentary elections—it could seek to reopen discussions on key program policies. The experience of the last two Fund programs with Ukraine suggests that reforms commitments could weaken significantly as soon as initial reforms unlock market financing and stabilize the economy. On the positive side, the current leadership has publicly, in words and action, shown exceptional transparency and commitment to reform. Moreover, any future government will need to address the deep and persistent economic problems of the country and respond to the public yearning for a break with problematic past governance practices. These dynamics would mitigate the chance of significant reopening of policy discussions.

C. Strategy for Mitigating Program Risks and Uncertainties

49. Extensive precautions have been taken to mitigate program implementation risks.

These include a program design that balances strong action with measures to sustain public support for the reforms, strong and comprehensive set of prior actions, broad-based endorsement of program objectives and policies from key stakeholders, and financing commitments from official and multilateral sources.

- **The program's strong adjustment package needs to be put in place upfront as deep macroeconomic imbalances are threatening to destabilize the economy.** At the same time, to sustain public support for the reforms and cushion the impact of the adjustment on the most vulnerable, the authorities aim for decisive improvements in governance and enhanced social safety net. Specifically, by tackling corruption, addressing loopholes in tax administration, promoting transparency in management of public resources and better targeting social assistance, the authorities will ensure that the burden of the adjustment is more equally distributed within the society;
- **To demonstrate their commitment to program objectives, the authorities have implemented twelve prior actions in the areas critically important for program success.** Going forward, staff expects that program reviews will be conditional on other macro-critical prior actions.
- **The program will start with two high-frequency bi-monthly reviews.** The first review sets end-May as a test date. This will ensure close monitoring of policy developments. Deviations from the agreed policies will be spotted early and addressed promptly.
- **Staff met three leading presidential candidates and representatives of several political parties and civil society organizations,** who expressed their agreement with key program objectives and policies. This reduces the political risks to the program from the possible outcome of the presidential elections in May/June 2014.
- **The program with Ukraine enjoys exceptionally strong and broad international support.** The EU, the U.S., Japan, Canada, China, as well as the World Bank, the EBRD, and the EIB have expressed their support for the program and have committed financing to Ukraine. This strong backing suggests that there may be scope for increased donor support for Ukraine over the program period.

PROGRAM MODALITIES AND CAPACITY TO REPAY

A. Access and Phasing

50. The authorities request a 24-month SBA in an amount equivalent to

SDR 10.976 billion, or 800 percent of quota (about US\$17.1 billion). Even with the programmed strong macroeconomic adjustment, Ukraine still faces a large balance of payments financing need over the next two years that needs to be covered by official assistance. The country has lost access

to international capital markets, and rollover rates for corporate and bank obligations are projected to drop considerably in 2014. Meanwhile, the country needs to strengthen its international reserves position (Table 3). As a result, gross external financing requirements are projected at about US\$27 billion over the course of the program, driven by still substantial current account deficits, large external debt obligations of the private sector, and the need to replenish reserves (Box 3).

51. The Fund will play a crucial role in filling the financing needs of Ukraine and unlocking official and private support to cover the remaining financing gap. Absent Fund and other

official financing, debt service and critical import payments could have completely depleted the remaining official reserves by end-2014. This could have forced Ukraine to default on its external obligations. Support from the Fund and other official sources will help bring Ukraine's GIR to comfortable levels (over 100 percent of the composite reserve metric by end-2016). The committed official financing from World Bank, the European Commission, the EBRD and other sources is projected to exceed US\$6 billion in 2014 and US\$4 billion in 2015, including for budget support operations, and private inflows are expected to increase from 2016. Nevertheless, to cope with risks of delayed official support, the program includes adjustors.

Government Financing by IFIs and Other Sources, 2014-16

(Billions of U.S. dollars)

	2014	2015	2016
Official financing	6.3	5.4	3.3
World Bank	1.9	1.6	0.4
European Commission	2.2	0.6	0.1
Of which: MFA	1.9	...	...
EBRD/EIB/Others	2.2	3.1	2.8
Eurobonds 1/	1.0	1.0	3.0
Memorandum items:			
IMF financing	3.7	7.1	1.1
Prospective purchases	7.4	8.6	1.1
Of which: Budget support	2.0	0.0	0.0
Repurchases	3.7	1.5	0.0

Sources: National Bank of Ukraine; and IMF staff estimates.

1/ In 2014, includes US\$1 billion Eurobond guarantee from the U.S.

52. Ample public financing needs and limited market access justify an allocation of Fund financing for the budget in 2014. International debt markets are closed to Ukraine. Liquidity in the domestic market is very low, reflecting weaknesses in banks and corporate balance sheets affected by economic contraction, devaluation, and deposit outflows. In this situation, it will be very difficult for the authorities to finance the general government and Naftogaz deficits in 2014 without very large support from the NBU, which would tarnish NBU independence and its ability to meet NDA targets under the program. To help cover fiscal financing needs in the environment of restricted market access, the authorities have requested Fund financing so that the domestic currency counterpart of Fund purchases would be used to finance the budget deficit in the amount of SDR 1.290 billion (equivalent to about US\$2 billion, 1.4 percent of GDP) from the first purchase. Such use of Fund financing is consistent with the Fund's relevant policy framework. Specifically: (i) Ukraine needs financial support under the proposed SBA to address its current account deficit and pressures on the capital account, as well as to build up reserves; (ii) in addition to having an actual and acute balance of payments need, Ukraine has committed to implement policies that will assist in resolving its balance of payments problems and ensure repayment of Fund resources; and (iii) Ukraine's program is designed in a manner that envisages that an amount equivalent to foreign exchange purchases from the Fund will be used to meet a balance of payments deficit or to strengthen reserves.

53. The phasing of disbursements under the program is consistent with its objectives of ensuring external solvency and promoting reforms. It aims to smooth the balance of payments

profile given the timing of commitments by other international partners of Ukraine and encourage the authorities to persevere with the reform agenda over the course of the program.

B. Exceptional Access Criteria

54. The proposed SBA entails exceptional access. Staff's evaluation is that Ukraine meets all four exceptional access criteria.

- Criterion 1:** *The member is experiencing or has the potential to experience exceptional balance of payments pressures on the current account or the capital account resulting in a need for Fund financing that cannot be met within the normal limits.* Ukraine is experiencing exceptional balance of payments pressures emanating from both the current and capital accounts. Though Ukraine's current account deficit is expected to shrink substantially this year, it will remain at elevated levels. Official reserves have fallen to dangerously low levels, with significant payment obligations coming due this year. In addition, Ukraine faces risks of economic and trade disruption resulting from geopolitical tensions. Together, these factors are generating actual and potential financing needs beyond what can be financed within normal limits, even taking into account expected financial support from the broader international community. Absent strong policies backed by exceptional financing from the Fund, the reserve cover is projected to fall further.
- Criterion 2:** *A rigorous and systemic analysis indicates that there is a high probability that the member's public debt is sustainable in the medium term. However, in instances where there are significant uncertainties that make it difficult to state categorically that there is a high probability that the debt is sustainable over the period, exceptional access would be justified if there is a high risk of international systemic spillovers.* In staff's view, this criterion is met. The envisaged fiscal adjustment under the program, if fully implemented, would strengthen public finances and reduce public debt to levels well below the standard DSA high-risk benchmark of 70 percent. Nevertheless, the DSA also indicates certain vulnerabilities and risks to debt sustainability. The projected average level of gross financing needs is close to the standard high-risk benchmark of 15 percent. Debt could exceed the 70 percent benchmark if growth significantly disappoints, the exchange rate depreciates considerably, or higher than projected contingent liabilities materialize. Ukraine's debt structure indicates significant exposure to exchange rate movements and external market sentiment, not unlike other emerging markets. These risks are somewhat alleviated by the significant shift in the composition of external financing towards official sources. Moreover, after the initial shocks, the debt trajectory remains non-explosive. More importantly, full implementation of the program, including the fiscal adjustment, and the expected return to growth supported by the exchange rate adjustment and structural reforms would ensure that public debt is sustainable with high probability in the medium term.
- Criterion 3:** *The member has prospects of gaining or regaining access to private capital markets within the timeframe when Fund resources are outstanding.* Ukraine's loss of access to capital markets is linked largely to domestic vulnerabilities and policies, though geopolitical events have also played a role. The policy mix under the proposed program addresses the long-standing domestic and external imbalances in a way that would stabilize the economy and, in the

medium-term, revive growth. Staff anticipates that with a successful implementation of program measures, combined with support from the broader international community, Ukraine has good prospects of regaining greater access to private capital markets within the timeframe when Fund resources are outstanding. In 2013, two sovereign Eurobonds and several private debt issues were placed on expectations that a Fund-supported program could be agreed. This suggests that the debt markets will likely reopen for Ukraine as soon as macroeconomic stabilization is achieved, although the program has conservative assumptions about the size of such financing in 2014–15.

- Criterion 4:** *The policy program provides a reasonably strong prospect of success, including not only the member's adjustment plans but also its institutional and political capacity to deliver that adjustment.* Staff believes that this criterion is met. While Ukraine's past track record of adherence to Fund programs is poor, the new authorities offer an opportunity for a decisive break with the past. The government has already put in place a strong set of important policy measures as prior actions, including fiscal and energy tariff adjustment that lend credibility to their commitment to further reforms in these areas in the medium term. The NBU has floated the exchange rate and has begun to reform its regulatory and supervisory framework. The government is also preparing ambitious structural reform plans to improve transparency and fight corruption. A well-calibrated set of strong prior actions—more comprehensive than in previous programs—has launched the main components of the macroeconomic adjustment and thereby reduced the risks to achieving program targets. Moreover, staff finds that IMF advice appears to have considerably more traction with the authorities. The government's institutional and technical capacity has been strengthened by extensive and ongoing technical support from the Fund and other partners in recent years, and staff judges it to be sufficiently strong to deliver the core elements of reform. Leading presidential candidates and representatives of political parties and civil society organizations supported key program objectives and policies. Recent and ongoing geopolitical developments have so far united parliament and may finally galvanize the support needed to overcome the resistance of vested interests to reform. Accordingly, staff judges that the policy program provides a reasonably strong prospect of success.

C. Capacity to Repay the Fund

55. With the envisaged strong program implementation, Ukraine's capacity to repay the Fund will remain adequate provided important risks to the program are contained. (Table 7). By the end of the arrangement in 2016, outstanding credit to the Fund is expected to peak at about 10.5 percent of GDP, or 62.4 percent of gross reserves. Meanwhile, in 2014–15 Ukraine is expected to complete repayments of its obligations to the Fund that originated from previous SBAs. Debt service to the Fund as a ratio of exports of goods and services would peak at 7.3 percent in 2019, including both the liabilities of the NBU and the central government to the Fund. Over the program period, Ukraine's capacity to repay will depend on its ability to correct its current account, unlock official and multilateral financing, regain market access, and strengthen budget and Naftogaz finances. Risks to Ukraine's capacity to repay the Fund stem from possible deterioration in the economic outlook as a result of geopolitical developments and incomplete implementation of the program's macroeconomic adjustment and growth-supporting policies. In so far, Ukraine remains

current on all its payments to the Fund, and the authorities reaffirmed their commitment to continue servicing their obligations to the IMF as a matter of priority.

D. Program Monitoring and Conditionality

56. Program performance will be monitored first through bi-monthly and then through quarterly reviews. The initial disbursement will be SDR 2.058 billion upon program approval. The first review under the program will be set for July 25, 2014, based on end-May 2014 targets, the second review is proposed for September 25, 2014, based on end-July 2014 targets, and the third review is proposed for December 15, 2014, based on end-September 2014 targets. Thereafter, performance will be monitored on quarterly basis, subject to quantitative performance criteria and structural benchmarks. The authorities are also undertaking a number of decisive prior actions to support their request for the arrangement (MEFP Table 1 and Box 6).

Box 6. Proposed Stand-By Arrangement (continues)

Access: SDR 10.976 billion (800 percent of quota or US\$17.1 billion).

Length: 24 months.

Phasing: SDR 2.058 billion will become available upon the Board's approval of the arrangement, with the domestic currency counterpart of SDR 1.290 billion (about US\$2 billion) to be used to finance the government's budget deficit. The second and the third tranches equal to SDR 914.67 million each and the fourth tranche equal to SDR 914.66 million are contingent upon completion of reviews based on end-May, end-July and end-September 2014 test dates. The fifth, sixth, seventh, and eighth tranches will equal SDR 1.372 billion and are contingent upon completion of quarterly reviews based on targets starting from end-December 2014. The last tranche contingent upon completion of the eighth review (targets for end-December 2015) will equal SDR 686 million.

Conditionality.

Prior Actions

- The NBU will adopt a regulation specifying that the official exchange rate is calculated as a weighted average of rates on the same day's interbank transactions.
- The NBU will instruct the largest 35 banks to launch diagnostic studies on the basis of end-December 2013 data and terms of reference developed by the NBU.
- The NBU will repeal Resolution 109 and announce a specific timetable, agreed with IMF staff, for gradually unwinding banks' net open foreign exchange positions, beginning May 1, 2014 and concluding in 20 months.
- Government will approve a package of revenue and expenditure measures yielding at least UAH 45 billion and implement them by passing a supplementary budget.
- Parliament will pass a new public procurement law to strengthen governance and checks and balances, including reducing exemptions from regular competitive procedures.
- Parliament will pass a reversal of the already introduced VAT rate reduction in 2015 and keep the rate at 20 percent.
- Parliament will pass an extension until October 1, 2014 in the recently expired VAT exemption regime for grain exporters.
- The gas price regulator NERC will adopt and officially publish a decision to raise end-user gas tariffs for households by 56 percent, effective May 1, 2014. Similarly, the utility price regulator NURC will adopt decisions to raise the heating tariffs for households by 40 percent on average, effective July 1, 2014.

Box 6. Proposed Stand-By Arrangement (concluded)

- The decision and schedule for tariff increases through 2017 will be publicly announced, where the schedule will include the following: (i) in 2015, raise end-user gas and heating tariffs by 40 percent on average, effective May 1; and (ii) thereafter, raise these tariffs by 20 percent on average in each of 2016 and 2017, effective May 1.
- Parliament will pass legislation to vest NURC with the exclusive authority to set heating tariffs in the country.
- Government will approve a decision to introduce a new social assistance scheme to compensate the increase in the gas and heating tariffs for the most vulnerable.
- The NBU Council will establish an independent audit committee with a well-defined mandate to provide close oversight of the financial reporting, audit processes and system of internal controls at the NBU.

Quantitative and Continuous Performance Criteria

- Floor on net international reserves
- Ceiling on net domestic assets
- Ceiling on the cash deficit of the general government
- Ceiling on cash deficit of the general government and Naftogaz
- Ceiling on publicly guaranteed debt
- Non-accumulation of external debt payments arrears by the general government

Quantitative Indicative Targets

- Ceiling on monetary base
- Ceiling on VAT refund arrears

Structural Benchmarks

- Complete diagnostic studies and review of business plans for the 15 largest banks.
- If existing fit and proper shareholders are unwilling or incapable of recapitalizing in full a weak bank, public funds could be used to bring it back into solvency, according to strict criteria. Government and the NBU will reach agreement with IMF staff on these criteria.
- The government should be prepared to manage its financial sector shareholdings in the event that it is called on to use public funds--and to this end, a specialized unit will be set up at the Finance Ministry.
- After discussion within government and with the private sector, we will prepare a proposal for the reform of VAT in agriculture with a view to bringing the regime in this sector closer to the general VAT regime.
- To provide an accurate picture of Naftogaz finances, Naftogaz will launch a tender by April 3 to conduct audits of Naftogaz operations, led by an external auditor. The auditor will be in place within 60 days of the tender. The results of the audits will be shared with the IMF within 30 days of each period, initially on a monthly basis beginning with data for end-May 2014, and then on a quarterly basis for end-September data forward.
- To strengthen payment discipline for the heating sector, Parliament will pass legislation that will make distribution accounts fully operational and mandatory for utility payments.
- A comprehensive diagnostic study to be completed in close consultation with IMF staff prior to the first review will cover the anti-corruption framework, the design and implementation of key laws and regulations that may have impact on the business climate, the effectiveness of the judiciary, and tax administration.

57. An update safeguards assessment of the NBU has been initiated and is expected to be completed by the first review of the proposed arrangement. The previous assessment was completed in February 2011. There are some recommendations from that assessment that have yet to be addressed, in particular introduction of legal and institutional changes to strengthen the NBU's financial and operational independence and governance practices. The NBU has recently taken steps to strengthen governance. As a prior action for the program, an independent audit committee of the NBU Council was established on April 4 and vested with a well-defined mandate to provide oversight of the NBU's financial reporting, external and internal audit processes, and the system of internal controls (MEFP ¶28). To provide assurances concerning the existence and availability of international reserves, the NBU has appointed its external audit firm to conduct a special audit of foreign exchange and gold holdings as of February 28, 2014 and report its findings to the NBU by May 1.

STAFF APPRAISAL

58. Success of the proposed program depends critically on the authorities' sustained reform drive The program is designed to stabilize Ukraine's economy following one of the deepest crises in Ukraine's modern history and address long-standing structural weaknesses and macroeconomic imbalances that hinder growth. A comprehensive turnaround of previous unsustainable policies is needed for Ukraine to re-emerge as a dynamic and competitive economy and catch up with its European neighbors. By implementing a strong set of prior actions, the new government of Ukraine and the Parliamentary majority supporting it have demonstrated their commitment to program objectives and policies. Going forward, strong political and broad public backing will be needed for the program's success to come as a decisive break with the past.

59. Strengthening the NBU's independence and upgrading its monetary policy toolkit is crucial for program success. For most of 15 years, Ukraine has relied on stabilized exchange rate arrangements as the nominal policy anchor, which resulted in periods of stability intertwined with acute balance of payments crises. To keep prices stable over the medium term without re-pegging the exchange rate, NBU needs to regain control over monetary aggregates in 2014:H2 and switch to an inflation targeting framework in 2015. The existing NBU law and additional legal changes envisaged under the program are designed to protect NBU independence and bolster its mandate for focusing squarely on the domestic price stability as its main policy objective.

60. The proposed banking sector reforms and safeguards will help restore confidence and stem deposit outflows. The already launched diagnostic studies of the largest banks are expected to clarify their financial health and quality of data reporting. Based on the diagnostic results, the largest banks will need to address the revealed shortcomings expeditiously, by contributing additional capital and upgrading the reporting standards. This should assure their depositors and clients of their soundness, and help reverse the deposit outflows, establishing the basis for robust credit recovery from 2015 on.

61. The fiscal adjustment under the program involves moderate front-loading and a gradual transition to a sustainable deficit level. The program envisages a relatively modest

structural fiscal balance improvement of 2 percent of GDP over three years, with half of it achieved in the first year. This adjustment path appropriately balances the need to reduce fiscal imbalances and keep the public debt on a sustainable. It also represents a difficult trade-off between reasserting the country's economic sovereignty through achieving fiscal viability and the social and political costs of transformation. Given the very large public expenditure, the focus of the adjustment should fall on expenditure rationalization in the medium term, including control over wages and public procurement, facilitated by the new procurement law.

62. The energy sector reforms will gradually bring Naftogaz finances back to health, and must be accompanied by mitigating measures to protect the poorest. The seemingly large tariff increases will be applied to extremely low existing gas and heating tariffs relative to even poorer neighboring countries and even relative to an energy exporting country like Russia. The actual impact of these increases on the population will be manageable given the low share of gas and heating in the budget of most households. It is critically important to implement, on schedule, the proposed new program to alleviate the impact of energy price hikes on Ukraine's most vulnerable. The existing and the envisaged utility subsidy and compensation schemes will protect nearly 30 percent of the most vulnerable Ukrainians from the impact of the tariff increases. Given the large Naftogaz losses and distance to cost recovery, the authorities need to persevere with significant household energy price adjustments over several years. In addition to reducing quasi-fiscal losses and budget subsidies, these price adjustments are crucial for Ukraine's ability to increase energy efficiency, promote domestic production, and alleviate governance problems in the energy sector.

63. Directly tackling weak governance, transparency, and business climate in Ukraine is critical to achieve higher growth and restore trust in government. Weak governance and resistance from entrenched vested interests derailed two previous SBA-supported programs. Corruption Perception Index compiled by Transparency International ranks Ukraine the most corrupt country in Europe. Perceived corruption and of government and judiciary as well as opaque operations of state-owned enterprises reduce investment attractiveness of Ukraine and prevent it from unlocking full growth potential. At the same time, international experience indicates that governance reform is generally a long process involving deep institutional and cultural change. Success in this area can only come through a comprehensive approach with strong leadership and ownership from top to bottom.

64. The program is fully financed ex-ante, but hard work will be needed to unlock all available funding. Unprecedented strong official support for Ukraine, bilateral and multilateral, generates sufficient financing commitments to cover the balance of payments and fiscal needs in the next two years. It also made possible the relatively smooth fiscal adjustment path under the program, which limits the strains on economy and population, particularly the most vulnerable groups. At the same time, the authorities need to collaborate closely with their international partners and implement reforms as planned to ensure timely delivery of all committed assistance.

65. Originating in a period of heightened political and economic uncertainty and elevated risks, the program builds in extensive safeguards for their mitigation. The external risks include the possibility of adverse regional developments and shortfalls in projected official financing. The

economies of Ukraine and Russia are highly integrated and strong efforts should be made from both sides to preserve economic relations. On the domestic side, political instability in parts of the country and the upcoming presidential elections complicate decision making and cloud the economic outlook. All this increases the risk of slippages and setbacks in program implementation. To mitigate these risks and foster steadfast policy implementation, the program includes a number of safeguards. These include a comprehensive set of prior actions to advance critical reforms, high frequency of program reviews (with the first two on bi-monthly basis), and massive financial backing by the international community that can help mitigate new shocks. Furthermore, the program envisages a gradual adjustment path supported by increase in enhanced social assistance to the most vulnerable, which should cushion its impact on the economy and society and secure public support for the envisaged indispensable reforms.

66. Nevertheless, Ukraine does face considerable risks that are difficult to mitigate. A long-lasting disruption of relations with Russia that depresses exports, investment, and growth, or a loss of economic control over the East that reduces budget revenue would require a significant recalibration of the program and additional financing, including from Ukraine's bilateral partners.

67. Decisive implementation of program policies provides the best chance for Ukraine to stabilize the economy, resolve the imbalances, and lay the basis for fast and sustainable growth. Staff believes that the reform-based program adjustment path supported by international community will offer Ukraine best chance for sustained growth and prosperity. It will pave the way for Ukraine to restore external sustainability, reassert sovereignty, and graduate from Fund support by the end of the arrangement. On the basis of the authorities' recent actions and forward-looking commitments, staff supports the authorities' request for a Stand-By Arrangement.

Proposed Decision

The following decision, which may be adopted by a majority of the votes cast, is proposed for adoption by the Executive Board

Ukraine—Stand-By Arrangement

1. The Government of Ukraine has requested a Stand-By Arrangement for a period of twenty four (24) months in an amount equivalent to SDR 10,976 million.
2. The Fund approves the Stand-By Arrangement for Ukraine set forth in EBS/14/47 and decides that purchases may be made under the arrangement on the condition that the information provided by Ukraine on the implementation of the measures specified as prior actions in Table 1 of the memorandum of Economic and Financial Policies attached to the letter from the Acting President, the Prime Minister, the Minister of Finance of Ukraine and the Governor of the National Bank of Ukraine (NBU), dated April 22, 2014, is accurate.
3. The Fund waives the limitation in Article V, Section 3(b)(iii).

Table 1. Ukraine: Program Scenario – Selected Economic and Social Indicators, 2011–19

	2011	2012	2013	2014	2015	2016	2017	2018	2019
			Est.	Projections					
Real economy (percent change, unless otherwise indicated)									
Nominal GDP (billions of Ukrainian hryvnias)	1,302	1,411	1,455	1,506	1,736	1,950	2,169	2,414	2,687
Real GDP	5.2	0.3	0.0	-5.0	2.0	4.0	4.0	4.5	4.5
Contributions:									
Domestic demand	12.6	5.6	0.9	-8.2	2.0	4.6	4.8	5.3	5.3
Private consumption	10.0	7.8	5.6	-3.7	0.8	2.5	2.5	2.8	2.8
Public consumption	-0.6	0.4	-0.5	-0.5	-0.3	-0.2	0.3	0.3	0.3
Investment	3.2	-2.6	-4.2	-4.0	1.5	2.4	2.0	2.2	2.2
Net exports	-7.4	-5.3	-1.0	3.2	0.0	-0.6	-0.8	-0.8	-0.8
GDP deflator	14.3	8.1	3.1	9.0	13.0	8.0	7.0	6.5	6.5
Output gap (percent of potential GDP)	0.9	0.2	-1.0	-3.2	-2.3	-1.0	-0.5	0.0	0.0
Unemployment rate (ILO definition; percent)	7.9	7.5	7.2	8.5	8.0	7.5	7.0	6.5	6.5
Consumer prices (period average)	8.0	0.6	-0.3	8.3	12.9	6.3	5.8	5.0	4.8
Consumer prices (end of period)	4.6	-0.2	0.5	16.2	7.4	6.3	5.4	5.0	4.6
Nominal monthly wages (average)	17.5	14.9	8.0	4.7	14.0	9.5	9.1	8.7	8.5
Real monthly wages (average)	8.8	14.2	8.3	-3.3	1.0	3.0	3.1	3.5	3.5
Savings (percent of GDP)	14.5	10.3	6.5	5.0	7.1	10.1	12.0	14.1	16.1
Private	14.2	11.7	9.3	8.7	9.5	11.1	12.6	14.1	15.6
Public	0.3	-1.4	-2.8	-3.7	-2.4	-1.1	-0.6	0.0	0.6
Investment (percent of GDP)	20.7	18.4	15.7	9.5	11.4	13.9	15.9	17.9	19.9
Private	17.7	15.5	13.7	8.0	9.5	12.0	13.7	15.5	16.9
Public	3.0	2.9	2.0	1.5	1.9	2.0	2.2	2.5	3.0
Public finance (percent of GDP)									
General government balance 1/	-2.8	-4.3	-4.8	-5.2	-4.2	-3.1	-2.9	-2.5	-2.4
Overall balance (including Naftogaz operational deficit)	-4.3	-6.6	-6.7	-8.5	-6.1	-4.4	-3.1	-2.5	-2.4
Structural general government balance	-3.2	-4.4	-4.6	-3.6	-3.1	-2.6	-2.6	-2.5	-2.4
Public debt (end of period) 2/	36.8	37.4	40.9	56.5	62.1	61.2	57.9	51.9	45.3
Money and credit (end of period, percent change)									
Base money	6.3	6.4	20.3	21.5	14.8	14.2	13.7	13.5	13.3
Broad money	14.7	12.8	17.6	11.8	17.6	14.6	14.0	13.8	13.6
At program exchange rate	15.0	13.4	15.7	2.9	14.5	13.2	13.2	13.6	13.1
Credit to nongovernment	9.5	2.2	11.8	8.7	11.7	10.8	11.0	10.9	11.8
At program exchange rate	7.2	0.9	10.7	-1.8	7.5	8.7	9.7	10.4	11.0
Velocity	1.9	1.8	1.6	1.5	1.5	1.4	1.4	1.4	1.3
Interbank overnight rate (annual average, percent) 3/	5.8	10.8	3.8	10.6	...	...	...	...	...
Balance of payments (percent of GDP)									
Current account balance	-6.3	-8.1	-9.2	-4.4	-4.3	-3.9	-4.0	-3.8	-3.7
Foreign direct investment	4.3	3.8	1.8	2.0	2.5	2.6	2.7	2.9	3.0
Gross reserves (end of period, billions of U.S. dollars)	31.8	24.5	20.4	19.2	26.7	32.3	34.9	37.9	39.3
Months of next year's imports of goods and services	3.7	2.9	2.8	2.6	3.4	3.9	4.0	4.0	3.9
Percent of short-term debt (remaining maturity)	55.4	38.1	30.3	33.9	53.6	58.5	60.5	67.7	96.3
Percent of the IMF composite measure (float)	78.3	57.0	47.3	62.3	91.9	114.6	118.5	127.3	131.0
External debt (percent of GDP)	77.2	76.5	78.6	99.5	99.3	95.4	91.0	87.1	81.5
Goods exports (annual volume change in percent)	6.5	1.7	-8.3	-2.8	6.5	6.3	6.4	6.8	6.9
Goods imports (annual volume change in percent)	21.9	2.1	-4.1	-13.8	2.7	6.1	6.4	6.8	7.0
Goods terms of trade (percent change)	7.7	-3.1	2.6	-1.0	-2.5	-1.3	-0.3	0.2	0.4
Exchange rate									
Hryvnia per U.S. dollar (end of period)	8.0	8.0	8.3	10.5	11.5	12.0	12.4	12.5	12.8
Hryvnia per U.S. dollar (period average)	8.0	8.0	8.2	10.6	11.6	11.9	12.2	12.5	12.8
Real effective rate (CPI-based, percent change)	0.4	2.3	-3.7	-18.0	1.5	0.9	0.5	0.2	0.0
Memorandum items:									
Per capita GDP / Population (2013): US\$3,928 /45.4 million			Quota (current): SDR 1,372 million (2,098 million U.S. dollars)						
Literacy / Poverty rate: 100 percent / 2.9 percent			Sovereign ratings: Caa3 (Moody's), CCC (S&P, Fitch)						
Sources: Ukrainian authorities; World Bank, World Development Indicators; and IMF staff estimates.									
1/ The general government includes the central and local governments and the social funds.									
2/ Government and government-guaranteed debt.									
3/ For 2014, average of rates for January-March.									

Table 2. Ukraine: Program Scenario – General Government Finances, 2011–19 1/

(Billions of Ukrainian hryvnia)

	2011	2012	2013	2014		2015	2016	2017	2018	2019
				Before program measures	Proj.			Projection		
Revenue	558.2	627.3	634.9	651.3	677.3	781.2	875.0	969.3	1070.2	1178.2
Tax revenue	499.8	547.8	551.2	575.9	601.9	692.5	775.5	858.5	946.9	1041.0
Tax on income, profits, and capital gains	115.3	123.9	127.2	125.6	125.6	146.2	164.2	181.3	199.7	219.1
Personal income tax	60.2	68.1	72.2	74.3	74.3	85.2	93.6	102.7	112.3	121.8
Corporate profit tax	55.1	55.8	55.0	51.3	51.3	61.1	70.6	78.6	87.4	97.3
Payroll tax	161.2	183.5	193.7	200.2	200.2	229.3	251.9	276.5	302.3	328.0
Property tax	10.7	12.6	12.8	14.0	14.0	16.1	18.1	20.1	22.4	24.9
Tax on goods and services	175.7	189.7	175.8	188.3	205.2	235.7	268.8	300.0	333.6	370.7
VAT	130.1	138.8	128.3	136.6	146.1	166.9	188.2	209.9	232.3	258.3
Excise	33.9	38.4	36.7	39.4	46.8	55.0	65.3	73.3	82.9	92.2
Other	11.7	12.5	10.8	12.3	12.3	13.8	15.3	16.8	18.4	20.3
Tax on international trade	11.8	13.2	13.3	14.9	24.0	27.2	29.5	32.2	35.2	38.5
Other tax	25.1	24.9	28.4	33.0	33.0	38.0	43.0	48.4	53.8	59.7
Nontax revenue	58.4	79.5	83.7	75.4	75.4	88.6	99.5	110.8	123.3	137.2
Expenditure	594.1	687.9	704.9	778.8	755.3	854.4	934.9	1031.8	1130.6	1241.8
Current	550.1	643.2	672.6	738.0	718.8	819.8	894.2	981.4	1068.6	1159.6
Compensation of employees 2/	135.1	157.5	167.7	182.5	174.6	197.1	209.4	230.2	251.3	274.0
Goods and services	88.6	104.5	103.7	107.2	110.0	119.1	125.0	138.3	153.7	168.2
Interest	25.6	27.0	35.9	49.5	51.5	74.6	92.5	103.6	107.7	107.7
Subsidies to corporations and enterprises	24.6	43.2	29.4	35.3	31.7	35.1	39.0	43.4	48.3	53.7
Social benefits	275.9	310.4	335.6	363.3	350.8	393.6	428.1	465.7	507.4	555.8
Social programs (on budget)	42.3	54.5	56.3	66.6	63.9	69.4	78.0	86.8	96.6	107.5
Pensions	210.8	233.7	250.3	265.3	260.2	294.0	317.5	344.1	373.7	408.7
Unemployment, disability, and accident insurance	22.8	22.2	29.0	31.4	26.7	30.2	32.6	34.9	37.1	39.5
Other current expenditures	0.3	0.6	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Capital	39.2	40.8	29.3	34.7	22.2	32.5	38.5	48.2	59.7	79.9
Net lending	4.8	3.9	3.0	4.7	5.9	0.6	0.7	0.7	0.7	0.8
Overall balance	-35.9	-60.5	-70.1	-127.5	-78.0	-73.2	-59.8	-62.5	-60.3	-63.7
Naftogaz balance	-20.4	-32.2	-27.5	-55.4	-50.4	-32.7	-25.3	-4.1	0.0	0.0
General government and Naftogaz balance	-56.3	-92.7	-97.6	-182.9	-128.4	-105.9	-85.1	-66.6	-60.4	-63.7
General government financing	35.9	60.5	70.1		78.0	73.2	59.8	62.5	60.3	63.7
External	16.1	28.6	19.1		56.9	4.4	40.5	12.4	53.3	61.9
Disbursements	29.7	42.8	51.6		102.6	73.9	74.9	71.3	73.4	75.3
Amortizations	-13.5	-14.2	-32.6		-45.8	-69.4	-34.5	-58.9	-20.0	-13.4
Domestic (net)	30.6	31.9	51.0		21.1	68.8	19.4	50.1	7.0	1.8
Bond financing	16.3	22.3	50.4		6.9	54.8	5.4	38.1	-5.0	-10.2
Direct bank borrowing	-0.7	-3.0	-0.1		0.0	0.0	0.0	0.0	0.0	0.0
Deposit finance	-8.1	-0.3	-1.4		4.5	0.0	0.0	0.0	0.0	0.0
Privatization	23.2	12.9	2.1		9.7	14.0	14.0	12.0	12.0	12.0
Other financing	8.9	0.0	1.4		15.0	0.0	0.0	0.0	0.0	0.0
Bank recapitalization	8.9	0.0	1.4		15.0	0.0	0.0	0.0	0.0	0.0
Naftogaz financing	20.4	32.2	27.5		50.4	32.7	25.3	4.1	0.0	0.0
Government financing 3/	8.0	8.5	5.8		61.6	32.7	25.3	4.1	0.0	0.0
Accumulation of arrears	0.0	0.0	18.9		-16.1	0.0	0.0	0.0	0.0	0.0
Other 4/	12.4	23.7	2.9		4.9	0.0	0.0	0.0	0.0	0.0
Total financing	65.1	92.7	99.0		143.4	105.9	85.1	66.6	60.4	63.7
Memorandum items:										
Public sector debt 6/	479.4	527.3	595.6		850.7	1,078.3	1,193.8	1,257.0	1,253.9	1,217.0
Of which: In foreign currency	302.8	331.3	349.4		485.5	584.3	631.5	627.1	606.5	562.0
Domestic	174.4	213.8	288.6		386.5	480.3	518.6	573.3	582.4	563.0
External	305.0	313.5	307.0		464.2	598.0	675.2	683.7	671.5	654.0

Table 2. Ukraine: Program Scenario – General Government Finances, 2011–19 (Concluded) 1/
(Percent of GDP)

	2011	2012	2013	2014		2015	2016	2017	2018	2019
				Before program measures	Proj.	Projection				
Revenue	42.9	44.5	43.6	43.2	45.0	45.0	44.9	44.7	44.3	43.8
Tax revenue	38.4	38.8	37.9	38.2	40.0	39.9	39.8	39.6	39.2	38.7
Tax on income, profits, and capital gains	8.9	8.8	8.7	8.3	8.3	8.4	8.4	8.4	8.3	8.2
Personal income tax	4.6	4.8	5.0	4.9	4.9	4.9	4.8	4.7	4.6	4.5
Corporate profit tax	4.2	4.0	3.8	3.4	3.4	3.5	3.6	3.6	3.6	3.6
Payroll tax	12.4	13.0	13.3	13.3	13.3	13.2	12.9	12.7	12.5	12.2
Property tax	0.8	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Tax on goods and services	13.5	13.4	12.1	12.5	13.6	13.6	13.8	13.8	13.8	13.8
VAT	10.0	9.8	8.8	9.1	9.7	9.6	9.7	9.7	9.6	9.6
Excise	2.6	2.7	2.5	2.6	3.1	3.2	3.3	3.4	3.4	3.4
Other	0.9	0.9	0.7	0.8	0.8	0.8	0.8	0.8	0.8	0.8
Tax on international trade	0.9	0.9	0.9	1.0	1.6	1.6	1.5	1.5	1.5	1.4
Other tax	1.9	1.8	2.0	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Nontax revenue	4.5	5.6	5.8	5.0	5.0	5.1	5.1	5.1	5.1	5.1
Expenditure	45.6	48.7	48.5	51.7	50.2	49.2	48.0	47.6	46.8	46.2
Current	42.2	45.6	46.2	49.0	47.7	47.2	45.9	45.2	44.3	43.2
Compensation of employees 2/	10.4	11.2	11.5	12.1	11.6	11.4	10.7	10.6	10.4	10.2
Goods and services	6.8	7.4	7.1	7.1	7.3	6.9	6.4	6.4	6.4	6.3
Interest	2.0	1.9	2.5	3.3	3.4	4.3	4.7	4.8	4.5	4.0
Subsidies to corporations and enterprises	1.9	3.1	2.0	2.3	2.1	2.0	2.0	2.0	2.0	2.0
Social benefits	21.2	22.0	23.1	24.1	23.3	22.7	22.0	21.5	21.0	20.7
Social programs (on budget)	3.2	3.9	3.9	4.4	4.2	4.0	4.0	4.0	4.0	4.0
Pensions	16.2	16.6	17.2	17.6	17.3	16.9	16.3	15.9	15.5	15.2
Unemployment, disability, and accident insurance	1.8	1.6	2.0	2.1	1.8	1.7	1.7	1.6	1.5	1.5
Other current expenditures	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital	3.0	2.9	2.0	2.3	1.5	1.9	2.0	2.2	2.5	3.0
Net lending	0.4	0.3	0.2	0.3	0.4	0.0	0.0	0.0	0.0	0.0
Overall balance	-2.8	-4.3	-4.8	-8.5	-5.2	-4.2	-3.1	-2.9	-2.5	-2.4
Naftogaz balance	-1.6	-2.3	-1.9	-3.7	-3.3	-1.9	-1.3	-0.2	0.0	0.0
General government and Naftogaz balance	-4.3	-6.6	-6.7	-12.1	-8.5	-6.1	-4.4	-3.1	-2.5	-2.4
General government financing	2.8	4.3	4.8		5.2	4.2	3.1	2.9	2.5	2.4
External	1.2	2.0	1.3		3.8	0.3	2.1	0.6	2.2	2.3
Disbursements	2.3	3.0	3.5		6.8	4.3	3.8	3.3	3.0	2.8
Amortizations	-1.0	-1.0	-2.2		-3.0	-4.0	-1.8	-2.7	-0.8	-0.5
Domestic (net)	2.4	2.3	3.5		1.4	4.0	1.0	2.3	0.3	0.1
Bond financing	1.3	1.6	3.5		0.5	3.2	0.3	1.8	-0.2	-0.4
Direct bank borrowing	-0.1	-0.2	0.0		0.0	0.0	0.0	0.0	0.0	0.0
Deposit finance	-0.6	0.0	-0.1		0.3	0.0	0.0	0.0	0.0	0.0
Privatization	1.8	0.9	0.1		0.6	0.8	0.7	0.6	0.5	0.4
Other financing	0.7	0.0	0.1		1.0	0.0	0.0	0.0	0.0	0.0
Bank recapitalization	0.7	0.0	0.1		1.0	0.0	0.0	0.0	0.0	0.0
Naftogaz financing	1.6	2.3	1.9		3.3	1.9	1.3	0.2	0.0	0.0
Government financing 3/	0.6	0.6	0.4		4.1	1.9	1.3	0.2	0.0	0.0
Accumulation of arrears	0.0	0.0	1.3		-1.1	0.0	0.0	0.0	0.0	0.0
Other 4/	1.0	1.7	0.2		0.3	0.0	0.0	0.0	0.0	0.0
Total financing	5.0	6.6	6.8		9.5	6.1	4.4	3.1	2.5	2.4
Memorandum items:										
Cyclically-adjusted general government balance 5/	-3.2	-4.4	-4.3		-3.6	-3.1	-2.6	-2.6	-2.5	-2.4
Structural general government balance	-3.2	-4.4	-4.6		-3.6	-3.1	-2.6	-2.6	-2.5	-2.4
Government deposits at NBU	0.9	0.8	0.8		0.8	0.7	0.6	0.5	0.5	0.4
Public sector debt 6/	36.8	37.4	40.9		56.5	62.1	61.2	57.9	51.9	45.3
Of which: In foreign currency	23.3	23.5	24.0		32.2	33.7	32.4	28.9	25.1	20.9
Domestic	13.4	15.1	19.8		25.7	27.7	26.6	26.4	24.1	21.0
External	23.4	22.2	21.1		30.8	34.4	34.6	31.5	27.8	24.3
Nominal GDP (billions of Ukrainian hryvnia)	1,302	1,411	1,455		1,506	1,736	1,950	2,169	2,414	2,687

Sources: Ministry of Finance; National Bank of Ukraine; and IMF staff estimates and projections.

1/ National methodology, cash basis.

2/ Numbers are based on actual local governments' budgets.

3/ Government spending on Naftogaz financing and recapitalization, including through T-bills issuance. In 2014, includes repayment of a US\$1.6 billion Eurobond.

4/ Includes external and domestic net disbursements, trade credits, deposit drawdowns, as well as company receivables.

5/ Preferred to cyclically-adjusted primary balance, as two-thirds of the interest bill relates to domestic debt.

6/ Government and government-guaranteed debt.

Table 3. Ukraine: Program Scenario – Balance of Payments, 2011–19

(Billions of U.S. dollars, unless otherwise indicated)

	2011	2012	2013	2014	2015	2016	2017	2018	2019
			Est.						
Current account balance	-10.2	-14.3	-16.3	-6.3	-6.4	-6.4	-7.1	-7.4	-7.9
Goods and services trade balance	-10.2	-14.3	-15.5	-5.0	-4.8	-6.5	-7.8	-8.9	-9.9
Merchandise trade balance	-16.3	-19.5	-19.6	-10.4	-10.1	-11.4	-12.3	-13.0	-13.8
Exports, f.o.b.	69.4	70.2	65.0	62.5	65.8	68.9	73.1	78.3	84.2
Imports, f.o.b. 1/	-85.7	-89.7	-84.6	-72.9	-75.9	-80.2	-85.4	-91.3	-98.0
Of which: gas	-12.4	-14.2	-9.9	-9.0	-9.9	-9.9	-10.0	-10.3	-10.7
Services (net)	6.1	5.2	4.1	5.4	5.3	4.8	4.5	4.2	3.9
Receipts	19.4	19.8	20.4	18.8	18.7	18.5	18.4	18.5	18.7
Payments	-13.3	-14.6	-16.2	-13.4	-13.4	-13.6	-14.0	-14.4	-14.9
Income (net)	-3.8	-3.0	-3.0	-3.6	-4.2	-2.6	-2.2	-1.7	-1.4
Current transfers (net)	3.7	3.0	2.1	2.3	2.6	2.7	2.9	3.2	3.5
Capital and financial account balance	6.6	8.4	15.8	-4.9	1.4	7.6	8.0	12.9	13.7
Capital account	0.1	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	6.5	8.4	15.8	-4.9	1.4	7.6	8.0	12.9	13.7
Direct investment (net)	7.0	6.6	3.3	2.8	3.7	4.2	4.7	5.5	6.3
Portfolio investment (net)	1.6	5.7	8.7	0.5	-2.4	1.5	1.0	4.1	3.9
Of which: general government	1.0	3.5	4.2	0.2	-3.0	0.8	0.0	3.0	2.9
Other investment (net)	-2.1	-4.0	3.9	-8.2	0.1	1.9	2.2	3.3	3.5
Medium and long-term loans	-1.1	1.9	0.8	-4.2	0.5	0.5	0.2	1.3	1.3
Official	-0.5	-2.5	-0.5	-2.1	-0.6	-0.6	-1.0	-0.6	-0.5
Disbursements 2/	...	...	...	...	...	...	...	...	...
Repayments 3/	-0.5	-2.5	-0.5	-2.1	-0.6	-0.6	-1.0	-0.6	-0.5
Banks	-3.4	-1.7	-0.4	-0.5	0.4	1.0	0.5	1.0	1.0
Other sectors	2.8	6.0	1.7	-1.6	0.7	0.2	0.7	0.8	0.8
Short-term loans	10.7	5.3	3.5	-3.4	-0.6	1.3	2.0	2.1	2.2
Banks	1.8	-0.9	-0.1	-0.5	0.3	0.2	0.2	0.1	0.1
Other sectors 4/	8.9	6.2	3.6	-3.0	-0.9	1.1	1.8	2.0	2.1
Currency and deposits	-11.7	-11.2	-0.4	-0.5	0.2	0.1	0.0	0.0	0.0
Banks	-0.4	-2.5	2.3	-0.5	0.2	0.1	0.0	0.0	0.0
Other sectors 5/	-11.3	-8.6	-2.7	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	0.2	0.6	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-3.4	-5.3	-0.8	-11.2	-5.0	1.2	0.9	5.5	5.8
Official financing	0.3	1.5	2.3	6.3	5.4	3.3	2.8	2.9	2.9
World Bank	0.2	0.9	0.3	1.9	1.6	0.4	0.3	0.3	0.3
EU	0.1	0.1	0.1	2.2	0.6	0.1	0.1	0.1	0.1
EBRD/EIB/Others	0.0	0.5	2.0	2.2	3.1	2.8	2.5	2.5	2.5
Financing	3.1	3.8	-1.5	4.9	-0.4	-4.5	-3.8	-8.4	-8.7
Gross official reserves (increase: -)	3.1	7.2	4.1	1.2	-7.5	-5.6	-2.6	-3.0	-1.4
Net use of IMF resources	0.0	-3.4	-5.6	3.7	7.1	1.1	-1.2	-5.4	-7.3
Of which: Prospective Fund purchases	...	...	...	7.4	8.6	1.1	...	...	...
Memorandum items:									
Total external debt	126.2	135.1	140.1	141.5	149.1	156.6	161.6	168.3	171.8
Total external debt (percent of GDP)	77.2	76.5	78.6	99.5	99.3	95.4	91.0	87.1	81.5
Current account balance (percent of GDP)	-6.3	-8.1	-9.2	-4.4	-4.3	-3.9	-4.0	-3.8	-3.7
Goods and services trade balance (percent of GDP)	-6.2	-8.1	-8.7	-3.5	-3.2	-4.0	-4.4	-4.6	-4.7
Gross international reserves	31.8	24.5	20.4	19.2	26.7	32.3	34.9	37.9	39.3
Months of next year's imports of goods and services	3.7	2.9	2.8	2.6	3.4	3.9	4.0	4.0	3.9
Percent of short-term debt (remaining maturity)	55.4	38.1	30.3	33.9	53.6	58.5	60.5	67.7	96.3
Percent of the IMF composite measure (float) 6/	78.3	57.0	47.3	62.3	91.9	114.6	118.5	127.3	131.0
Merchandise export value (percent change)	33.0	1.2	-7.5	-3.8	5.3	4.7	6.1	7.1	7.5
Merchandise import value (percent change)	41.4	4.7	-5.7	-13.8	4.0	5.8	6.4	7.0	7.3
Merchandise export volume (percent change)	6.5	1.7	-8.3	-2.8	6.5	6.3	6.4	6.8	6.9
Merchandise import volume (percent change)	21.9	2.1	-4.1	-13.8	2.7	6.1	6.4	6.8	7.0
Goods terms of trade (percent change)	7.7	-3.1	2.6	-1.0	-2.5	-1.3	-0.3	0.2	0.4
Gross domestic product (current prices)	163.4	176.5	178.2	142.3	150.2	164.1	177.6	193.3	210.7

Sources: National Bank of Ukraine; and IMF staff estimates and projections.

1/ Gas import prices for 2012 and 2013 were US\$427 and US\$371 per tcm, respectively. For 2014, the price of US\$357 per tcm is projected. For 2015–19, projected gas prices are: \$385, \$366, \$354, \$347, \$341, respectively.

2/ Financing from World Bank, EU, and EBRD is recorded below the line.

3/ Includes repayment of Naftogaz Eurobond in September 2014.

4/ Includes trade credit and arrears, including those related to Naftogaz arrears owed to Gazprom.

5/ Mainly reflects residents' conversion of hryvnia cash to foreign currency held outside the banking system.

6/ The IMF composite measure is calculated as a weighted sum of short-term debt, other portfolio liabilities, broad money, and exports in percent of GDP, with different weights for "fixed" and "floating" exchange rate regime. Official reserves are recommended to be in the range of 100–150 percent of the appropriate measure. For Ukraine "fixed" weights are used until 2013, and "floating" weights are used from 2014 onwards.

Table 4. Ukraine: Program Scenario – Gross External Financing Requirements, 2011–19

(Billions of U.S. dollars)

	2011	2012	2013	2014	2015	2016	2017	2018	2019
			Est.			Projection			
Total financing requirements	71.1	85.5	73.7	63.0	58.0	55.0	57.6	56.2	58.1
Current account deficit	10.2	14.3	16.3	6.3	6.4	6.4	7.1	7.4	7.9
Portfolio investment	6.7	9.2	7.5	2.2	5.7	3.5	4.5	1.5	1.5
Private	2.1	3.7	5.4	1.2	1.2	1.2	1.2	1.5	1.5
Public	4.6	5.4	2.0	1.0	4.5	2.3	3.3	0.0	0.0
Medium and long-term debt	16.2	19.0	18.0	17.5	11.9	12.0	11.8	11.4	11.4
Private	15.7	16.5	17.5	15.4	11.3	11.3	10.8	10.8	10.8
Banks	5.9	6.2	4.7	5.3	5.3	5.3	5.3	5.3	5.3
Corporates	9.8	10.3	12.8	10.1	6.0	6.0	5.5	5.5	5.5
Public /1	0.5	2.5	0.5	2.1	0.6	0.6	1.0	0.6	0.5
Short-term debt (including deposits)	12.2	14.8	12.8	12.1	11.9	12.2	13.1	13.6	13.9
Other net capital outflows 2/	12.0	10.6	-1.9	0.0	0.0	0.0	0.0	0.0	0.0
Trade credit	13.9	17.6	21.2	24.9	22.1	21.0	21.2	22.3	23.4
Total financing sources	67.4	79.7	73.0	51.8	53.1	56.2	58.6	61.7	63.9
Capital transfers	0.1	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Direct investment, net	7.0	6.6	3.3	2.8	3.7	4.2	4.7	5.5	6.3
Portfolio investment	8.2	14.9	16.1	2.7	3.3	4.9	5.5	5.6	5.4
Private	2.6	6.0	9.9	1.5	1.8	1.9	2.2	2.6	2.5
Public	5.6	8.9	6.3	1.2	1.5	3.0	3.3	3.0	2.9
Medium and long-term debt	15.9	20.5	18.8	13.3	12.4	12.5	12.0	12.7	12.7
Private	15.7	19.8	18.8	13.3	12.4	12.5	12.0	12.7	12.7
Banks	2.4	4.6	4.3	4.8	5.7	6.3	5.8	6.3	6.3
Corporates	13.2	15.2	14.5	8.5	6.7	6.2	6.2	6.3	6.3
Public 3/	0.3	0.7	...	...	...	...	...	...	...
Short-term debt (including deposits)	16.5	19.4	13.8	10.9	12.7	13.3	14.0	14.6	14.9
Trade credit	19.7	18.2	21.1	22.1	21.0	21.2	22.3	23.4	24.6
Increase in gross reserves	-3.1	-7.2	-4.1	-1.2	7.5	5.6	2.6	3.0	1.4
Errors and omissions	0.2	0.5	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Total financing needs	0.3	-1.9	-3.3	10.0	12.5	4.4	1.7	-2.5	-4.4
Official financing	0.3	-1.9	-3.3	10.0	12.5	4.4	1.7	-2.5	-4.4
IMF	0.0	-3.4	-5.6	3.7	7.1	1.1	-1.2	-5.4	-7.3
Prospective purchases	...	...	...	7.4	8.6	1.1	...	...	...
Repurchases	0.0	3.4	5.6	3.7	1.5	0.0	1.2	5.4	7.3
Official creditors	0.3	1.5	2.3	6.3	5.4	3.3	2.8	2.9	2.9
World Bank	0.2	0.9	0.3	1.9	1.6	0.4	0.3	0.3	0.3
EU	0.1	0.1	0.1	2.2	0.6	0.1	0.1	0.1	0.1
EBRD/EIB/Others	0.0	0.5	2.0	2.2	3.1	2.8	2.5	2.5	2.5
Memorandum items:									
Gross international reserves	31.8	24.5	20.4	19.2	26.7	32.3	34.9	37.9	39.3
Percent of short-term debt (remaining maturity)	55.4	38.1	30.3	33.9	53.6	58.5	60.5	67.7	96.3
Months of next year's imports of goods and service:	3.7	2.9	2.8	2.6	3.4	3.9	4.0	4.0	3.9
Percent of the IMF composite measure (float) 4/	78.3	57.0	47.3	62.3	91.9	114.6	118.5	127.3	131.0
Loan rollover rate (percent)									
Banks	72.2	82.9	90.8	88.8	106.9	112.8	107.4	112.7	113.0
Corporates	140.3	148.7	116.2	89.2	108.2	107.9	111.2	112.0	111.9
Total	114.4	125.0	107.6	87.7	107.9	109.7	109.0	111.4	111.4

Sources: National Bank of Ukraine; and IMF staff estimates and projections.

1/ Includes repayment of Naftogaz Eurobond in September 2014.

2/ Mainly reflects residents' conversion of hryvnia cash to foreign currency held outside of the banking system.

3/ For the projection period (2014–19), financing from official sources is recorded below the line.

4/ The IMF composite measure is calculated as a weighted sum of short-term debt, other portfolio liabilities, broad money, and exports in percent of GDP, with different weights for "fixed" and "floating" exchange rate regime. Official reserves are recommended to be in the range of 100-150 percent of the appropriate measure. For Ukraine "fixed" weights are used until 2013, and "floating" weights are used from 2014 onwards.

Table 5. Ukraine: Program Scenario – Monetary Accounts, 2011–19

Table 5. Ukraine: Program Scenario – Monetary Accounts, 2011–19												
	2011	2012	2013	2014				2015	2016	2017	2018	2019
				Mar.	Jun.	Sep.	Dec.					
				Est.	Projection								Projection
(Billions of Ukrainian hryvnias)												
Monetary survey												
Net foreign assets	61	67	51	8	31	16	21	20	60	100	193	294
Foreign assets	365	328	273	255	...	...	...	...	...	...	...	...
Foreign liabilities	304	261	222	247	...	...	...	...	...	...	...	...
Net domestic assets	625	706	858	937	941	972	996	1,176	1,310	1,462	1,585	1,724
Domestic credit	965	1,031	1,198	1,338	1,327	1,360	1,371	1,569	1,717	1,896	2,046	2,223
Net claims on government	147	188	248	294	283	313	338	415	439	477	473	464
Credit to the economy	798	815	911	1,002	1,003	1,007	990	1,106	1,225	1,360	1,508	1,686
Domestic currency	474	515	601	585	578	588	588	633	694	766	846	949
Foreign currency	324	300	310	417	425	418	402	473	531	593	662	737
Other items, net	-340	-325	-340	-401	-386	-388	-375	-393	-407	-434	-461	-499
Broad money	686	773	909	945	971	987	1,017	1,196	1,370	1,562	1,778	2,019
Currency in circulation	193	203	238	269	301	296	305	347	396	450	510	577
Total deposits	489	568	668	671	668	688	708	845	970	1,108	1,263	1,436
Domestic currency deposits	281	320	422	380	377	392	403	492	573	663	765	881
Of which: Time deposits	163	200	276	246	...	...	...	...	...	...	...	...
Foreign currency deposits	208	248	246	291	291	296	305	353	397	445	498	555
Of which: Time deposits	156	191	194	216	...	...	...	...	...	...	...	...
Accounts of the NBU												
Net foreign assets	145	113	124	120	135	120	107	121	179	231	339	458
Net international reserves	137	106	114	117	131	116	105	119	177	229	337	455
Reserve assets	250	192	157	162	198	202	198	302	382	425	468	495
Reserve liabilities	113	86	43	46	68	86	94	184	205	197	131	40
Net domestic assets	94	142	183	209	228	242	266	307	309	324	292	257
Net domestic credit	144	191	218	286	286	300	321	384	400	441	432	427
Net claims on government	77	116	145	183	180	198	222	287	304	350	346	347
Claims on government	90	117	149	199	229	247	224	289	306	352	348	349
Liabilities to government	12	1	4	17	50	49	2	2	2	2	2	2
Net claims on banks	66	75	72	103	106	101	99	96	96	90	85	80
Other items, net	-49	-48	-35	-78	-58	-58	-55	-77	-91	-116	-140	-170
Base money	240	255	307	329	363	362	373	428	489	556	631	715
Currency in circulation	193	203	238	269	301	296	305	347	396	450	510	577
Banks' reserves	47	52	69	60	62	65	68	81	93	106	121	138
Cash in vault	17	20	24	22	22	23	26	30	35	40	46	52
Required reserves	15	20	27	32	31	32	28	33	38	44	50	57
Excess reserves	15	13	18	7	9	11	14	17	20	23	26	29
Deposit money banks												
Net foreign assets	-85	-46	-73	-112	-104	-104	-86	-101	-120	-131	-147	-163
Foreign assets	106	129	106	89	...	...	...	...	...	...	...	...
Foreign liabilities	190	174	179	201	...	...	...	...	...	...	...	...
Net domestic assets	572	612	740	782	772	792	794	946	1,090	1,239	1,409	1,599
Domestic credit	867	890	1,048	1,111	1,104	1,127	1,114	1,258	1,397	1,543	1,712	1,903
Net claims on government	69	72	103	111	104	115	115	128	135	127	127	117
Credit to the economy	797	814	910	1,001	1,002	1,006	990	1,105	1,224	1,359	1,507	1,685
Other claims on the economy	20	28	40	42	42	42	40	40	41	41	42	42
Net claims on NBU	-20	-24	-4	-44	-44	-36	-31	-15	-3	16	36	58
Of which: Refinancing loans	74	78	79	110	113	108	105	103	102	97	92	86
Other items, net	-295	-278	-308	-329	-332	-336	-320	-312	-307	-304	-303	-304
Banks' liabilities	488	566	667	669	668	688	708	845	970	1,108	1,263	1,436
Demand deposits	169	175	197	207	...	...	...	...	...	...	...	...
Time deposits	319	391	470	462	...	...	...	...	...	...	...	...
Memorandum items:												
(Year-on-year percent change, unless otherwise indicated)												
Base money	6.3	6.4	20.3	28.5	31.5	27.1	21.5	14.8	14.2	13.7	13.5	13.3
Broad money	14.7	12.8	17.6	18.0	16.1	13.3	11.8	17.6	14.6	14.0	13.8	13.6
At program exchange rate	15.0	13.4	15.7	5.9	4.6	3.3	2.9	14.5	13.2	13.2	13.6	13.1
Credit to the economy	9.5	2.2	11.8	21.2	19.5	16.3	8.7	11.7	10.8	11.0	10.9	11.8
At program exchange rate	7.2	0.9	10.7	6.5	5.0	4.2	-1.8	7.5	8.7	9.7	10.4	11.0
Velocity of broad money, ratio	1.90	1.83	1.60	1.54	1.51	1.51	1.48	1.45	1.42	1.39	1.36	1.33
Money multiplier, ratio	2.86	3.03	2.96	2.87	2.68	2.73	2.72	2.79	2.80	2.81	2.82	2.83
Hryvnia per U.S. dollar, end-of-period	7.99	7.99	8.30	11.44	11.00	10.60	10.50	11.50	12.02	12.38	12.50	12.75
Sources: National Bank of Ukraine; and IMF staff estimates and projections.												

Table 6. Ukraine: Financial Soundness Indicators for the Banking Sector, 2009–14

(Percent, unless otherwise indicated)

	2009	2010	2011	2012	2013				2014
					Mar.	Jun.	Sep.	Dec.	Mar.
Ownership									
Number of banks	182	176	176	176	175	176	181	180	181
Private	180	174	174	171	170	171	175	173	174
Domestic	129	119	121	118	117	120	124	124	123
Foreign	51	55	53	53	53	51	51	49	51
Of which: 100% foreign-owned	18	20	22	22	22	21	21	19	19
State-owned	2	2	2	2	2	2	3	3	3
Foreign-owned banks' share in statutory capital	35.8	40.6	41.9	39.5	38.3	34.2	34.2	34.0	33.6
Concentration									
Share of assets of largest 10 banks	52.8	53.9	52.8	52.7	52.7	53.7	53.6	54.3	55.5
Share of assets of largest 25 banks	76.5	75.9	74.6	74.7	74.8	75.2	74.9	76.0	77.2
Number of bank with assets less than \$150 million	107	92	81	75	73	74	75	77	95
Capital Adequacy									
Regulatory capital to risk-weighted assets	18.1	20.8	18.9	18.1	18.2	18.0	17.9	18.3	14.8
Capital to total assets	13.1	14.6	14.8	15.0	14.1	14.0	13.9	14.0	12.8
Asset Quality									
Credit growth (year-over-year percent change) 1/	-2.3	1.1	9.5	2.2	3.8	5.1	7.0	11.8	21.2
Credit to GDP ratio 1/	78.9	67.3	61.2	57.8	58.3	59.1	60.7	62.6	68.6
NPLs to total loans (NBU definition) 2/	13.1	14.9	14.3	16.5	15.9	15.2	14.0	12.9	13.3
NPLs to total loans (broad definition) 3/	37.6	40.3	37.7	26.7	27.1	27.2	25.6	23.5	...
NPLs net of provisions to capital 2/	32.0	29.2	25.8	36.0	35.7	35.7	31.8	30.7	37.6
Specific provisions (percent of NPLs, NBU definition)	65.1	66.6	68.3	63.9	77.6	77.9	81.0	80.4	79.4
Specific provisions (percent of total loans)	8.9	10.2	10.1	12.7	12.4	11.8	14.9	13.6	13.8
Foreign Exchange Rate Risk									
Loans in foreign currency to total loans 1/	51.2	46.5	40.6	36.9	37.2	36.7	35.7	34.1	41.7
Deposits in foreign currency to total deposits	47.2	42.1	42.6	43.8	41.7	39.9	39.1	36.9	43.5
Foreign currency loans to foreign currency deposits 1/	239.2	194.8	155.7	121.1	124.6	125.9	122.6	126.0	143.4
Net open FX position to regulatory capital (NBU definition) 4/	28.5	21.6	8.4	2.5	7.1	9.6	9.0	6.9	13.4
Net open FX position to regulatory capital (staff estimate) 4/	-23.6	-36.9	-40.0	-29.4	-24.1	-19.6	-18.2	-13.9	...
Liquidity Risk									
Liquid assets to total assets	11.5	18.8	18.7	22.2	24.7	22.7	22.8	20.6	...
Customer deposits to total loans to the economy 1/	45.3	56.7	61.2	69.6	71.5	73.1	74.4	73.3	66.9
Earnings and Profitability									
Return on assets (after tax; end-of-period)	-4.4	-1.5	-0.8	0.5	1.1	0.2	0.2	0.1	-0.6
Return on equity (after tax; end-of-period)	-32.5	-10.2	-5.3	3.0	7.3	1.4	1.3	0.8	-4.2
Net interest margin to total assets	6.2	5.8	5.3	4.5	4.0	4.0	4.1	4.1	4.6
Interest rate spreads (percentage points; end-of-period)									
Between loans and deposits in domestic currency	5.6	7.6	6.6	4.3	6.4	5.9	5.4	4.8	7.4
Between loans and deposits in foreign currency	0.7	4.7	2.8	4.5	4.4	4.3	3.7	2.4	1.9
Between loans in domestic and foreign currency	9.4	5.3	9.4	9.1	7.4	6.1	6.3	8.9	11.4
Between deposits in domestic and foreign currency	4.5	2.4	5.6	9.4	5.4	4.5	4.5	6.5	5.9
Number of banks not complying with banking regulations									
Not meeting capital adequacy requirements for Tier I capital	12	3	2	2	0	0	0	0	6
Not meeting prudential regulations	22	8	11	6	6	3	5	6	28
Not meeting reserve requirements	15	5	5	9	7	3	3	8	...

Sources: National Bank of Ukraine; and IMF staff estimates.

1/ Monetary statistics data.

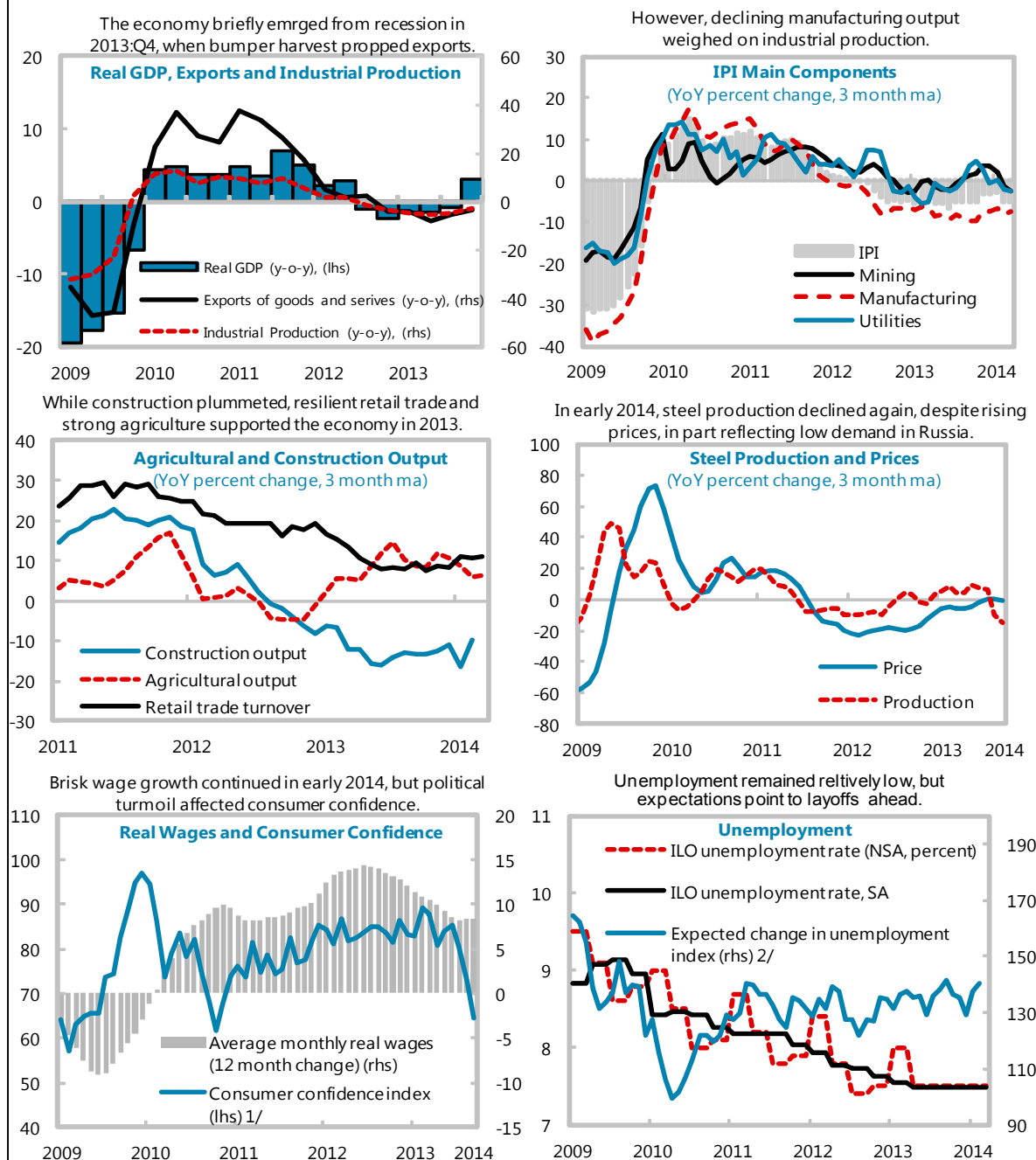
2/ From December 2012, NBU changed loan classification, which resulted in the NPL series break. Up to September 2012, share of loans classified as doubtful and loss in the total loans. From December 2012, share of loans of IV and V category of quality in the total loans.

3/ Included NPLs that are classified as substandard, doubtful, and loss. From December 2012, estimated by staff using NPL data published by NBU according to new methodology, which resulted in series break.

4/ NBU definition does not take into account the effects of NBU Resolution 109, which forced banks into holding large negative open foreign exchange (FX) positions.

Table 7. Ukraine: Indicators of Fund Credit, 2012–19

Table 7. Ukraine: Indicators of Fund Credit, 2012–19								
	2012	2013	2014	2015	2016	2017	2018	2019
	Projection							
Stock of existing and prospective Fund credit 1/ 2/								
Millions of SDRs	7,016	3,359	5,771	10,290	10,976	10,233	6,803	2,144
Percent of quota	511	245	421	750	800	746	496	156
Percent of GDP	6.1	2.9	6.3	10.7	10.5	9.2	5.6	1.6
Percent of exports of goods and services	12.0	6.1	11.0	19.0	19.8	17.6	11.1	3.3
Percent of gross reserves	44.0	25.3	46.5	60.2	53.5	46.2	28.2	8.6
Existing Fund credit 1/ 2/								
Millions of SDRs	7,016	3,359	969	0	0	0	0	0
Percent of quota	511	245	71	0	0	0	0	0
Percent of GDP	6.1	2.9	1.1	0	0	0	0	0
Percent of exports of goods and services	12.0	6.1	1.8	0	0	0	0	0
Percent of gross reserves	44.0	25.3	7.8	0	0	0	0	0
Prospective Fund credit 1/ 2/								
Millions of SDRs	0	0	4,802	10,290	10,976	10,233	6,803	2,144
Percent of quota	0	0	350	750	800	746	496	156
Percent of GDP	0	0	5.2	10.7	10.5	9.2	5.6	1.6
Percent of exports of goods and services	0	0	9.1	19.0	19.8	17.6	11.1	3.3
Percent of gross reserves	0	0	38.7	60.2	53.5	46.2	28.2	8.6
Obligations to the Fund from existing and prospective drawings 2/								
Millions of SDRs	2,434	3,788	1,670	1,132	255	1,023	3,694	4,762
Percent of quota	177	276	122	82	19	75	269	347
Percent of GDP	2.1	3.3	1.8	1.2	0.2	0.9	3.1	3.6
Percent of exports of goods and services	4.1	6.8	3.1	2.0	0.5	1.8	6.0	7.3
Percent of gross reserves	15.3	28.5	13.5	6.6	1.2	4.6	15.3	19.1
Obligations to the Fund from existing drawings 2/								
Millions of SDRs	2,434	3,788	1,626	976	0	0	0	0
Percent of quota	177	276	119	71	0	0	0	0
Percent of GDP	2.1	3.3	1.8	1.0	0	0	0	0
Percent of exports of goods and services	4.1	6.8	3.0	1.8	0	0	0	0
Percent of gross reserves	15.3	28.5	13.1	5.7	0	0	0	0
Obligations to the Fund from prospective drawings 2/								
Millions of SDRs	0	0	44	156	255	1,023	3,694	4,762
Percent of quota	0	0	3	11	19	75	269	347
Percent of GDP	0	0	0.0	0.2	0.2	0.9	3.1	3.6
Percent of exports of goods and services	0	0	0.1	0.3	0.5	1.8	6.0	7.3
Percent of gross reserves	0	0	0.4	0.9	1.2	4.6	15.3	19.1
Sources: IMF staff estimates.								
1/ End of period.								
2/ Repayment schedule based on repurchase obligations.								

Figure 1. Ukraine: Real Sector Indicators, 2009–14

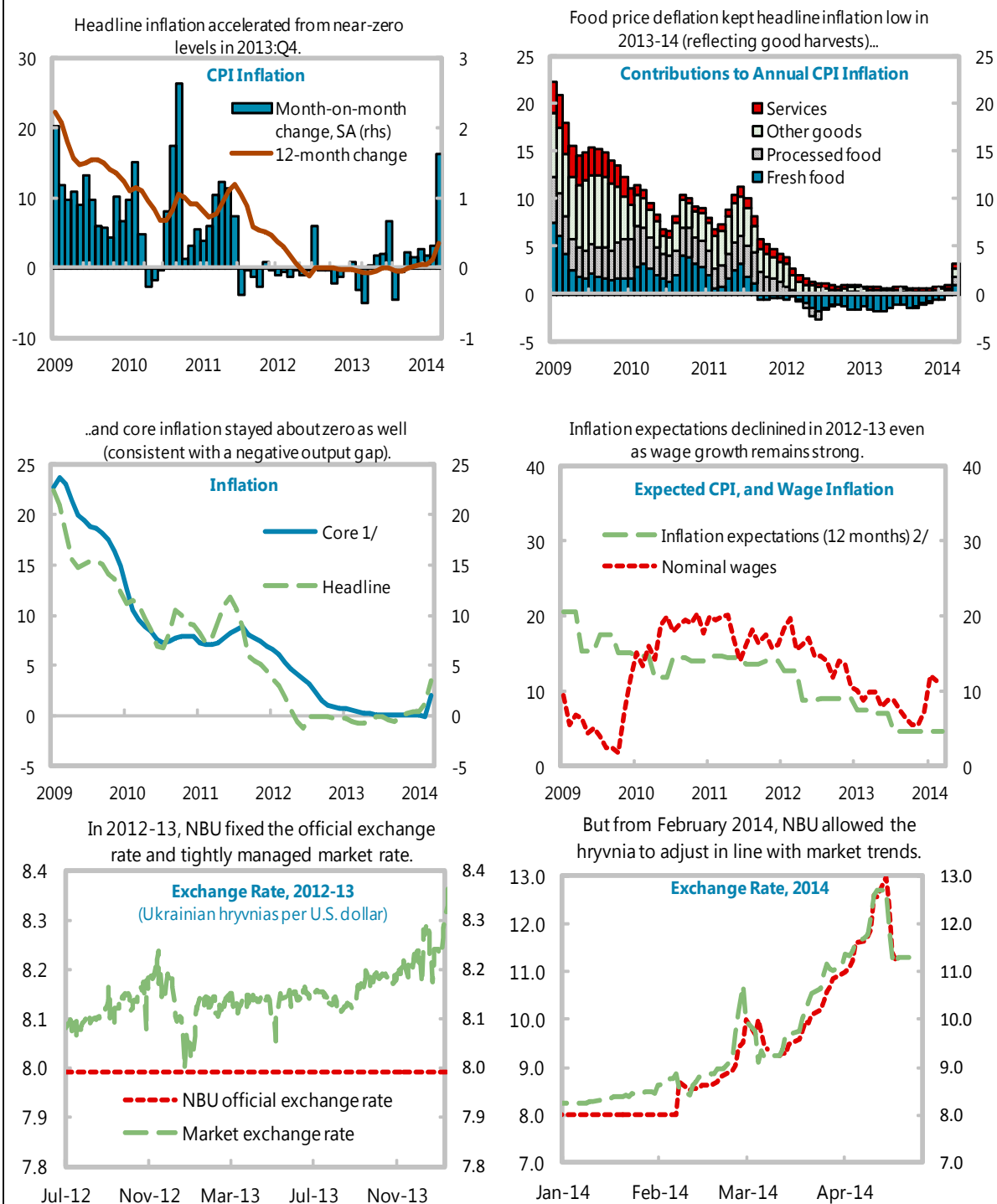
Sources: State Statistics Committee of Ukraine; Haver; Bloomberg; GFK Ukraine; International Centre for Policy Studies; and IMF staff calculations.

1/ Consumer confidence index is based on survey respondents' answers to questions that relate to personal financial standing, changes in personal financial standing, economic conditions over the next year, economic conditions over the next five years, and propensity to consume. Index values range from 0 to 200. The index equals 200 when all respondents positively assess the economic situation. It totals 100 when the shares of positive and negative assessments are equal. Indices of less than 100 indicate the prevalence of negative assessments.

2/ Values above 100 indicate that more respondents expect unemployment to rise than fall over the next one to two months. Values can vary from 0 to 200.

Figure 2. Ukraine: Inflation, Monetary, and Exchange Rate Developments, 2009–14

(Year-on-year percent change, unless otherwise indicated)



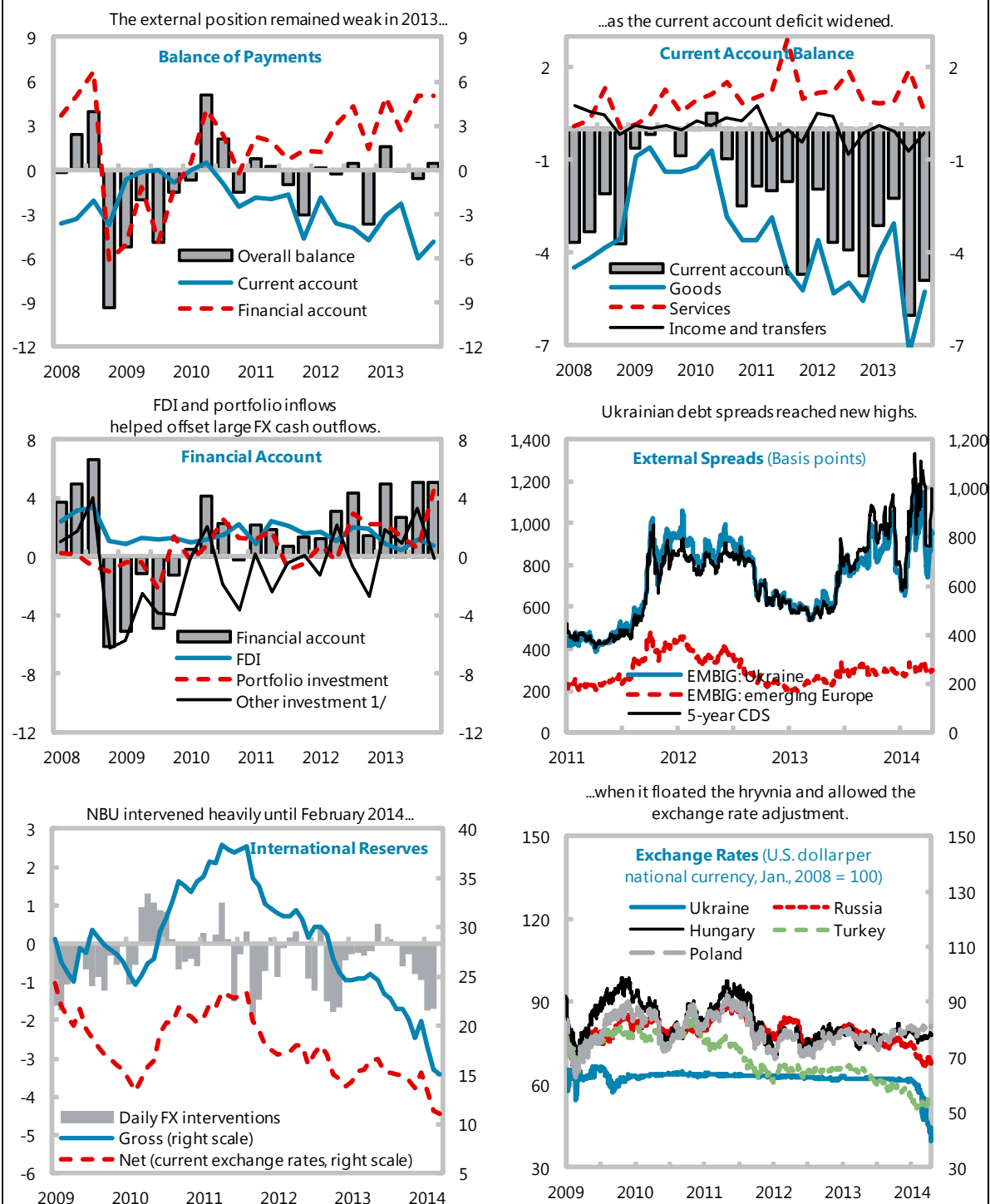
Sources: State Statistics Committee of Ukraine; International Centre for Policy Studies; National Bank of Ukraine; Bloomberg; and IMF staff calculations.

1/ Broad core excludes unprocessed food, fuel, and administrative services.

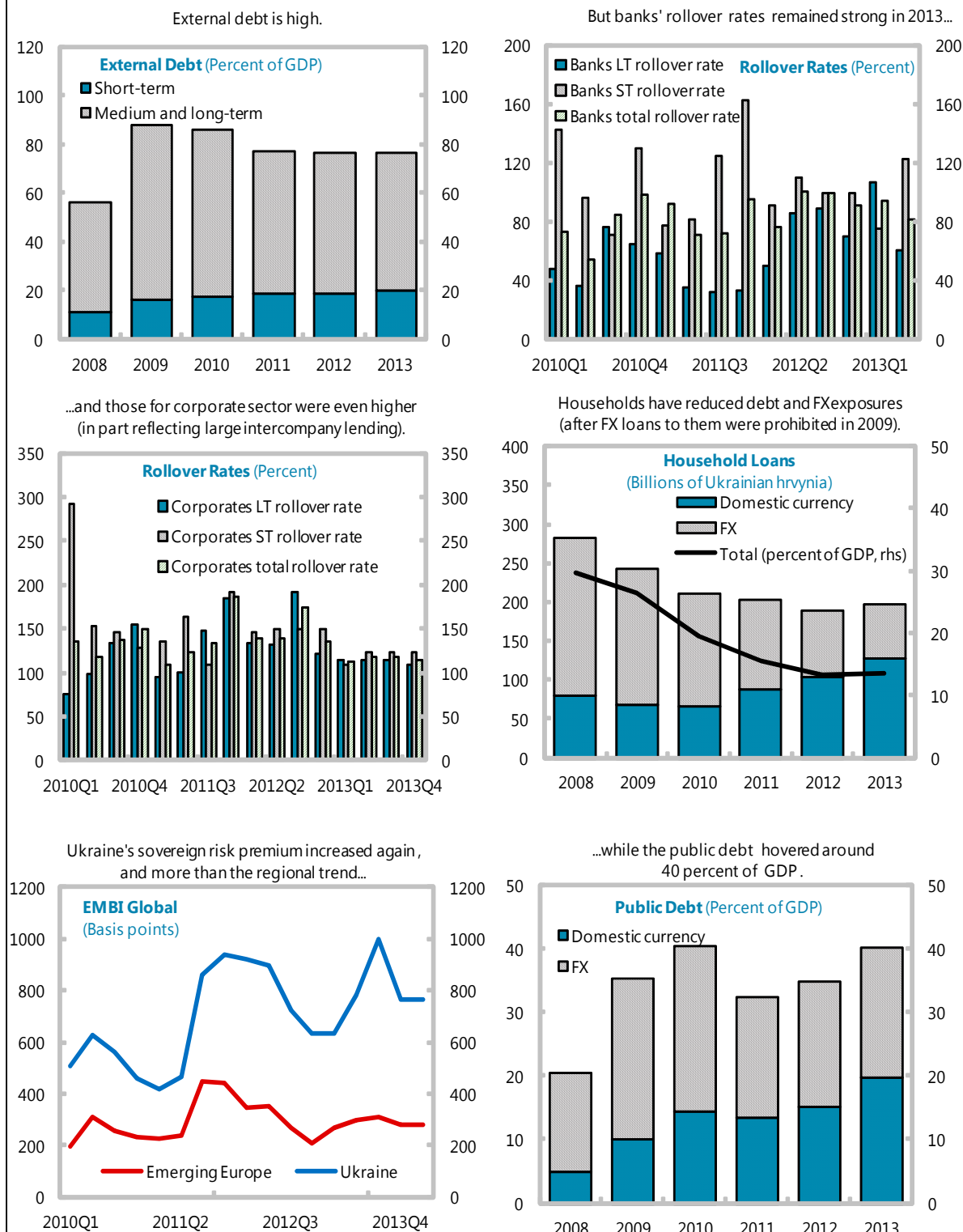
2/ Inflation expectations are surveyed and compiled by the NBU.

Figure 3. Ukraine: External Sector Developments, 2008–14

(Billions of U.S. dollars, unless otherwise indicated)



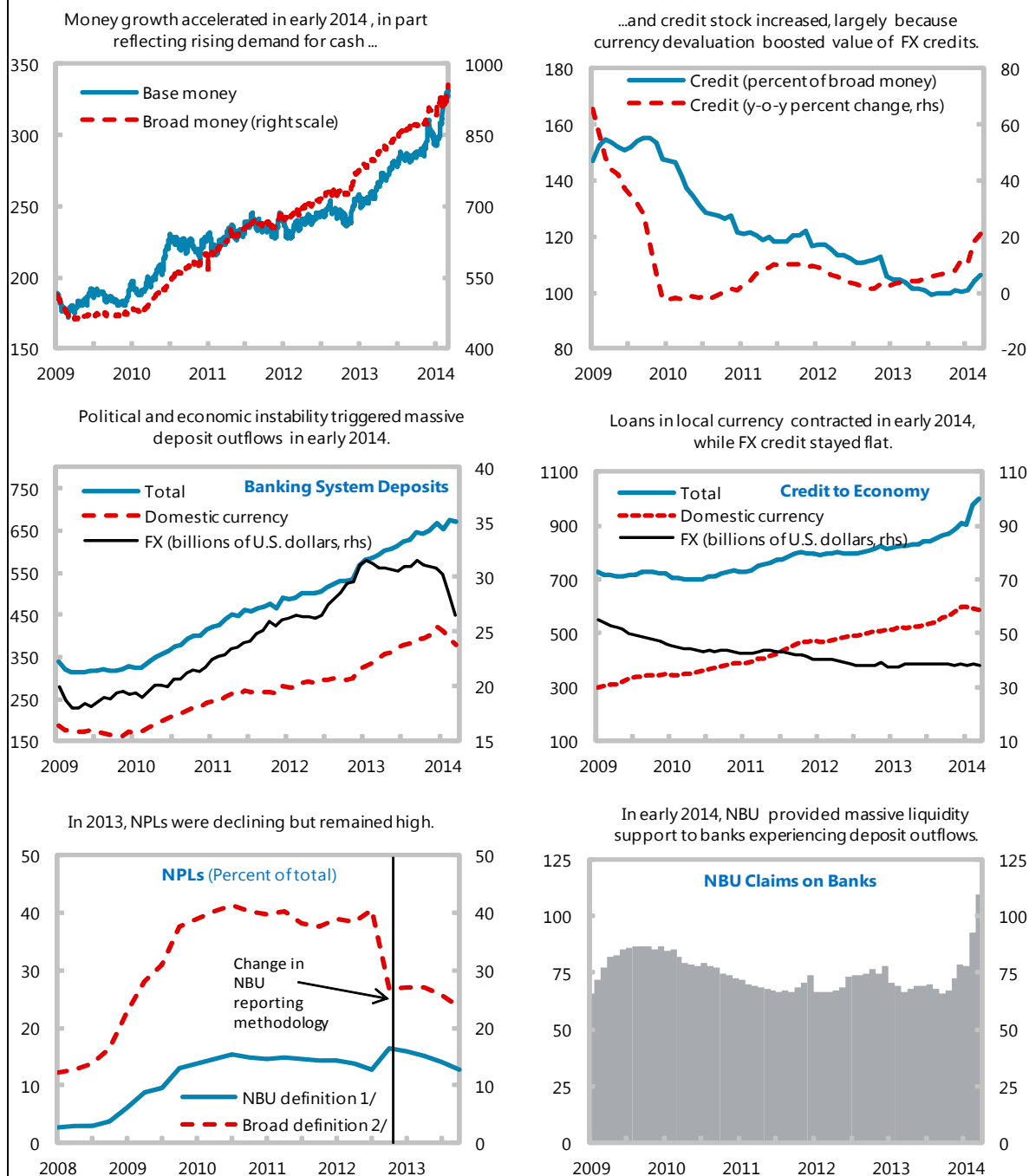
Sources: National Bank of Ukraine; State Committee of Statistics; Bloomberg; and IMF staff estimates and calculations.
 1/ Includes residents' conversion of hryvnia cash to foreign currency held outside the banking system.

Figure 4. Ukraine: Debt and Rollover of Debt, 2008–13

Sources: National Bank of Ukraine; Bloomberg; Ministry of Finance; and IMF staff estimates.

Figure 5. Ukraine: Financial Sector Indicators, 2009–14

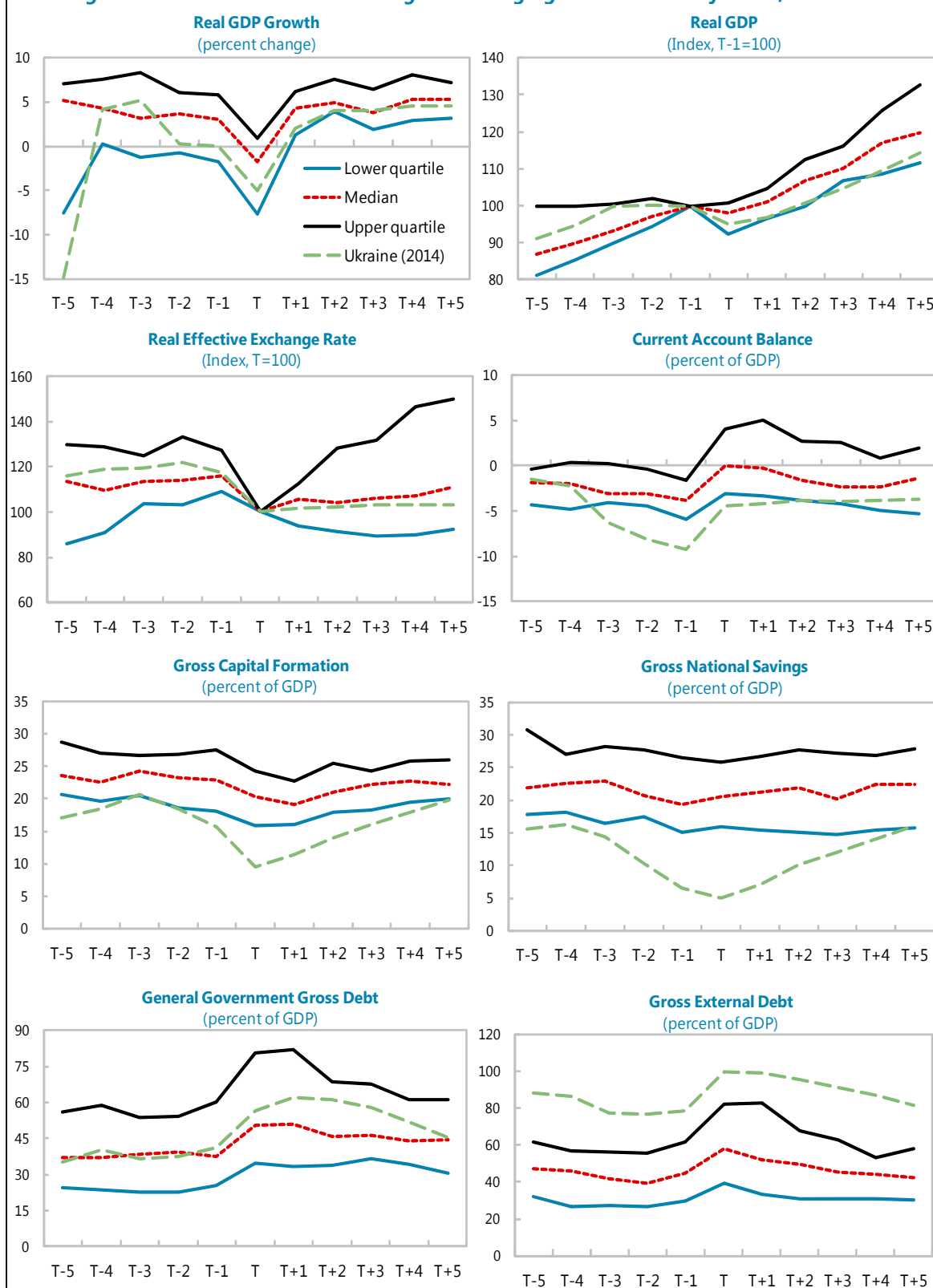
(Billions of Ukrainian hryvnias, unless otherwise indicated)



Sources: National Bank of Ukraine; and IMF staff calculations.

1/ Included NPLs that were classified as doubtful and loss until December 2012, when the NBU changed its classification of reported NPLs, which resulted in series break.

2/ Included NPLs that are classified as substandard, doubtful, and loss. From December 2012, estimated by staff using NPL data published by NBU according to new methodology, which resulted in series break.

Figure 6. Economic Indicators during Past Emerging Market Currency Crises, 1990-2014

Source: INS; WEO; Laven and Valencia (2012); and IMF staff estimates.

Annex I. Public Debt Sustainability Analysis

Despite its rapid increase, Ukraine's public debt is assessed to be sustainable with high probability. Under the baseline scenario, public debt is projected to peak at 63½ percent of GDP in 2015, below the 70 percent of GDP high-risk threshold used in the debt sustainability framework. Debt is projected to decline thereafter reaching 45 percent of GDP by 2019 driven by fiscal adjustment and elimination of quasi fiscal losses in the energy sector and as the effects of the stabilization and improved economic performance become entrenched. The baseline public debt path is subject to considerable risks particularly from lower growth, real exchange rate, and contingent liabilities shocks. Gross financing needs are forecast to peak in 2014 at 17.5 percent of GDP but will average 13 percent of GDP over the medium term, pointing to a reduction of rollover risks over the program period.

Macroeconomic and fiscal assumptions: The assumptions underpinning the DSA are those of the program scenario. Real GDP growth is projected at -5 percent in 2014 rising gradually to 4.5 percent in the medium term. Starting from a low level, inflation (measured by the GDP deflator) is projected to rise to 9 percent on average in 2014 and peak at 13 percent in 2015 as the effects of the significant exchange rate depreciation in 2014 are felt. The general government fiscal deficit is projected to increase in 2014 (5¼ percent of GDP) and then decline to 3.1 percent over the program years and reach 2½ percent by 2019. Historic and projected public financing for the state-owned gas company Naftogaz is added to the general government debt as well. The DSA tool that assesses the realism of the main assumptions on growth, primary balance, and inflation does not reveal systematic forecast errors.

The definition of public debt in this DSA includes: (i) central government debt as reported by the authorities (includes domestic debt held by the NBU (10¼ percent of GDP at end-2013); (ii) government guarantees on loans extended to state enterprises (including Naftogaz);¹ (iii) debt of local governments; and (iv) National Bank of Ukraine's (NBU's) liabilities to the IMF.

The DSA framework suggests that Ukraine's public debt is currently below the high-risk benchmark although it will continue to rise rapidly until 2015. The DSA suggests that debt will reach 57½ percent of GDP at end-2014, a jump of over 16 percentage points, driven by large financing needs under past unsustainable policies as well as significant exchange rate depreciation. Public debt is projected to peak in 2015 at 63½ percent of GDP as disbursements by the IMF and other donors, including to the NBU, come into full force but will then steadily decline reaching 45 percent of GDP in 2019. The debt-to-GDP ratio would remain below 70 percent, the indicative threshold used in the DSA framework to highlight high risk debt levels.²

¹ All past government guarantees (whether called or not) as well as projected issuances of guarantees are reflected in the public debt numbers. Existing guarantees are amortized as they expire reflecting a schedule provided by the authorities. Projected issuances of guarantees are assumed to have a five-year maturity.

² The 70 percent of GDP debt benchmark is based on a cross-country early-warning exercise of emerging market countries that have experienced episodes of debt distress.

Under a number of individual shock scenarios the debt-to-GDP ratio remains below the corresponding high-risk benchmark of 70 percent. These shocks pertain to an unchanged primary balance or a historical scenario where key variables remain at their 10-year historical average. Other one-time shocks to the primary balance and the real interest rate lead to moderate increases in the debt trajectory in the medium term while remaining below the 70 percent threshold.

Other shocks, however, would send the debt-to-GDP ratio above the critical value of 70 percent. These relate to growth shocks, a combined macro-fiscal shock, a contingent liability shock, and a real exchange rate shock. Under a growth shock, entailing a cumulative growth decline of nearly 9 percent in 2015–16 on top of the projected 2014 decline of 5 percent, the debt-to-GDP ratio reaches 86 percent in 2016, breaching the 70 percent indicative threshold (yellow in the heat map on page 52). The combined macro-fiscal shock is an aggregation of the shocks to real growth as well as the interest rate, the primary balance and the exchange rate while taking care not to double-count the effects of individual shocks. This shock produces the largest effect of all shocks, sending debt to 112 percent of GDP in 2016. The contingent liabilities shock is essentially designed to highlight risks from implicit guarantees to the banking sector. This shock includes an associated shock to growth and resulting deterioration in the primary balance together with an increase in interest rates and decrease in inflation. Under this shock debt peaks at 83 percent of GDP in 2016. The real exchange rate shock includes deterioration in inflation, interest rates, and the primary balance. Under this shock debt reaches nearly 75 percent of GDP in 2015.

The baseline scenario and the numerous shocks produced by the DSA template highlight that Ukraine is exposed to considerable risks related to the large financing needs of the budget and Naftogaz. Under the baseline, gross financing needs are 17½ percent of GDP in 2014 (above the high-risk indicative threshold of 15 percent), but they decline steadily over the program period and beyond and drop below the high risk threshold by 2016. The gross financing needs are magnified under the various shocks, especially under the growth shock and the combined macro-fiscal shock.

A heat map confirms the manageable risks to the debt level under the baseline, but highlights the risks stemming from high gross financing needs and deteriorating debt profile. Risks from the debt level (the top row of the heat map) are deemed low or medium given that public debt remains below the high-risk threshold of 70 percent under the baseline and certain (even if not all) shocks. As for gross financing needs, the middle row of the heat map flashes red, pointing to high risk given that Ukraine breaches the relevant threshold in 2014–15 under the baseline. On the other hand, excluding financing needs generated by debt held by the NBU, gross financing needs would be at or below 15 percent of GDP, mitigating the risk signal of this indicator. Some risks to the debt profile (bottom row) are also high as captured by Ukraine's EMBIG spreads, the economy-wide external financing requirements, and debt held by non-residents. These risks are somewhat alleviated by the significant shift in the composition of external financing in favor of official sources.

The risks highlighted by the DSA point to the vital role of the SBA-supported program. Full implementation of the program, including through fiscal adjustment and reform in the energy sector together with the expected return to growth supported by the exchange rate adjustment and structural reforms would entrench public debt sustainability in the medium term.

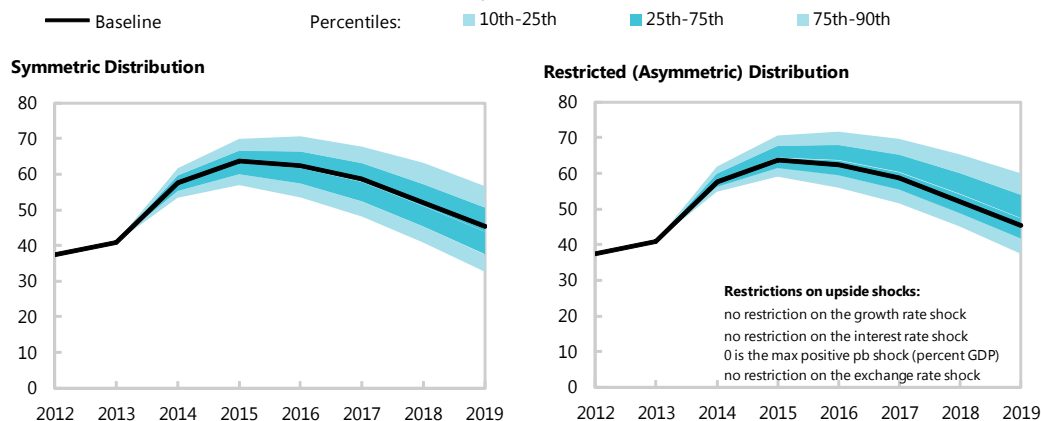
Ukraine Public DSA Risk Assessment

Heat Map

Debt level ^{1/}	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Gross financing needs ^{2/3/}	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile ^{4/}	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

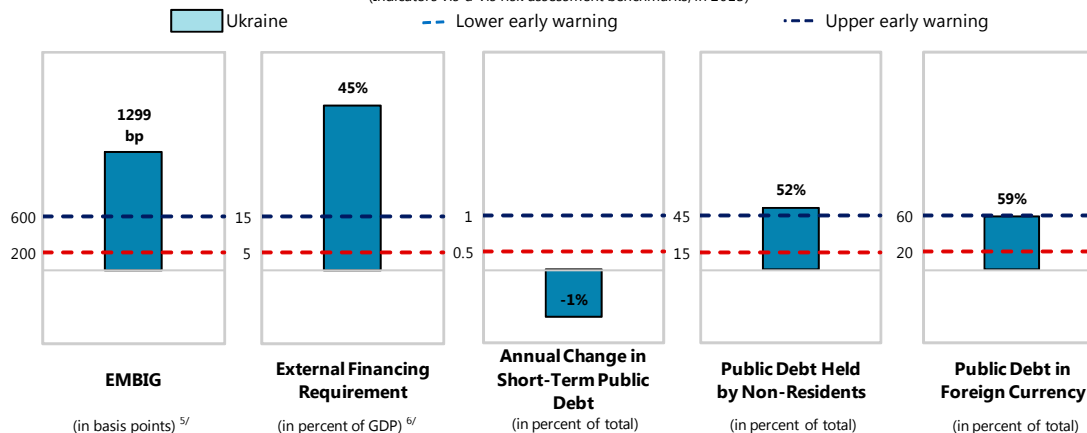
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2013)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The central bank holdings of domestic public debt mitigate somewhat risks emanating from the gross financing needs. Excluding financing needs generated by this component of debt, gross financing needs would peak at 15 percent of GDP in 2014.

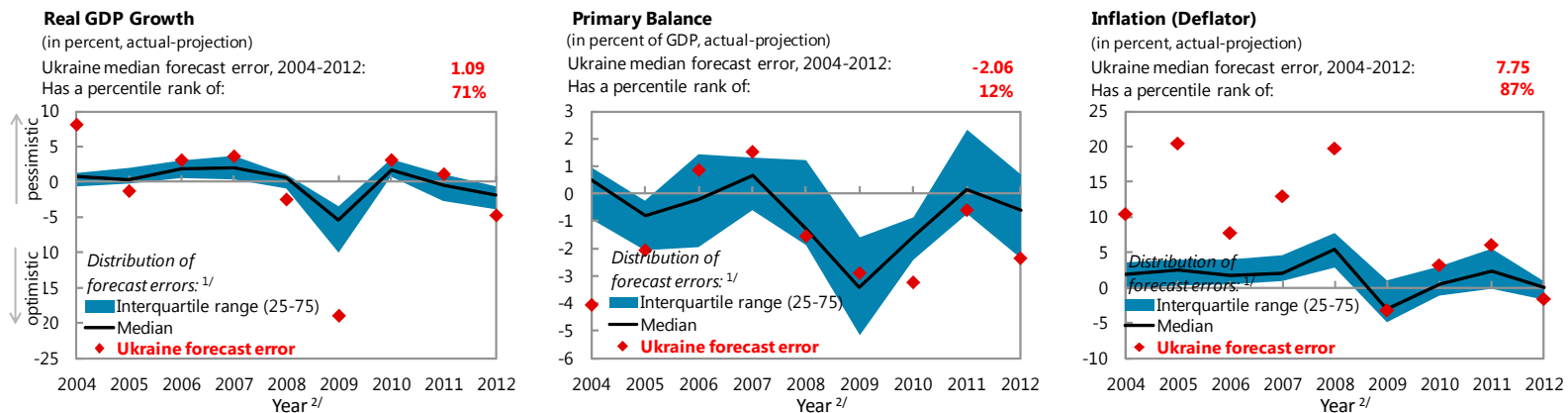
4/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white. Lower and upper risk-assessment benchmarks are: 200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

5/ EMBIG, an average over the last 3 months, 04-Jan-14 through 04-Apr-14.

6/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

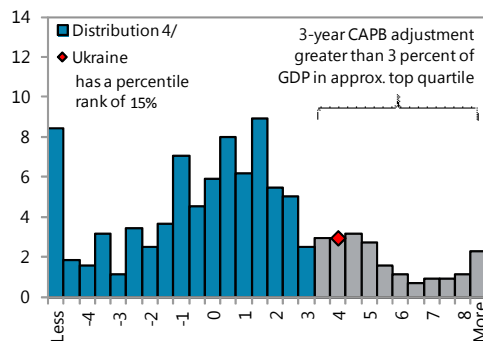
Ukraine Public DSA—Realism of Baseline Assumptions

Forecast Track Record, versus program countries

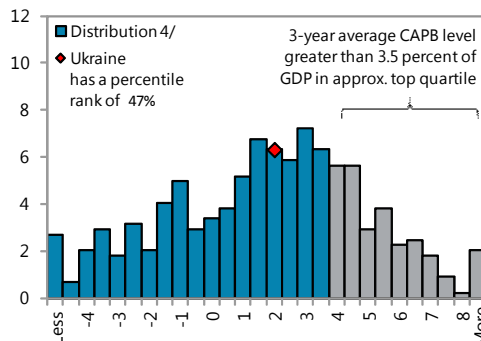


Assessing the Realism of Projected Fiscal Adjustment

3-Year Adjustment in Cyclically-Adjusted Primary Balance (CAPB) (Percent of GDP)



3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB) (Percent of GDP)



Boom-Bust Analysis^{3/}

Real GDP growth (in percent)



Source : IMF Staff.

1/ Plotted distribution includes program countries, percentile rank refers to all countries.

2/ Projections made in the spring WEO vintage of the preceding year.

3/ Not applicable for Ukraine, as it meets neither the positive output gap criterion nor the private credit growth criterion.

4/ Data cover annual observations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Ukraine Public Sector Debt Sustainability Analysis (DSA)—Baseline Scenario

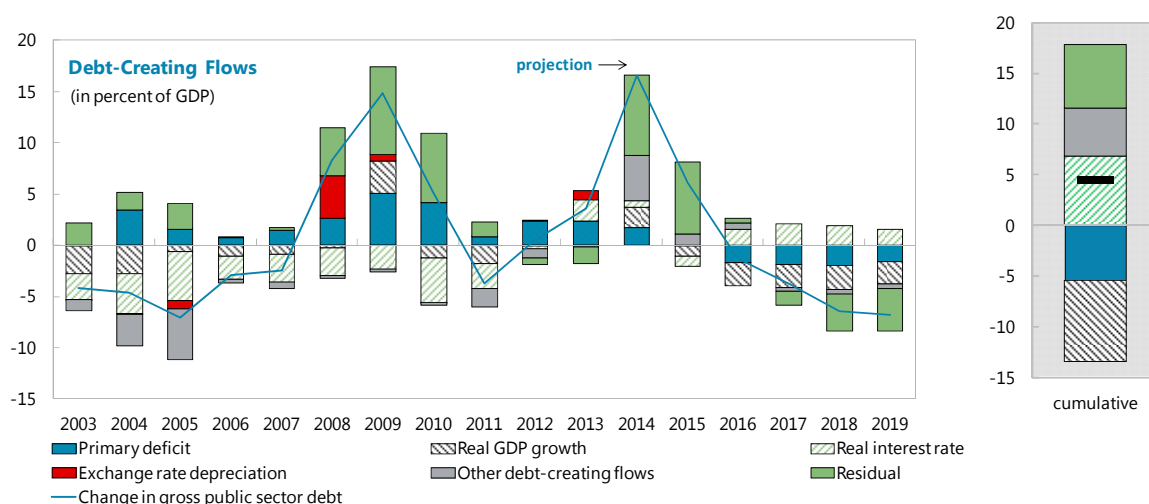
(in percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators ^{1/}

	Actual			Projections						As of April 21, 2014
	2003-2011 ^{2/}	2012	2013	2014	2015	2016	2017	2018	2019	
Nominal gross public debt	25.8	37.4	40.9	57.5	63.6	62.3	58.6	52.1	45.4	Sovereign Spreads EMBIG (bp) 3/ 905 5Y CDS (bp) 890
Of which: guarantees	5.9	8.2	7.2	9.3	13.3	12.3	10.1	6.1	1.4	
Public gross financing needs	5.5	9.3	9.9	17.5	16.3	12.0	12.6	11.4	9.9	
Real GDP growth (in percent)	4.1	0.3	0.0	-5.0	2.0	4.0	4.0	4.5	4.5	Ratings Foreign Local Moody's Caa3 Caa3 S&P's CCC B- Fitch CCC B-
Inflation (GDP deflator, in percent)	17.2	8.1	3.1	9.0	13.0	8.0	7.0	6.5	6.5	
Nominal GDP growth (in percent)	22.0	8.4	3.1	3.5	15.3	12.3	11.3	11.3	11.3	
Effective interest rate (in percent) ^{4/}	6.1	7.4	8.7	10.1	11.3	11.1	11.0	10.4	10.2	

Contribution to Changes in Public Debt

	Actual			Projections						cumulative	debt-stabilizing primary balance ^{9/}
	2003-2011	2012	2013	2014	2015	2016	2017	2018	2019		
Change in gross public sector debt	0.4	0.6	3.6	16.6	6.1	-1.3	-3.7	-6.5	-6.8	4.4	
Identified debt-creating flows	-2.8	1.1	5.2	8.8	-1.0	-1.8	-2.4	-2.9	-2.6	-1.8	
Primary deficit	2.2	2.4	2.4	1.8	-0.1	-1.7	-1.9	-1.9	-1.6	-5.4	-1.0
Primary (noninterest) revenue and grants	41.6	44.5	43.6	45.0	45.0	44.9	44.7	44.3	43.8	267.6	
Primary (noninterest) expenditure	43.8	46.8	46.0	46.7	44.9	43.2	42.8	42.4	42.2	262.2	
Automatic debt dynamics ^{5/}	-3.6	-0.3	3.0	2.6	-2.0	-0.7	-0.2	-0.4	-0.5	-1.2	
Interest rate/growth differential ^{6/}	-4.0	-0.3	2.1	2.6	-2.0	-0.7	-0.2	-0.4	-0.5	-1.2	
Of which: real interest rate	-3.1	-0.2	2.0	0.6	-1.0	1.6	2.1	1.9	1.6	6.8	
Of which: real GDP growth	-0.9	-0.1	0.0	2.0	-1.0	-2.3	-2.2	-2.4	-2.1	-8.0	
Exchange rate depreciation ^{7/}	0.4	0.0	0.9	...	...	...	...	...	...	...
Other identified debt-creating flows	-1.4	-0.9	-0.1	4.4	1.1	0.6	-0.4	-0.5	-0.4	4.8	
General Government: Net Privatization Proceeds (negative)	-1.4	-0.9	-0.1	-0.6	-0.8	-0.7	-0.6	-0.5	-0.4	-3.7	
Contingent liabilities	0.0	0.0	0.0	5.1	1.9	1.3	0.2	0.0	0.0	8.5	
Please specify (2) (e.g., ESM and Euroarea loans)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes ^{8/}	3.1	-0.6	-1.6	7.8	7.1	0.5	-1.3	-3.6	-4.2	6.2	



Source: IMF staff.

1/ Public sector is defined as general government and includes public guarantees, defined as Assumed 1 percent of GDP each year in projection period allocated and assumed called.

2/ Based on available data.

3/ EMBIG.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as $[(r - \pi(1+g) - g + ae(1+r))/(1+g+\pi+gnt)]$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi(1+g)$ and the real growth contribution as $-g$.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

8/ Includes changes in the stock of guarantees, asset changes, and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

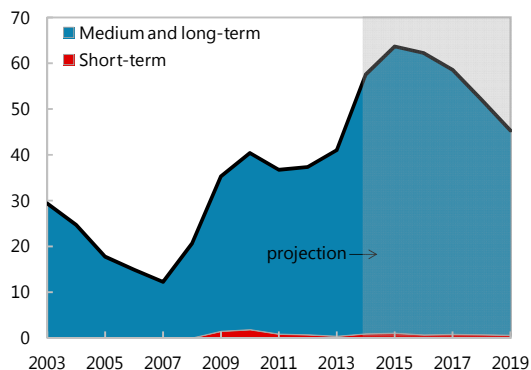
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Ukraine Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

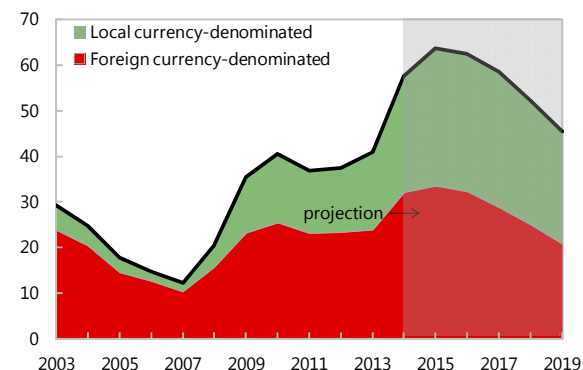
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)



Alternative Scenarios

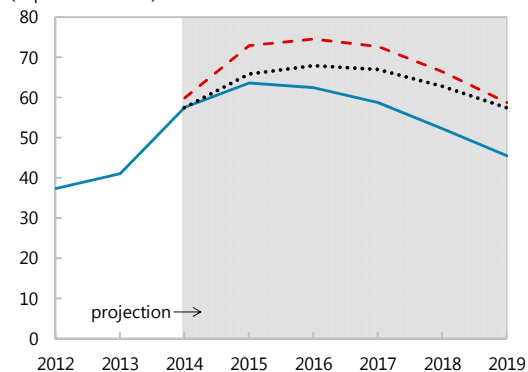
— Baseline

..... Historical

--- Constant Primary Balance

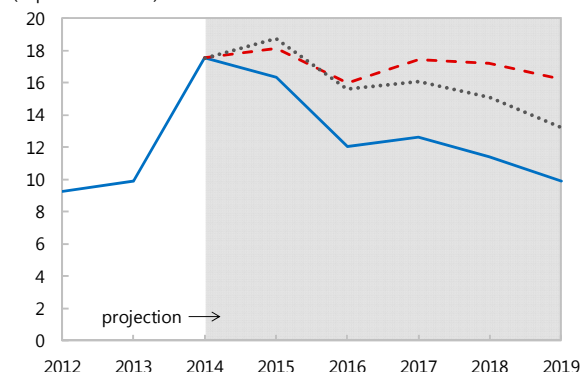
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

Baseline Scenario

	2014	2015	2016	2017	2018	2019
Real GDP growth	-5.0	2.0	4.0	4.0	4.5	4.5
Inflation	9.0	13.0	8.0	7.0	6.5	6.5
Primary Balance	-1.8	0.1	1.7	1.9	1.9	1.6
Effective interest rate	10.1	11.3	11.1	11.0	10.4	10.2

Constant Primary Balance Scenario

	2014	2015	2016	2017	2018	2019
Real GDP growth	-5.0	2.0	4.0	4.0	4.5	4.5
Inflation	9.0	13.0	8.0	7.0	6.5	6.5
Primary Balance	-1.8	-1.8	-1.8	-1.8	-1.8	-1.8
Effective interest rate	10.1	11.3	11.1	10.9	10.2	9.9

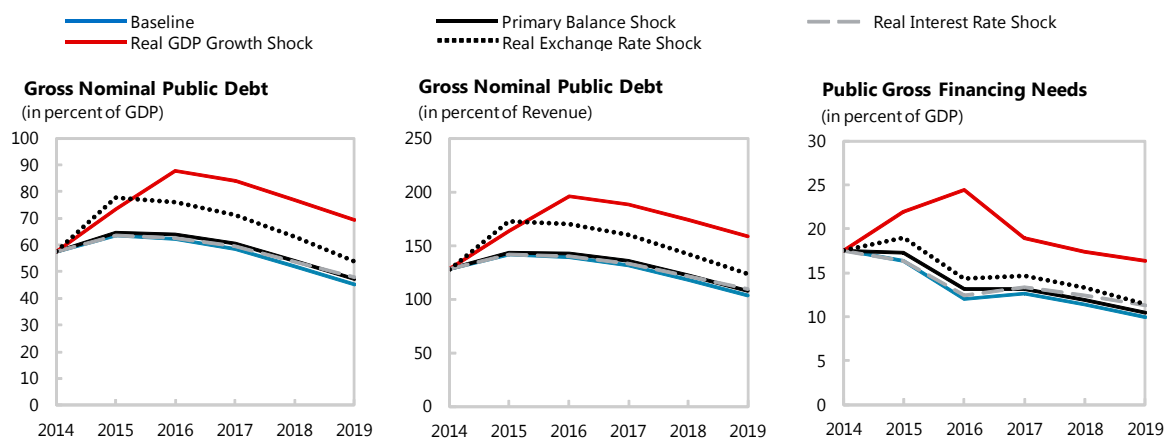
Historical Scenario

	2014	2015	2016	2017	2018	2019
Real GDP growth	-5.0	2.7	2.7	2.7	2.7	2.7
Inflation	9.0	13.0	8.0	7.0	6.5	6.5
Primary Balance	-1.8	-2.5	-2.5	-2.5	-2.5	-2.5
Effective interest rate	10.1	11.3	8.2	6.4	4.5	3.3

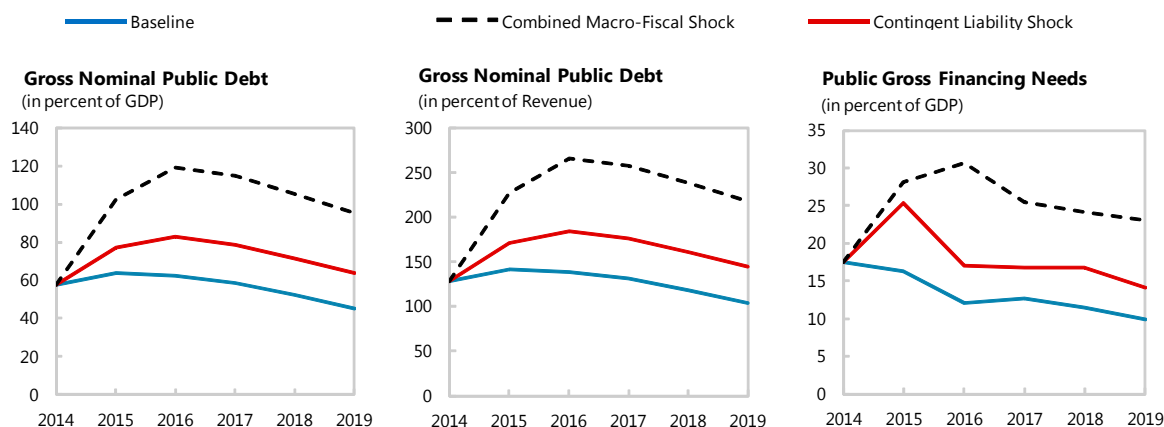
Source: IMF staff.

Ukraine Public DSA—Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests

Underlying Assumptions
(in percent)

Primary Balance Shock							Real GDP Growth Shock						
	2014	2015	2016	2017	2018	2019		2014	2015	2016	2017	2018	2019
Real GDP growth	-5.0	2.0	4.0	4.0	4.5	4.5	Real GDP growth	-5.0	-5.2	-3.2	4.0	4.5	4.5
Inflation	9.0	13.0	8.0	7.0	6.5	6.5	Inflation	9.0	11.2	6.2	7.0	6.5	6.5
Primary balance	-1.8	-0.8	0.9	1.8	1.9	1.6	Primary balance	-1.8	-4.1	-6.7	1.9	1.9	1.6
Effective interest rate	10.1	11.3	11.1	11.1	10.5	10.2	Effective interest rate	10.1	11.3	11.3	11.5	10.9	10.5
Real Interest Rate Shock							Real Exchange Rate Shock						
Real GDP growth	-5.0	2.0	4.0	4.0	4.5	4.5	Real GDP growth	-5.0	2.0	4.0	4.0	4.5	4.5
Inflation	9.0	13.0	8.0	7.0	6.5	6.5	Inflation	9.0	30.5	8.0	7.0	6.5	6.5
Primary balance	-1.8	0.1	1.7	1.9	1.9	1.6	Primary balance	-1.8	0.1	1.7	1.9	1.9	1.6
Effective interest rate	10.1	11.3	12.0	12.4	12.2	12.3	Effective interest rate	10.1	14.3	10.4	10.5	10.0	10.0
Combined Shock							Contingent Liability Shock						
Real GDP growth	-5.0	-5.2	-3.2	4.0	4.5	4.5	Real GDP growth	-5.0	-5.2	-3.2	4.0	4.5	4.5
Inflation	9.0	11.2	6.2	7.0	6.5	6.5	Inflation	9.0	11.2	6.2	7.0	6.5	6.5
Primary balance	-1.8	-4.1	-6.7	1.8	1.9	1.6	Primary balance	-1.8	-6.9	1.7	1.9	1.9	1.6
Effective interest rate	10.1	14.3	10.3	11.0	11.2	11.6	Effective interest rate	10.1	12.5	11.0	11.0	10.3	10.1

Source: IMF staff.

Annex II. External Debt Sustainability Analysis

The recent external adjustment and growth shock are expected to materially increase gross external debt—which stood at 78.6 percent of GDP at end 2013—to almost 100 percent of GDP in 2014, and around 81.5 percent of GDP over the medium term. The compounding effects of the recent hryvnia devaluation and expected GDP decline of about 5 percent will materially boost gross external debt to a peak of 99.5 percent of GDP in 2014. However, successful implementation of a Fund arrangement would allow for a solid resumption of growth over the medium term, along with the return of confidence and investment and competitiveness gains, all of which would set external debt on a slowly falling trajectory to 81.5 percent of GDP at 2019. Nevertheless, until the effects of years of deterioration in economic domestic fundamentals are fully unwound, the ratio of external debt to exports will remain fairly elevated, though falling to 167 percent at 2019.

Further downside growth risks could weigh heavily on the debt outlook. A permanent $\frac{1}{2}$ standard deviation shock to growth would imply a contraction of around 8.6 percent in 2014 (about 3.6 percentage points below the baseline), with a subsequent contractions of 1.6 percent in 2015 and less than 1 percent GDP growth annually thereafter. This shock would raise the debt-to-GDP ratio to a peak of 107.3 percent of GDP at 2015 and around 104 percent of GDP at 2019 (22.5 percentage points above the baseline). Alongside, the ratio of external debt to exports would reach around 213 percent at 2019 (46 percentage points above the baseline).

Ukraine: Program External Debt Sustainability Framework, 2011–19

(Percent of GDP, unless otherwise indicated)

	Actual			Projections					
	2011	2012	2013	2014	2015	2016	2017	2018	2019
Baseline: external debt	77.2	76.5	78.6	99.5	99.3	95.4	91.0	87.1	81.5
Change in external debt	-8.8	-0.7	2.1	20.8	-0.2	-3.8	-4.4	-4.0	-5.5
Identified external debt-creating flows (4+8+9)	-13.2	-4.6	1.7	7.0	1.5	-3.2	-2.8	-4.9	-4.7
Current account deficit, excluding interest payments	0.6	2.4	3.1	-3.2	-3.3	-3.6	-3.6	-3.5	-3.4
Deficit in balance of goods and services	6.2	8.1	8.7	3.5	3.2	4.0	4.4	4.6	4.7
Exports	54.4	51.0	47.9	57.1	56.2	53.2	51.5	50.1	48.8
Imports	60.6	59.1	56.6	60.7	59.4	57.2	55.9	54.7	53.5
Net non-debt creating capital inflows (negative) 1/	-5.2	-7.0	-6.7	-2.3	-0.9	-3.5	-3.2	-5.0	-4.9
Automatic debt dynamics 2/	-8.5	0.0	5.3	12.6	5.6	3.9	4.0	3.6	3.5
Contribution from nominal interest rate	5.7	5.7	6.1	7.7	7.5	7.5	7.5	7.4	7.1
Contribution from real GDP growth	-3.7	-0.2	0.0	4.9	-1.9	-3.6	-3.5	-3.8	-3.6
Contribution from price and exchange rate changes 3/	-10.5	-5.6	-0.8	...	...	...	...	...	...
Residual, including change in gross foreign assets (2-3) 4/	4.4	3.9	-0.4	13.8	-1.7	-0.6	-1.6	0.9	-0.8
External debt-to-exports ratio (percent)	142.1	150.0	164.2	174.0	176.6	179.3	176.6	173.7	167.0
Gross external financing need (billions of U.S. dollars) 5/	70.8	85.4	73.5	63.0	58.0	55.0	57.6	56.2	58.1
Percent of GDP	43.3	48.4	41.3	44.3	38.6	33.5	32.5	29.1	27.6
Scenario with key variables at their historical averages 6/			78.6	63.9	52.1	42.5	32.2	23.9	15.1
Key macroeconomic assumptions underlying baseline									
Real GDP growth (percent)	5.2	0.3	0.0	-5.0	2.0	4.0	4.0	4.5	4.5
GDP deflator in U.S. dollars (change in percent)	13.9	7.7	1.0	-16.0	3.5	5.0	4.1	4.2	4.3
Nominal external interest rate (percent)	7.9	8.0	8.0	7.8	8.0	8.3	8.5	8.8	8.9
Growth of exports (U.S. dollar terms, percent)	28.3	1.3	-5.2	-4.7	3.9	3.4	4.8	5.8	6.3
Growth of imports (U.S. dollar terms, percent)	35.2	5.4	-3.4	-14.4	3.4	5.2	5.8	6.4	6.7
Current account balance, excluding interest payments	-0.6	-2.4	-3.1	3.2	3.3	3.6	3.6	3.5	3.4
Net non-debt creating capital inflows	5.2	7.0	6.7	2.3	0.9	3.5	3.2	5.0	4.9

1/ Includes debt securities due to data limitations on the composition of FDI and portfolio flows.

2/ Derived as $[r - g - r(1+g) + ea(1+r)] / (1+g+r+gr)$ times previous period debt stock, with r = nominal effective interest rate on external debt; g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share

3/ The contribution from price and exchange rate changes is defined as $[-r(1+g) + ea(1+r)] / (1+g+r+gr)$ times previous period debt stock. r increases with an appreciating domestic currency ($e > 0$) and rising inflation (based on GDP deflator).

4/ For projection, line includes the impact of price and exchange rate changes.

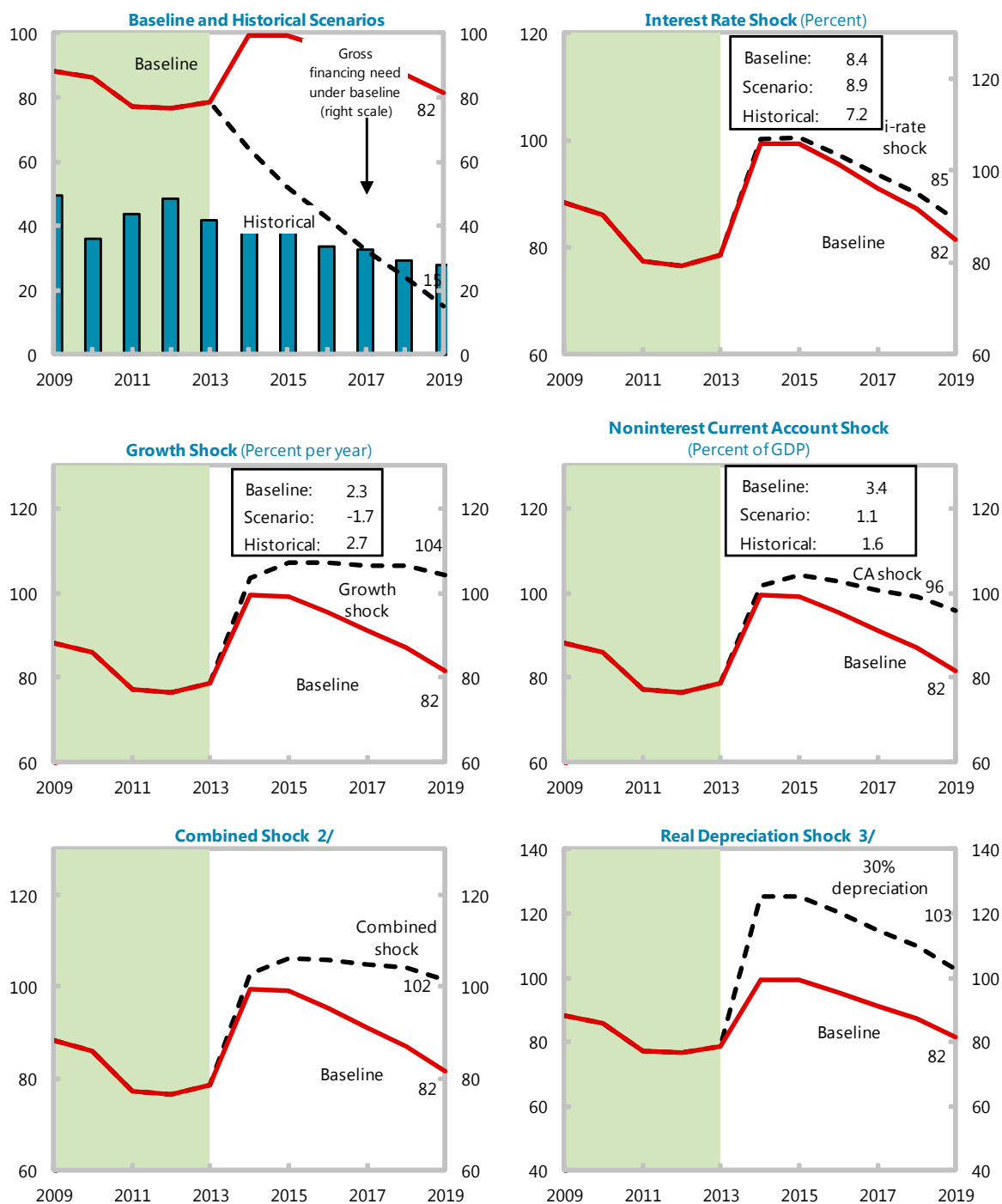
5/ Defined as the sum of current account deficit, amortization on medium- and long-term debt, short-term debt at end of previous period, and other net capital outflows (mainly reflecting residents' conversion of hryvnia cash to foreign currency held outside the banking system). Excludes IMF transactions.

6/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

7/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Ukraine: Program External Debt Sustainability: Bound Tests 1/

(External debt in percent of GDP)



Source: IMF staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

3/ In line with standard IMF stress tests, the shock simulates the impact of a one-time real depreciation of 30 percent in 2010.

Appendix I. Stand-By Arrangement

Attached hereto is a letter from the Acting President, Prime Minister, the Minister of Finance of Ukraine and the Governor of the National Bank of Ukraine (NBU), dated April 22, 2014 ("April 2014 Letter"), with its annexed Memorandum of Economic and Financial Policies ("April 2014 MEFP") and Technical Memorandum of Understanding ("April 2014 TMU"), requesting a Stand-By Arrangement ("Arrangement") from the International Monetary Fund and setting forth:

- (a) the objectives and policies that the authorities of Ukraine intend to pursue for the period of this Arrangement;
- (b) the policies and measures that the authorities of Ukraine intend to pursue during the first year of this Arrangement; and
- (c) understandings of Ukraine with the Fund regarding reviews that will be made of progress in realizing the objectives of the program and of the policies and measures that the authorities of Ukraine will pursue for the remaining period of this Arrangement.

To support these objectives and policies, the International Monetary Fund grants this Arrangement in accordance with the following provisions:

1. For a period of 24 months from the date of the approval of this Arrangement, Ukraine will have the right to make purchases from the Fund in an amount equivalent to SDR 10,976 million, subject to paragraphs 2, 3, 4, and 5 of this Arrangement, without further review by the Fund.
2.
 - (a) Purchases under this Arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 2,058 million until July 25, 2014, the equivalent of SDR 2,972.67 million until September 25, 2014, the equivalent of SDR 3,887.34 million until December 15, 2014, the equivalent of SDR 4,802 million until March 15, 2015, the equivalent of SDR 6,174 million until June 15, 2015, the equivalent of SDR 7,546 million until September 15, 2015, the equivalent of SDR 8,918 million until December 15, 2015, and the equivalent of SDR 10,290 million until March 15, 2016.
 - (b) None of the limits in (a) above shall apply to a purchase under this Arrangement that would not increase the Fund's holdings of Ukraine's currency subject to repurchase beyond 25 percent of quota.
3. Ukraine will not make purchases under this Arrangement that would increase the Fund's holdings of Ukraine's currency subject to repurchase beyond 25 percent of quota:

- (a) Subject to paragraph 2 of Decision No. 14407-(09/105), during any period in which the data at the end of the preceding period indicate that:

- (i) the ceiling on cash deficit of the general government, or
- (ii) the ceiling on cash deficit of the general government and Naftogaz, or
- (iii) the floor on cumulative change in net international reserves; or
- (iv) the ceiling on cumulative change in net domestic assets of the NBU; or
- (v) the ceiling on publicly guaranteed debt,

as specified in Table 3 of the April 2014 MEFP and as further specified in the April 2014 TMU, is not observed; or

(b) if at any time during the period of this Arrangement,

- (i) the general government accumulates new external debt payments arrears, as specified in Table 3 of the April 2014 MEFP and in the April 2014 TMU; or
- (ii) Ukraine imposes or intensifies restrictions on the making of payments and transfers for current international transactions; or
- (iii) Ukraine introduces or modifies multiple currency practices; or
- (iv) Ukraine concludes bilateral payments agreements that are inconsistent with Article VIII; or
- (v) Ukraine imposes or intensifies import restrictions for balance of payments reasons; or

(c) after July 24, 2014, September 24, 2014, December 14, 2014, March 14, 2015, June 14, 2015, September 14, 2015, December 14, 2015, March 14, 2016 respectively, until the reviews contemplated in paragraph 29 of the April 2014 MEFP are completed.

When Ukraine is prevented from purchasing under this Arrangement because of this paragraph 3, purchases will be resumed only after consultation has taken place between the Fund and Ukraine and understandings have been reached regarding the circumstances in which such purchases can be resumed.

4. Ukraine will not make purchases under this Arrangement during any period in which Ukraine: (i) has an overdue financial obligation to the Fund or is failing to meet a repurchase expectation in respect of a noncomplying purchase pursuant to Decision No. 7842-(84/165) on the Guidelines on Corrective Action; or (ii) is failing to meet a repayment obligation to the PRGF-ESF Trust established by Decision No. 8759-(87/176) PRGF, or a repayment expectation to that Trust pursuant to the provisions of Appendix I to the PRGF-ESF Trust Instrument.

5. Ukraine's right to engage in the transactions covered by this Arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally or in order to consider a proposal,

made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of Ukraine. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 5, purchases under this Arrangement will be resumed only after consultation has taken place between the Fund and Ukraine and understandings have been reached regarding the circumstances in which such purchases can be resumed.

6. Purchases under this Arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, unless, at the request of Ukraine, the Fund agrees to provide SDRs at the time of the purchase.

7. Ukraine shall pay a charge for this Arrangement in accordance with the decisions of the Fund.

8. (a) Ukraine shall repurchase the amount of its currency that results from a purchase under this Arrangement in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those relating to repurchases as Ukraine's balance of payments and reserve position improves.

(b) Any reductions in Ukraine's currency held by the Fund shall reduce the amounts subject to repurchase under (a) above in accordance with the principles applied by the Fund for this purpose at the time of the reduction.

9. During the period of this Arrangement Ukraine shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to Ukraine or of representatives of Ukraine to the Fund. Ukraine shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Ukraine in achieving the objectives and policies set forth in the April 2014 Letter, April 2014 MEFP and April 2014 TMU.

10. In accordance with the April 2014 Letter Ukraine will consult the Fund on the adoption of any measures that may be appropriate at the initiative of the Government or whenever the Managing Director requests consultation because any of the criteria in paragraph 3 of this Arrangement have not been observed or because the Managing Director considers that consultation on the program is desirable. In addition, after the period of this Arrangement and while Ukraine has outstanding purchases in the upper credit tranches, the Government will consult with the Fund from time to time, at the initiative of the Government or at the request of the Managing Director, concerning Ukraine's balance of payment policies.

Appendix II. Letter of Intent

Kyiv, April 22, 2014

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington DC, 20431

Dear Ms. Lagarde:

1. In recent years, unsustainable policies and weak governance in Ukraine have led to economic stagnation and excessive fiscal and external imbalances. In early 2014, political turbulence and deteriorating consumer and investor confidence drove bank deposit outflows, a collapse of fiscal revenues, a depletion of international reserves, and rapid depreciation of the hryvnia. Recent emergency measures under the new government have led to a degree of stability, but the situation remains fragile. Substantial repayments of domestic and external debt over the next two years together with sizeable gas import payments and other pressures will impose a heavy burden on the economy and public finances.

2. The Ukrainian government is committed to a comprehensive economic reform program to restore macroeconomic stability, strengthen economic governance and transparency, and lay the foundation for robust and balanced economic growth. A sequence of near- and medium-term reforms will aim at achieving external balance, strengthening the financial sector, restoring sound public finances, rationalizing the energy sector, and improving the business environment. A number of key measures will be put in place immediately to demonstrate our commitment to program policies and objectives. These prior actions, which are described below and appear in Table 1, will address long-standing issues in monetary and exchange rate policy, the financial sector, fiscal policy, and governance. In this context, we will take steps to cushion the negative impact of reforms on the most vulnerable groups of our society. The program of the Government, that envisages the cooperation with the IMF, is supported by all major political parties.

3. We request the support of the IMF for the ambitious reforms needed to achieve our program objectives. Based on our estimated balance of payments needs, we request the approval of a 24-month Stand-By Arrangement (SBA) in the amount of SDR 10,976 million (800 percent of quota). We need financial support under the proposed SBA not only to address current account deficit and pressures on capital account but also to build up reserves. The first disbursement will be SDR 2,058 million, of which the domestic currency counterpart of Fund purchases in the amount of SDR 1,290 million will be used to finance the budget deficit.

4. We regard the policies set forth in the attached Memorandum of Economic and Financial Policies (MEFP) as adequate to achieve program objectives but will take any additional measures that may become appropriate for this purpose. We will consult with the IMF on the adoption of such

additional measures in advance of revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultation. We will provide the Fund with the information it requests for monitoring progress during program implementation. We will also consult the Fund on our economic policies after the expiration of the arrangement, in line with Fund policies on such consultations, while we have outstanding purchases in the upper credit tranches. Reaffirming commitment to our policy of transparency, we consent to the IMF's publication of this letter, the attached MEFP, the Technical Memorandum of Understanding (TMU), and the accompanying Executive Board documents.

Yours sincerely,

/s/

Oleksander Turchinov
Acting President

/s/

Arsenii Yatseniuk
Prime Minister

/s/

Oleksandr Shlapak
Minister of Finance

/s/

Stepan Kubiv
Governor
National Bank of Ukraine

Attachment I. Memorandum of Economic and Financial Policies

I. BACKGROUND AND MACROECONOMIC FRAMEWORK

1. Ukraine's macroeconomic imbalances reached unsustainably high levels over the past year. The 2013 fiscal deficit was 4½ percent of GDP, and the government accumulated sizeable expenditure arrears. The 2013 deficit of the state-owned gas company Naftogaz reached nearly 2 percent of GDP, driven by the sharp increase in loss-making sales to district heating companies and declining profitability of sales to industries. Public debt rose to 41 percent of GDP, while external debt remained elevated at 77 percent of GDP. The (until recently) pegged and overvalued exchange rate drove the current account deficit to over 9 percent of GDP. With significant external payments and limited access to international debt markets, international reserves fell to a critically low level of around two months of imports. Ukraine needs financial support under the proposed SBA not only to address current account deficit and pressures on capital account but also to build up reserves.

2. Following the intense economic and political turbulence of recent months, Ukraine has achieved some stability, but faces enormous challenges. To safeguard reserves and address currency overvaluation, the National Bank of Ukraine (NBU) floated the exchange rate in February. Measures implemented in February and March helped stabilize financial markets and ensure that critical budget priority payments have been met. In this context, the NBU provided liquidity support to banks and increased its holdings of government bonds, which helped to ease government financing conditions. Nonetheless, the economic and political environment remains uncertain. With no current market access, large foreign debt repayments loom in 2014–15 (including to the IMF). Early presidential elections are scheduled for May 25, 2014.

3. Economic performance in 2014 will be mixed. Under our proposed economic reform program, the current account deficit will fall to about 4½ percent of GDP, helped by the exchange rate adjustment and fiscal tightening. Growth could contract significantly during the year, reflecting weak investor and consumer confidence, leading to the annual GDP decline of about 5 percent. Inflation will temporarily spike in response to the recent exchange rate adjustment (and also gas and heating tariff increases), reaching 16 percent at end-2014. International reserves will stabilize at around 2½ months of import coverage. The currency devaluation and official borrowing (to help finance a still-wide government deficit) is expected to push public sector debt up to 56½ percent of GDP and external debt to 99½ percent of GDP.

4. Our economic reform program, backed by support from the Fund and other partners, will boost Ukraine's medium-term prospects. Policies will strengthen competitiveness, restrain the current account deficit to 4–4¼ percent of GDP in 2015–16, and restore public and private sector access to international capital markets. The public sector will continue to meet its obligations, and Naftogaz will meet ongoing gas import payments. Macroeconomic stabilization and structural reforms, including improvements in governance and the business environment, will strengthen

investment, raise growth, and enhance fiscal and external sustainability. Exports are projected to grow by over 6 percent in 2015–16. By end-2016, inflation will fall to about 6 percent and the NBU will replenish its international reserves to cover nearly 4 months of imports.

II. PROGRAM OBJECTIVES

5. Our program aims to restore macroeconomic stability, strengthen economic governance and transparency, and lay the foundation for robust and balanced economic growth. The policy strategy centers on near-term measures to secure stability and deeper reforms to: durably reduce current account and fiscal deficits to ensure debt sustainability; strengthen the policy making framework; and achieve higher, sustainable growth.

6. Official and multilateral financing will play a critical role in supporting our stabilization, adjustment and reform efforts. In addition to IMF financing, we have secured financing commitments from the EU, U.S., World Bank, EBRD, EIB, and other bilateral donors and international financial institutions (IFIs). We will strive to unlock all committed bilateral and multilateral financing and collaborate closely with international partners in key reform areas.

III. POLICIES UNDER THE PROGRAM

7. The reform program will focus on monetary and exchange rate policies, the financial sector, fiscal payments and adjustment, the energy sector, and strengthen governance, transparency, and the business climate.

- a. ***Monetary policy will focus more squarely on domestic price stability***, targeting 3 to 5 percent inflation over the medium-term consistent with the productivity differential with our trading partners. The exact inflation target and range will be specified in the course of introducing IT. In this context, the NBU will maintain a flexible exchange rate policy. Within 12 months of program approval, the NBU will adopt inflation targeting. Until then, monetary policy will utilize the NBU's net international reserves (NIR) and net domestic assets (NDA) to ensure base money growth consistent with domestic price stability. We anticipate that this approach will help bring domestic price stability, eliminate external imbalances, and facilitate gradual rebuilding of depleted international reserves.
- b. ***Financial sector reforms will aim to ensure financial stability***. We will monitor liquidity levels and ensure financial resilience in the banking sector, restructure and recapitalize financial institutions in need, upgrade the regulatory and supervisory framework, and take steps to facilitate restructuring of non-performing loans (NPLs) in the banking sector. We anticipate this approach will boost depositor confidence and promote healthy credit growth.
- c. ***Fiscal policy will seek to meet priority spending obligations during the coming months, and implement deeper fiscal adjustment measures over the medium-term***. The initial stabilization in 2014 will be achieved through a mix of revenue and expenditure measures. For 2015–16, we envision a gradual expenditure-oriented fiscal adjustment—proceeding at a pace commensurate with the economy's speed of recovery—aiming to reduce the structural fiscal

deficit by around 2 percent of GDP by 2016. We expect this approach to achieve a fiscally sustainable position and boost confidence.

- d. **Energy sector reforms will focus on reducing the fiscal drag from this sector, and enhancing its efficiency.** A key mechanism for achieving this will be gradual increases in retail gas and heating tariffs—backed by corresponding gas price hikes to district heating entities—and accompanied by enhanced social assistance measures to mitigate the impact on the poorest. We will also improve the transparency of Naftogaz’s accounts and launch the process of its restructuring. Over time, we expect these measures will also promote domestic investment and growth, increase energy independence, and reduce balance of payments pressures.
- e. **Strong governance, transparency, and business climate reforms are central to our program.** We will build capacity to more effectively conduct anti-money laundering (AML) activities, anti-corruption actions, and seek recovery of stolen assets. We plan to increase transparency of government operations and address governance problems in Naftogaz and other publicly-owned institutions—and will seek out expertise from the IMF and other international partners to help achieve our goals in these areas. We expect these measures to help improve the business climate and remove long-standing barriers to growth.

A. Exchange Rate and Monetary Policy

8. **We are committed to maintaining a flexible exchange rate.** This will help facilitate much-needed external adjustment, preserve scarce international reserves, and provide an important shock absorber. The exchange rate adjustment implemented in early 2014 has eliminated the estimated pre-crisis overvaluation of the hryvnia and created preconditions for reducing the external current account deficit. These factors, combined with other reforms under the program, will help maintain a real exchange rate level broadly in line with fundamentals. Going forward:

- a. **As the NBU’s international reserves through 2014 are projected to remain critically low despite sizable official assistance, the NBU will seek to gradually accumulate reserves through market purchases, consistent with reserve targets in Table 3.** This will help maintain market confidence that the country has sufficient foreign exchange resources for the Government to make external debt service payments and for Naftogaz to settle its gas payment arrears. Should the balance of payments turn out better than projected, the pace of reserve accumulation will accelerate. On rare occasions, the NBU may deploy well-timed but limited foreign exchange sales if needed to help contain a self-fulfilling expectations-depreciation loop.
- b. **We will facilitate development of a more robust, transparent, and predictable foreign exchange market, including private-to-private hedging instruments.** This is essential to instill confidence and reduce unnecessary market costs. In this context, we will not impose any new restrictions affecting foreign exchange operations, nor intensify existing restrictions during the program period. We will request an IMF assessment of existing foreign exchange restrictions (by end-May 2014), and will formulate and begin implementing a plan for their staged removal (by end-July 2014), starting with the most distortionary controls while safeguarding macrofinancial stability.

- c. ***As a prior action for the IMF Board's consideration of the SBA, on March 31, 2014 the NBU adopted a regulation specifying that the official exchange rate is calculated as a weighted average of rates on the same day's interbank transactions.*** This will further increase transparency of the official exchange rate and eliminate a multiple currency practice (MCP).

9. Monetary policy will focus on domestic price stability in line with the NBU's core mandate. For the coming year, monetary policy will employ a NIR/NDA targeting framework to ensure a money supply path consistent with domestic price stability. Initially, it will accommodate some budget deficit and bank financing needs, while maintaining an appropriate NIR level. However, from mid-2014, with confidence in the banking system restored and fiscal accounts strengthened, domestic financing needs will be strictly subordinated to the primary monetary policy objective of controlling inflation. Going forward:

- a. ***The NBU will provide banks with greater flexibility to manage their liquidity*** by abolishing daily limits on the minimum account balances held in their accounts with the NBU, and instead require banks to meet the obligatory reserve ratios on average over the monthly reserve managing period.
- b. ***We will abstain from using administrative regulations and restrictions*** as a substitute for conventional monetary policy tools.

10. Within 12 months of program approval, the NBU will have completed necessary technical preparations and will adopt inflation targeting (IT) as its new monetary policy anchor. To this end, we will:

- a. ***Set a clear timeline (by end-June 2014) for completing the remaining preparations needed to adopt IT.*** This should include measures to strengthen the NBU's forecasting capacity, independence, communications, and operational framework of monetary policy.
- b. ***Reform the decision-making process in the NBU*** so as to separate clearly the policy-setting function (which should be vested in the NBU Board and, eventually, in the Monetary Policy Committee (MPC)) from the function of conducting open market operations. Once the MPC is reactivated, we will vest in it the authority to set policy interest rates consistent with the inflation objectives.
- c. ***Provide the NBU full authority to develop and use its own projections*** for inflation and other macroeconomic variables for the monetary policy purposes (decision-making will be firmly anchored in the NBU's macroeconomic research). Importantly, the NBU will be free to set its own inflation target and will no longer be obliged to accommodate inflation projections developed by the Ministry of Economy and approved by the Government.
- d. ***Publish (with an appropriate lag) minutes of the NBU Board monetary policy meetings,*** and more generally strengthening the NBU's communications strategy.
- e. ***Refine the NBU's monetary policy instruments*** so as to align closely the interest rates on its active and passive operations of the NBU with the official policy rate. As the introduction of IT

approaches, the NBU will increasingly rely on adjusting its policy rate as needed to support domestic price stability, and anticipates maintaining positive real interest rates.

11. To help strengthen the independence, governance, transparency, and accountability of the NBU, and pave the way for adopting the inflation targeting regime, we will:

- a. ***Establish an audit committee of the NBU Council*** (see paragraph 28).
- b. ***Enact legal amendments abolishing the superiority of the Budget Law over the NBU Law***, and discontinue advance profit transfers from the NBU to the budget during the fiscal year.

12. We will monitor our program through targets on net international reserves and monetary aggregates. We intend to meet NDA ceilings and NIR floors (*quantitative performance criteria*), with base money as an *indicative target* (see Table 3). The proposed NDA ceilings are consistent with our inflation objectives, while the NIR floors are designed to ensure an adequate level of international reserves.

B. Financial Sector Policies

13. We are committed to strengthening financial stability with a view to supporting economic growth. In recent years we have made progress in strengthening our financial sector. However, this sector has experienced some losses and liquidity pressures in recent months. We are taking steps to reduce vulnerabilities, protect depositors, and ensure financial stability by:

- (i) properly monitoring and supporting bank liquidity; (ii) assessing financial resilience in banks;
- (iii) restructuring and recapitalizing financial institutions in need; (iv) upgrading the regulatory and supervisory framework; and (v) enhancing banks' capacity to resolve NPLs.

Monitoring and supporting bank liquidity levels

14. We will continue to provide adequate liquidity in the banking system in a transparent and expeditious manner. In February 2014 we eased reserve requirements and improved our liquidity facilities by accepting performing loans as collateral for our emergency liquidity support, after a prudent discount. We continue to monitor liquidity conditions on a daily basis. To facilitate the banks' liquidity management and enhance our surveillance, we will ease reserve requirements further and allow banks to average their required reserves over the monthly maintenance period, as noted above in paragraph 9. We will also require, beginning end-March 2014, the largest 35 institutions to provide the NBU with their cash flow forecast for the following week. The NBU stands ready to take appropriate measures to maintain sufficient liquidity in all banks.

Assessing financial resilience

15. With the aim of enhancing market confidence and preserving financial stability, we will ensure that banks are well capitalized. To this end, we will:

- a. ***Require independent diagnostic studies of current asset valuation and banks' business plans through 2016 to verify the solvency and viability of our banks.***
 - On April 14, 2014, the NBU instructed the largest 35 banks to launch diagnostic studies on the basis of end-December 2013 data and terms of reference developed by the NBU (**prior action**). The diagnostic studies will assess the capital adequacy to meet a Tier 1 capital ("T1") target of 7 percent within an overall capital requirement of 10 percent and 4.5 percent under the baseline and adverse macroeconomic scenarios agreed with the IMF, respectively. Additionally, banks will be required to submit to the NBU their business plans with the view to maintaining capital requirements through 2016. The terms of reference for the diagnostic studies, agreed with IMF and World Bank staff, will be prepared on the basis of the manual of the 2014 ECB Asset Quality Review and delivered to the auditors by end-April 2014. The terms of reference will, inter alia, specify that the selected auditor should not have conducted the regular annual audit of the specific bank during the past three years.
 - For the 15 largest banks, these diagnostic studies and review of business plans will be completed by end-July 2014 (**structural benchmark**). Diagnostic studies of the 20 next largest banks and review of business plans will be completed by end-September 2014. Where an audit shows adequate capitalization and a business plan for a viable business and proper capitalization through 2016, no further steps will be required. However, banks with diagnostic studies revealing capital deficiencies or a non-self sustainable business through 2016 will be required to submit recapitalization and restructuring plans. These plans should address the findings of the diagnostic studies, including a clear commitment to fill capital shortfalls. Plans should be submitted for the NBU's approval by end-September 2014 for the 15 largest banks and end-November 2014 for the 20 next largest banks.
 - The NBU will appoint a Steering Committee to oversee the diagnostic process for each of the 35 banks to ensure consistency and that implementation meets the goals and modalities of the overall exercise. Staff of the IMF and the World Bank will be involved in the process.
 - Assessment of the financial conditions of the remaining smaller institutions in the banking system will be completed by the second quarter of 2015 using banks' annual audits and after factoring in any revisions to IFRS implementation that emanate from the assessment of IFRS implementation discussed below.
- b. ***Take steps to ensure adequate capitalization of the financial sector.*** Banks must be compliant with the T1 capital targets of 7 percent under the baseline scenario and 4.5 percent under the adverse scenario through 2016. The deadlines for compliance are end-December 2014 for the 15 largest banks and end-February 2015 for the 20 next largest banks. Private owners of

banks will be asked to make up any shortfall under the base scenario against the 7 percent T1 and under the adverse scenario against the 4.5 percent T1 scenario through cash injection.

- c. ***Ensure proper backup recapitalization or restructuring funds are available should financing to cover capital shortfalls in systemically important banks not be forthcoming from the private sector.***
- If existing fit and proper shareholders are unwilling or incapable of recapitalizing in full a weak bank, public funds could be used to bring it back into solvency or orderly restructure it, according to strict criteria. Government and the NBU will reach agreement with IMF staff on these criteria by May 31, 2014 (***structural benchmark***). These criteria should include requirements to ensure that losses are passed to the shareholders before public funds are injected to recapitalize or restructure a bank and the appointment of a monitoring trustee to oversee the bank's activities on behalf of the state. They will also include the requirement for a voluntary suspension of voting rights of shares held by any party that may be in process of filing documentation establishing ultimate ownership before the NBU. For these purposes, we will make the necessary legislative changes.
 - The government will seek authorization in a supplementary budget as needed to provide sufficient financial support to banks, subject to strict procedures as agreed with the Fund staff, for the use of such support.
 - We will set up a high level committee by end-March 2014 that will ensure proper governance in the use of public funds in bank recapitalizations and restructuring. This committee should be comprised of the Minister of Finance, the Governor of the NBU, and the head of the Deposit Guarantee Fund (DGF). This committee will immediately appoint a spokesperson to be in charge of the communication strategy of the recapitalization process with the aim of keeping markets and depositors effectively and timely informed.
 - The government should be prepared to manage its financial sector shareholdings in the event that it is called on to use public funds—and to this end, a specialized unit will be set up at the Finance Ministry by end-September 2014 (***structural benchmark***). This unit will have a mandate to maximize the value of the State's holdings and interact with the respective banks on an arm's length basis. We will ensure that bank board members representing the State and bank managers are fit and proper and professionally suitable, and take responsibility for key decisions regarding the government as a shareholder. To ensure no political interference in the banks' commercial business, a relationship framework between the Finance Ministry and each bank with State shareholding should be signed to govern the interaction between the two parties.
- d. ***Use the resolution mechanism in place when a bank is not supported by its shareholders or deemed unviable.*** Resolution will take place through, in order of preference and according to feasibility, mergers, purchase and assumption (P&A), the use of bridge banks, full bank recapitalization by the State, or liquidation. The DGF should continue its role as the resolution agency to resolve banks, and steps will be taken to ensure it is adequately staffed and trained

and has adequate reserves to fulfill its obligations in a timely manner (by end-July 2014). We will ensure that coordination between the NBU, the Finance Ministry, and the DGF is enhanced. To this end, we will revise the existing memorandum of understanding governing the relationship between these institutions (including on information sharing and cooperation) and publish, after consultation with IMF and World Bank staff, the revised version on their individual websites by end-May 2014.

- e. ***Address in a timely manner any bank that becomes problematic before the diagnostic studies process described above is complete.*** We will monitor the banking system closely and send inspection teams to the field as needed. If a bank's capital declines below the regulatory minimum, the NBU will require that the shareholders submit an action plan to recapitalize the bank, as well as impose restrictions on the bank's activities in line with the law. If the capital of the bank is below one-third of the minimum legally required level, the owners will be required to bring the bank immediately back into solvency in line with the existing legal framework. Otherwise, the institution will be put under temporary administration that removes bank managers and suspends the powers of general shareholders' meeting, supervisory board, and board of directors. We commit to subject all banks under resolution to an official investigation by the DGF with the aim to identify whether wrong doing or bad banking practices led the bank into insolvency and to prosecute those found responsible.

Upgrading the regulatory and supervisory framework

16. To boost confidence in the banking system, we will enhance our regulatory and supervisory framework. To this end, we will:

- a. ***Ensure conservative implementation of IFRS accounting and disclosure practices on related parties, loan provisioning, collateral valuation and income recognition on NPLs.*** In this regard, upon the completion of the diagnostic studies discussed above, we will, with technical assistance from the IMF, complete an assessment of whether accounting practices followed by a sample of large and medium-sized Ukrainian banks are comparable with those followed by international banks in other jurisdictions, by end-October 2014. If this assessment were to find material room to enhance IFRS implementation, including provisioning rules, assets and collateral valuation, then after consultation with IMF and World Bank staff, we will prepare guidelines to correct current practices in the banking system by end-November 2014 with the aim to be used in the preparation of the banks' 2014 financial statements.
- b. ***Align existing foreign exchange rules to international best practices.*** An important step in this regard will be to unwind Resolution 109. To this end, on April 4, 2014 the NBU repealed Resolution 109 and announced a specific timetable, agreed with IMF staff, for gradually unwinding banks' net open foreign exchange positions, beginning May 1, 2014 and concluding in 20 months (prior action).
- c. ***Ensure actions to comply with Core Principles for Effective Bank Supervision (CPEBS),*** particularly regarding the NBU's supervisory model and consolidated supervision, as well as

crisis management. By end-December 2015, we will request from the IMF and World Bank a stand-alone assessment of our compliance with the CPEBS.

- d. **Set up a central credit register at the NBU.** This register aims to monitor credit risk concentration and enhance the monitoring of large business groups (including those related to bank owners) and become an important tool of off-site and on-site banking supervision. To this end, the existing legal framework for the credit register will be revised by end-August 2014, in consultation with the IMF and WB staff, with the aim to become operational no later than August 2015.

Facilitating banks' capacity to resolve NPLs

17. We will take measures to facilitate effective private sector debt resolution. We will work on two fronts:

- a. **Assessing the banks' policies and procedures for loan workouts.** As part of the diagnostic studies, we will ask the auditing firms to assess the quality of debt restructuring policies and procedures to ensure effective debt restructuring, including write-off and transfer of NPLs. The auditing firms' reports will be completed by end-September 2014.
- b. **Identifying legal impediments for effective out-of court debt resolution.** To this end, with technical assistance from the IMF by end-October 2014 we will review the current legal framework for NPLs resolution and identify existing legal, regulatory, and tax obstacles to effective debt restructuring.

C. Fiscal Policy

18. The government's immediate emphasis is maintaining timely priority spending. Large macroeconomic and political uncertainties and disruptions have eroded revenues and led to a build-up of unpaid bills of (0.4 percent of GDP as of end-March). To address this challenge, the government approved a resolution on budget execution priorities in early March, and is further strengthening weekly cash management and expenditure prioritization tools. These tools include:

- a. **Near-term revenue administration measures, including:** (i) breaking tax evasion schemes; (ii) halting imports through entries other than official checkpoints; (iii) strengthening control over sales of alcohol; (iv) enforcing collection of large debts; (v) tightening verification of compliance with recurrent tax obligations (VAT) through automation; (vi) conducting tax audits and expeditiously collecting the assessed amounts; and (vii) enhancing efforts to collect utility payments to improve the financial situation of Naftogaz.
- b. **Expenditure prioritization** to meet debt service, wage, and pension obligations. Other spending pressure points will also be identified.
- c. **Tapping financing** from the banking sector where possible.

The initial phase of fiscal adjustment will rely on a mix of revenue and expenditure measures (text table). We are targeting a structural fiscal adjustment of 1.0 of GDP this year. To this end, Government approved a package of revenue and expenditure measures yielding at least UAH 45 billion and implemented them by passing a supplementary budget on March 27, 2014 (**prior action**).

<i>Expenditure measures</i>	Yield (UAH mln)
Maintain the level of minimum wage and the first category tariff grade wage unchanged at their January 1, 2014 level during 12 months of 2014.	7,300
Maintain the level of minimum subsistence level entering calculation of pensions and various pension-linked benefits at their January 1, 2014 level during 12 months of 2014 and suspend wage indexation of pensions.	2,900
Rationalization of expenditures in non-pension social funds and transfer of savings to the pension fund.	4,100
Rationalization of social assistance spending	2,300
Prioritization and rationalization of capital expenditures	7,700
Prioritization and rationalization of subsidies to enterprises	2,100
Enhancing efficiency of public procurement and reduction of other expenditures	3,200
Additional debt service costs associated with exchange rate depreciation and called guarantees	-3,700
Total expenditure measures	25,900
<i>Revenue measures</i>	
Suspend application of zero VAT rate to export operations with grain and industrial crops during April 1–September 30, 2014.	4,000
Increase fees on the usage of mineral resources and broaden the base.	1,600
Increase in excise tax rates, expansion of tax bases, and indexation of land prices	4,600
Introduce a reduced 7 percent VAT rate on the first delivery of pharmaceutical and medical products	2,200
Improvement of tax administration through elimination of tax frauds discovered in fuel imports and production of alcoholic beverages.	6,700
Total revenue measures	19,100

Expenditure measures

- a. We cancelled the increase in minimum wage previously planned for July and October 2014 and will keep the minimum wage at UAH 1,218 and the first category tariff grade wage at UAH 852 level until end-2014. This will restrain the increase of the wage bill in the public sector. We will discuss with Fund staff our wage policy for 2015 during program reviews.
- b. We cancelled the increase in the minimum subsistence level entering calculations of pensions and pension-linked benefits previously planned for July and October 2014. Also, we suspended wage indexation of pensions previously planned for March 1, 2014.
- c. We will maintain a hiring freeze for the general government, which will facilitate reduction in government employment headcount through the normal attrition and staff optimization. Exceptions from the hiring freeze to fill critical positions will amount to no more than 1/5 of the newly opening vacancies and need to be approved by the respective line ministries (which will monitor implementation as well).
- d. In cooperation with the World Bank, we will re-prioritize social assistance benefits so as to move from a privilege-based system to a well-targeted means-tested framework.
- e. On April 10, 2014 Parliament passed a new public procurement law to strengthen governance and checks and balances, including reducing exemptions from regular competitive procedures (**prior action**). This law will allow us to save substantial amounts on government purchases.
- f. We will reduce: (i) administrative and non-priority expenditure of non-pension social funds; and (ii) subsidies to SOEs.
- g. To limit fiscal risks and foster transparency, we will limit new loan guarantees issued by the central (state) government loan guarantees to no more than UAH 25 billion in 2014 (**quantitative performance criterion**). We will focus these guarantees on high priority projects, including where such guarantees are required to unlock complementary external financing.

Revenue measures

- a. On March 27, 2014 Parliament passed a reversal of the already introduced VAT rate reduction in 2015, keeping the rate at 20 percent (**prior action**). We also introduced VAT taxation of pharmaceutical products at a rate of 7 percent.
- b. After discussion within government and with the private sector, by end-September 2014 we will prepare a proposal for the reform of VAT in agriculture with a view to bringing the regime in this sector closer to the general VAT regime (**structural benchmark**). In this context, we will consider a reduction in VAT exemptions in agriculture in 2015.
- c. As a stop-gap measure in the short run, on March 27 Parliament passed an extension in the recently expired VAT exemption regime for grain exporters until October 1, 2014 (**prior action**).
- d. We revised relevant legislation to increase excise rate tax for diesel fuel (€98 and €128 per ton) instead of the current differentiation of rates subject to content of sulfur (€46, 68, 75 and 98 per

ton), and conduct price indexation of selected products and series subject to excise taxation and duties, expressed as absolute values.

- e. Our decisive efforts to improve revenue collection have already led to breaking two major fraudulent tax evasion schemes of the previous regime. This, together with the ongoing reorganization of state tax and customs services, will yield considerable additional revenues.

19. Over the medium-term, we will emphasize expenditure-led gradual fiscal consolidation to build confidence and reduce imbalances. High levels of public spending-to-GDP call for expenditure-led consolidation. Areas under consideration are steps to enhance public sector efficiency, including a broad review of public administration, and better utilization of the existing performance-based expenditure framework. An IMF mission is expected in late April to assess and provide options and priorities in this area, and we will embed key reforms from that discussion into our program at the time of the first review.

20. Consistent with the above strategy, we will target a cumulative structural fiscal adjustment of 2 percent of GDP through 2016. We will then target a gradually slowing pace of adjustment through 2019. This fiscal path takes into account the weaker economy this year while retaining some upfront consolidation to reduce large funding needs, build confidence, and support the external adjustment. This approach will place public debt firmly on a declining path.

- a. ***This fiscal path implies the following overall fiscal balances.*** We will target combined deficits of the general government and Naftogaz consistent with 8.5 percent of GDP in 2014, 6.1 percent of GDP in 2015, and 4.4 percent of GDP in 2016. For the general government, we will target deficits consistent with 5.2 percent of GDP in 2014, 4.2 percent of GDP in 2015, and 3.1 percent of GDP in 2016. Intra-year targets consistent with these annual targets will be set as ***quantitative performance criteria*** (Table 3).
- b. ***In order to address a build-up of VAT refund arrears that deprives companies of working capital, we will issue up to UAH 16.7 billion in government bonds this year.*** In this context: (i) we will make every effort to first identify ways to pay these refund arrears in cash; (ii) this will be a one-off operation; (iii) all arrears to be cleared with the bonds will first be properly verified; (iv) the bonds will be used only to pay VAT refund arrears accumulated through end-2013; and (v) the bonds will be fully marketable and issued at market interest rates. Finally, we will also undertake the reforms to the VAT refund process, as discussed in paragraph 26 below.

D. Energy Sector Policy

21. Two key operational elements of our energy sector strategy are: (i) strengthening finances in the sector by gradually narrowing the gap between tariffs and their cost-recovery levels; and (ii) providing better targeted subsidies to protect the poorest segment of society from higher tariffs. These efforts are expected to support other important goals of our energy strategy, namely to: reduce large quasi-fiscal losses and budget subsidies; rein in the current account deficit; provide resources and incentives to increase energy efficiency; promote domestic production and secure funds for domestic investment (and thereby boost growth and move towards energy

independence); and alleviate governance problems in the sector by reducing arbitrage opportunities for gas sales created by the existing tariff differentials across customer categories.

22. Strengthening Naftogaz finances and reducing budget subsidies will require sustained increases in tariffs. Naftogaz's deficit is driven by the very low regulated prices on sales to households and district heating companies. Overall energy subsidies in Ukraine, on- and off-budget, are estimated to have been 7½ percent of GDP in 2012 with relatively well-off households capturing the larger share of the benefits. Naftogaz's shortage of funds has also led to large arrears to Russia's Gazprom, which exacerbate balance of payments problems, while vested interests continue to act as a drag on needed reforms.

- a. ***In 2014, the main objective will be to offset the negative impact of the exchange rate adjustment on Naftogaz balances and contain its deficit to 3.3 percent of GDP.*** We will reduce Naftogaz's deficit to 1.9 percent of GDP in 2015 and aim to eliminate it by 2018.
- b. ***However, Naftogaz's financing gap this year is large,*** at UAH 62 billion, of which the government has already provided UAH 11 billion. Filling the remaining gap of UAH 51 billion will require further support from the government. For this purpose, the government's supplementary budget will include UAH 22 billion in 'recapitalization' bonds. To fill the remaining gap, Naftogaz will need to develop a plan, based on cost rationalization, improved revenue collection, and—taking into account the full effect of these measures—further financial backing from the budget, for repayment of its large arrears to Gazprom in a timely manner.
- c. ***To this end, we will ensure that:*** (i) by April 10, 2014 the gas price regulator NERC will adopt and officially publish a decision to raise end-user gas tariffs for households by 56 percent, effective May 1, 2014; (ii) similarly, by April 18, 2014, the utility price regulator NURC will adopt decisions to raise the heating tariffs for households by 40 percent on average, effective July 1, 2014 (prior action). We will also complete the required legislative changes so that, going forward, all tariff increases will become effective within 40 days of their announcement. Full-cost retail gas and heating tariffs will be reflected on consumers' utility bills to promote awareness of the importance of the reform for the medium term.
- d. ***We also passed and publicly announced on April 18, 2014 the decision and schedule for tariff increases through 2017,*** where the schedule includes the following: (i) in 2015, we will raise end-user gas and heating tariffs by 40 percent on average, effective May 1; and (ii) thereafter we will raise these tariffs by 20 percent on average in each of 2016 and 2017, effective May 1, until losses of Naftogaz are eliminated by 2018 (prior action). To ensure de-politicization of tariff setting, Parliament passed legislation on April 10, 2014 to vest NURC with the exclusive authority to set heating tariffs in the country (prior action). NURC's respective powers will not be infringed by adjacent reforms in the area of public administration.
- e. ***A well-coordinated campaign will be put in place*** to inform the population why tariff hikes are necessary. The campaign will also lay out our approach to increased social assistance.

- f. ***By April 7, gas prices to industrial and budget consumers were adjusted in line with the actual gas imports costs***, taking into account new gas import prices and exchange rate movements.
- g. ***To provide an accurate picture of Naftogaz finances, we launched a tender on April 3 for an external auditor to conduct audits of Naftogaz operations.*** The auditor will be in place within 60 days of the tender. The results of the audits will be shared with the IMF within 30 days of each period, initially on a monthly basis beginning with data for end-May 2014, and then on a quarterly basis for end-September data forward (structural benchmark). This will enhance Naftogaz's transparency and support progress toward improved finances.
- h. ***To strengthen payment discipline for the heating sector***, Parliament will pass legislation that will make distribution accounts fully operational and mandatory for utility payments by end-June 2014 (structural benchmark). These accounts receive customer payments and then distribute them to Naftogaz and utility companies according to predetermined shares that ensure that Naftogaz recovers the cost of gas in the heating tariff. We will also: (i) raise building-level heating meter coverage from 36 to 45 percent by end-2014 together with heat controls at IHS; and (ii) move to respective consumption based utility bills rather than current use of norms. We expect that these measures will reduce incentives for district heating companies to overestimate residential heat consumption and overcharge residential consumers in order to reduce their financial losses.
- i. ***Deeper structural reforms are expected to diversify gas supply sources and reform Naftogaz***, in accordance with Ukraine's membership in the Energy Community. We will work with the World Bank to consider options to identify strategic priorities, including restructuring.
- j. ***In close cooperation with the World Bank, we will continue our efforts to improve the energy efficiency*** of Ukraine's heating sector by addressing the efficiency of the residential sector (building efficiency, consumption-based billing), utilities (production efficiency, transmission of heat and distribution efficiency) and the public sector (public buildings).

23. Protecting the most vulnerable from the impact of gas and heating tariff increases is a priority of our social policy. To help offset the impact of the gas and heating tariff increases detailed above on the poorest segment of society, we will improve the targeting of our social assistance programs, consulting with IMF and World Bank experts. The existing Housing and Utility Subsidy program that covers the utility bills above 10/15 percent of the enrolled households' income will fully shield them from the increase in gas and heating prices and will cover new entrants who have fallen on hard times. Moreover, to protect vulnerable households not covered by the existing scheme, Government approved on April 5, 2014 a decision to introduce a new social assistance scheme (**prior action**). By April 10, the government will share with IMF and World Bank staff a draft proposal specifying eligibility for the new scheme (with an envelope of UAH 3 billion), the amount of benefits, the mode of delivery, and the administrative process to obtain the assistance. The scheme will become effective July 1, 2014.

E. Governance, Transparency, and the Business Climate

24. Strengthening governance and transparency of government operations and improving the business climate is a top priority of the new government. While we are taking various steps in others areas to facilitate higher sustainable growth, we recognize that Ukraine's business and investment environment remains a major drag on economic activity. Weak governance and transparency can be seen in a broad range of areas. These include weaknesses in the anti-corruption framework, the design and implementation of laws and regulations, the effectiveness of the judiciary, the anti-money laundering/combating of financing of terrorism (AML-CFT) framework, tax administration, procurement, and the energy sector. These weaknesses undermine public confidence in government, discourage foreign and domestic investment by raising the costs of doing business, and ultimately lead to reduction in public revenues. We believe that if we do not urgently address these challenges, we will not be able to meet our economic objectives.

25. Many of these issues require deeper assessment and analysis to develop the most effective policy prescription. Accordingly, we have requested a comprehensive diagnostic study to be completed in close consultation with IMF staff by July 15 that will cover the anti-corruption framework, the design and implementation of key laws and regulations that may have impact on business climate, the effectiveness of the judiciary, and tax administration (**structural benchmark**). Specifically, the diagnostic study will: (i) assess the current governance arrangements and frameworks in place, identifying areas for strengthening and reform; (ii) judge the relative importance of the issues flowing from the diagnostic findings; and (iii) propose specific remedial measures and time frames for their implementation. We welcome the assurance of IMF staff that other international organizations and bilateral partners active in these areas will be closely consulted as part of the study and that due regard will be paid to ensuring a collaborative and effective division of labor among our assisting partners. We commit to providing full support for the conduct of the study and to follow-up on its recommendations.

26. There are also a number of issues that we can begin to address now. We will:

- a. **Establish by end-September 2014 specific criteria and rigorous procedures at the NBU needed to assess the fit and proper requirement in compliance with the AML/CFT standards**, including requirements to check the source of wealth/funds of owners of qualifying holdings of banks.
- b. **Strengthen our AML framework. In this respect, relevant laws, will be revised in line with international standards by end-September 2014**, in consultation with IMF staff as needed, to ensure that: (i) banks are required to conduct enhanced due diligence on business relationships with domestic politically exposed persons; (ii) the laundering of the proceeds of tax crimes is criminalized; and (iii) financial secrecy laws do not inhibit AML implementation. Once the legal framework is in place, we will implement regulations and policies.
- c. **Follow-up on our recent request for assistance from the World Bank, in the context of the Stolen Asset Recovery ("STAR") Initiative.** We will work with the World Bank to develop a

strategy and action plan for pursuing and recovering stolen assets. In addition, we will reach out to international partners for their assistance, as appropriate.

- d. ***Prepare, in consultation with the IMF and other international partners, a strategy by end-June 2014 for strengthening tax compliance of high income earners and those with foreign assets.***
- e. ***Address delays and weak transparency in granting VAT refunds.*** This has been a long-standing problem that has given rise to governance issues. We commit to the following measures in support of a more systematic, timely, and transparent approach for issuing VAT refunds: (i) implementation of an automatic VAT refund system to low-risk taxpayers without pre-payment inspection or audit of refund claims (by end-June 2014); (ii) resume publishing the amounts of VAT claims, outstanding refunds, settlements (including amounts released automatically), and arrears (by end-June); (iii) explore the possibilities of upgrading IT system to manage such refunds; (iv) revamp VAT refund criteria related to the taxpayer's wage level to directly address the underreporting of wages; (v) ensure that all large taxpayers administered by the Large Taxpayer Inspectorates (LTIs) are by default included in the automated system (initially the current taxpayers administered by the LTI); (vi) consistent with the Tax Code, the practice of requesting CIT advance payments in exchange for VAT refunds will be prohibited—the State Tax Service will issue instructions to all tax offices to confirm this by end-June 2014.

27. We also recognize the need to take other actions to address the weak business climate and facilitate higher growth in Ukraine. The regulatory environment in Ukraine is overly complicated and imposes unnecessary costs for business. Measures will be developed in coordination with the World Bank and the EBRD, in the context of program reviews.

IV. SAFEGUARDS

28. We recognize the importance of completing an update safeguards assessment of the NBU by the first review of the Stand-By Arrangement. To facilitate this, we have authorized the NBU's external auditors to provide all necessary information and hold discussions directly with IMF staff. The special audit of international reserves is currently being conducted by the NBU's external audit firm to detail the composition and degree of encumbrance of gold and foreign exchange reserves. The report should be finalized by May 1. We also commit to receiving a safeguards mission and providing that mission with all requested information without delay, including information related to correspondent banks and foreign reserves placements. We will address outstanding issues from the 2011 safeguards assessment. In particular, we will take steps to strengthen the NBU's governance, control and internal audit functions. On April 4 the NBU Council appointed an independent audit committee with two external members and with a well-defined mandate to provide close oversight of the financial reporting, audit processes and system of internal controls at the NBU (**prior action**). We will also undertake a review of the NBU's legal framework to provide for the financial autonomy of the central bank and implement the independence requirements for NBU Council members by end-September 2014. Also, we will prepare a report by end-2014 on the status and steps taken to implement the recommendations of the external audit as to quality standards;

and select an external audit firm, by end-September 2014, to carry out the external audit of the NBU financial statement.

V. PROGRAM MONITORING

29. Program implementation will be monitored through prior actions, reviews (bi-monthly and then quarterly), quantitative performance criteria and indicative targets, and structural benchmarks. The phasing of purchases under the arrangement and the review schedule are set out in Table 2. The first bi-monthly review will be set for July 2014 based on end-May 2014 quantitative targets and taking into consideration structural benchmarks. For all reviews, quantitative targets will include: a ceiling on the cash deficit of the general government and on the combined deficits of the general government and Naftogaz; a ceiling on publicly guaranteed debt; a floor on cumulative change in the NIR; a ceiling on cumulative change in the NBU's NDA; and non-accumulation of external debt payments arrears by the general government. The prior actions and structural benchmarks are set out in Table 1. The quantitative targets for target dates through end-December 2014, along with continuous quantitative performance criterion are set out in Table 3. The understandings between the Ukrainian authorities and IMF staff regarding the quantitative performance criteria and the structural measures described in this memorandum are further specified in the Technical Memorandum of Understanding (TMU) attached to this memorandum.

Table 1. Ukraine: Proposed Prior Actions and Structural Benchmarks 1/ (continues)

Prior actions	Completion Date
The NBU will adopt a regulation specifying that the official exchange rate is calculated as a weighted average of rates on the same day's interbank transactions.	March 31, 2014
The NBU will instruct the largest 35 banks to launch diagnostic studies on the basis of end-December 2013 data and terms of reference developed by the NBU.	April 14, 2014
The NBU will repeal Resolution 109 and announce a specific timetable, agreed with IMF staff, for gradually unwinding banks' net open foreign exchange positions, beginning May 1, 2014 and concluding in 20 months.	April 4, 2014
Government will approve a package of revenue and expenditure measures yielding at least UAH 45 billion in and implement them by passing a supplementary budget.	March 27, 2014
Parliament will pass a new public procurement law to strengthen governance and checks and balances, including reducing exemptions from regular competitive procedures.	
Parliament will pass a reversal of the already introduced VAT rate reduction in 2015 and keep the rate at 20 percent.	March 27, 2014
Parliament will pass an extension in the recently expired VAT exemption regime for grain exporters until October 1, 2014.	March 27, 2014
We will ensure that: (i) the gas price regulator NERC will adopt and officially publish a decision to raise end-user gas tariffs for households by 56 percent, effective May 1, 2014; (ii) similarly the utility price regulator NURC will adopt decisions to raise the heating tariffs for households by 40 percent on average, effective July 1, 2014.	
We will also publicly announce the decision and schedule for tariff increases through 2017, where the schedule will include the following: (i) in 2015, we will raise end-user gas and heating tariffs by 40 percent on average, effective May 1; and (ii) thereafter we will raise these tariffs by 20 percent on average each year, effective May 1, until losses of Naftogaz are eliminated by 2018.	April 18, 2014
To ensure de-politicization of tariff setting, Parliament will pass legislation to vest NURC with the exclusive authority to set heating tariffs in the country.	April 10, 2014
To protect vulnerable households not covered by the existing scheme, Government will approve a decision to introduce a new social assistance scheme, as described in ¶23.	April 5, 2015
The NBU Council will establish an independent audit committee with a well-defined mandate to provide close oversight of the financial reporting, audit processes and system of internal controls at the NBU.	April 4, 2014

Table 1. Ukraine: Proposed Prior Actions and Structural Benchmarks (concluded)

Structural benchmarks	Completion Date
Complete diagnostic studies and review of business plans for the 15 largest banks, as described in ¶15.	July 31, 2014
If existing fit and proper shareholders are unwilling or incapable of recapitalizing in full a weak bank, public funds could be used to bring it back into solvency, according to strict criteria. Government and the NBU will reach agreement with IMF staff on these criteria.	May 31, 2014
The government should be prepared to manage its financial sector shareholdings in the event that it is called on to use public funds—and to this end, a specialized unit will be set up at the Finance Ministry.	September 30, 2014
After discussion within government and with the private sector, we will prepare a proposal for the reform of VAT in agriculture with a view to bringing the regime in this sector closer to the general VAT regime.	September 30, 2014
To provide an accurate picture of Naftogaz finances, Naftogaz will launch a tender by April 3 to conduct audits of Naftogaz operations, led by an external auditor. The auditor will be in place within 60 days of the tender. The results of the audits will be shared with the IMF within 30 days of each period, initially on a monthly basis beginning with data for end-May 2014, and then on a quarterly basis for end-September data forward.	By June 30, 2014 and then monthly through October; then quarterly
To strengthen payment discipline for the heating sector, Parliament will pass legislation that will make distribution accounts fully operational and mandatory for utility payments.	June 30, 2014
Complete a comprehensive diagnostic study in close consultation with IMF staff that will cover the anti-corruption framework, the design and implementation of key laws and regulations that may have impact on business climate, the effectiveness of the judiciary, and tax administration, as described in ¶25.	By July 15, 2014
1/ Additional structural benchmarks will be proposed at the time of first program review.	

Table 2. Ukraine: Access and Phasing Under the Stand-By Arrangement

Date	Amount of purchase		Conditions
	Millions of SDRs	Percent of quota	
April 30, 2014 1/	2,058.00	150.00	Board approval of arrangement
July 25, 2014	914.67	66.67	First review and end-May 2014 performance criteria
September 25, 2014	914.67	66.67	Second review and end-July 2014 performance criteria
December 15, 2014	914.66	66.67	Third review and end-September 2014 performance criteria
March 15, 2015	1,372.00	100.00	Fourth review and end-December 2014 performance criteria
June 15, 2015	1,372.00	100.00	Fifth review and end-March 2015 performance criteria
September 15, 2015	1,372.00	100.00	Sixth review and end-June 2015 performance criteria
December 15, 2015	1,372.00	100.00	Seventh review and end-September 2015 performance criteria
March 15, 2016	686.00	50.00	Eighth review and end-December 2015 performance criteria
Total	10,976	800.0	
Source: IMF staff estimates.			
1/ Of which SDR1,290 (about US\$2 billion) for budget support.			

Table 3. Ukraine: Quantitative Program Targets 1/

(End of period; millions of Ukrainian hryvnias, unless otherwise indicated)

	2014				
	March	May	July	September	December
	Estimated	Performance criteria		Indicative targets	
I. Quantitative performance criteria					
Ceiling on the cash deficit of the general government (- implies a surplus) 2/	18,000	31,000	47,500	59,000	78,000
Ceiling on the cash deficit of the general government and Naftogaz (- implies a surplus) 2/	28,200	44,700	69,200	94,800	128,500
Floor on cumulative change in net international reserves (in millions of U.S. dollars) 3/ 4/	10,640	-1,273	1,096	266	-687
Ceiling on cumulative change in net domestic assets of the NBU 3/ 4/	212,508	36,383	21,292	29,685	51,527
Ceiling on publicly guaranteed debt 2/	0	25,000	25,000	25,000	25,000
II. Continuous performance criterion					
Non-accumulation of new external debt payments arrears by the general government 2/	0	0	0	0	0
III. Indicative Targets					
Ceiling on cumulative change in base money 3/	329,061	22,438	33,303	32,593	44,003
Ceiling on net accumulation of VAT refund arrears 5/	21,700	0.0	0.0	-2,500	-5,000
IV. Memorandum Items					
External project financing 2/	317	22,300	31,400	31,400	31,400
NBU loans to DGF and purchases of Government bonds issued for DGF financing or banks recapitalization 3/	0	0	0	0	15,000
Government bonds issued for banks recapitalization 3/	0	0	0	0	15,000
Stock of budgetary arrears on social payments 2/	0	0	0	0	0
Programmed disbursements of international assistance except IMF (millions of U.S. dollars) 3/ 4/	29	1,150	4,746	5,786	6,286
Percent of it applied to adjustment	...	100	100	75	75
Naftogaz foreign exchange purchases from NBU for the purposes of repaying gas payment arrears to Gazprom and Eurobond issue maturing in September 2014 (millions of U.S. dollars) 3/	813	2,160	2,160	3,830	4,830
NBU purchases of T-bonds Issued by Government for Naftogaz recapitalization 3/ 4/	11,100	23,662	23,662	41,956	52,911
Financing by multilateral institutions and official bilateral creditors disbursed to Naftogaz for investment projects 2/	0	0	0	0	0
Net transfers made by Gazprom (advance transit fee) 2/	0	0	0	0	0
Arrears to Gazprom for gas imports (millions of U.S. dollars) 6/	2,160	0	0	0	0
Ceiling on bonds issued to pay VAT refund arrears (VAT bonds) 2/	0	16,700	16,700	16,700	16,700
Program exchange rate, Hryvnia per U.S. dollar	10.9546	10.9546	10.9546	10.9546	10.9546

Sources: Ukrainian authorities; and IMF staff estimates and projections.

1/ Definitions and adjustors are specified in the Technical Memorandum of Understanding (TMU).

2/ Targets and projections are cumulative flows from end-2013. Data for March are flows from end-December, 2013.

3/ Targets and projections are cumulative flows from April 1, 2014. Data for March are stocks as of end-March, 2014.

4/ Calculated using program exchange rates specified in the TMU.

5/ Targets and projections are cumulative flows from January 1, 2014. Data for March are stocks as of end-March, 2014. MoF will issue UAH 16.7 bln in VAT bonds to settle VAT refund arrears accumulated through December 31, 2013.

6/ Targets and projections are cumulative flows from the Board approval of the Program. Data for March are stocks as of end-March, 2014.

Attachment II. Technical Memorandum of Understanding

April 22, 2014

1. This Technical Memorandum of Understanding (TMU) sets out the understandings between the Ukrainian authorities and IMF staff regarding the definitions of the variables subject to quantitative targets (performance criteria and indicative targets) for the economic program supported under the Stand-By Arrangement, as described in the authorities' Letter of Intent (LOI) dated April 22, 2014 and the attached Memorandum of Economic and Financial Policies (MEFP). It also describes the methods to be used in assessing the program performance and the information requirements to ensure adequate monitoring of the targets. As is standard under all Fund arrangements, we will consult with the Fund before modifying measures contained in the LOI, or adopting new measures that would deviate from the goals of the program, and provide the Fund with the necessary information for program monitoring.
2. The quantitative performance criteria are shown in Table 3 of the MEFP. The definitions of these quantitative targets and the adjustment mechanisms are described in Section I below. Prior actions and structural benchmarks are listed in Table 1 of the MEFP, with corresponding definitions in Section I below. The official exchange rate is defined in Section II. Reporting requirements are specified in Section III.
3. For the purposes of the program, all exchange rates used to evaluate reserve levels and monetary aggregates are (i) the official exchange rate of the Ukrainian hryvnia to the U.S. dollar of 10.9546 set by the NBU as of March 31, 2014, and (ii) reference exchange rates of foreign currencies reported by the European Central Bank (ECB) on its web site as of March 28, 2014, which the NBU used to set official exchange rates of hryvnia to those currencies. In particular, the Swiss Franc is valued at 0.8857 per dollar, the Euro is valued at 1.3759 dollars, Pound Sterling is valued at 1.6633 dollars, Australian dollar is valued at 0.9243 U.S. dollars, and the Japanese yen is valued at 102.41 per dollar. The accounting exchange rate for the SDR will be 0.647773 per dollar. Official gold holdings were valued at 1,295.75 dollars per fine ounce. These program exchange rates are kept fixed over the program period. Therefore, the program exchange rate differs from the actual exchange rate set in the foreign exchange market. Furthermore, setting a program exchange rate for the purpose of computing monetary aggregates does not imply that there is any target exchange rate for policy purposes.
4. For the purpose of the program, gross domestic product is compiled as per the System of National Accounts 1993 (SNA'93). The State Statistics Service has indicated that they plan to change to the System of National Accounts 2008 and discontinue the series based on SNA'93 at some point in 2014. We will reach agreement with the Fund before making any modifications in GDP compilation used for purposes of the program.

I. QUANTITATIVE PERFORMANCE CRITERIA, INDICATIVE CEILINGS, AND CONTINUOUS PERFORMANCE CRITERIA

A. Floor on Cumulative Change in Net International Reserves (Performance Criterion)

Definition

5. Net international reserves (NIR) of the NBU are defined as the dollar value of the difference between usable gross international reserve assets and reserve-related liabilities to nonresidents, evaluated at program exchange rates.

6. Usable gross international reserves comprise all readily available claims on nonresidents denominated in convertible foreign currencies, consistent with the Balance of Payments Manual (Fifth Edition) and the Special Data Dissemination Standard (SDDS) (Table A, item 1). Excluded from usable reserves, *inter alia*, are:

- any assets denominated in foreign currencies held at, or which are claims on, domestic institutions (i.e., institutions headquartered domestically, but located either domestically or abroad, or institutions headquartered abroad, but located domestically). Also excluded are all foreign currency claims of the NBU on domestic banks, and NBU deposits held at the Interbank Foreign Currency Exchange Market and domestic banks for trading purposes;
- any precious metals or metal deposits, other than monetary gold and gold deposits, held by the NBU;
- any assets that correspond to claims of commercial banks in foreign currency on the NBU and any reserves assets that are: (i) encumbered; or (ii) pledged as collateral (in so far as not already included in foreign liabilities, or excluded from reserve assets); or (iii) frozen; and
- any reserve assets that are not readily available for intervention in the foreign exchange market, *inter alia*, because of lack of quality or lack of liquidity that limits marketability at the book price.

7. For the purpose of this program, reserve-related liabilities comprise:

- all short-term liabilities of the NBU vis-à-vis nonresidents with an original maturity of one year or less;
- the stock of IMF credit outstanding;

- the nominal value of all derivative positions¹ (including swaps, options, forwards, and futures) of the NBU and general government, implying the sale of foreign currency or other reserve assets against domestic currency; and
- all foreign exchange liabilities of the NBU to resident entities (e.g. claims in foreign exchange of domestic banks, and NBU credits in foreign exchange from domestic market) excluding foreign exchange liabilities to the general government, or related to deposit guarantees.

Table A. Components of Net International Reserves

Type of Foreign Reserve Asset or Liability ²	NBU Balance Sheet and memorandum Accounts
1. International reserves	
Monetary gold	1100, 1107
Foreign exchange in cash	1011, 1017
Demand deposits at foreign banks	1201, 1202
Short-term time deposits at foreign banks	1211, 1208
Long-term deposits at foreign banks	1212
SDR holdings and Reserve Position in the IMF	IMF, Finance Department ³
Securities issued by nonresidents	1300, 1305, 1307, 1308, minus 1306
2. Short-term liabilities to nonresidents (in convertible currencies)	
Correspondent accounts of nonresident banks	3201
Funds under required reserves transferred by the banks	3203
Short-term deposits of nonresident banks	3211
Operations with nonresident customers	3230, 3232, 3233
Use of IMF credit	IMF, Finance Department

¹ This refers to the notional value of the commitments, not the market value.

² The definitions used in this technical memorandum will be adjusted to reflect any changes in accounting classifications introduced during the period of the program. The definitions of the foreign accounts here correspond to the system of accounts in existence on March 31, 2014. The authorities will inform the staff before introducing any change to the Charts of Accounts of the NBU and the Commercial Banks, and changes in the reporting forms.

³ Before receiving the monthly data from the IMF's Finance Department, these components will be calculated on the basis of preliminary data from the NBU and memorandum accounts.

Adjustment mechanism

- For end-May and end-July 2014 test dates, the NIR targets will be adjusted upward (downward) by the full amount of the cumulative excess (shortfall) in program disbursements relative to the baseline projection (Table B). For end-September and end-December 2014 test dates, the NIR targets will be adjusted upward (downward) by the full amount (75 percent) of the cumulative excess (shortfall) in program disbursements relative to the baseline projection (Table B). Program disbursements are defined as external disbursements from official multilateral creditors (World Bank, European Commission, European Investment Bank, and European Bank for Reconstruction and Development), official bilateral creditors (net), and external bond placements that are usable for the financing of the central government budget.
- NIR targets will be adjusted upward by the full amount of the cumulative shortfall in Naftogaz purchases of foreign exchange from NBU for the purposes of repaying gas supply arrears to Gazprom and Eurobond issue maturing in September 2014 relative to the baseline projection (Table C).

Table B. Eurobond Placements and Disbursements from IFIs and Official Sources: Projections for NIR/NDA Adjustment

(Cumulative flows from end-March 2014, millions of US dollars at program exchange rate)

	Eurobond placement	World Bank	EU	EBRD	EIB	Others (Canada, Japan)	Total
End- May 2014	0	175	160	273	341	200	1,150
End-July 2014	1,000	1,350	867	546	683	300	4,746
End-September 2014	1,000	1,350	1,907	546	683	300	5,786
End-December 2014	1,000	1,850	1,907	546	683	300	6,286

Table C. Naftogaz Purchases of Foreign Exchange from NBU: Projections for NIR/NDA Adjustment

(Cumulative flows from end-March 2014)

	Naftogaz purchases of foreign exchange from NBU for the purposes of repaying gas supply arrears to Gazprom and Eurobond issue maturing in September 2014 (millions of U.S. dollars)	NBU purchases of T-bonds issued by Government for Naftogaz recapitalization (millions of hryvnia, at program exchange rates)
End-May 2014	2,160	23,662
End-July 2014	2,160	23,662
End-September 2014	3,830	41,956
End-December 2014	4,830	52,911

B. Ceiling on Cumulative Change in Net Domestic Assets of the NBU (Performance Criterion)

Definition

8. Net domestic assets (NDA) of the NBU are defined as the difference between the monetary base (as defined below) and the NIR of Ukraine (as defined above). For the purpose of computing the NDA target, the NIR is valued at the program exchange rate of UAH 10.9546 per dollar and expressed in hryvnia.

Adjustment mechanism

- Consistent with the NIR target adjustment mechanism (as defined above), NDA targets for the end-May and end-July 2014 test dates will be adjusted downward (upward) by the full amount of the cumulative excess (shortfall) in program disbursements relative to the baseline projection (Table B) and evaluated at the program exchange rate. NDA targets for end-September and end-December 2014 test dates will be adjusted downward (upward) by the full amount (75 percent) of the cumulative excess (shortfall) in program disbursements relative to the baseline projection (Table B) and evaluated at the program exchange rate.
- Consistent with the NIR target adjustment mechanism (as defined above), NDA targets will be adjusted downward by the full amount of the cumulative shortfall in NBU purchases of T-bonds issued by Government for Naftogaz recapitalization for the purposes of repaying gas supply

arrears to Gazprom and Eurobond issue maturing in September 2014 relative to the baseline projection, evaluated at the program exchange rate (Table C).

- NDA targets will be adjusted upward by the full amount of the cumulative excess in the total amount of NBU loans to the Deposit Guarantee Fund (DGF) as well as total amount of NBU purchases of government bonds issued for the purposes of DGF financing, and NBU purchases of government bonds issued (up to a limit of UAH 15 billion) for bank recapitalization, relative to the baseline projection (Table D).

Table D. NBU Loans to DGF and Purchases of Government Bonds Issued for DGF Financing or Banks Recapitalization: Projections for NDA/Monetary Base Adjustment

(Cumulative flows from end-March 2014, millions of hryvnia, at program exchange rates when applicable)

	NBU purchase of Government bonds issued for DGF financing	NBU purchase of Government bonds issued for banks recapitalization	NBU loans to DGF	Total
End-May 2014	0.0	0.0	0.0	0.0
End-July 2014	0.0	0.0	0.0	0.0
End-September 2014	0.0	0.0	0.0	0.0
End-December 2014	0.0	15,000	0.0	15,000

C. Ceiling on Cumulative Change in Monetary Base of the NBU (Base Money) (Indicative Target)

Definition

9. The NBU's monetary base comprises domestic currency outside banks and banks' reserves, including cash in vault of commercial banks,¹ and funds of customers at the NBU. Currency outside banks is defined as: Currency—banknotes and coins—(NBU accounts 3000 (net)+3001 (net)-3007A-3009A-1001A-1004A-1007A-1008A-1009A) minus cash in vault at deposit money banks (DMBs) (DMB accounts 1001A:1005A, and 1007A). Banks' reserves are defined as: cash in vault at deposit money banks (DMB accounts 1001A:1005A, and 1007A) plus DMB correspondent account deposits

¹ The definitions set out here will be modified to include any other accounts that may be identified or created in the future in connection with domestic currency issue and the deposit money banks' deposits at the NBU.

at the NBU in hryvnia (NBU liabilities accounts 3200, 3203, 3204, and 3206) plus funds of customers at the NBU in hryvnia (NBU liabilities accounts of groups 323², 3250, 4731, 4732, 4735, 4736, 4738, 4739, and 4750), plus accrued interest on time deposits of DMBs in national currency (NBU accounts 3208L), plus accrued interest on client's current accounts in national currency.

Adjustment mechanism

- Consistent with the NDA target adjustment mechanism (as defined above), monetary base targets will be adjusted upward by the full amount of the cumulative excess in the total amount of NBU loans to the Deposit Guarantee Fund (DGF) as well as total amount of NBU purchases of government bonds issued for the purposes of DGF financing or banks recapitalization (up to a limit of UAH 15 billion for purposes of recapitalization), relative to the baseline projection (Table D), and evaluated at the program exchange rate if provided in foreign exchange.

D. Ceiling on Cash Deficit of the General Government (Performance Criterion)

Definition

10. The general government comprises the central (state) government, including the Road Fund (UkrAvtoDor), all local governments, and all extra budgetary funds, including the Pension, Unemployment Insurance, Temporary Disability Insurance, Occupational Injury and Disease Insurance Funds. The budget of the general government comprises: (i) the state budget; (ii) all local government budgets; and (iii), if not already included in (i), the budgets of the extra budgetary funds listed above, as well as any other extra budgetary funds included in the monetary statistics compiled by the NBU. The government will inform the IMF staff of the creation or any pending reclassification of any new funds, programs, or entities, immediately. The cash deficit of the general government is measured by means of net financing flows as:

- total net treasury bill sales³ (in hryvnias and foreign currency) as measured by the information kept in the NBU registry of treasury bill sales (net treasury bill sales are defined as the cumulative total funds realized from the sales of treasury bills at the primary auction and Government securities issued for recapitalization of banks and SOEs, less the cumulative total redemption of principal on treasury bills), excluding bonds issued to recapitalize Naftogaz⁴ and other SOEs and banks; plus

² Includes accounts of following sectors: 2 – other financial intermediaries and other financial organizations; 6 – regional and local authorities; 7 – government non-financial corporations; 8 – private and foreign-controlled non-financial corporations; 9 – non-commercial organizations serving households.

³ From here on, treasury bills are defined as all treasury securities (including long term instruments or treasury bonds).

⁴ These are included in the calculation of Naftogaz' cash deficit when they are used (as collateral for a loan, or as an outright sale) by the latter to obtain financing.

- other net domestic banking system credit to general government as measured by the monetary statistics provided by the NBU (this consists of all non-treasury-bill financing in either domestic or foreign currency extended to the general government by banks less the change in all government deposits in the banking system) as well as any other financing extended by entities not reflected by the monetary statistics provided by the NBU; plus
- total receipts from privatization received by the State Property Fund and local governments (including the change in the stock of refundable participation deposits); plus
- the difference between disbursements and amortization on any bond issued by the general government or the NBU to nonresidents for purposes of financing the deficit of the general government; plus
- the difference between disbursements of foreign credits to the general government (including project loans on-lent to public enterprises) and the amortization of foreign credits by the general government (including on lent project loans); plus
- the net sales of SDR allocation in the SDR department; plus
- the net change in general government deposits in nonresident banks, or other nonresident institutions; plus
- net proceeds from any promissory note or other financial instruments issued by the general government.

11. For the purposes of measuring the deficit of the general government, all flows to/from the budget in foreign currency (including from the issuance of foreign currency denominated domestic financial instruments) will be accounted in hryvnias at the official exchange rate established as of the date of the transaction.

Adjustment mechanism

- The ceiling on the cash deficit of the general government is subject to an automatic adjuster based on deviations of external project financing (defined as disbursements from bilateral and multilateral creditors to the consolidated general government for specific project expenditure) from program projections (Table E). Specifically, if the cumulative proceeds from external project financing (in hryvnia evaluated at actual exchange rates):
 - a) exceed program projections, the ceiling on the consolidated general government deficit will be adjusted upward by 100 percent of the excess in external project financing; and
 - b) fall short of program projections, the ceiling on the consolidated general government deficit will be adjusted downward by 100 percent of the shortfall in external project financing.

Table E. External Financing of General Government Projects—Adjustment

Cumulative flows from January 1, 2014	In millions of hryvnia
External project financing (technical assumption for the adjuster purpose)	
End-May 2014	22,300
End-July 2014	31,400
End-September 2014	31,400
End-December 2014	31,400

- The ceilings on the cash deficit of the general government at end-May, end-July, end-September, and end-December 2014 are subject to an automatic adjuster corresponding to the full amount of NBU purchases of government bonds issued for the purposes of DGF financing (excluding subsequent interest payments on the securities or other instruments issued). These ceilings are also subject to an automatic adjuster corresponding to the amount of NBU purchases of government bonds issued for the purposes of banks recapitalization, up to a cumulative maximum of UAH 15 billion in 2014. The test date ceilings on the cash deficit of the general government for 2015 will be adjusted upward by any amount of the UAH 15 billion bank recapitalization ceiling under the program that is not used in 2014.
- The ceiling on the cash deficit of the general government is subject to an automatic adjuster on the stock of budgetary arrears on social payments. Budgetary arrears on social payments comprise all arrears of the consolidated budget on wages, pensions, and social benefits owed by the Pension Fund, and the central or local governments. Budgetary arrears are defined as payments not made thirty days after they are due. Wages are defined to comprise all forms of remuneration for work performed for standard and overtime work. Pension obligations of the Pension Fund comprise all pension benefits and other obligations of the Pension Fund.
- The ceilings on the cash deficit of the general government at end-May, end-July, end-September, and end-December 2014 are subject to an automatic upward adjustment for the full amount of bonds used to pay VAT refund arrears (VAT bonds) accumulated before January 1, 2014, and will be limited to no more than UAH 16.7 billion cumulatively during 2014. No such bonds will be issued in 2015 or later, and therefore there is no such adjustment for the other test dates. The ceiling on the cash deficit of the general government at all other 2014 test dates will be automatically adjusted downward by VAT refund arrears accumulated in excess of ceilings defined in Section E from January 1, 2014.

E. Ceiling on VAT Refund Arrears (Indicative Target)

12. The ceiling on net accumulation of VAT refund arrears is set to UAH 5 billion at end-May 2014, UAH 5 billion at end-July 2014, UAH 2.5 billion at end-September 2014, and UAH 0 billion at end-December 2014. The stock of VAT refund arrears is defined as those claims that have not been settled (through a cash refund, netting out against obligations of taxpayers, payment with a government bond (VAT bond) or an official decision to reject the claim) within a specified time period after the VAT refund claim has been submitted to the State Tax Service (STS). In 2014, this time period is 74 days, allowing for verification of the validity and payment processing of claims. According to this definition, the stock of VAT refund arrears as of December 31, 2013 was UAH 16.7 billion and UAH 21.7 billion as of March 31, 2014.

F. Ceiling on Cash Deficit of the General Government and Naftogaz (Performance Criterion)

Definition

13. The cash deficit of the General Government and Naftogaz is the cash deficit of the General Government as defined above plus the cash deficit of Naftogaz.

14. Naftogaz is defined as the national joint stock company “Naftogaz of Ukraine.” The cash deficit of Naftogaz is measured from below the line as:

- net domestic banking system credit to the company (this consists of all financing in either domestic or foreign currency extended to the company by banks less the change in company deposits in the banking system); plus
- the difference between disbursements of private foreign loans to Naftogaz (including private placements) and the amortization of private foreign loans (including private placements); plus
- the difference between disbursements of official foreign credits to Naftogaz (including project loans) and the amortization of official foreign credits (including project loans); plus
- the disbursements of trade credits from Gazprom to import gas; plus
- the difference between disbursements and amortization on any bonds issued by Naftogaz; plus
- the net change in deposits of Naftogaz in nonresident banks, or other nonresident institutions; plus
- net proceeds from any promissory note or other financial instruments issued by Naftogaz; plus
- net receipts from sale of financial assets (including recapitalization or other form of treasury securities issued to Naftogaz, irrespective of their issuance date); plus

- any other forms of financing of the company not identified above.

15. For the purposes of measuring the deficit of Naftogaz, all flows in foreign currency will be accounted in hryvnias at the official exchange rate established as of the date of the transaction.

Adjustment mechanism

- The ceiling on the cash deficit of the general government and Naftogaz will be adjusted upward by the amount of financing by multilateral institutions and official bilateral creditors disbursed to Naftogaz for investment projects.
- The ceiling on the cash deficit of the general government and Naftogaz will be adjusted downward by the net transfers made by Gazprom (advance transit fee). These transfers are measured on a cumulative basis from the beginning of each calendar year.
- The ceiling on the cash deficit of the general government and Naftogaz will be adjusted downward by the amount of arrears to Gazprom for gas imports the day after their payment is due (7th day of the subsequent month of imports).

G. Ceiling on Non-Accumulation of New External Debt Payments Arrears by the General Government (Continuous Performance Criterion)

Definition

16. For the purposes of the program, an external debt payment arrear will be defined as a payment by the general government, which has not been made within seven days after falling due (including grace period, if any). The performance criterion will apply on a continuous basis throughout the program period.

H. Ceiling on Publicly Guaranteed Debt (Performance Criterion)

Definition

17. The ceiling on publicly guaranteed debt will apply to the amount of guarantees issued in 2014 by the central (state) government. The official exchange rate will apply to all non-UAH denominated debt. New state guarantees in 2014 will amount to no more than UAH 25 billion.

I. Other Continuous Performance Criteria

18. During the period of the Stand-By Arrangement, Ukraine will not (i) impose or intensify restrictions on the making of payments and transfers for current international transactions; (ii) introduce or modify multiple currency practices; (iii) conclude bilateral payments agreements that are inconsistent with Article VIII; and (iv) impose or intensify import restrictions for balance of payments reasons.

II. OFFICIAL EXCHANGE RATE

Determination of the official exchange rate

19. The NBU will, on a daily basis, set the official rate calculated as a weighted average of rates on the same day's interbank market transactions. NBU will make public its official exchange rate by no later than 16:00 of the day for which it is set.

III. REPORTING REQUIREMENTS

A. National Bank of Ukraine

20. The NBU will continue to provide to the IMF on a monthly basis, no later than the 25th day of the following month, an aggregate balance sheet for the NBU and a consolidated balance sheet for the deposit money banks.

21. The NBU will provide to the IMF, on a weekly basis, with daily data the stock of net and gross international reserves, at both actual and program exchange rates. In addition, it will provide on a weekly and monthly basis, no later than the 25th of the following month, the full breakdown of NBU accounts included in net international reserves (defined in Table A above).

22. The NBU will provide the IMF on a daily basis with information on official foreign exchange interventions. In this context, it will also provide the results of any foreign exchange auctions.

23. The NBU will provide the IMF on a daily basis with information on balances held in the analytical accounts 2900 "Accounts payable per transactions for the foreign exchange, banking and precious metals purchase and sale on behalf of banks' clients", created according to the NBU Resolution 49.

24. The NBU will continue to provide on its web site the daily holdings of treasury bills at primary market prices, at current exchange rates. The NBU will also provide information on daily holdings of treasury bills broken down by type of holders (including state-owned banks and private banks) at primary market prices at the rate fixed on the day of auction information on t-bills sales, including in the foreign exchange, from the beginning of the year at the official rate as of the date of placement, as well as the t-bills in circulation, by principal debt outstanding at the official

exchange rate as of the date of placement (OP-2); reports on each treasury bill auction; and provide to the IMF the monthly report on treasury bills, in the format agreed with the IMF staff.

- 25.** The NBU will provide information on daily transactions (volumes and yields) on the secondary market treasury bills (including over the counter transactions).
- 26.** The NBU will provide to the IMF, on a daily basis, the information on the banks' claims on the loans provided and liabilities in the format agreed with the IMF staff.
- 27.** The NBU will keep providing to the IMF, on a monthly basis, general information on the NBU financing (as well as the refinancing) of the banks of Ukraine, and on the operations of mopping up (absorption) of the liquidity from the banking system (including through the CDs issuance) in the format agreed with the IMF staff.
- 28.** The NBU will provide to the IMF, on a quarterly basis but not later than 30 days after the expiration of the reporting quarter, the report on the banking sector financial stability indicators in the format agreed with the IMF staff.
- 29.** Every 10 days, the NBU will continue to provide the IMF with the operational monetary survey of the NBU, including any additional information that is needed for the IMF staff to monitor monetary policy and developments in the banking sector.
- 30.** The NBU will provide to the IMF, on a monthly basis, the net domestic assets data based on the monthly balance sheets within three weeks following the end of the month.
- 31.** The NBU will continue to provide to the IMF the daily operational balance sheets of the NBU and commercial banks on a daily basis according to standard reporting forms, including detailed information on loans of the banking sector provided to the general government, with detailed breakdown of this information by indebtedness of the central (state) government and local budgets, including in national and foreign currency, by loan and by security, as well as the information on the balances of the funds of the Government held at the NBU, in particular, the balances of the Single Treasury Account denominated in the national currency (account 3240 A) and the funds of the State Treasury denominated in foreign currency (account 3513 A).
- 32.** The NBU will provide to the IMF, on a monthly basis, projections for external payments falling due in the next twelve months. The data on actual settlement of external obligations, reflecting separately principal and interest payments as well as actual outturns for both the public and private sectors, shall be provided on a quarterly basis, within 80 days following the end of the quarter.
- 33.** The NBU will provide to the IMF, on a quarterly basis, the stock of short- and long-term external debt (including arrears) for both public and private sectors.
- 34.** The NBU will provide to the IMF on a daily basis aggregated data on main currency flows, including government foreign receipts and payments by currencies as well as currency breakdown of

interbank market operations. The NBU will continue to provide daily information on exchange market transactions including the exchange rate.

35. The NBU will provide to the IMF reports N 381.25; 381.26 with information on reserve requirements.

36. The NBU will provide the IMF, on a two weekly basis, with daily data on the total financing (including refinancing) issued by the NBU to commercial banks, broken down by types of instrument, original maturity of the financing, interest rate as well as transactions to absorb liquidity from the banking system.

37. The NBU will provide the IMF on a two weekly basis, in an agreed format, data for the entire banking sector as well as on a bank-by-bank basis for Group I and Group II banks on total assets and liabilities; weighted averages based on banks' total assets; capital adequacy ratios for normative and regulatory capital (Tier I and Tier II); deposits (maturity, currency, and type of depositor); loans (local currency, foreign exchange, provided to the public and private sector, classified as standard, watch, substandard, doubtful); provisions for all loans (classified by types of loans); foreign exchange net open position; banks holding of government and private debt instrument; mandatory reserve requirement and access holding at the NBU.

38. The NBU will inform the IMF within the same day of any regulatory and supervisory measures against banks violating the NBU regulations, including lower capital adequacy, liquidity ration, large exposures, connected lending.

39. The NBU will continue to provide on a monthly basis, no later than 25 days after the end of the month, banking system monitoring indicators in an agreed format. This includes inter alia data on nonperforming loans (substandard, doubtful, and loss criterion).

40. The NBU will continue to provide detailed quarterly balance of payments data in electronic format within 80 days after the end of the quarter.

41. The NBU will provide data on credit to nongovernment units that are guaranteed by the NBU on a monthly basis no later than 25 days after the end of the month.

42. The NBU will inform IMF staff if the Treasury does not pay interest or principal on treasury bills due to the NBU, deposit money banks, or nonbank entities and individuals. In such case, the NBU will provide information on outstanding interest and principal payments.

43. The NBU will inform IMF staff of any changes to reserve requirements for deposit money banks.

44. The NBU will communicate (electronically) to the IMF staff any changes in the accounting and valuation principles applicable to the balance-sheet data and will notify the staff before introducing any changes to the Charts of Accounts and reporting forms of both the NBU and the commercial banks.

45. The NBU Internal Audit Department will continue to provide an assurance report to the Fund, no later than six weeks after each test date, confirming that: (i) the monetary data are in accordance with program definitions and have been verified and reconciled to accounting records; and (ii) that there have been no changes to the chart of accounts or valuation methods that would impact the data reporting.

46. The NBU will continue to provide the Fund with a copy of the annual management letter from the external auditor within six weeks of completion of each audit. As required under the Fund's safeguard policy, this will remain in effect for the duration of the arrangement and for as long as credit remains outstanding.

B. Ministry of Finance

47. The Ministry of Finance will provide the IMF with the monthly consolidated balances (end-month) of other non-general government entities, including SOEs, holding accounts at the Treasury no later than 25 days after the end of the month.

48. The Treasury will continue to provide to the IMF reports on: daily operational budget execution indicators, daily inflow of borrowed funds (by currency of issuance) to the state budget and expenditures related to debt service (interest payments and principals), weekly balances of Treasury cash flow (outturn and forecast), including data on government foreign exchange deposits, in a format agreed with IMF staff, 10-day basis data on revenue of the state, local government, and consolidated budgets, monthly data on funds deposited with the Single Treasury Account, on the registration accounts of the entities which are not included to the state sector, information on the stock of public entities in account #3712 within the Single Treasury Account, on inflow to the State budget from placing Treasury or any other liabilities to households in foreign and domestic currency and their redemption.

49. The Treasury will continue to provide to the IMF in electronic form monthly and quarterly treasury reports, no later than 25 and 35 days after the end of the period respectively. The Treasury will continue to provide to the IMF in electronic form the final fiscal accounts at the end of each fiscal year, no later than March of the following year. Inter alia, these reports will provide expenditure data by programs and key spending units, as well as based on standard functional and economic classifications. In addition, quarterly reports will contain standard information on budget expenses to cover called government guarantees.

50. The Ministry of Finance will report monthly data on the public wage bill in line with the template agreed with the IMF staff. It will also provide monthly reports on the borrowing (disbursements, interests and amortization) of UrkAvtoDor in line with the format agreed with IMF staff. The Ministry of Finance will report to the IMF on a monthly basis, no later than 15 days after the end of the month, the cash deficit of the general government, with details on budget execution data for privatization receipts of the state and local governments; disbursements of external credits (including budget support and project loans for on-lending) to the consolidated budget and amortization of external debt by the consolidated budget; net domestic borrowing of the general

government, including net t-bill issuance, issuance of other government debt instruments, and change in government deposits. The Ministry of Finance will report to the IMF on a monthly basis information on municipal borrowing and amortization of debt in format agreed with IMF staff.

51. The Ministry of Finance will report to the IMF on a monthly basis, no later than 15 days after the end of the month, the cash deficit of the general government, with details on budget execution data for privatization receipts of the state and local governments; disbursements of external credits (including budget support and project loans for on-lending) to the consolidated budget and amortization of external debt by the consolidated budget; net domestic borrowing of the general government, including net t-bill issuance, issuance of other government debt instruments, and change in government deposits.

52. The Ministry of Finance will provide data on the stock of all budgetary arrears on a monthly basis, no more than 25 days after the end of the month, including separate line items for wages, pensions, social benefits, energy, communal services, and all other arrears on goods and services. The Treasury will report monthly data on accounts payable for state and local budgets (economic and functional classification).

53. The Ministry of Finance will provide monthly information, no later than 25 days after the end of each month, on the amounts and terms of all external debt contracted or guaranteed by the central government.

54. The Ministry of Finance will provide to the IMF in electronic form on a monthly basis, no later than 25 days after the end of the month, (a) data on the outstanding stock of domestic and external debt of the state and local budgets (including general and special funds), (b) the standard files planned and actual external debt disbursement, amortization, and interest payments (including general and special funds), broken down in detail by creditor categories as agreed with Fund staff, and (c) the report on external debt amortization and interest payments by days and currencies. The Ministry of Finance will also report the accumulation of any budgetary arrears on external and domestic debt service.

55. The Ministry of Finance will provide to the IMF monthly debt (domestic and external) amortization schedules updated on a weekly basis.

56. The Ministry of Finance will provide data on external and domestic credit to key budgetary spending units as well as nongovernment units (including Naftogaz, State Mortgage Institution, Deposit Guarantee Fund and Agrarian Fund) that is guaranteed by the government (amount of sovereign guarantees extended by executive resolutions and actually effectuated; total amount of outstanding guarantees and list of their recipients) on a monthly basis no later than 25 days after the end of the month.

57. The Ministry of Finance will provide data on the approved budgets and quarterly operational data (daily for the Pension Fund only) on the revenue, expenditures, and arrears, and balance sheets of the Pension Fund (detailed data on the breakdown of revenues and expenditure by main

categories are expected for this Fund), Social Insurance Fund, Employment Fund (detailed data on the breakdown of revenues and expenditure by main categories are expected for this Fund), Occupational Accident and Sickness Insurance Fund, and any other extra budgetary funds managed at the state level no later than 50 days after the end of each quarter (each month in case of the Pension Fund). Any within-year amendments to the budgets of these funds will be reported within a week after their approval. The Ministry of Finance will also report the annual financial statement including the final fiscal accounts of those funds at the end of each fiscal year, no later than April of the following year.

58. The Ministry of Finance will report semi-annual data on the number of employees of budgetary institutions financed from the central (state) and local budgets, starting from January 2010. After any public sector wage increase, the Ministry of Finance will provide an estimate of its costs for the current and two subsequent fiscal years, for the state and local government budgets.

59. The Ministry of Finance will provide, no later than 15 days after the end of each month, monthly data on the budgetary costs associated with the recapitalization of banks and SOEs. This cost includes the upfront impact on the cash deficit of the general government of the recapitalization of banks and SOEs as well as the costs associated with the payment of interests.

60. The Ministry of Finance will provide monthly data on their expenditure plans (ROSPIS) for state budget.

61. The State Tax Service (STS) and, where applicable, State Customs Service (SCS) will provide monthly data, no later than 25 days after the end of the month, on tax arrears, inclusive of deferred payments, interest and penalties outstanding, in the following format:

	Beginning Stock				Netting out during month	DEFERALS DURING MONTH	Write-offs (arrears written off during month)	Collections of outstanding debt at beginning of month	New Arrears (tax liabilities becoming overdue during month)	Ending Stock
	Total	Principal	Interest	Penalties						
Tax arrears										

62. The STS will continue to provide on a quarterly basis, no later than two months after the end of the quarter, a listing of all tax exemptions granted, specifying the beneficiary the exemption provided, the duration, and the estimated subsequent revenue loss for the current fiscal year.

63. The STS will continue to provide monthly information, no later than 25 days after the end of the month, on VAT refunds in the following format: (i) beginning stock of refund requests; (ii) refund

requests paid in cash; (iii) refunds netted out against obligations of the taxpayer; (iv) denied requests; (v) new refund requests; (vi) end-of-period stock of requests; and (vii) stock of VAT refund arrears according to the definition in paragraph 11 (unsettled VAT refund claims submitted to the STS more than 74 days before the end-of-period).

64. The STS will continue to provide monthly reports 1.P0 on actual tax revenue and 1.P6 on tax arrears, no later than 25 days after the end of each month.

65. The STA will provide monthly data on revenue plans (ROSPIS) for state and local budgets.

C. Ministry of Economy, Ministry of Energy and Coal Industry, Ministry of Housing and Municipal Economy of Ukraine, NURC and NERC

66. The Ministry of Economy will provide quarterly information on actual levels of communal service tariffs in all regions for major services (heating, water supply, sewage and rent) and their level of cost recovery. In addition, the Ministry of Economy, the Ministry of Housing and Municipal Economy of Ukraine, and the National Energy Regulatory Commission will provide the methodology underlying the tariff calculations for full cost recovery, including heating and gas.

67. For each month, no later than the 25th of the following month, the government (based on information by the Ministry of Energy and Coal Industry, the Ministry of Economy, STS/SCS, MoF, NERC, and Naftogaz) will provide IMF staff with information in electronic form (in an agreed format defined as "Ukraine: The Financial Position of Gas Sector") on financial indicators in the gas and heating sectors, including prices and volumes of domestically produced (by production entity) and imported (by sources of imports) gas, sales, tariffs, arrears, payments to the budget, subsidies, and debt. On a monthly basis, Naftogaz will provide to IMF staff updated information on the Company's financial liabilities, with a schedule of loan-by-loan interest and principal payments.

68. For each month, no later than the 25th of the following month, the Ministry of Energy and Coal Industry (based on information by Naftogaz) will provide IMF staff with information "in electronic form (in an agreed format) on the cash flows and deficit of the company, as defined above. This report will break down the total cash outlays for gas imports from Gazprom by month in a separate table mutually agreed with IMF staff. This report is subjected to auditing by a reputable external auditor, first on a monthly and then on a quarterly basis, as set out in the MEFP.

69. For each month, no later than the 25th of the following month, the Ministry of Energy and Coal Industry (based on information by Naftogaz) will provide IMF staff with information in electronic form (in an agreed format and verified by a reputable external auditor) on the domestic gas used by Naftogaz for sales to households, heating utilities, budget institutions, and industries, including gas produced by SC "Ukrigasvydobuvannya," SJSC "Chornomornaftogas," and OJSC "Ukrnafta".

70. For each week, no later than the Thursday of the following week, the Ministry of Energy and Coal Industry (based on information by Naftogaz) will provide IMF staff with information in

electronic form in an agreed format on the cash flow transactions of the company for the previous week.

71. For each quarter, no later than the 25th of the following month, the Ministry of Housing and Municipal Economy will provide IMF staff with information of the quantity of heating energy meters installed at a building-level measured also as a ratio to the applicable buildings.

72. For each month, no later than the 25th of the following month, the Ministry of Energy and Coal Industry (based on information by Naftogaz) will provide IMF staff with information in electronic form on the amount of Naftogaz arrears to domestic suppliers including Naftogaz subsidiaries, Ukrtransgas, Ukgas vydobuvannya, Ukrnafta, Chornomornaftogas 90 days after they are due.

D. State Statistics Service

73. The State Statistics Service and Naftogaz will provide to the IMF, on a monthly basis, no later than 45 days after the end of the month, data on prices, volumes, and payments (payments data provided by Naftogaz) for imported and exported oil and natural gas by country of origin and destination.

74. In case of any revisions of gross domestic products the State Statistics Service will provide to the IMF revised quarterly data on gross domestic product (nominal, real, deflator) and their components (economic activities, expenditure, income), no later than 10 days after any revisions have been made.