



UKRAINE

August 2015

FIRST REVIEW UNDER THE EXTENDED ARRANGEMENT—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR UKRAINE

In the context of the first review under the Extended Arrangement, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on July 31, 2015, following discussions that ended on May 29, 2015, with the officials of Ukraine on economic developments and policies underpinning the IMF arrangement under the Extended Fund Facility. Based on information available at the time of these discussions, the staff report was completed on July 22, 2015.
- A **Staff Supplement** updating information on recent developments.
- A **Statement by the Executive Director** for Ukraine.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Ukraine*

Memorandum of Economic and Financial Policies by the authorities of Ukraine*

Technical Memorandum of Understanding*

*Also included in Staff Report

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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July 31, 2015

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IMF Executive Board Completes First Review of Ukraine's EFF and Approves US\$1.7 Billion Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the first review of Ukraine's Extended Arrangement under the Extended Fund Facility (EFF). The completion of this review enables the disbursement of SDR 1,182.1 million (about US\$1.7 billion), which would bring total disbursements under the arrangement to SDR 4.72 billion (about US\$6.68 billion).

Ukraine's four-year SDR 12.348 billion (about US\$17.5 billion) EFF was approved on March 11, 2015 (see [Press Release No. 14/189](#)) to support the government's economic program, which aims to put the economy on the path to recovery, restore external sustainability, strengthen public finances, maintain financial stability, and support economic growth by advancing structural and governance reforms, while protecting the most vulnerable.

Following the Executive Board's discussion, Mr. David Lipton, First Deputy Managing Director and Acting Chair, said:

“The Ukrainian economy remains fragile, but encouraging signs are emerging. In recent months, the exchange rate has stabilized, domestic-currency retail deposits have been increasing, and the pace of economic decline is moderating. Continued prudent policies and further reforms should allow the economy to turn the corner and growth to resume in the period ahead.

“Since the approval of a financial arrangement under the IMF's Extended Fund Facility, the authorities have made a strong start in implementing their economic program. The momentum needs to be sustained, as significant structural and institutional reforms are still needed to address economic imbalances that held Ukraine back in the past.

“Maintaining an appropriately tight monetary policy and building up official foreign exchange reserves will be critical to entrench external stability and anchor inflation expectations. As disinflation takes root, monetary policy can be carefully eased to support economic activity. Removal of administrative measures on foreign exchange operations should proceed in a gradual and sequenced manner, once the enabling conditions are in place.

“Restoring a sound banking system is key for economic recovery. To this end, the strategy to strengthen banks through recapitalization, reduction of related-party lending, and resolution of impaired assets should be implemented decisively.

“The authorities recognize that continued fiscal discipline is needed to reduce risks and strengthen public finances. Strong political support should be mobilized to sustain budgetary consolidation and energy sector reforms going forward, while ensuring an adequate social safety net. At the same time, restoring debt sustainability will require the completion of a debt operation consistent with program objectives. The authorities and the holders of their sovereign debt should continue their efforts to reach an agreement ahead of the next program review. In the event that talks with private creditors stall, and Ukraine determines that it cannot service this debt, the Fund could continue to lend to Ukraine consistent with its Lending-into-Arrears Policy.

“Further substantial progress with structural reforms is essential to enable strong recovery of private activity. In this regard, efforts to fight corruption, improve the business climate, and reform state-owned enterprises should be stepped up.”



UKRAINE

FIRST REVIEW UNDER THE EXTENDED ARRANGEMENT

July 22, 2015

EXECUTIVE SUMMARY

The economy is still fragile, but signs of stabilization are emerging. The escalation of the conflict in the East and the sharp depreciation of the hryvnia in early 2015 deepened the recession in 2015:Q1, raised inflation, and eroded further bank balance sheets. In recent months, however, signs of stabilization have been emerging. The balance of payments is in line with the program and the exchange rate has stabilized, retail hryvnia deposits are gradually increasing, the budget deficit is very low, and the pace of economic decline is moderating.

The authorities have made a strong start in implementing the program. All performance criteria (PCs) for end-March 2015 and, based on preliminary information, all PCs for end-June were met. Eight benchmarks were completed, albeit four of them with a delay and two were converted into prior actions for this review.

Discussions with creditors have made progress towards a debt operation that would restore fiscal sustainability. The engagement has intensified recently with direct negotiations with the ad hoc creditor committee on the authorities' restructuring proposal. The two sides reported further steps forward in their discussions and reiterated their common objective to finalize the terms of the debt operation as soon as possible.

Policy discussions focused on strengthening macroeconomic stability and sustaining progress in structural reforms. Supporting policies in the period ahead aim to: (i) continue the current prudent monetary policy, maintain exchange rate flexibility, and improve banks' financial health; (ii) strengthen public finances, via fiscal consolidation and Naftogaz's reform, while revamping the social safety net; and (iii) advance structural reforms, specifically the anti-corruption framework and judicial system, overhaul the State-Owned Enterprise (SOE) sector, and improve business climate.

In view of the authorities' performance under the program, their policy commitments for the period ahead, and progress toward a debt operation in line with its stated objectives, staff recommends the completion of the first review. The purchase released upon completion of the review would be in the amount equivalent to SDR 1,182.1 million.

Approved By
**Thanos Arvanitis and
 Mark Flanagan**

Discussions were held in Kyiv during May 12–29, 2015. The IMF team comprised Nikolay Gueorguiev (head), Anita Tuladhar, Etienne Yehoue, Pamela Madrid, Beata Jajko, Linda Kaltani, Ricardo Llaudes, Brett Rayner, Almira Buzaushina (EUR); Olga Stankova (COM); David Amaglobeli (FAD); Emmanuel Mathias, Sebastiaan Pompe (LEG); Luis Cortavarria-Checkley, Annamaria Kokenyne Ivanics, Johannes Forss Sandahl (MCM); Cesar Serra (SPR); Jerome Vacher and Wim Fonteyne (Resident Representative office). Thanos Arvanitis (Deputy Director, EUR) and Oleksandr Petryk (Alternate ED) participated in discussions. Nikita Kannekanti and Christine Rubio (both EUR) provided support from headquarters.

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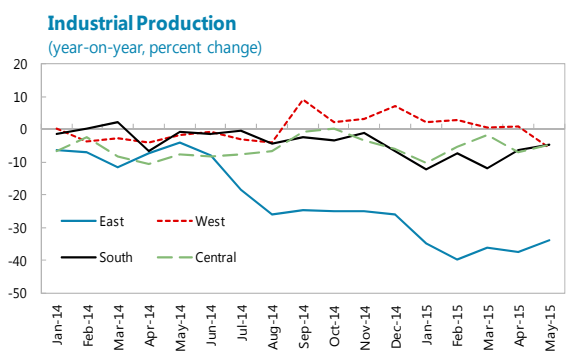
INTRODUCTION

1. **The economy has yet to turn the corner, but signs of stabilization are appearing.** The escalation of the conflict in January and a sharp depreciation of the exchange rate in February took their toll on economic activity. In recent months, the exchange rate volatility has subsided and the latest high-frequency indicators point to a gradual moderation in economic decline. However, the situation remains fragile. Foreign currency deposit outflows have eased but continue, banks' balance sheets are weak, and inflation is high.
2. **The ceasefire in the East is broadly holding, despite intermittent flare-ups.** The intensity of the conflict has subsided, but isolated attacks continue amid recurring regrouping and consolidation of military forces on both sides. The risks of intensification of the conflict are still high. The full implementation of the Minsk II agreement remains challenging amid uncertainties about local elections, border control, and constitutional reform for further decentralization. On the positive side, parliament approved legislation on decentralization proposed by the government, and the legislation is now under review by the Constitutional Court.
3. **The political situation remains challenging.** The parliament is divided between reformist and status-quo factions, with the latter heavily influenced by vested interests. In the run up to local elections in the fall, political pressures to undo reforms are mounting. For example, recently several populist bills that threatened to reverse a number of program policies in the fiscal and energy sectors were submitted, but eventually not considered by parliament. The government continues to fight corruption and public misconduct, but these actions are yet to gain sufficient traction to permanently weaken the influence of vested interests on the economy and truly transform the business climate.
4. **Despite the headwinds, the authorities remain firmly committed to the program.** All performance criteria (PCs) for end-March were met and, based on preliminary data, all end-June PCs are also met. Eight benchmarks were implemented, four of which with a delay, and two were converted into prior actions (MEFP Table 1). Going forward, the success of the program will crucially hinge on (i) the full and timely implementation of envisaged policies; (ii) adequate and timely external financing from the official sector and the private sector via the debt operation; and (iii) the non-intensification of the conflict in the East.

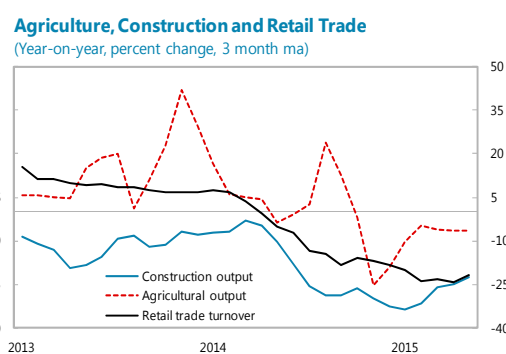
RECENT ECONOMIC DEVELOPMENTS

5. **The recession deepened in early 2015.** Industrial production, construction, and retail trade declined by double digit rates on the back of heightened uncertainty from the escalation of the conflict as well as reduced demand from real incomes compression. In 2015:Q1, GDP declined by 17.2 percent y-o-y, some 1¼ percentage point worse than expected at the outset of the program. High frequency data for Q2 indicate continued decline, albeit at a more moderate pace. The crisis

has taken the heaviest toll on the Eastern regions, but has also affected (to a lesser extent) the rest of the country (text chart).



Source: State Statistics Service of Ukraine.

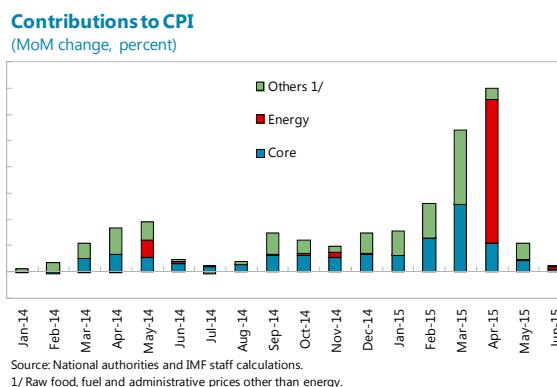


Source: State Statistics Service of Ukraine.

6. Inflation rose sharply in March–April on the back of one-off factors, but has declined since.

The rapid pass-through of the large exchange rate depreciation in February and increases in regulated energy prices pushed inflation to 61 percent y-o-y in April (Figure 2 and text chart).¹ As the hryvnia recovered and stabilized in April–June, prices of some imported goods declined while increases in prices of non-tradables remained moderate. As a result, inflation in June moderated to 0.4 percent m-o-m, or 57½ percent y-o-y.

The high y-o-y number masks the sharp disinflation that has already occurred: the seasonally adjusted annualized inflation in May–June 2015 fell to 13 percent.



Source: National authorities and IMF staff calculations.
1/ Raw food, fuel and administrative prices other than energy.

7. The balance of payments (BoP) moved broadly in line with the program projections.

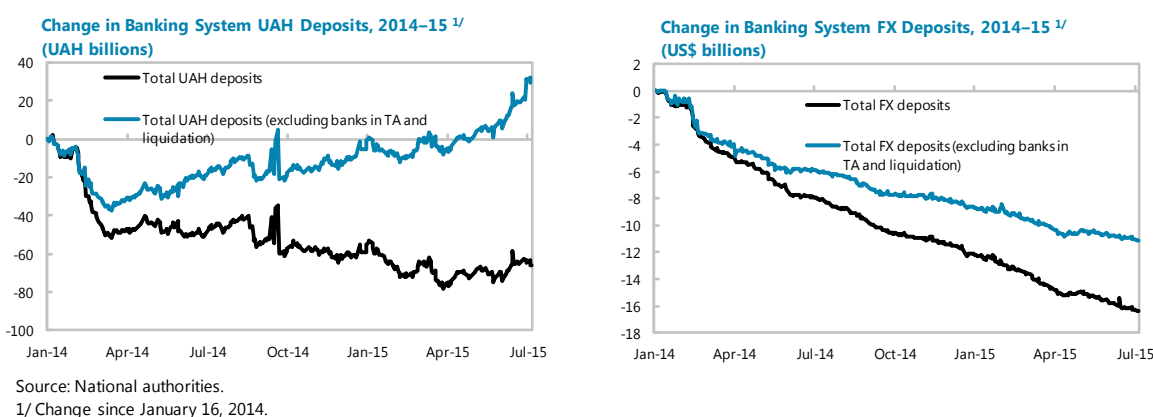
In January–May 2015, the current account deficit narrowed to US\$0.35 billion. While exports underperformed (affected by trade restrictions imposed by Russia and the decline in commodity prices), imports were also compressed due to the weak economy, the hryvnia depreciation, and the import surcharge.² Private outflows were lower than projected (by about US\$0.7 billion), reflecting the ongoing restructuring of debt by private sector companies, and lower than projected FX cash outflows from the banking system. While FDI was somewhat higher than projected, in part due to

¹ The authorities have revised the impact of gas tariff increases on inflation from June 2015. The previous methodology overstated the impact in April by about 4 percentage points, reflecting only the higher-tier tariff increase in the two-tier tariff structure.

² The WTO did not reach consensus to approve Ukraine's import surcharge. The authorities reiterated their commitment to let the surcharge expire at end-2015 as planned.

bank recapitalization flows, portfolio flows remain minimal as investors are cautious amid the yet-to-be-concluded debt operation, the downgrade in Ukraine's sovereign ratings and the unsettled conflict in the East. Official financing, excluding the IMF, amounted to US\$1.4 billion, below the projected US\$2.5 billion, as the authorities needed more time to meet the prior actions for the World Bank's multi-sector DPL, which also delayed the associated financing from Japan and Norway. In addition, discussions with Switzerland took longer than expected.

8. **Hryvnia deposits are rising while the decline in FX deposits is slowing.** In 2015:Q2, hryvnia deposits increased by 1.9 percent q-o-q (excluding banks in temporary administration and liquidation), following a 0.8 percent decline in 2015:Q1 (text chart). FX deposits continue to decline, but the pace of outflows slowed to -2.4 percent q-o-q on average in 2015:Q2 from -3.1 percent on average in 2015:Q1.



9. **Bank liquidity is gradually easing.** New drawing of NBU refinancing has slowed recently. Nevertheless, outstanding NBU loans are still elevated for a number of domestic banks. At end-June, the aggregate liquidity ratio among the 35 largest banks was 15.2 percent, although seven of these domestic privately-owned banks had liquidity ratios below 5 percent.

DEBT OPERATION

10. **The authorities continue efforts to reach a collaborative agreement with creditors on the restructuring of public debt.** They have pursued a two-track approach to restructure the US\$22.7 billion of public and State-owned-Enterprise (SoE) debt included in the debt operation.

- Discussions for the restructuring of Ukraine's sovereign Eurobonds and sovereign guaranteed external debt (about US\$19.3 billion) are taking place through a creditor committee representing four large private bondholders holding US\$8.9 billion (nearly 40 percent of the debt subject to the operation). While progress in the discussions was initially slower than expected, the engagement has intensified recently. The creditor committee members have signed confidentiality agreements and have direct discussions over various aspects of the debt operation. While differences still remain, particularly on the degree of nominal haircut that might

be needed, following a further round of discussions on July 15, the authorities and the creditors issued a joint statement signaling their objective to reach agreement on the terms of the debt operation as soon as possible.

- Discussions on the restructuring of external debt of state-owned entities (UkrEximBank, Oschadbank, and Ukrainian Railways for a total amount of about US\$3.4 billion) have taken place through separate processes tailored to the specific circumstances of each entity. This debt has been included in the perimeter of the debt operation solely to achieve the external financing target of US\$15.3 billion. As this debt is not part of public debt, the terms of their restructuring do not have an impact on the debt-to-GDP ratio (target 2) and government's gross financing needs (target 3). On July 6, the authorities launched a consent solicitation for a restructuring deal with a creditor group of Oschadbank (on Eurobonds and loans amounting to US\$1.3 billion) and on July 7, the authorities announced a restructuring deal on three Eurobonds issued by UkrEximBank (amounting to US\$1.5 billion).³ Discussions on the restructuring of the debt of the railway company continue.

11. **The authorities expect the discussions with creditors of sovereign Eurobonds to intensify in the coming weeks.** During this time, they have remained current on all debt service obligations falling due. At the same time, they have publicly noted that they cannot let this process drag on indefinitely, as they do not have the resources to repay public debt on its original terms. In this regard, on May 19 the Ukrainian parliament authorized the government to declare a moratorium on payments to holders of sovereign and sovereign-guaranteed debt if negotiations do not make adequate progress.

MACROECONOMIC FRAMEWORK AND RISKS

12. **The program's macroeconomic framework has been revised to take into account recent developments** (Table 1).

- **Growth.** The 2015 baseline growth projection has been marked down to -9 percent (relative to -5½ percent at the EFF approval), driven by a delayed pick up in industrial production, construction, and retail trade, and expectations of a weaker agricultural season. Domestic demand will be somewhat more constrained than anticipated earlier by tighter credit conditions and larger-than-expected decline in real incomes amid higher inflation. Growth is expected to start recovering in the second half of the year, supported by growing consumer and investor confidence, gradual rehabilitation of the banking system, and restoration of broken supply chains in metals, mining, and energy production. Later on, manufacturing should also start benefitting from the restored competitiveness of Ukraine's exports. However, the recovery is

³ The deal, supported by the Ad Hoc Committee for UkrEximBank debt, envisages a 7-year maturity extension, gradual bond amortization beginning 3–4 years after the original maturity date, and an average increase in the coupon rate of about 1.3 percentage points.

expected to take hold only gradually through 2016. Medium-term growth projections remain unchanged.

- **Inflation.** The 2015 inflation has been revised upwards to 46 percent at end-2015, compared to 27 percent at program approval, driven by the faster-than-expected pass-through effects of the large exchange rate overshooting in March. Inflation is projected to recede quickly in 2016 to around 12 percent as the one-off effects subside and economic stabilization takes hold. Monthly core inflation rates are already well below 1 percent and expected to remain in such territory, as the negative output gap, subdued demand, and the stabilization of the exchange rate will put downward pressure on inflation.
- **Balance of payments.** The overall balance of payments remains broadly unchanged. The current account deficit is expected to widen to 1.7 percent of GDP in 2015, compared to 1.4 percent of GDP at program approval. Both exports and imports are projected to decline considerably this year, driven by (i) falling export prices and larger-than-expected loss of export capacity stemming from the conflict; and (ii) the weaker economy and steeper fall of energy consumption. The small increase in the current account deficit is expected to be offset by a better-than-expected financial account, driven mainly by continued restructuring by private companies of their external claims and higher-than-expected net sales of FX cash by the population. The average exchange rate is projected at UAH 22/US\$1 in 2015, taking into account the recent stabilization of the hryvnia and assuming a slow depreciation in 2015:Q3 and Q4, reflecting seasonal factors and the programmed reserve accumulation.

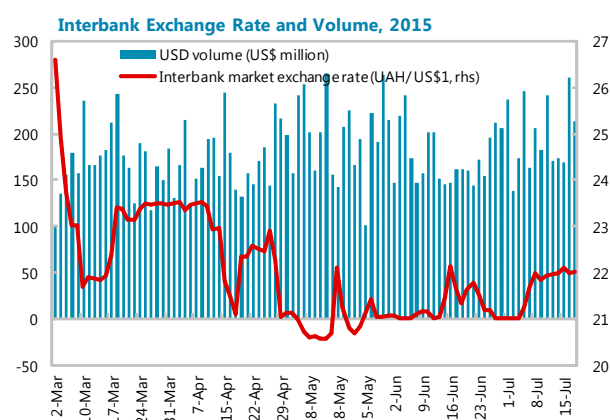
13. **Risks to the outlook remain exceptionally high.** Risks to economic growth are predominantly on the downside reflecting (i) uncertainty about the duration and depth of the conflict in Eastern Ukraine; (ii) prolongation of the discussions on the debt operation (which could disrupt capital flows); and (iii) slippages in policy implementation. In addition, confidence could fail to revive due to these factors, or due to a more protracted bank resolution process. Higher-than-expected inflation—due to inflation expectations becoming more entrenched—could reduce domestic demand further. On the upside, an early resolution of the conflict could boost confidence and growth faster than projected.

MONETARY AND EXCHANGE RATE POLICY

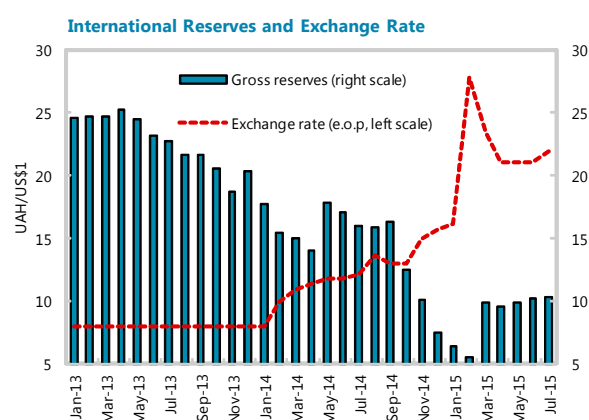
A. Background

14. **The authorities' monetary policy has been in line with the program.** The authorities have met the end-March NIR and NDA targets with comfortable margins. In order to anchor inflation expectations, the NBU has kept its discount rate unchanged at 30 percent and its CD rates at 20–27 percent (the effective rates at which it has been absorbing liquidity). It is closely monitoring price developments, paying special attention to the impact of large supply shocks from the exchange rate depreciation and energy price hikes on inflation expectations.

15. **As the balance of payments improved, the NBU has been accumulating reserves.** Since program approval, the interbank FX market has become more balanced and its volatility has declined. The temporary administrative measures tightened at the onset of the program have helped contain BoP pressures and prevented destabilizing exchange rate overshooting. These measures were recently extended for three more months. Despite the administrative measures being in place, the spread between NBU official rate and the black cash market rate has been narrow. The NBU has been accumulating reserves through market purchases (about US\$1 billion by end-June) while Naftogaz has also managed to purchase FX in the market covering the bulk of its FX needs. The NBU's purchases kept reserves at US\$10.3 billion at end-June (in line with program projections excluding the second IMF disbursement), despite delays in official financing (¶142).



Source: National Bank of Ukraine.



16. **Additional financing resources identified since program approval provide a buffer for NBU reserves in case of need.** The swap line with the People's Bank of China of RMB 15 billion (about US\$2.4 billion) was extended until 2018.

B. Policies

17. **Monetary policy stance.** The authorities and staff agreed that the current policy stance is appropriate given that (i) inflation has started to decelerate and expectations remain contained; (ii) the NBU's effective policy rate remains positive in real terms vis-à-vis core inflation on a forward-looking basis at 3–12 month horizons; and (iii) further tightening would have significant negative implications on credit, economic activity, and the fragile banks. If inflation expectations remain well anchored, inflation subsides in line with program projections, and the foreign exchange market stability continues, the monetary policy stance could be eased later in the year to support economic activity.

18. **Reserve accumulation.** In keeping with program targets, the NBU will continue to accumulate reserves through market purchases. To support the NBU's task, the Ministry of Finance has started to partially roll over the government's domestic FX debt liabilities by offering suitable

interest rate and maturity instruments. In addition, Naftogaz and other SOEs will seek to meet their import FX needs from the FX market or through FX borrowing, including from multilateral and regional development banks.

19. **Administrative measures on FX operations and deposit controls.** Staff and the authorities agreed that the current framework of capital and administrative restrictions remains appropriate for the time being, in view of the still tenuous financial situation and elevated uncertainty in the period ahead. The authorities are committed to removing the administrative measures, including capital flow measures imposed to help contain BOP pressures once conditions allow. To this end, in cooperation with Fund staff, they have developed a conditions-based plan for the gradual removal of restrictions introduced since the outset of the crisis in early 2014 (MEFP ¶6). The plan specifies conditions for the relaxation of these measures and suggests appropriate sequencing in view of the risks and uncertainties going forward. In the meantime, the NBU will continue to monitor and enforce bank compliance with existing restrictions, and enhance communication on progress being made in cleaning the banking system.

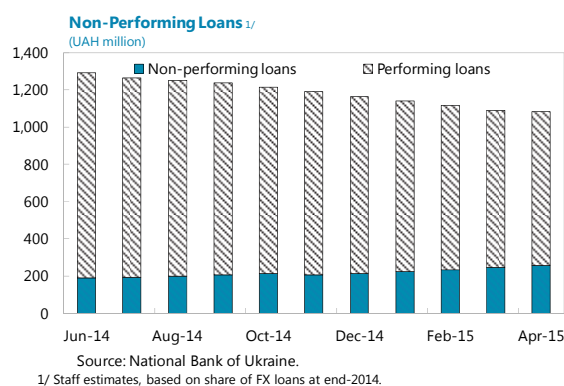
20. **The authorities are continuing their efforts to strengthen the NBU's institutional foundation and independence.** To this end, as a prior action, parliament passed amendments to the NBU law in accordance with IMF staff advice. The amendments enhance the supervisory mandate of the NBU Council and strengthen the NBU Executive Board's ability to formulate and implement financial and monetary policies. The amendments also uphold the financial autonomy of the NBU by ensuring that profits can be distributed only after the audited annual financial statements are ready and NBU general reserves are replenished.

BANKING SECTOR

A. Background

21. **The recession and sharp exchange rate depreciation increased strains on banks.**

- The NPL ratio reached 24.1 percent at end-May compared to 20.4 percent in January. Slightly less than half of the increase was due to new impaired loans, while the rest stemmed from the declining credit stock and valuation effects.
- The aggregate regulatory capital adequacy ratio (CAR) dropped to 7.7 percent at end-May 2015 compared to 13.8 percent at end-January, reflecting (i) the impact of the exchange rate depreciation on the banks' negative open position in FX; (ii) higher NPLs; and (iii) increased provisioning (from 63.7 percent of nonperforming loans to 68.5 percent).



- Since January 2014, 51 insolvent banks, accounting for 21.8 percent of the system's total assets, have been intervened (42 of them liquidated and the remaining placed under temporary administration), including two large banks.

22. **Work on addressing related-party lending has advanced.** The top 10 banks submitted reports on related party exposure based on the new legal and regulatory framework by mid-June and a review process by independent accounting firms has begun. Once this is completed, the next stage—unwinding the above-the-limit loans to related parties—will commence. Additionally, the authorities are also working on the establishment of a specialized unit that will identify and monitor loans to related parties in all banks.

B. Policies

23. **Related party lending.** To further support the review and monitoring process of related parties, the authorities plan to (i) create an internal committee to oversee the related-party review process and advise the NBU Board on the approval of the banks' unwinding plan; and (ii) enhance the NBU's monitoring capacity through greater information sharing with public registers and other financial sector regulators on shareholdings and asset ownership. The legal framework will also be strengthened to ensure that an appeal in court by borrowers—defined as related parties to a bank—does not halt the banks' unwinding plans.

24. **Bank supervision.** The NBU's supervisory capacity is being strengthened through establishment of a credit registry at the NBU and enhanced reporting of banks under special administration. Discretionary supervisory powers to request higher recapitalization of banks as a result of provisioning requirements above IFRS are being reinforced on the basis of international best practices.

25. **Bank recapitalization and resolution.** The authorities plan to focus their efforts on two fronts:

- Full implementation of the recapitalization plans based on the 2014 diagnostic studies was, by and large, achieved by end-June 2015 as planned. Thirteen banks raised their capital by a cumulative UAH 45.6 billion (2.3 percent of GDP), while five did not and were resolved. Total fiscal cost of recapitalization remains at an estimated 9½ percent of GDP, out of which 6.9 percent of GDP remain available for future needs (see below).
- A new wave of bank diagnostics, based on data as of March 2015, is underway with the aim to identify capital shortages as a result of losses associated with the recent macroeconomic shocks and the ongoing conflict in the East. To this end, the authorities have agreed to grant banks up to end-2018 to complete full recapitalization (MEFP ¶112).⁴ To this end, the largest 20 banks are

⁴ These facilities will be granted upon upfront recognition by banks of forward-looking losses in their loan portfolio (a similar gradual recapitalization approach was used in Indonesia and Korea during the Asian crisis)

set to submit credible recapitalization plans between August–October 2015, which should include clear commitments on capital injections going forward.

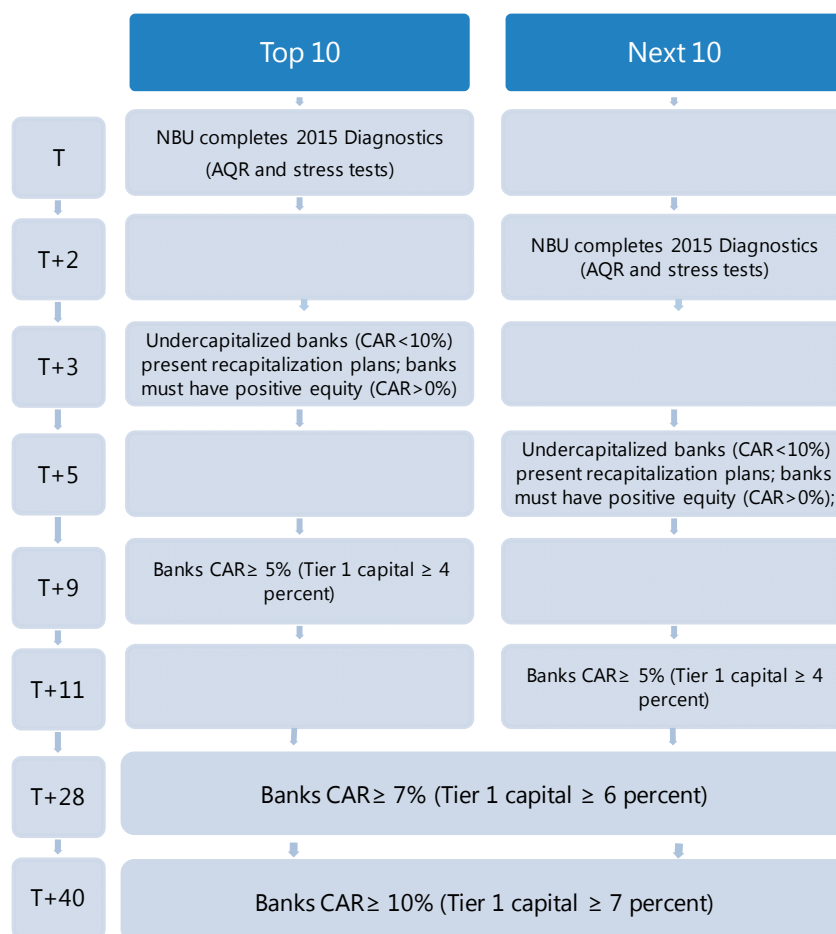
- Contingency planning to minimize fiscal costs associated with downside risks in the potential resolution of systemically important banks (SIBs) is being enhanced (MEFP ¶13). To this end, *inter alia* the authorities have agreed to:
 - provision related loans in full and transfer them into a specialized unit inside the bank in case it is needed to ensure medium-term financial viability of any resolved SIB.
 - inject public funds in the SIBs only after shareholders have been completely diluted and non-deposit unsecured creditors are bailed in (MEFP ¶14).
 - ensure that the Financial Stability Council will develop a public communication strategy to explain how the authorities' actions protect depositors and help restore financial stability.

26. **Strengthening the Deposit Guarantee Fund (DGF).** The process of improving asset recovery, depositor payout, and DGF accountability is ongoing. The authorities have extended the timeframe to complete bank liquidation from three to five years with the view to maximize asset recovery. In addition, a process has been launched to conduct due diligence investigations (forensic audits) of failed banks.

27. **Addressing NPLs.** To address the rising NPLs, the authorities will draw on the recent Fund TA and strengthen the legal framework related to private debt restructuring. Parliament will approve by end-March 2016 (**structural benchmark**) amendments to the legislation listed in MEFP ¶17, consistent with IMF staff advice, to strengthen the corporate insolvency and credit enforcement regimes and to remove tax impediments. Specifically, these will include (i) the Bankruptcy Law to address key areas of weakness; (ii) the relevant laws to strengthen the legal environment of credit; and (iii) the Tax Code and other regulations to remove disincentives to insolvency and debt-restructuring activities (MEFP ¶17). The authorities are also progressing on designing a coordinated out-of-court restructuring arrangement for corporate debt (MEFP ¶18) and facilitating the restructuring of foreign-currency denominated mortgage loans through a voluntary negotiation process between borrowers and banks (MEFP ¶19). In light of this comprehensive approach, the president has committed to veto the recent legislation on FX loan conversion (which would entail substantial losses for banks, without necessarily resolving underlying problems).⁵

⁵ On July 2, parliament adopted a bill that would require banks to convert retail FX loans into hryvnia at the exchange rate when the loan was issued (around 5 UAH/US\$1).

Timeline for Bank Recapitalization Strategy



FISCAL POLICY

A. Background

28. **The end-March general government deficit target was met with a large margin, owing to revenue overperformance and under-execution of spending.** The general government balance was in surplus of UAH 3.1 billion in 2015:Q1.⁶ Tax revenues have benefitted from higher-than-projected inflation and exchange rate depreciation. General government spending has been temporarily lower than projected, as the authorities have maintained strict discipline amid tight domestic financing conditions.

⁶ Measured below the line, as per the TMU, the surplus amounted to UAH 14.5 billion owing to valuation effects stemming from the large exchange rate depreciation in 2015:Q1. This has more than offset the increase in arrears in VAT refunds, an indicative target in the program that was missed for both March and June 2015.

29. **The authorities have also made progress with fiscal structural reforms** (MEFP ¶24).

- **Revenue administration.** In close cooperation with the Fund staff, the authorities have developed a coherent revenue administration reform strategy and started its implementation. In particular, after analyzing different models the authorities decided in favor of a revenue administration organized along functional streams, each headed by one deputy commissioner. Recognizing the challenges that are most pressing for Ukraine the reform plan includes specific measures to strengthen the fight against corruption and improve transparency. Moreover, the reform plan aims at fully integrating compliance enforcement through: demilitarizing the tax police and merging it with customs' compliance enforcement personnel; introducing a clear accountability framework for the revenue administration leadership; developing a new financial model to ensure that the revenue administration is adequately funded to meet its strategic objectives; and downsizing the revenue administration.
- **Health and education reform.** Parliament has recently approved laws allowing the public procurement of medicines through UN-based organizations, which will reduce costs. Draft laws changing the basis of public financing for healthcare and education legislation, which will allow for the consolidation of the secondary school network, are being finalized.
- **Public procurement reform.** The authorities have started piloting e-procurement in various government ministries and is developing draft legislation that will facilitate the introduction of a new procurement system starting from 2016.

B. Policies

30. **2015 budget.** The authorities remain committed to meet the programmed budget deficit of 4.2 percent of GDP and the targeted primary surplus of 1.1 percent of GDP. This is necessary to keep public debt sustainable after the debt operation is complete. The small projected revenue overperformance—after accounting for the higher interest costs stemming from the exchange rate depreciation and the monetary tightening—will be channeled to finance immediate priority needs and facilitate various structural reforms. These priority needs and reforms cover (i) national security needs; (ii) allocating sufficient funds for pensions and social assistance, including to support the internally displaced persons from the conflict in the East; (iii) clearing VAT refund arrears; and (iv) supporting ongoing judicial and civil service reforms (MEFP ¶23).

31. **2016 fiscal policy.** The authorities remain committed to the program's general government deficit target of 3¾ percent of GDP and a primary balance of 1.4 percent of GDP. The target is ambitious, due mainly to a large (about 2¼ percent of GDP) loss of one-time 2015 revenue in 2016 on account of the temporary import surcharge and the smaller NBU profit transfer. To meet the deficit target, the authorities intend to implement both revenue-raising and spending-cut measures of about equal proportions. The precise measures are still evolving, given the early phase of the budget formulation. Planned structural policies—which could cover the fiscal gap—include:

- **Agriculture VAT.** The tax code amendments, which the authorities plan to submit to parliament in September, will propose an elimination of the special VAT regime for agriculture effective January 1, 2016.
- **Social Security Contribution (SSC) reform.** Based on the analysis of the impact of recent amendments governing calculations of SSC rates, the authorities will develop—in close consultations with Fund staff—specific target features of the reformed SSC. One of the options being considered is to set a minimum income threshold against which SSC has to be paid.
- **Natural resource taxation.** By end-July 2015 the authorities will submit to parliament amendments to the tax code to shift tax burden from royalties to profits. The new taxation regime aims to strike a balance between preserving revenue (relative to GDP), while encouraging investments into the industry.
- **Revenue administration reform.** Specific measures for 2015 include (i) the introduction of the system of special VAT accounts in the whole country (in a pilot phase until June 2015); (ii) moving large taxpayers to a designated large taxpayers' office; and (iii) design of measures to enhance taxation of high-net-worth individuals.
- **Pension reform.** To strengthen the financial viability of the pension system, the authorities will subject the system to a thorough review, with the aim to launch a substantial reform that would reduce the pension bill already in 2016. The authorities will sequence the pension reform first to reform the pay-as-you-go system to reduce its structural deficit and will consider the introduction of the funded pillar by the time when all key preconditions are expected to be in place. Parliamentary adoption of the pension reform is expected by end-December 2015 (MEFP ¶24).
- **Wage bill.** The authorities will continue downsizing the budget sector, with proper compensation and safety-net programs (MEFP ¶24).
- **A strengthened medium-term budget framework.** The authorities remain committed to maintain key macroeconomic indicators, fiscal objectives and targets, and revenue and expenditure policies in line with the program commitments. The expenditure ceilings will be calibrated to deliver the adjustment needed for 2016–18. To this end, total expenditure in 2016 will be contained below 43.4 percent of GDP, of which current expenditure will not exceed 40.8 percent of GDP. The medium-term budget planning process will be strengthened to ensure that targeted ceilings for 2017–18 are achieved.

ENERGY POLICY

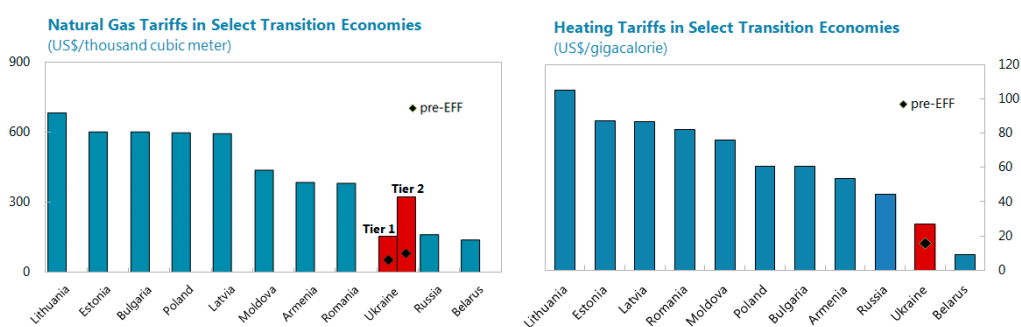
A. Background

32. **Progress is being made in tackling Naftogaz's deficit, despite economic headwinds.** In 2015:Q1, the deficit reached 0.7 percent of GDP, within the program target. Revenue collections were lower than projected, in part due to the weak economy. However expenditures were contained, in part by lower import volumes. Under the latest projected energy import prices and exchange rate, the 2015 deficit target relative to GDP remains within reach, as does the medium-term objective to eliminate the Naftogaz deficit by 2017.⁷

B. Policies

33. **The authorities have started reforming the loss-making and opaque energy sector.** The sector weighs heavily on public finances, the external sector, and the overall economy. Very low prices for residential gas and district heating encourage excessive energy consumption and lead to large losses by Naftogaz, drive gas imports up, discourage investment in domestic production, and breed governance problems.

- **Gas and heating prices increases.** Gas prices for households were increased by 285 percent on average, effective April 1. Heating prices were also increased by 67 percent, effective May 8.⁸ Despite these increases, gas and heating prices remain among the lowest in the region. The program aims to reach 75 percent of cost recovery gas and heating prices based on international prices by April 2016 and 100 percent by April 2017.



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

⁷ An interim agreement through 2015:Q2 was reached in March between Naftogaz and Gazprom at a price of US\$248/tcm. However, trilateral negotiations between Ukraine, Gazprom and the European Commission ended without agreement on extending gas supply for 2015:Q3. Talks on supply for Q4 and beyond are expected to resume later in 2015.

⁸ The impact of the delay on Naftogaz's deficit is estimated to be around 0.04 percent of GDP.

Box 1. Impact of Social Assistance on Household Utility Costs

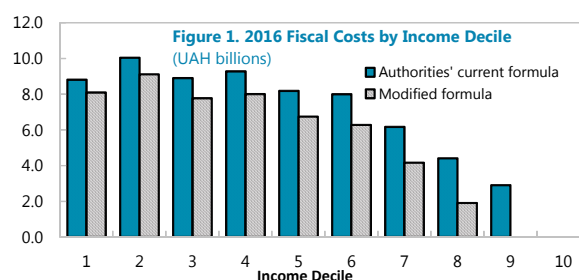
The Ukrainian authorities have initiated an ambitious and comprehensive reform agenda for the energy sector. In the context of this agenda, the authorities aim to bring gas and heating prices to cost recovery based on international prices by 2017 as low prices weigh on public finances, push gas imports up, and discourage investment in domestic production.

Higher gas and heating prices will be accompanied by additional social assistance to support vulnerable households. Under the program, energy-related benefits will be scaled up significantly from UAH 6 billion in 2014 to around UAH 21 billion this year and UAH 43 billion in 2016 (Table 1). In addition, the current system will be reformed to better target benefits to the most vulnerable households.

Table 1. Estimated Costs of Social Assistance

	2015	2016	2017
	(UAH billions)		
1. Existing programs and formula	20.6	55.5	96.5
2. Merger and modified formula by May 2016	20.6	43.0	61.3
	(Percent of GDP)		
1. Existing programs and formula	1.0	2.5	3.8
2. Merger and modified formula by May 2016	1.0	1.9	2.4

Source: National authorities and IMF staff calculations.



Existing social assistance programs are being streamlined to improve targeting. Following the recent elimination of the largely-redundant “energy compensation” program, there are two remaining energy-related social assistance programs: the category-based privileges program and the formula-based housing utilities subsidy program. The authorities have committed to streamline these two programs and modify the benefits formula by May 2016 to reduce the current near-universal coverage at upper income levels. In the meantime, the privileges program is being means tested to help target benefits to lower income households.

There are various modifications to the authorities’ current formula which would improve targeting. By way of illustration, the authorities could require larger contributions to the utility bill, in particular from higher-income households. A fiscally sustainable option would increase average household contribution by 2 percent of income and 8 percent of the utility bill on average, and even less for lower income groups.

Table 2. 2016 Utility Payments as a Share of Household Income

	Decile										Avg.
	1	2	3	4	5	6	7	8	9	10	
1. Under existing formula	0.08	0.09	0.09	0.10	0.11	0.12	0.13	0.14	0.16	0.23	0.12
2. Under modified formula	0.09	0.10	0.11	0.12	0.12	0.13	0.14	0.16	0.18	0.26	0.14

Source: IMF staff calculations.

- **Social safety net.** To help protect vulnerable households, social assistance is being scaled up significantly. Given the gas and heating price increases, energy-related benefits would increase from 0.4 percent of GDP in 2014 to a budgeted 1.2 percent this year, which is expected to be sufficient to cover eligible households. However, reforms will be needed to ensure sustainability of the social assistance system in 2016 and beyond. Staff and the authorities agreed on the need to streamline energy-related social assistance programs by May 2016 in order to improve targeting and manage fiscal costs (Box 1).

- **Gas market law.** The law, which was approved by parliament in April and becomes effective on October 1, establishes a new model of the gas market in Ukraine and paves the way for Naftogaz's restructuring, planned to be completed by June 1, 2016.
- **Naftogaz receivables.** An independent audit of Naftogaz receivables (end-June SB) has been completed.
- **Naftogaz collections.** Legislative amendments to improve Naftogaz collections were delayed (end-March SB). On May 14, the 2005 moratorium on enforcement proceedings against energy companies was lifted, effective September 1. The moratorium on enforcement proceedings against companies with at least 25 percent state ownership with debts to Naftogaz and its daughter companies is expected to be lifted as a **prior action**.

STRUCTURAL REFORMS

A. Background

34. Since the approval of the program, the authorities have made progress in implementing structural reforms.

- **Anti-corruption.** The National Anti-corruption Bureau (NAB) has been established (end-April SB) and the AML framework is being strengthened to assist prevention and detection of misuse of financial institutions by corrupt officials (end-June SB). A program implementing the anti-corruption strategy until 2017 has recently been adopted by the Cabinet of Ministers.
- **Business climate.** In April, parliament adopted a Law on Investor Protection aimed at (i) safeguarding minority shareholder's rights; (ii) improving transparency in business transactions; and (iii) strengthening independent audits.
- **Deregulation.** In March, the government adopted a deregulation action plan to remove a large number of regulatory and legislative impediments to a growth-conducive business climate. The first monthly report on progress with implementation of the plan has been published on the State Regulatory Service (SRS) website. Moreover, two laws, which substantially reduce the number of licenses and permits, were adopted by parliament in March.
- **Judiciary.** In February, parliament adopted a Law on the Judiciary and the Status of Judges as an initial step to strengthen effectiveness of the judiciary. This law is a step forward, although the Venice Commission of the Council of Europe also identified a number of important shortfalls, necessitating amendment of the constitution. The law on selective increases of court fees to provide financial incentives on whether or not to litigate and complement the budget of the judiciary was approved in May.
- **SOE reform.** (i) The first annual report on Ukraine's top 100 SOEs has been published; (ii) in May, the cabinet approved a list of about 350 state-owned assets that are subject to privatization in 2015 and the State Property Fund has prepared a privatization strategy for 10 SOEs among

them; (iii) in May, the first statement of fiscal risks assessment was prepared and the SOEs reform strategy was adopted; and (iv) the authorities have also prepared a draft law on corporate governance and are implementing a new nomination procedure for appointment of CEOs in SOEs through an independent committee.

B. Policies

35. **Business climate.** The authorities remain committed to streamlining business procedures and strengthening transparency and governance to attract investors and spur growth. In the near term, they will (i) ensure full implementation of the deregulation action plan; (ii) prepare a broad-scale revision of regulatory norms to reduce the burden and administrative costs on business; (iii) ensure all new and amended draft legislation includes a quantitative analysis of their regulatory impact starting October 2015; and (iv) take the necessary steps to ensure that the recently adopted law on licensing of business activities is fully operational (MEFP ¶129).

36. **Anti-corruption and anti money laundering (AML).** Addressing corruption is a difficult endeavor in Ukraine's context. Investigations on the recovery of assets allegedly stolen by the former regime have not led to any significant confiscation yet, the public does not see major progress in reducing or sanctioning corruption, and vested interests continue to threaten recent progress. The authorities' ongoing efforts can support progress towards tangible results, including by making the NAB operational (**structural benchmark**) and able to access relevant information and supported by a specialized and autonomous anticorruption prosecution function (**structural benchmark**). The steps taken by the NBU and the financial intelligence unit to implement the AML framework, in close coordination with Fund TA, should assist in preventing and deterring the laundering of the proceeds of corruption. The government's initiative to amend the legal framework for asset disclosure, particularly to ensure that high-level officials disclose assets they beneficially own or control, is critical to facilitate corruption investigations.

37. **Judicial reform.** To strengthen the management of the judiciary, including on disciplinary oversight, the authorities will ensure that the High Council of Justice will become fully operational including by a prompt allocation of the budget to meet salary requirements. The authorities will also develop measures to speed up debt-claim enforcement, including order of payment procedure, garnishment, and setting up a private enforcement profession.

38. **SOE reform.** The authorities will continue implementing SOEs reform in line with the recently adopted SOE reform strategy. In the near term, they will focus on enhancing SOEs fiscal-risk assessment through the establishment of an inter-ministerial working group tasked with identifying and monitoring fiscal risks and preparing recommendations for risk-mitigating measures. The authorities are also pressing ahead with an ambitious privatization and restructuring agenda. Following the preparation of a priority-privatization list of 10 SOEs and respective privatization action plans, the authorities will seek adoption, by cabinet resolution, of the action plans for five companies by end-September 2015 (**structural benchmark**). Finally, the authorities will prepare a list of 10 SOEs posing the biggest fiscal risks that will be restructured and will prepare detailed

restructuring action plans for five of these companies by end-January 2016 (**structural benchmark**). Necessary legislative steps to support these actions will be pursued, including adoption of a government decree mandating external audits for at least the largest 100 SOEs and a review of needed changes to the SOEs remuneration policy to better align shareholders and management's interests (MEFP 130).

Box 2. The SOE Sector in Ukraine

Ukraine's SOEs still account for a sizeable share of the economy, with assets equivalent to around 50 percent of GDP. The sector remains highly inefficient, characterized by weak governance and legal structures. Moreover, fiscal risks stemming from SOEs are significant. A comprehensive reform agenda is needed to tackle these deep-seated problems.

SOEs still play a significant role in Ukraine's economy. Ukraine has 1,833 operating SOEs out of 3,350 registered SOEs, with output amounting to around 10 percent of GDP. A few large companies dominate the sector, with the top 100 SOEs accounting for around 90 percent of total SOE assets. The main industries of operation include energy, infrastructure, and manufacturing.

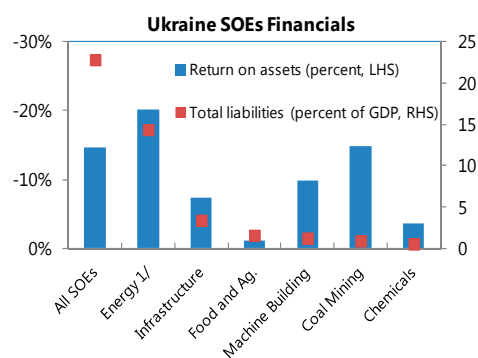
Severe inefficiency problems in the sector are rooted in weak corporate governance systems. Ukraine SOEs generally lack proper corporate governance structures, such as supervisory boards or independent directors, geared at improving efficiency in operations. In this regard, appointment of SOE management lacks transparency and accountability, resulting in ill-prepared ownership. Moreover, financial statements of SOEs are considered to be unreliable as most SOEs are not subject to independent audits. The legal framework for SOEs in Ukraine also presents significant shortcomings, with unwieldy and fragmented legislation contributing to governance gaps.

A large number of loss-making enterprises represent a significant fiscal risk for government finances.

The operating and financial results of SOEs reflect the acute deficiencies that characterize the system: 740 out of 1,833 operating SOEs were loss-making through 2014:Q3, with losses amounting to around 1 percent of GDP. SOEs have also accumulated substantial liabilities at around 12.3 percent of GDP.¹ Unprofitable enterprises represent a significant fiscal risk as these may require ever increasing budget funding (subsidies, grants, and loan guarantees): Direct subsidies to SOEs in 2014 amounted to around 2 percent of GDP while the stock of outstanding loan guarantees is around 3.5 percent of GDP. Moreover, accumulation of arrears by SOEs is another source of risks for the government.

A broad-based reform agenda is needed. The authorities have formulated a reform strategy aimed at increasing SOE efficiency. This includes (i) improving budgetary oversight by enhancing the fiscal risk assessment; (ii) implementing a comprehensive ownership policy; (iii) strengthening corporate governance, including by adoption of a new law on corporate governance; (iv) prioritizing enterprises subject to restructuring; and (v) transparent privatization in the medium run.

¹ Numbers exclude Naftogaz. Including Naftogaz, the ratio reaches 22.8 percent of GDP.



Source: Ministry of Economy. Data through September 2014.

^{1/} Includes Naftogaz.

PROGRAM FINANCING AND MODALITIES

A. Program Monitoring

39. **The attached Letter of Intent (LOI) and Memorandum of Economic and Financial Policies (MEFP) describe the authorities' progress in implementing their economic program and set out their commitments.** Modifications to the program's conditionality are proposed as well as PCs for end-September 2015 and end-December 2015, and new structural benchmarks (MEFP Table 1). One structural benchmark relating to the Code on Civil Procedure is proposed to be reset in light of additional time needed for technical preparations.

B. Financing Assurances

40. **Firm financing assurances are in place for the next 12 months, with good prospects for the rest of the program.** Notwithstanding some delays in disbursements, official financing commitments are broadly on track. Since program approval, Turkey has announced fresh financing of US\$50 million for budget support and US\$10 million worth of humanitarian assistance, and Sweden is in discussions about extending a US\$100 million loan in 2016. Disbursements from other multilateral and bilateral donors are also broadly on track. Specifically, Canada's C\$200 million and EC's €250 million have been disbursed, and a US-guaranteed US\$1 billion bond has been issued. The authorities have also ratified an agreement with the EC on a third MFA operation for €1.8 billion, of which €600 million is expected to be disbursed before end-July. Two DPLs of US\$500 million each from the World Bank and an associated loan of US\$300 million from Japan are expected to be disbursed shortly once the related prior actions for the DPLs are met.

41. **The authorities are committed to continuing constructive efforts to reach agreement with creditors in line with the debt objectives set in the program.** Successful completion of the debt operation in the coming months would close the financing gap in 2015–18, and put debt firmly on a sustainable path. If discussions with private creditors reach an impasse and a timely agreement proves infeasible, the authorities have publicly noted their preparedness to impose a temporary moratorium on debt payments while continuing best efforts to reach an appropriate restructuring agreement. The debt operation, as discussed above, together with the financing commitments from multilateral and bilateral donors, should provide sufficient financing to meet financing needs over the next 12 months.

C. Capacity to Repay the Fund and Risks to the Program

42. **Under the baseline, Ukraine's capacity to repay the Fund remains adequate** (Table 7). Repayment to the Fund over the next five years would peak at a manageable 7.6 percent of reserves in 2018. The debt operation would also keep gross financing needs contained during the period when the first large repayments come due to the Fund in 2018 as well as during the post-program period, mitigating risks to the Fund. With the envisaged policies and reforms, the revival of growth,

the external and fiscal adjustment, and the buildup of reserves, Ukraine is expected to have an adequate capacity to repay the Fund. By the end of the arrangement in early 2019, outstanding credit to the Fund is expected to peak at about 16.4 percent of GDP, or 54 percent of gross reserves. Debt service to the Fund as a ratio of exports of goods and services would peak at 4 percent in 2018.

43. **Notwithstanding these factors, risks remain exceptionally high given the large uncertainties surrounding the baseline scenario.** The main risk is related to geopolitical developments. While the program can adapt and withstand moderate domestic and external economic shocks, Ukraine's ability to repay could be adversely affected by a prolonged or intensified conflict that could weigh further on market and investment sentiment. Regarding program implementation, policy reversals, including regarding the flexible exchange rate policy and fiscal/energy price adjustment could lead to continuing balance of payments problems and raise repayment risks. The longer Fund engagement under the EFF will help support Ukraine undertake deeper reforms, but it also commits Fund resources for a longer period.

44. **A recent safeguards mission confirmed that the NBU has made progress in strengthening its governance and control environment.** The amendments to the NBU legal framework, enacted in June (prior action), will further improve financial autonomy and governance. To address the credit risks stemming from the financial assistance to domestic banks, the assessment recommended that the ongoing reforms of the loan management process be given priority and fully implemented by October 2015 (MEFP ¶31).

Box 3. Exceptional Access Criteria

Staff is of the view that the program continues to satisfy the substantive criteria for exceptional access. This assessment is premised on the expectation that the authorities' policies under the program are implemented in full and completed in line with the program's objectives.

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. Official reserves remain low at US\$10.3 billion at end-June, covering only 23 percent of short-term debt. To stabilize the foreign exchange market, a package of capital control measures has been implemented. In addition, Ukraine faces risks of further economic and trade disruptions from an escalation of geopolitical tensions. Together, these factors generate actual and potential financing needs beyond what can be financed within normal limits, despite expected financial support from the international community.

Box 3. Exceptional Access Criteria (concluded)

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.* The authorities have made progress in discussions with creditors towards the debt operation in line with its stated objective (see ¶10 above). After the debt operation, public debt-to-GDP ratio is projected to decline steadily to around 70.8 percent of GDP by 2020. While debt would remain high relative to high-risk thresholds, this is compensated by gross financing needs staying significantly below DSA higher risk benchmarks. Sensitivity tests show that debt remains on a sustainable path after a number of macroeconomic shocks. A large shock associated with a sharp escalation of the conflict in the east could render debt dynamics unsustainable, but most observers consider this scenario unlikely. In light of the preceding discussion, staff judges that the debt will become sustainable over the medium term with high probability.

Criterion 3. *The member has prospects of gaining or regaining access to private capital markets within the timeframe when Fund resources are outstanding.* The policy and financing mix under the program addresses the long-standing domestic and external imbalances needed to stabilize the economy and revive growth in the medium term. These measures, together with the effects of a completion of the debt operation in line with the authorities' objectives would improve confidence in the economy, helping to bring Ukraine CDS and bond spreads down and ultimately lead to regaining market access. Staff anticipates that with a successful implementation of the program and the debt operation, combined with support from the broader international community, Ukraine has good prospects for regaining access to private capital markets before the end of the program period. That said, in case that an agreement with creditors is not reached within a reasonable period and a moratorium on debt service is imposed, arrears to private creditors will provide temporary program financing. In this event, it will be important that the authorities continue to pursue good-faith efforts to reach a collaborative agreement with creditors in a timely manner in line with the objectives of the program and the Fund's lending into arrears policy, which should allow the authorities to return to markets in due course.

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.* The authorities performed reasonably well under the SBA-supported program and the EFF-supported one is on track with all PCs for end-March and end-June met. Key prior actions and structural reforms in areas such as NBU independence, Naftogaz reforms, gas-market law, anti-corruption legislation, SOE reforms, and banking resolution have been implemented, notwithstanding the adverse economic environment. While the conflict in the East and growing populist pressures in parliament present major challenges, the authorities' willingness and capacity to implement the program and prevent policy reversals remain strong, as evidenced by parliament's recent refusal to consider populist bills that aimed to roll back program policies and the president's commitment to veto any such legislation (MEFP ¶23). Given the authorities' implementation of program conditionality and indications of stabilization of Ukraine's conflict situation, staff is of the view that there are reasonably good prospects for program success.

STAFF APPRAISAL

45. **Tentative signs of stabilization have appeared, but the economy is yet to turn around.**

Following a challenging period that took a heavy toll on the economy and the Ukrainian population, the conditions are now in place for economic activity to turn the corner. The balance of payments is in line with program projections, the foreign exchange market has stabilized, and the NBU is accumulating reserves. The fiscal position was better than programmed. However, the more prolonged recession and the higher inflation pose new challenges that need to be tackled.

46. **To entrench stability and restart growth, the authorities need to persevere with the decisive and timely implementation of policies and reforms under the program.** Against significant headwinds, the authorities showed again their determination to stay the course of the program. This same determination is needed in the period ahead, as significant structural and institutional reforms are pending, which are necessary to address economic imbalances that held Ukraine back in the past. However, although domestic support for a new Ukraine is strong, pressures from populist forces and vested interests are growing. Moreover, the local elections in the fall pose a risk that the reform momentum could fade. Against this, the authorities need to garner the necessary support to prevent policy reversals and push ahead reforms that are so needed to achieve robust and sustainable growth.

47. **Maintaining an appropriately tight monetary policy and continuing with the targeted buildup of reserves will be critical to entrench stability.** The authorities need to keep monetary policy oriented toward supporting disinflation, towards the aim of broader macroeconomic stability and to protect the incomes of the most vulnerable. Consistent with transitioning to a flexible exchange rate regime, and as market conditions permit, the NBU should continue to accumulate reserves through market purchases. For the time being, however, administrative measures will need to continue to play a critical role in guarding against BOP pressures. As external stability becomes more entrenched, and as disinflation gains speed, monetary policy can be carefully eased to support economic activity. In parallel, and in a coordinated manner, the authorities should proceed, in close consultations with the Fund, with removing administrative measures in a gradual and sequenced manner, carefully monitoring the impact of the relaxation. The temporary import surcharge should be allowed to expire at end-2015 as planned.

48. **Efforts to restore a sound banking system to support the economic recovery need to advance in a decisive manner.** To this end, implementation of the program's strategy to strengthen banks' financial health, through recapitalization, reduction of related-party lending, and resolution of impaired assets will be critical to regain public confidence and support economic recovery. In addition, the authorities need to proceed with the NBU institutional reform to entrench central bank independence and facilitate implementation of inflation targeting in due course.

49. **Maintaining fiscal discipline in 2015 and formulating a robust 2016 budget consistent with the program are critical to reduce fiscal vulnerabilities.** The reform agenda is challenging but important. Reforms to rationalize expenditure and improve tax administration need to proceed,

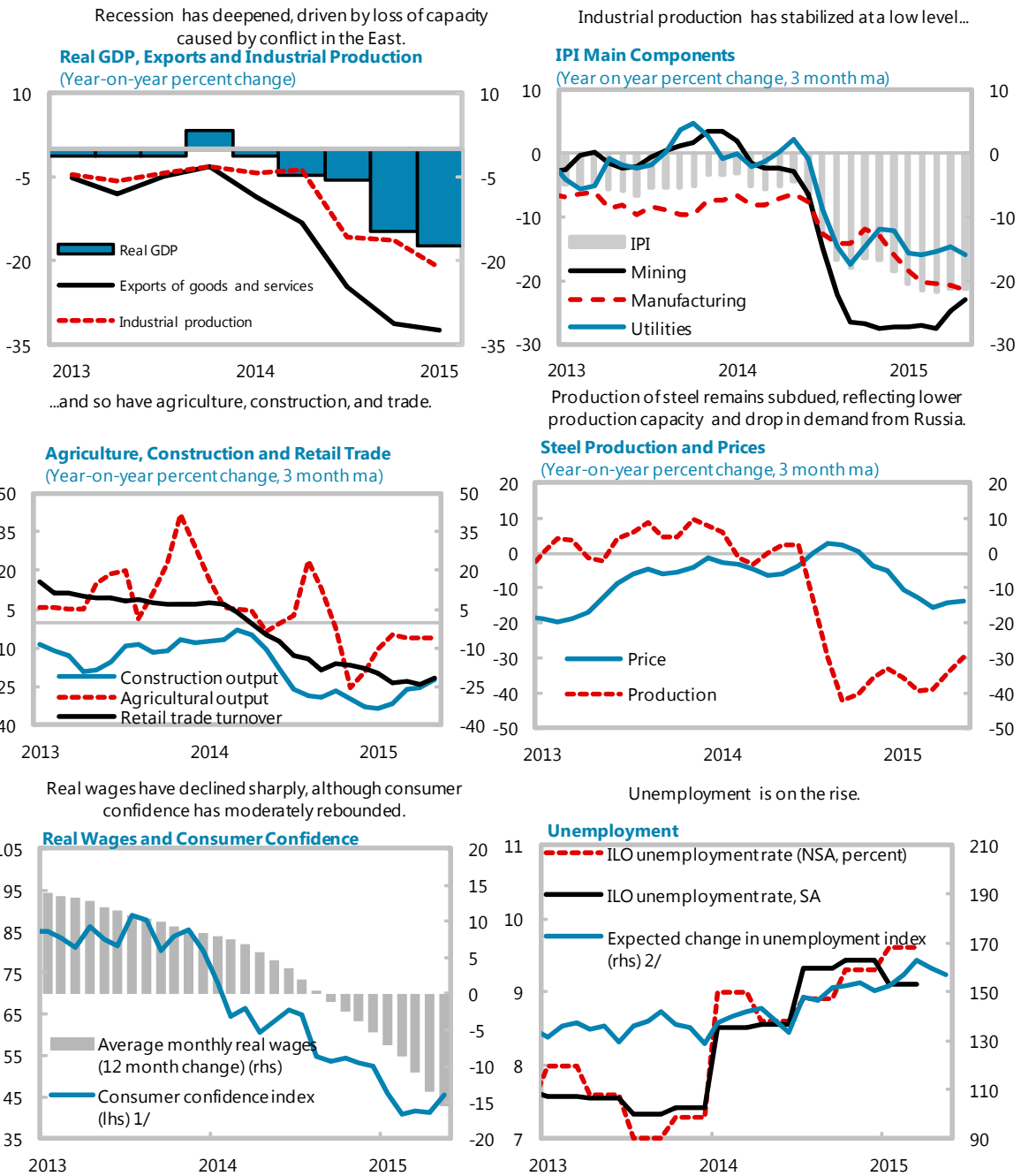
while the social safety net should be strengthened. Pension, health, and education reforms remain critical for ensuring that the budget remains in line with program understandings in 2016 and beyond. These reforms have been difficult for Ukraine in the past, and success will require careful design as well as building stakeholder coalitions to overcome resistance. Structural measures to enhance collections of receivables and reform Naftogaz need to be implemented expeditiously to limit Naftogaz's fiscal burden in the short run and eliminate Naftogaz deficit by 2017 as targeted.

50. **Further substantial progress with structural reforms is essential for enabling strong recovery of investment and private economic activity.** Overhauling governance and fighting corruption, improving the business climate, and reforming state-owned enterprises should remain the authorities' priorities. To this end, anti-corruption and judiciary reforms should proceed in a timely manner. A successful reform of the SOEs sector, although not without its challenges, will substantially limit fiscal risks and support development of the private sector of the economy.

51. **The authorities' efforts merit adequate financial support from all partners.** The authorities need to ensure that all conditions for the disbursement of multilateral and official bilateral loans are implemented on a timely basis. At the same time, the authorities and the creditors need to continue their efforts to reach a collaborative agreement in line with program objectives, to close the financing gaps and restore debt sustainability with high probability. Since Ukraine lacks the resources under the program to fully service its debts on the original terms, which it has recognized in passing legislation enabling a moratorium, and since significant debt service will come due by the end of the third quarter of 2015, timely completion of the debt operation with high participation is important. If the authorities were to decide on imposing a moratorium, it would be important for Ukraine to continue efforts to reach a collaborative agreement with creditors in line with the Fund's policy on lending into arrears, which applies to private creditors. With respect to debt owed to official creditors, staff is of the view that there are a range of options that would be available to deal with these claims, if a need arises.

52. **In view of the authorities' performance under the program, their policy commitments for the period ahead, and progress towards the debt operation in line with its stated objectives, staff recommends the completion of the first review.**

Figure 1. Ukraine: Real Sector Indicators, 2013–15



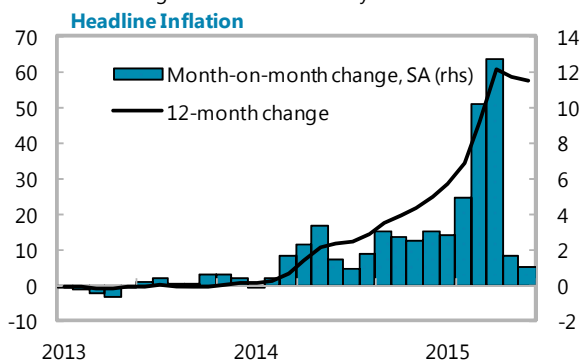
Sources: State Statistics Committee of Ukraine; Haver; Bloomberg; GFK Ukraine; International Centre for Policy Studies; and IMF staff calculations.

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.

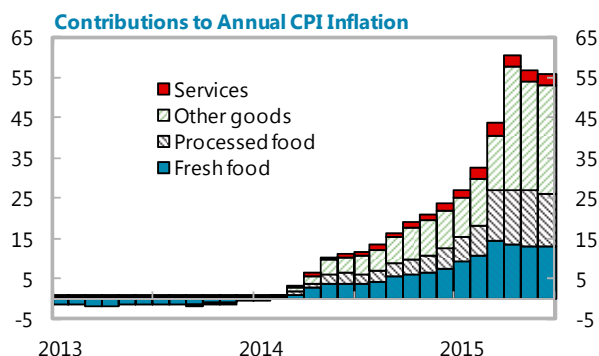
2/ Values above 100 indicate that more respondents expect unemployment to rise than fall over the next one to two months. Values can vary from 0 to 200.

Figure 2. Ukraine: Inflation, Monetary, and Exchange Rate Developments, 2013–15
(Year-on-year percent change, unless otherwise indicated)

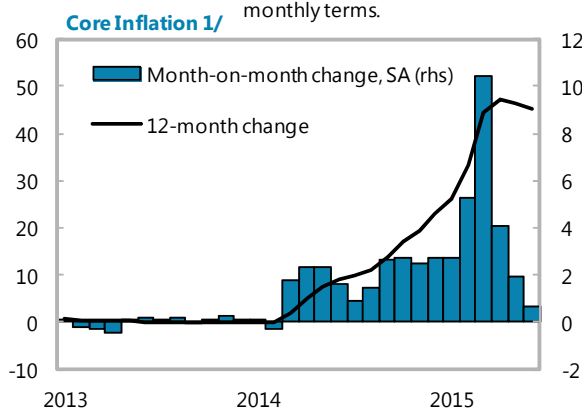
After peaking in April, inflation has eased sharply, reflecting weak demand and hryvnia stabilization.



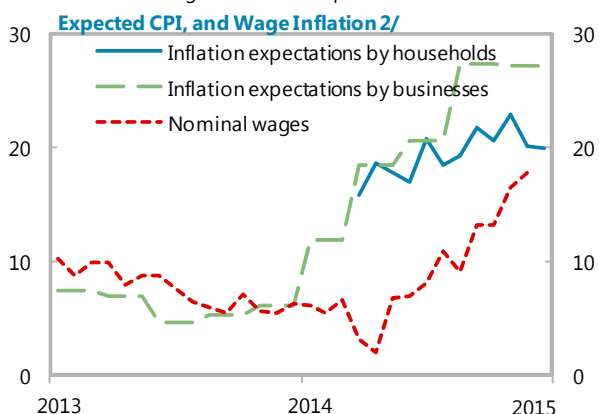
In June, prices of imported goods and non-tradables declined...



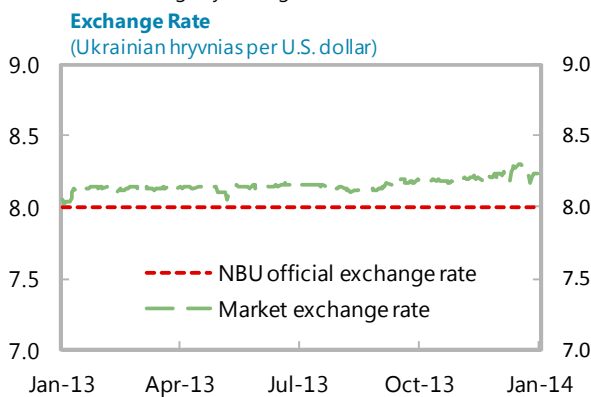
... as did core inflation, which has plummeted in monthly terms.



Nominal wage growth started to pick up, reflecting higher inflation expectations.



In 2013, NBU fixed the official exchange rate and tightly managed the market rate.



Since the NBU has let the exchange rate float, the hryvnia has lost about 60 percent of its value, though it has remained broadly stable in recent months.



Sources: State Statistics Committee of Ukraine; International Centre for Policy Studies; National Bank of Ukraine; Bloomberg; <http://fin.biz.ua>; and IMF staff calculations.

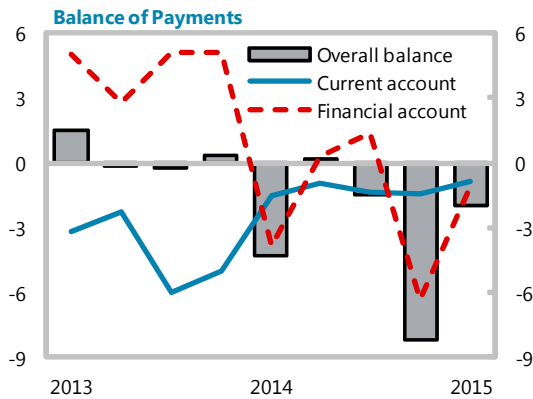
1/ Broad core excludes unprocessed food, fuel, and administrative services.

2/ 12-months ahead inflation expectations. For businesses from Business Outlook Survey, conducted by the NBU. For households from GfK-Ukraine Consumer Confidence Survey.

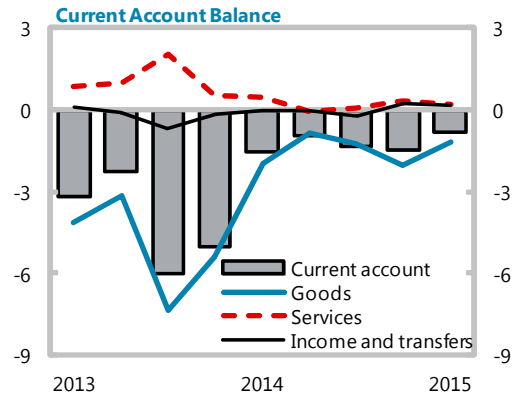
Figure 3. Ukraine: External Sector Developments, 2013–15

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

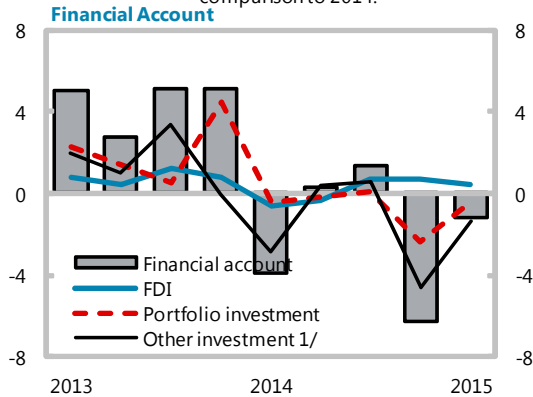
The external position improved in 2015:Q1 in line with program projections.



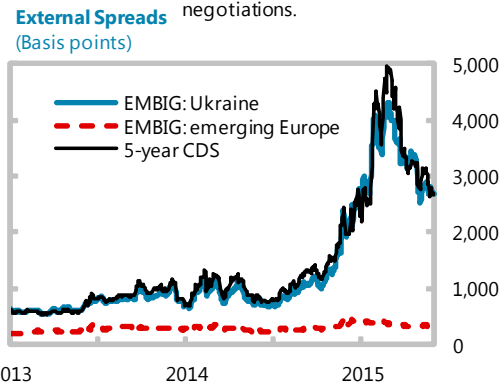
The current account deficit continued to narrow...



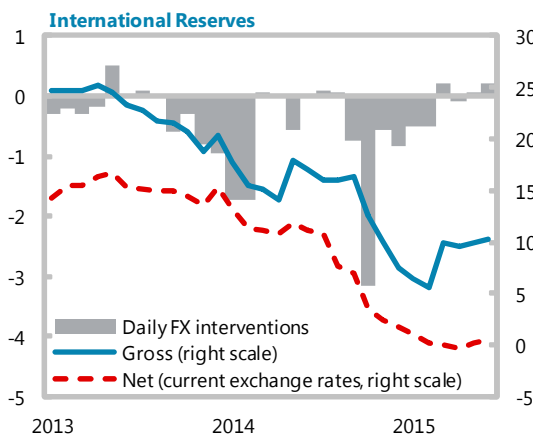
...and net capital outflows were limited in comparison to 2014.



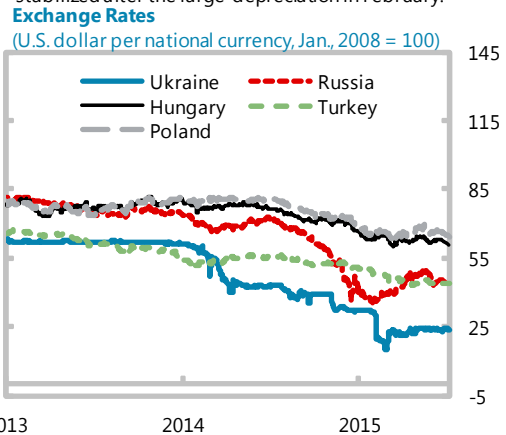
Spreads continue to reflect expectations of deep NPV reductions in the ongoing debt restructuring negotiations.



Gross reserves have started recovering...



...and like in other countries, the exchange rate has stabilized after the large depreciation in February.

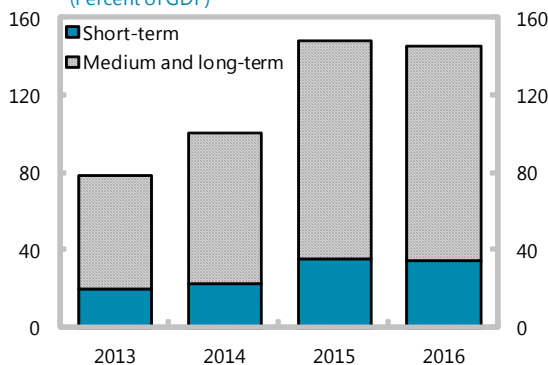


Sources: National Bank of Ukraine; State Committee of Statistics; Bloomberg; and IMF staff estimates and calculations.
1/ Includes residents' conversion of hryvnia cash to foreign currency held outside the banking system.

Figure 4. Ukraine: Debt and Rollover of Debt, 2013–16 ^{1/}

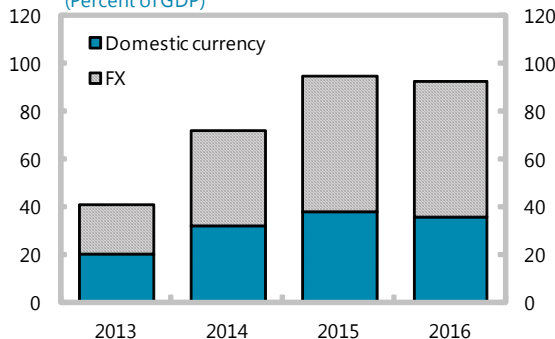
External debt is projected to exceed 150 percent of GDP in 2015...

External Debt
(Percent of GDP)



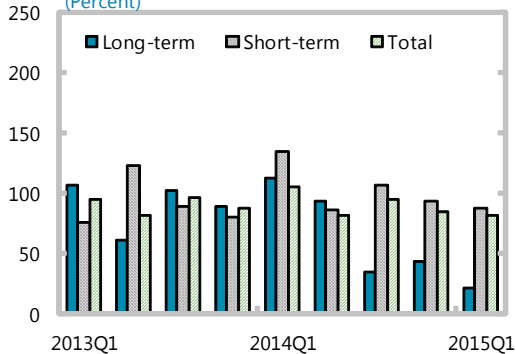
...while public debt will exceed 90 percent of GDP, partly due to exchange rate depreciation and bank recapitalization needs.

Public Debt
(Percent of GDP)



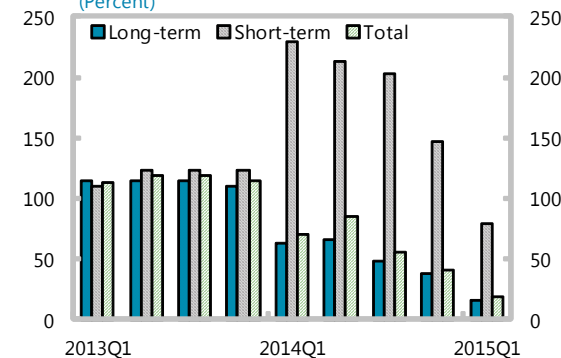
Bank rollover rates for long-term debt have weakened considerably.

Bank Rollover Rates
(Percent)



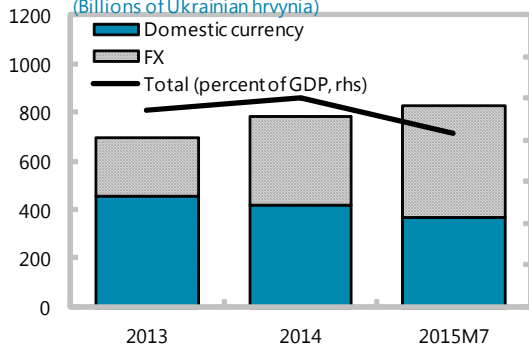
Corporate rollover rates remain subdued, with long-term financing severely constrained.

Corporate Rollover Rates
(Percent)



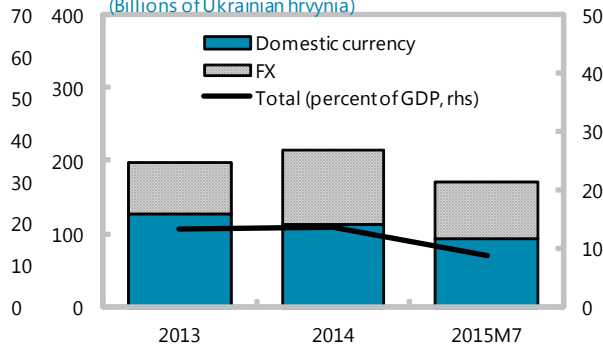
Corporate debt is declining, although hryvnia depreciation had significant balance sheet effects.

Corporate Loans
(Billions of Ukrainian hryvnia)



Household debt continues to decline as banks tighten credit.

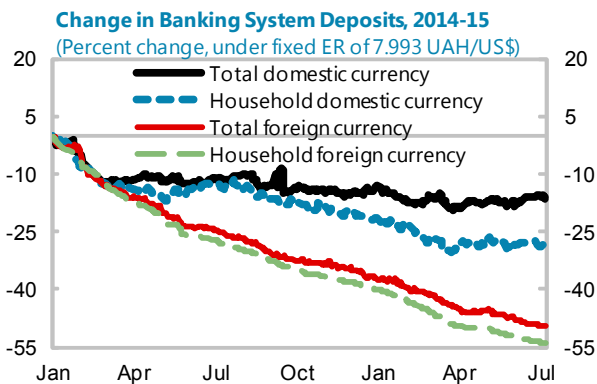
Household Loans
(Billions of Ukrainian hryvnia)



Sources: National Bank of Ukraine; Bloomberg; Ministry of Finance; and IMF staff estimates. 1/2015–16 are projections.

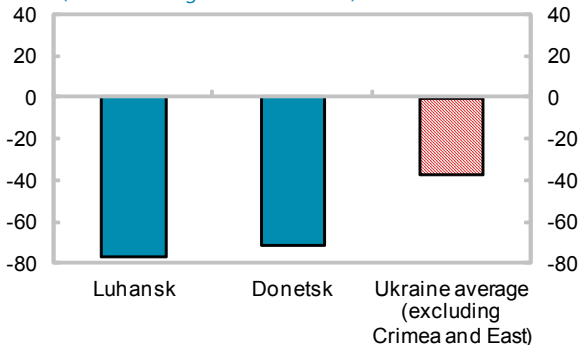
Figure 5. Ukraine: Banking Sector Deposits and Credit, 2014-15

Declines in household deposits have driven deposit trends since the start of the crisis...

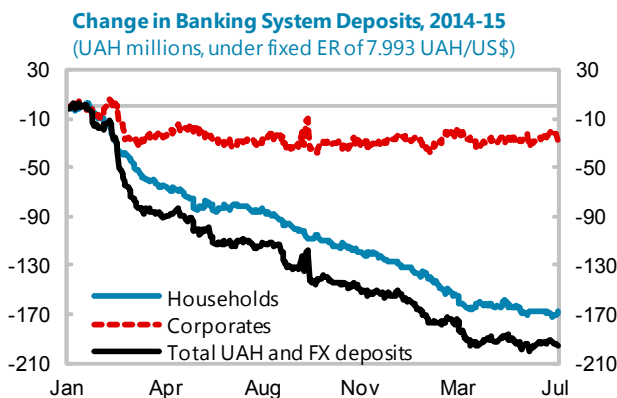


...with declines substantially higher in regions most affected by the conflict.

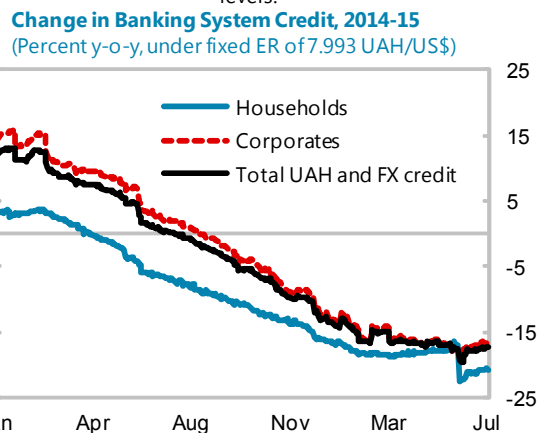
Household Deposits in Selected Regions, May 2015
(Percent change from end-2013)



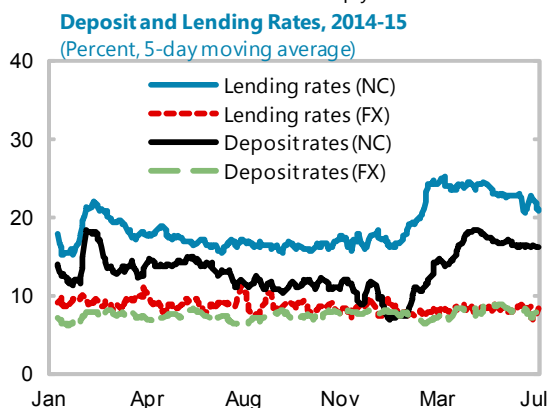
Household deposit outflows have moderated...



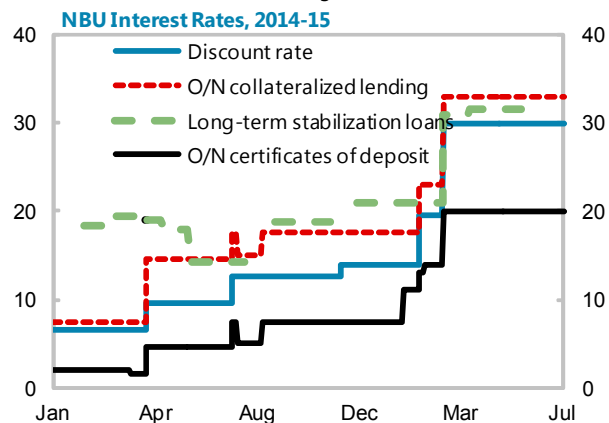
...and credit to households has stabilized at low levels.



Interest rates on hryvnia loans and deposits have increased sharply...



...following the increase in NBU's policy and refinancing rate.



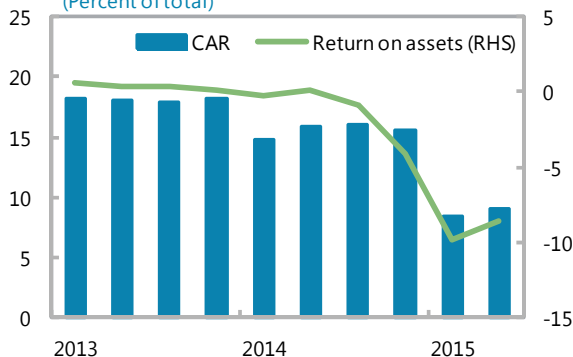
Sources: National authorities; and IMF staff estimates.

Figure 6. Ukraine: Financial Sector Indicators, 2013–15

(Billions of Ukrainian hryvnias, unless otherwise indicated)

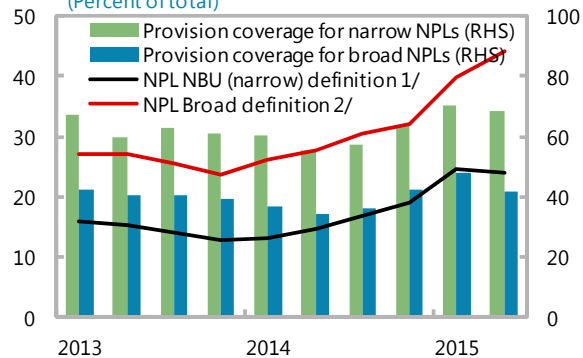
Capital and profits have decreased due to currency depreciation and the recession...

Capital adequacy and profitability
(Percent of total)



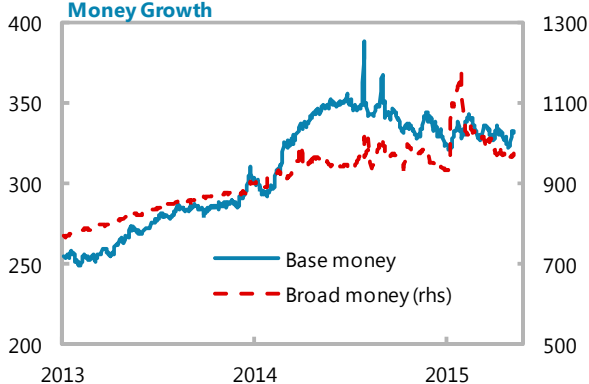
...with asset quality deterioration still ongoing.

Asset quality
(Percent of total)



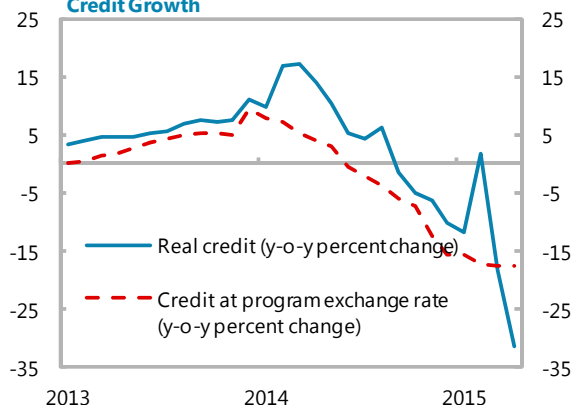
After a spurt of inflation, money growth has slowed.

Money Growth



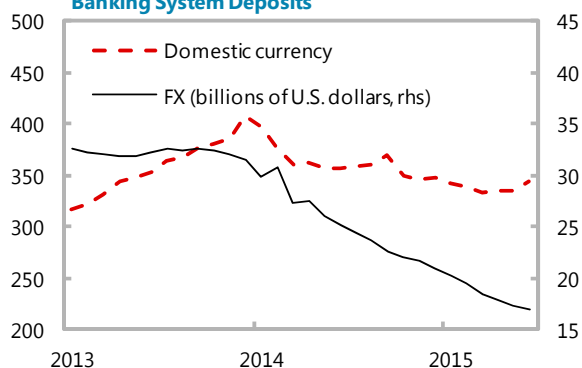
The economy is experiencing a credit squeeze.

Credit Growth



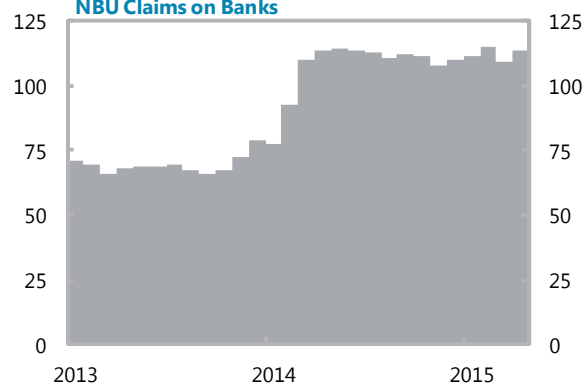
While deposit outflows have stalled in local currency, they continue in foreign currency.

Banking System Deposits



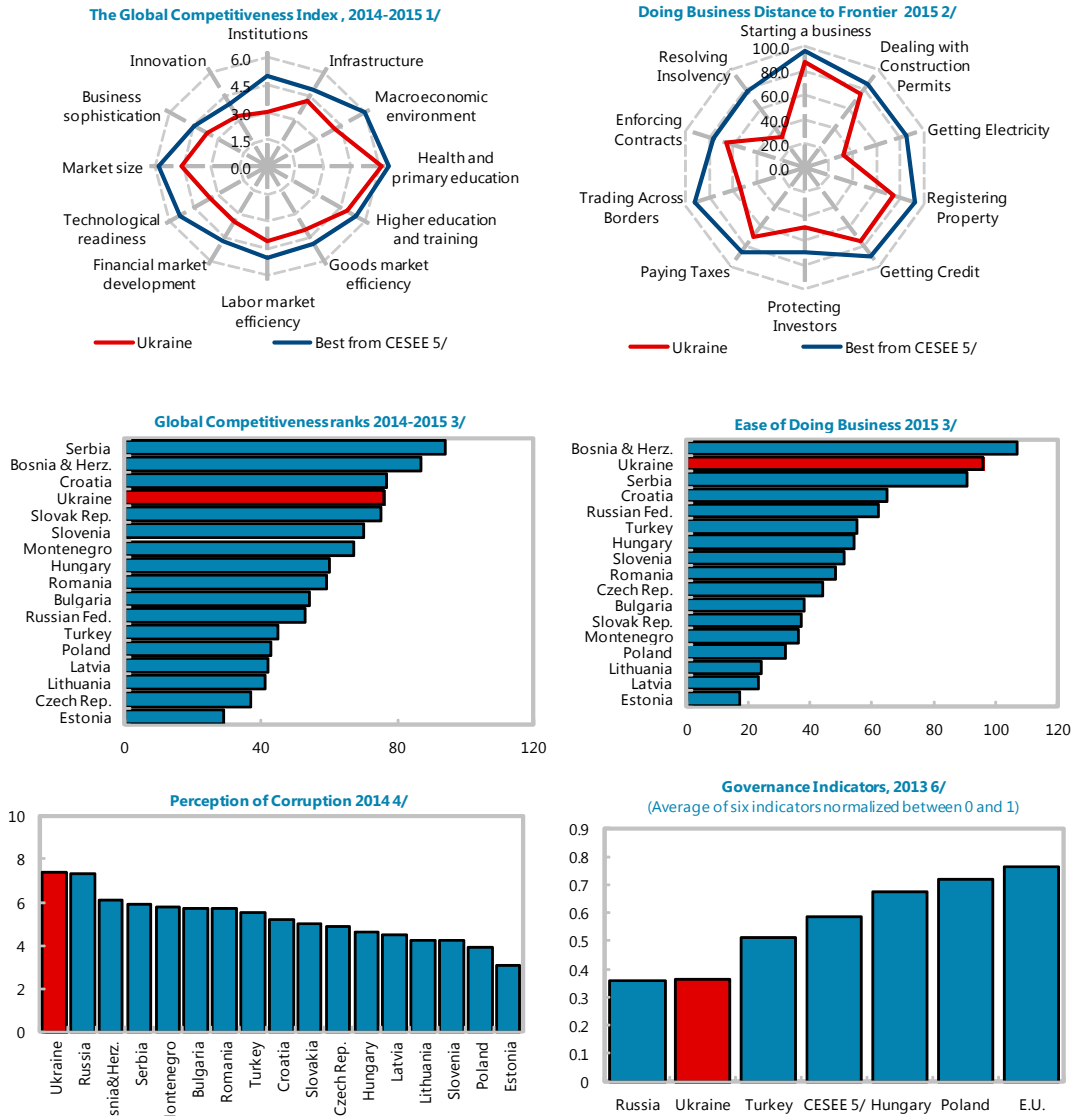
Since early 2014, NBU provided massive liquidity support to banks experiencing deposit outflows.

NBU Claims on Banks



Sources: National Bank of Ukraine; and IMF staff calculations.
1/ From December 2012, NPLs are credits classified as doubtful or loss.
2/ Includes also credits in substandard category.

Figure 7. Ukraine: Structural Reforms



Sources: World Bank, *Doing Business Indicators*; Transparency International, *Corruption Perceptions Index*; Heritage Foundation, *Index of Economic Freedom*; World Bank, *World Governance Indicators*, World Economic Forum *Global Competitiveness*; and IMF staff calculations and estimates.

1/ Index from 1 (the worst) to 7 (the best performer).

2/ The "frontier" represents the highest performance observed for each indicator across all economies in Doing Business. Scale from 0 (the lowest performance) to 100 (the frontier).

3/ The higher the rank the worse the score. Rank "1" indicates the best performer.

4/ Score indicates the perceived level of public-sector corruption. A high score corresponds to high perception of corruption.

5/ CESEE includes Estonia, Czech Rep., Poland, Turkey, Lithuania, Latvia, Slovenia, Hungary, Bulgaria, Russia, Slovak Rep. Montenegro, Ukraine, Romania, Croatia, Bosnia and Herzegovina, Serbia.

6/ Calculated as the normalized average of six indices from the World Bank Governance Database: rule of law, political stability and absence of violence, control of corruption, government effectiveness, regulatory quality, and voice and accountability.

Table 1. Ukraine: Program Scenario—Selected Economic and Social Indicators, 2014–20

	2014	2015		2016		2017	2018	2019	2020
	Preliminary	EFF request	Proj.	EFF request	Proj.	Proj.	Proj.	Proj.	Proj.
Real economy (percent change, unless otherwise indicated)									
Nominal GDP (billions of Ukrainian hryvnias) 1/	1,567	1,850	1,981	2,087	2,262	2,572	2,888	3,183	3,510
Real GDP 1/	-6.8	-5.5	-9.0	2.0	2.0	3.5	4.0	4.0	4.0
Contributions:									
Domestic demand	-13.5	-7.7	-13.1	2.6	2.9	4.1	4.4	4.8	5.3
Private consumption	-7.7	-5.2	-8.2	2.0	2.1	2.5	2.8	3.0	3.1
Public consumption	0.1	-0.2	-1.6	-0.9	-0.3	0.3	0.6	0.4	0.4
Investment	-5.9	-2.3	-3.3	1.4	1.1	1.3	1.0	1.4	1.8
Net exports	6.6	2.2	4.1	-0.6	-0.9	-0.6	-0.4	-0.8	-1.3
GDP deflator	14.8	27.6	39.0	10.6	12.0	9.9	8.0	6.0	6.0
Output gap (percent of potential GDP)	-2.6	-4.3	-5.4	-2.9	-3.3	-1.6	-0.6	-0.1	0.0
Unemployment rate (ILO definition; percent)	9.3	11.5	11.5	11.0	11.0	9.4	8.5	8.1	8.0
Consumer prices (period average)	12.1	33.5	50.0	10.6	14.2	9.9	7.0	5.0	5.0
Consumer prices (end of period)	24.9	26.7	45.8	8.7	12.0	8.0	5.0	5.0	5.0
Nominal monthly wages (average)	5.9	14.5	22.3	10.6	16.5	13.5	11.0	9.2	9.2
Real monthly wages (average)	-5.5	-14.2	-18.5	0.0	2.0	3.3	3.7	4.0	4.0
Savings (percent of GDP)	9.4	10.0	8.2	11.8	9.1	10.1	10.7	11.2	11.9
Private	12.6	11.7	10.1	12.9	10.4	10.4	10.5	10.6	11.2
Public	-3.2	-1.7	-1.9	-1.1	-1.4	-0.3	0.2	0.5	0.8
Investment (percent of GDP)	14.1	11.4	9.9	13.1	10.7	11.5	12.1	13.0	14.4
Private	12.8	8.9	7.5	10.6	8.4	8.8	9.3	10.1	11.5
Public	1.3	2.5	2.4	2.5	2.4	2.8	2.8	2.9	3.0
Public finance (percent of GDP)									
General government balance 2/	-4.5	-4.2	-4.2	-3.7	-3.7	-3.1	-2.6	-2.4	-2.2
Overall balance (including Naftogaz operational deficit)	-10.1	-7.4	-7.3	-3.9	-3.9	-3.1	-2.6	-2.4	-2.2
Public and Publicly Guaranteed Debt	71.2	94.1	94.4	92.6	92.1	87.8	82.4	76.9	70.8
Public debt excluding guarantees (end of period)	61.4	74.9	75.5	72.1	71.1	66.1	61.4	57.9	54.3
Public Debt Held Outside the Public Sector	49.6	72.3	73.1	74.8	74.9	74.1	72.2	69.9	65.6
Money and credit (end of period, percent change)									
Base money	8.5	27.3	27.3	11.3	17.7	12.4	10.7	9.5	8.3
Broad money	5.3	19.1	24.5	15.4	22.5	17.4	16.1	13.3	10.3
At program exchange rate	-16.8	8.5	11.8	15.1	22.9	17.2	16.1	13.3	10.4
Credit to nongovernment	12.4	13.0	15.2	11.8	14.0	12.5	8.7	7.7	11.3
At program exchange rate	-15.6	-0.6	-2.9	10.9	12.6	11.7	7.6	7.0	12.0
Velocity	1.6	1.6	1.7	1.6	1.6	1.5	1.5	1.4	1.4
Interbank overnight rate (annual average, percent)	11.5	...	...	...	...	...	...	...	...
Balance of payments (percent of GDP)									
Current account balance	-4.7	-1.4	-1.7	-1.3	-1.6	-1.4	-1.4	-1.9	-2.5
Foreign direct investment	0.3	1.4	1.6	1.9	2.0	2.1	2.0	2.1	2.0
Gross reserves (end of period, billions of U.S. dollars)	7.5	18.3	18.3	22.3	22.3	28.5	35.2	38.4	38.4
Months of next year's imports of goods and services	1.6	3.3	3.7	3.7	4.2	5.1	5.8	5.9	5.4
Percent of short-term debt (remaining maturity)	17.4	43.7	41.1	57.4	54.0	65.0	78.5	80.0	74.5
Percent of the IMF composite measure (float)	27.1	65.9	65.4	79.5	78.8	95.1	111.5	115.8	112.7
Goods exports (annual volume change in percent)	-11.1	-4.2	-10.8	5.1	5.1	6.0	6.5	6.1	6.1
Goods imports (annual volume change in percent)	-24.6	-11.9	-23.1	5.7	5.6	6.3	6.6	7.4	7.7
Goods terms of trade (percent change)	-0.1	0.4	-7.2	-0.7	-0.2	0.4	0.4	0.6	0.7
Exchange rate									
Hryvnia per U.S. dollar (end of period)	15.8	22.0	23.5	22.7	24.4	24.9	25.1	25.4	25.5
Hryvnia per U.S. dollar (period average)	12.0	21.7	22.0	22.5	24.1	24.7	25.0	25.3	25.5
Real effective rate (deflator-based, percent change)	-21.0		-10.7		-1.8	3.9	2.7	1.4	1.3
Real effective rate (deflator-based, 2010=100)	91.8		82.0		80.6	83.7	86.0	87.2	88.3
Memorandum items:									
Per capita GDP / Population (2014): US\$3,051 / 42.8 million									
Literacy / Poverty rate: 100 percent / 2.9 percent									

Sources: Ukrainian authorities; World Bank, World Development Indicators; and IMF staff estimates.

1/ Data based on SNA 2008, exclude Crimea and Sevastopol.

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

Table 2. Ukraine: Program Scenario—General Government Finances, 2014–20^{1/}
(Billions of Ukrainian hryvnia)

	2014	2015		2016	2017	2018	2019	2020	
			Proj.		Proj.	Proj.	Proj.	Proj.	
		EFF request		EFF request					
Revenue	639.7	792.5	808.4	840.2	898.3	1028.8	1155.5	1273.5	1399.7
Tax revenue	561.2	682.5	695.2	759.0	808.9	927.7	1044.7	1155.0	1273.6
Tax on income, profits, and capital gains	115.4	134.4	139.4	150.0	162.1	182.2	204.3	227.6	253.5
Personal income tax	75.2	95.5	95.5	106.2	112.0	125.2	140.2	153.6	167.9
Corporate profit tax	40.2	38.9	43.9	43.9	50.1	57.0	64.0	74.0	85.7
Payroll tax	184.2	195.6	189.9	217.5	228.3	263.3	295.0	323.0	353.0
Property tax	12.1	13.5	14.2	15.2	16.2	18.4	20.7	22.8	25.1
Tax on goods and services	201.3	253.2	262.8	295.3	310.6	350.3	393.3	434.7	482.0
VAT	139.0	170.9	185.6	198.7	218.1	245.9	277.6	305.7	337.4
Excise	45.1	70.5	64.9	80.9	76.1	86.9	97.2	108.0	119.9
Other	17.2	11.7	12.2	15.8	16.4	17.5	18.6	21.0	24.7
Tax on international trade	12.6	34.9	36.6	21.6	25.0	27.5	30.0	34.6	37.8
Other tax	35.6	51.0	52.3	59.4	66.7	85.9	101.4	112.3	122.2
Nontax revenue	78.5	110.0	113.1	81.2	89.4	101.2	110.8	118.5	126.1
Expenditure	710.5	870.7	891.1	916.4	982.7	1107.6	1229.4	1348.9	1476.0
Current	693.3	802.5	829.4	862.7	922.0	1020.3	1123.3	1224.5	1342.7
Compensation of employees	162.5	182.2	183.0	196.1	200.7	217.0	243.7	269.8	297.4
Goods and services	116.9	141.9	145.6	150.7	159.9	179.8	202.1	223.0	245.8
Interest	52.5	99.4	104.5	106.0	116.2	119.9	120.1	126.3	132.5
Subsidies to corporations and enterprises	37.1	23.5	28.9	25.6	28.8	30.9	34.7	38.2	42.1
Social benefits	324.2	353.9	365.8	384.1	416.2	472.5	522.5	567.0	624.7
Social programs (on budget)	58.3	76.5	79.8	84.5	105.0	120.3	127.7	133.6	148.2
Pensions	243.6	251.8	260.0	271.2	284.6	323.0	363.3	400.0	441.0
Unemployment, disability, and accident insurance	22.3	25.6	26.0	28.3	26.6	29.2	31.6	33.5	35.5
Other current expenditures	0.2	1.6	1.6	0.2	0.2	0.2	0.2	0.2	0.2
Capital	20.1	46.3	46.6	52.3	53.2	70.8	79.5	92.7	103.9
Net lending	-2.8	11.8	11.1	0.8	5.3	6.6	13.9	17.4	15.2
Discrepancy / reserve fund	0.0	10.1	3.9	0.6	2.3	9.9	12.7	14.3	14.3
Overall balance	-70.8	-78.2	-82.7	-76.2	-84.4	-78.8	-73.9	-75.4	-76.3
Naftogaz balance	-87.3	-58.0	-61.9	-5.4	-4.2	0.0	0.0	0.0	0.0
General government and Naftogaz balance	-158.1	-136.2	-144.6	-81.6	-88.6	-78.8	-73.9	-75.4	-76.3
General government financing	70.8	78.2	82.7	76.2	84.4	78.8	73.9	75.4	76.3
External	37.0	167.3	172.0	53.4	48.5	65.0	54.9	27.9	53.8
Disbursements	94.8	197.9	204.6	66.2	62.5	95.2	107.6	101.4	82.9
Exceptional Financing		92.0	93.4	50.7	54.2	81.4	0.0	0.0	38.2
Amortizations	-57.9	-122.6	-126.0	-63.6	-68.2	-111.6	-52.7	-73.5	-67.3
Domestic (net)	33.9	-89.1	-89.3	22.8	35.9	13.8	19.0	47.5	22.5
Bond financing	22.5	-72.9	-12.4	-12.7	-22.6	1.8	5.0	31.5	2.5
Direct bank borrowing	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Deposit finance	10.4	-25.0	-85.8	25.0	48.0	0.0	0.0	0.0	0.0
Privatization	0.8	8.8	8.8	10.5	10.5	12.0	14.0	16.0	20.0
Discrepancy									
Other financing	33.6	139.0	152.0	0.0	0.0	0.0	0.0	0.0	0.0
Bank recapitalization	26.7	139.0	152.0	0.0	0.0	0.0	0.0	0.0	0.0
VAT bonds	6.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Naftogaz financing	87.3	58.0	61.9	5.4	4.2	0.0	0.0	0.0	0.0
Government financing 2/	96.9	50.6	50.6	45.4	49.3	0.0	0.0	0.0	0.0
Accumulation of external arrears	1.0	0.0	0.0	-30.8	-33.0	0.0	0.0	0.0	0.0
Other 3/	-10.6	7.4	11.3	-9.2	-12.1	0.0	0.0	0.0	0.0
Total financing	191.7	275.2	296.6	81.6	88.6	78.8	73.9	75.4	76.3
Memorandum items:									
Structural general government primary balance 4/	2.8	38.3	49.2	54.8	61.6	57.4	51.4	52.0	56.2
Primary balance (general government)	-18.4	21.2	21.8	29.8	31.8	41.1	46.2	50.9	56.2
Primary balance (general government and Naftogaz)	-105.7	-36.8	-40.1	24.4	27.6	41.1	46.2	50.9	56.2
Primary current balance (general government)	-1.1	89.4	83.4	83.5	92.5	128.4	152.3	175.3	189.5
Public and Publicly Guaranteed Debt	1,115.7	1,741.6	1,869.4	1,933.1	2,082.4	2,258.5	2,379.1	2,448.1	2,483.8
Of which: In foreign currency	696.9	1,176.8	1,230.7	1,315.0	1,391.0	1,539.8	1,637.5	1,673.7	1,735.5
Domestic	495.2	663.9	744.1	717.7	797.7	821.2	837.6	882.8	868.9
External	620.5	1,077.7	1,125.3	1,215.3	1,284.7	1,437.3	1,541.5	1,565.3	1,614.9
Public debt excluding guarantees	962.0	1,385.0	1,495.5	1,505.1	1,608.6	1,701.3	1,772.0	1,842.7	1,905.2
Nominal GDP (billions of Ukrainian hryvnia)	1,567	1,850	1,981	2,087	2,262	2,571.93	2,888	3,183	3,510

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

1/ National methodology, cash basis.

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

3/ Includes external and domestic net disbursements, trade credits, and deposit drawdowns.

4/ The balance in 2014 treats part of the military spending and the EU grant as one-off operations. The balance in 2015 treats import duty surcharge, part of military spending and part of the NBU profit transfer as one-off operations.

Table 2. Ukraine: Program Scenario—General Government Finances, 2014–20 (Concluded) ^{1/}
(Percent of GDP)

	2014	2015		2016		2017	2018	2019	2020
		EFF request	Proj.	EFF request	Proj.	Proj.	Proj.	Proj.	Proj.
Revenue	40.8	42.8	40.8	40.3	39.7	40.0	40.0	40.0	39.9
Tax revenue	35.8	36.9	35.1	36.4	35.8	36.1	36.2	36.3	36.3
Tax on income, profits, and capital gains	7.4	7.3	7.0	7.2	7.2	7.1	7.1	7.2	7.2
Personal income tax	4.8	5.2	4.8	5.1	5.0	4.9	4.9	4.8	4.8
Corporate profit tax	2.6	2.1	2.2	2.1	2.2	2.2	2.2	2.3	2.4
Payroll tax	11.8	10.6	9.6	10.4	10.1	10.2	10.2	10.1	10.1
Property tax	0.8	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Tax on goods and services	12.8	13.7	13.3	14.1	13.7	13.6	13.6	13.7	13.7
VAT	8.9	9.2	9.4	9.5	9.6	9.6	9.6	9.6	9.6
Excise	2.9	3.8	3.3	3.9	3.4	3.4	3.4	3.4	3.4
Other	1.1	0.6	0.6	0.8	0.7	0.7	0.6	0.7	0.7
Tax on international trade	0.8	1.9	1.8	1.0	1.1	1.1	1.0	1.1	1.1
Other tax	2.3	2.8	2.6	2.8	2.9	3.3	3.5	3.5	3.5
Nontax revenue	5.0	5.9	5.7	3.9	4.0	3.9	3.8	3.7	3.6
Expenditure	45.4	47.1	45.0	43.9	43.4	43.1	42.6	42.4	42.0
Current	44.2	43.4	41.9	41.3	40.8	39.7	38.9	38.5	38.3
Compensation of employees	10.4	9.9	9.2	9.4	8.9	8.4	8.4	8.5	8.5
Goods and services	7.5	7.7	7.4	7.2	7.1	7.0	7.0	7.0	7.0
Interest	3.3	5.4	5.3	5.1	5.1	4.7	4.2	4.0	3.8
Subsidies to corporations and enterprises	2.4	1.3	1.5	1.2	1.3	1.2	1.2	1.2	1.2
Social benefits	20.7	19.1	18.5	18.4	18.4	18.4	18.1	17.8	17.8
Social programs (on budget)	3.7	4.1	4.0	4.0	4.6	4.7	4.4	4.2	4.2
Pensions	15.6	13.6	13.1	13.0	12.6	12.6	12.6	12.6	12.6
Unemployment, disability, and accident insurance	1.4	1.4	1.3	1.4	1.2	1.1	1.1	1.1	1.0
Other current expenditures	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Capital	1.3	2.5	2.4	2.5	2.4	2.8	2.8	2.9	3.0
Net lending	-0.2	0.6	0.6	0.0	0.2	0.3	0.5	0.5	0.4
Discrepancy / reserve fund	0.0	0.5	0.2	0.0	0.1	0.4	0.4	0.4	0.4
Overall balance	-4.5	-4.2	-4.2	-3.7	-3.7	-3.1	-2.6	-2.4	-2.2
Naftogaz balance	-5.6	-3.1	-3.1	-0.3	-0.2	0.0	0.0	0.0	0.0
General government and Naftogaz balance	-10.1	-7.4	-7.3	-3.9	-3.9	-3.1	-2.6	-2.4	-2.2
General government financing	4.5	4.2	4.2	3.7	3.7	3.1	2.6	2.4	2.2
External	2.4	9.0	8.7	2.6	2.1	2.5	1.9	0.9	1.5
Disbursements	6.1	10.7	10.3	3.2	2.8	3.7	3.7	3.2	2.4
Exceptional Financing		5.0	4.7	2.4	2.4	3.2	0.0	0.0	1.1
Amortizations	-3.7	-6.6	-6.4	-3.0	-3.0	-4.3	-1.8	-2.3	-1.9
Domestic (net)	2.2	-4.8	-4.5	1.1	1.6	0.5	0.7	1.5	0.6
Bond financing	1.4	-3.9	-0.6	-0.6	-1.0	0.1	0.2	1.0	0.1
Direct bank borrowing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Deposit finance	0.7	-1.4	-4.3	1.2	2.1	0.0	0.0	0.0	0.0
Privatization	0.1	0.5	0.4	0.5	0.5	0.5	0.5	0.5	0.6
Discrepancy									
Other financing	2.1	7.5	7.7	0.0	0.0	0.0	0.0	0.0	0.0
Bank recapitalization	1.7	7.5	7.7	0.0	0.0	0.0	0.0	0.0	0.0
VAT bonds	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Naftogaz financing	5.6	3.1	3.1	0.3	0.2	0.0	0.0	0.0	0.0
Government financing 2/	6.2	2.7	2.6	2.2	2.2	0.0	0.0	0.0	0.0
Accumulation of external arrears	-0.1	0.0	0.0	-1.5	-1.5	0.0	0.0	0.0	0.0
Other 3/	0.7	0.4	0.6	-0.4	-0.5	0.0	0.0	0.0	0.0
Total financing	12.2	14.9	15.0	3.9	3.9	3.1	2.6	2.4	2.2
Memorandum items:									
Structural general government primary balance 4/	0.2	2.0	2.3	2.5	2.6	2.2	1.8	1.6	1.6
Primary balance (general government)	-1.2	1.1	1.1	1.4	1.4	1.6	1.6	1.6	1.6
Primary balance (general government and Naftogaz)	-6.7	-2.0	-2.0	1.2	1.2	1.6	1.6	1.6	1.6
Primary current balance (general government)	-0.1	4.8	4.2	4.0	4.1	5.0	5.3	5.5	5.4
Public and Publicly Guaranteed Debt	71.2	94.1	94.4	92.6	92.1	87.8	82.4	76.9	70.8
Of which: In foreign currency	44.5	63.6	62.1	63.0	61.5	59.9	56.7	52.6	49.4
Domestic	31.6	35.9	37.6	34.4	35.3	31.9	29.0	27.7	24.8
External	39.6	58.3	56.8	58.2	56.8	55.9	53.4	49.2	46.0
Public debt excluding guarantees	61.4	74.9	75.5	72.1	71.1	66.1	61.4	57.9	54.3
Nominal GDP (billions of Ukrainian hryvnia)	1,567	1,850	1,981	2,087	2,262	2,572	2,888	3,183	3,510

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

1/ National methodology, cash basis.

2/ Government spending for Naftogaz financing, including through recapitalization bonds. In 2014, includes repayment of a US\$1.6 billion Eurobond.

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

4/ The balance in 2014 treats part of the military spending and the EU grant as one-off operations. The balance in 2015 treats import duty surcharge, part of military spending and part of the NBU profit transfer as one-off operations.

Table 3. Ukraine: Program Scenario—Balance of Payments, 2014–20

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

	2014	2015		2016		2017	2018	2019	2020
		EFF request	Proj.	EFF request	Proj.	Proj.	Proj.	Proj.	Proj.
Current account balance	-6.2	-1.2	-1.5	-1.2	-1.5	-1.5	-1.6	-2.4	-3.4
Goods and services trade balance	-6.2	-0.4	-1.2	-0.5	-1.2	-1.1	-0.8	-1.1	-1.8
Merchandise trade balance	-7.0	-0.4	-1.4	-1.2	-1.8	-1.9	-1.9	-2.3	-3.0
Exports, f.o.b.	55.3	49.8	43.6	53.0	46.4	50.0	53.9	58.0	62.4
Imports, f.o.b. 1/	-62.2	-50.2	-45.0	-54.1	-48.2	-51.9	-55.8	-60.4	-65.4
Of which: gas	-6.6	-6.0	-6.0	-4.7	-4.2	-5.0	-5.5	-6.1	-6.2
Services (net)	0.8	0.1	0.2	0.6	0.6	0.8	1.0	1.2	1.2
Receipts	13.2	12.1	10.1	13.5	11.2	11.9	12.5	13.3	14.0
Payments	-12.4	-12.0	-9.8	-12.9	-10.5	-11.0	-11.5	-12.1	-12.8
Income (net)	-1.5	-2.4	-2.0	-2.5	-2.2	-2.6	-3.0	-3.4	-3.9
Current transfers (net)	1.5	1.5	1.7	1.8	1.8	2.2	2.2	2.2	2.2
Capital and financial account balance	-11.8	-8.1	-7.9	-4.3	-3.4	-1.2	3.3	5.3	2.5
Capital account	0.0	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	-11.8	-8.1	-8.2	-4.3	-3.4	-1.2	3.3	5.3	2.5
Direct investment (net)	0.4	1.2	1.4	1.7	1.9	2.1	2.4	2.6	2.8
Portfolio investment (net)	-2.8	-3.4	-4.4	-3.6	-3.5	-3.4	0.4	2.1	-0.7
Of which: general government	-1.7	-2.5	-2.7	-2.6	-2.6	-2.3	2.0	1.0	-1.5
Of which: eurobond issuance	1.0	2.0	2.0	0.0	0.0	1.0	2.0	2.0	2.0
Other investment (net)	-9.4	-5.8	-5.2	-2.4	-1.8	0.1	0.5	0.6	0.4
Medium and long-term loans	-3.6	-5.3	-5.9	-2.5	-2.4	-0.3	-0.1	-0.1	-0.3
Official	-0.4	-0.9	-0.8	-0.8	-0.8	-0.7	-1.0	-0.9	-1.1
Disbursements 2/	...	...	...	...	...	...	...	...	...
Repayments	-0.4	-0.9	-0.8	-0.8	-0.8	-0.7	-1.0	-0.9	-1.1
Banks	-1.2	-0.6	-1.3	0.1	0.1	0.1	0.3	0.3	0.3
Other sectors	-2.0	-3.8	-3.8	-1.7	-1.6	0.3	0.6	0.6	0.6
Short-term loans	-4.2	0.5	0.7	-0.2	-0.2	0.3	0.6	0.5	0.5
Banks	0.1	0.0	-0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other sectors 3/	-4.2	0.5	0.9	-0.3	-0.3	0.2	0.5	0.4	0.4
Currency and deposits	-1.6	-1.0	0.0	0.3	0.8	0.1	0.1	0.1	0.1
Banks	1.1	-1.9	-1.1	0.2	0.2	0.1	0.1	0.1	0.1
Other sectors 4/	-2.7	0.9	1.0	0.1	0.6	0.0	0.0	0.0	0.0
Of which: FX deposit outflows	-7.1	-1.5	-2.2	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	0.1	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-17.9	-9.3	-9.3	-5.5	-5.0	-2.7	1.7	2.9	-1.0
Official financing 5/	4.2	6.3	6.3	3.6	3.1	2.9	2.3	2.0	1.3
World Bank	1.5	1.3	1.9	0.5	0.4	0.5	0.5	0.6	0.3
EU	2.2	1.8	1.8	0.7	0.7	0.0	0.0	0.0	0.0
EBRD/EIB/Others	0.5	3.2	2.7	2.4	2.0	2.4	1.8	1.4	1.0
Exceptional financing	0.0	5.2	5.2	3.4	3.4	4.4	2.3	0.0	1.5
Financing	13.8	-2.2	-2.2	-1.5	-1.5	-4.7	-6.3	-4.9	-1.8
Gross official reserves (increase: -)	12.9	-10.8	-10.7	-3.9	-4.0	-6.3	-6.6	-3.3	0.0
Net use of IMF resources	0.9	8.6	8.5	2.5	2.5	1.6	0.4	-1.7	-1.8
Of which: Prospective Fund purchases	4.6	10.0	9.9	2.5	2.5	2.5	2.5	...	...
Memorandum items:									
Total external debt (percent of GDP)	100.4	158.4	147.7	149.5	144.8	135.7	127.8	119.4	109.9
Current account balance (percent of GDP)	-4.7	-1.4	-1.7	-1.3	-1.6	-1.4	-1.4	-1.9	-2.5
Goods and services trade balance (percent of GDP)	-4.7	-0.4	-1.3	-0.6	-1.3	-1.0	-0.7	-0.9	-1.3
Gross international reserves	7.5	18.3	18.3	22.3	22.3	28.5	35.2	38.4	38.4
Months of next year's imports of goods and services	1.6	3.3	3.7	3.7	4.2	5.1	5.8	5.9	5.4
Percent of short-term debt (remaining maturity)	17.4	43.7	41.1	57.4	54.0	65.0	78.5	80.0	74.5
Percent of the IMF composite measure (float)	27.1	65.9	65.4	79.5	78.8	95.1	111.5	115.8	112.7
Merchandise export value (percent change)	-15.0	-10.5	-21.1	6.4	6.4	7.7	7.9	7.6	7.6
Merchandise import value (percent change)	-26.8	-19.7	-27.7	7.8	7.2	7.6	7.5	8.2	8.4
Merchandise export volume (percent change)	-11.1	-4.2	-10.8	5.1	5.1	6.0	6.5	6.1	6.1
Merchandise import volume (percent change)	-24.6	-11.9	-23.1	5.7	5.6	6.3	6.6	7.4	7.7
Goods terms of trade (percent change)	-0.1	0.4	-7.2	-0.7	-0.2	0.4	0.4	0.6	0.7
Gross domestic product (current prices)	130.7	85.4	90.1	92.6	93.8	104.3	115.5	126.0	137.9

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

1/ For 2015-20, projected gas prices are: \$291, \$292, \$310, \$319, \$325, and \$330 per tcm, respectively. Naftogaz is currently disputing the arrears to Gazprom. For program financing and risk assessment considerations the potential liability to Gazprom was estimated using US\$385.5 per tcm in 2014:Q2. This price is used for accounting purpose only and does not constitute an expression of a view by Fund staff on what the gas price should be.

2/ Financing and grants from the World Bank, EU, EIB, EBRD, and official bilateral are recorded below the line.

3/ Includes trade credit and arrears, including those related to Naftogaz potential arrears to Gazprom.

4/ Mainly reflects residents' conversion of hryvnia cash to foreign currency held outside the banking system and cash financing of informal trade.

5/ Includes project financing to the public and private sector. The planned Eurobond issuance of \$2 billion with U.S. guarantees is included above the line in portfolio investment, general government.

Table 4. Ukraine: Program Scenario—Gross External Financing Requirements, 2014–20
(Billions of U.S. dollars)

	2014	2015		2016		2017	2018	2019	2020
		EFF request	Proj.	EFF request	Proj.	Proj.	Proj.	Proj.	Proj.
Total financing requirements	66.9	48.2	49.3	51.6	52.1	49.4	48.6	48.2	53.8
Current account deficit	6.2	1.2	1.5	1.2	1.5	1.5	1.6	2.4	3.4
Portfolio investment	3.5	5.6	6.3	3.6	3.5	4.5	2.6	1.1	5.0
Private	0.7	1.2	1.6	1.0	0.9	1.2	2.6	0.1	1.5
Public	2.7	4.5	4.7	2.6	2.6	3.3	0.0	1.0	3.5
Medium and long-term debt	9.0	12.3	11.8	12.2	12.5	8.5	9.2	9.2	9.4
Private	8.6	11.4	11.1	11.4	11.7	7.8	8.3	8.3	8.3
Banks	2.9	2.5	2.8	2.5	2.8	2.8	2.8	2.8	2.8
Corporates	5.7	9.0	8.3	8.9	8.9	5.0	5.5	5.5	5.5
Public	0.4	0.9	0.8	0.8	0.8	0.7	1.0	0.9	1.1
Short-term debt (including deposits)	23.0	10.0	9.7	13.6	13.3	14.0	14.2	14.2	14.2
Other net capital outflows 1/	0.4	0.4	1.2	-0.1	-0.6	0.0	0.0	0.0	0.0
Trade credit	24.9	18.6	18.6	21.1	21.8	20.9	20.9	21.3	21.8
Total financing sources	48.9	38.9	39.8	46.1	47.2	46.7	50.1	51.1	52.7
Capital transfers 2/	0.0	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Direct investment, net	0.4	1.2	1.4	1.7	1.9	2.1	2.4	2.6	2.8
Portfolio investment	0.7	2.2	1.9	0.0	0.0	1.1	2.9	3.3	4.2
Private	-0.4	0.2	-0.1	0.0	0.0	0.1	0.9	1.3	2.2
Public	1.0	2.0	2.0	0.0	0.0	1.0	2.0	2.0	2.0
Of which: eurobond issuance	1.0	2.0	2.0	0.0	0.0	1.0	2.0	2.0	2.0
Medium and long-term debt	4.8	7.0	5.9	9.7	10.1	8.2	9.1	9.1	9.1
Private	4.8	7.0	5.9	9.7	10.1	8.2	9.1	9.1	9.1
Banks	1.7	1.9	1.4	2.5	2.8	2.9	3.1	3.1	3.1
Corporates	3.2	5.1	4.5	7.1	7.3	5.3	6.1	6.1	6.1
Public 2/	...	...	...	...	...	...	...	...	...
Short-term debt (including deposits)	22.1	8.8	9.9	14.6	14.3	14.4	14.4	14.4	14.4
Trade credit	20.9	19.7	20.5	20.1	20.9	20.9	21.3	21.8	22.2
Increase in gross reserves	-12.9	10.8	10.7	3.9	4.0	6.3	6.6	3.3	0.0
Errors and omissions	0.1	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Total financing needs	5.1	20.1	20.0	9.4	9.0	8.9	5.1	0.3	1.0
Official financing	5.1	14.9	14.8	6.0	5.6	4.5	2.7	0.3	-0.5
IMF	0.9	8.6	8.5	2.5	2.5	1.6	0.4	-1.7	-1.8
Prospective purchases	4.6	10.0	9.9	2.5	2.5	2.5	2.5	...	...
Repurchases	3.7	1.4	1.4	0.0	0.0	0.9	2.1	1.7	1.8
Official creditors 3/	4.2	6.3	6.3	3.6	3.1	2.9	2.3	2.0	1.3
World Bank	1.5	1.3	1.9	0.5	0.4	0.5	0.5	0.6	0.3
EU	2.2	1.8	1.8	0.7	0.7	0.0	0.0	0.0	0.0
EBRD/EIB/Others	0.5	3.2	2.7	2.4	2.0	2.4	1.8	1.4	1.0
Exceptional financing	0.0	5.2	5.2	3.4	3.4	4.4	2.3	0.0	1.5
Memorandum items:									
Gross international reserves	7.5	18.3	18.3	22.3	22.3	28.5	35.2	38.4	38.4
Percent of short-term debt (remaining maturity)	17.4	43.7	41.1	57.4	54.0	65.0	78.5	80.0	74.5
Months of next year's imports of goods and services	1.6	3.3	3.7	3.7	4.2	5.1	5.8	5.9	5.4
Percent of the IMF composite measure (float) 4/	27.1	65.9	65.4	79.5	78.8	95.1	111.5	115.8	112.7
Loan rollover rate (percent)									
Banks	96.6	94.4	86.6	102.2	102.2	103.1	104.9	104.9	104.9
Corporates	63.9	70.0	64.3	97.1	97.1	103.8	104.0	104.0	104.0
Total	85.4	81.0	77.3	99.6	99.5	103.8	104.6	104.6	104.6

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

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

2/ Financing and grants from official sources are recorded below the line.

3/ Includes project financing to the public and private sector. The planned Eurobond issuance of \$2 billion with U.S. guarantees is included above the line in portfolio investment, public.

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. Official reserves are recommended to be in the range of 100–150 percent of the appropriate measure.

Table 5. Ukraine: Program Scenario—Monetary Accounts, 2014–20

	2014	2015				2016	2017	2018	2019	2020
		Mar.	Jun.	Sep.	Dec.					
		Proj.	Proj.	Proj.	Proj.					
(Billions of Ukrainian hryvnias unless otherwise noted)										
Monetary survey										
Net foreign assets	-76	-145	-116	-92	-6	21	124	268	378	412
(In billions of US dollars)	-4.8	-6.2	-5.4	-4.1	-0.3	0.8	5.0	10.7	14.9	16.1
Foreign assets	253	475	...	...	...	...	...	...	...	...
Foreign liabilities	329	620	...	...	...	...	...	...	...	...
Net domestic assets	1,033	1,170	1,126	1,186	1,197	1,439	1,589	1,721	1,874	2,072
Domestic credit	1,507	1,683	1,625	1,685	1,803	2,053	2,222	2,359	2,518	2,719
Net claims on government	445	448	530	507	585	670	671	676	708	710
Credit to the economy	1,024	1,195	1,055	1,139	1,179	1,344	1,512	1,643	1,770	1,970
Domestic currency	549	534	437	481	615	707	796	841	894	1,032
Foreign currency	474	661	618	658	564	637	715	802	876	938
(In billions of US dollars)	30.1	28.2	28.9	29.1	24.0	26.1	28.7	31.9	34.5	36.7
Other items, net	-474	-513	-499	-499	-606	-614	-633	-638	-643	-647
Broad money	957	1,025	1,010	1,094	1,191	1,459	1,713	1,988	2,252	2,483
Currency in circulation	283	285	323	344	355	412	457	498	538	579
Total deposits	672	740	686	749	836	1,046	1,255	1,490	1,713	1,903
Domestic currency deposits	366	346	351	394	468	639	786	955	1,119	1,261
Foreign currency deposits	307	393	336	355	368	407	469	534	594	642
(In billions of US dollars)	19.4	16.8	15.7	15.7	15.7	16.7	18.8	21.3	23.4	25.2
Accounts of the NBU										
Net foreign assets	30	1	-11	38	93	132	246	403	527	574
(In billions of US dollars)	1.9	0.0	-0.5	1.7	4.0	5.4	9.9	16.0	20.8	22.5
Net international reserves	29	1	-11	37	93	132	246	403	527	574
(In billions of US dollars)	1.8	0.0	-0.5	1.7	4.0	5.4	9.9	16.0	20.8	22.5
Reserve assets	119	234	198	327	429	543	710	884	976	981
(In billions of US dollars)	7.5	10.0	9.2	14.5	18.3	22.3	28.5	35.2	38.4	38.4
Reserve liabilities	90	233	209	290	336	412	464	481	449	407
Net domestic assets	303	331	398	376	331	367	315	218	153	163
Net domestic credit	413	403	458	426	396	438	402	309	249	261
Net claims on government	324	309	320	318	319	334	297	239	167	126
Claims on government 1/	338	383	403	420	422	389	353	294	222	181
Liabilities to government	14	74	82	103	103	55	55	55	55	55
Net claims on banks	90	93	138	108	78	104	105	70	81	135
Other items, net	-111	-72	-61	-51	-66	-70	-87	-91	-95	-99
Base money	333	332	387	413	424	499	561	621	680	737
Currency in circulation	283	285	323	344	355	412	457	498	538	579
Banks' reserves	50	47	64	69	69	87	104	124	142	158
Cash in vault	22	20	22	24	27	34	41	48	56	62
Correspondent accounts	28	27	41	45	42	53	63	75	87	96
Deposit money banks										
Net foreign assets	-107	-146	-105	-130	-99	-111	-122	-136	-149	-162
(In billions of US dollars)	-6.8	-6.2	-4.9	-5.8	-4.2	-4.6	-4.9	-5.4	-5.9	-6.4
Foreign assets	129	171	176	197	217	221	223	223	222	221
(In billions of US dollars)	8.2	7.3	8.2	8.7	9.2	9.1	9.0	8.9	8.8	8.6
Foreign liabilities	235	317	282	298	316	333	345	358	371	383
Net domestic assets	778	884	792	879	936	1,158	1,377	1,625	1,862	2,066
Domestic credit	1,142	1,325	1,230	1,328	1,476	1,702	1,924	2,173	2,411	2,616
Net claims on government	121	139	210	189	266	336	374	437	541	584
Credit to the economy	1,023	1,194	1,055	1,139	1,179	1,344	1,512	1,643	1,770	1,970
Other claims on the economy	39	39	39	39	39	39	39	39	39	39
Net claims on NBU	-41	-48	-74	-39	-8	-17	-1	53	61	23
Of which: Refinancing loans	110	109	158	129	98	125	126	91	102	156
Other items, net	-364	-441	-439	-449	-541	-544	-547	-548	-549	-550
Banks' liabilities	671	738	686	749	836	1,046	1,255	1,490	1,713	1,903
Demand deposits	239	294	...	...	...	...	...	...	...	...
Time deposits	432	444	...	...	...	...	...	...	...	...
Memorandum items: (Year-on-year percent change, unless otherwise indicated)										
Base money	8.5	0.9	10.2	17.6	27.3	17.7	12.4	10.7	9.5	8.3
Broad money	5.3	8.5	6.4	10.0	24.5	22.5	17.4	16.1	13.3	10.3
At program exchange rate	-16.8	-16.6	-11.6	-7.2	11.8	22.9	17.2	16.1	13.3	10.4
Credit to the economy	12.4	19.3	6.6	13.8	15.2	14.0	12.5	8.7	7.7	11.3
At program exchange rate	-15.6	-17.4	-21.1	-14.3	-2.9	12.6	11.7	7.6	7.0	12.0
Real credit to the economy 2/	-10.0	-18.2	-32.5	-25.4	-21.0	1.8	4.1	3.5	2.6	6.0
Credit-to-GDP ratio, in percent	65.3	75.5	62.4	61.6	59.5	59.4	58.8	56.9	55.6	56.1
Velocity of broad money, ratio	1.64	1.54	1.68	1.69	1.66	1.55	1.50	1.45	1.41	1.41
Money multiplier, ratio	2.87	3.09	2.61	2.65	2.81	2.92	3.05	3.20	3.31	3.37
Hryvnia per U.S. dollar, market rate	15.8	23.4	21.4	22.6	23.5	24.4	24.9	25.1	25.4	25.5
Hryvnia per U.S. dollar, official rate	15.8	23.4	21.4	22.6	23.5	24.4	24.9	25.1	25.4	25.5

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

1/ Includes Naftogaz recapitalization bonds and DGF financing

2/ Deflated by CPI (eop), at current exchange rates.

Table 6. Ukraine: Financial Soundness Indicators for the Banking Sector, 2014–15

(Percent, unless otherwise indicated)

	2014				2015		
	Mar.	Jun.	Sep.	Dec.	Mar.	Apr.	May
Ownership							
Number of banks, of which 1/	181	174	168	163	148	145	143
Private	174	167	161	156	141	138	136
Domestic	123	116	110	105	95	93	91
Foreign	51	51	51	51	46	45	45
Of which: 100% foreign-owned	19	19	19	19	19	19	19
State-owned	3	3	3	3	3	3	3
State-controlled (incl. bridge banks)	4	4	4	4	4	4	4
Foreign-owned banks' share in statutory capital	33.6	32.3	32.1	32.5	30.5	28.0	28.0
Concentration							
Share of assets of largest 10 banks	55.5	57.3	58.8	59.7	63.8	63.6	64.7
Share of assets of largest 25 banks	77.2	79.5	81.0	82.0	83.8	85.5	86.6
Number of bank with assets less than \$150 million	95	95	91	103	99	n.a.	n.a.
Capital Adequacy							
Regulatory capital to risk-weighted assets	14.8	15.9	16.0	15.6	8.4	7.8	7.7
Capital to total assets	12.8	12.6	12.3	12.4	6.5	6.1	6.0
Asset Quality							
Credit growth (year-over-year percent change) 2/	21.2	18.0	15.7	12.4	19.3	10.5	4.0
Credit at program exchange rate growth (year-over-year percent change) 2/	5.3	-0.6	-5.9	-15.6	-17.4	-17.5	-21.1
Credit to GDP ratio 2/	67.7	65.9	65.2	66.8	74.9	n.a.	n.a.
NPLs to total loans (NBU definition) 3/	13.3	14.6	16.7	19.0	24.7	25.5	24.1
NPLs to total loans (broader definition) 5/	26.1	27.7	30.6	32.0	39.7	43.7	44.3
NPLs net of provisions to capital (NBU definition) 3/	37.6	47.0	55.0	61.1	129.5	126.5	n.a.
NPLs net of provisions to capital (broader definition) 4/	100.2	142.5	153.8	163.9	367.2	388.0	n.a.
Specific provisions (percent of NPLs, NBU definition) 3/	79.4	72.3	71.1	76.7	80.1	n.a.	n.a.
Specific provisions (percent of total loans, NBU definition) 3/	13.8	13.7	15.6	19.1	26.1	n.a.	n.a.
Specific provisions (percent of NPLs, broader definition) 4/	...	34.6	36.1	42.6	48.8	48.8	n.a.
Foreign Exchange Rate Risk							
Loans in foreign currency to total loans 2/	41.6	42.9	44.2	46.4	55.3	52.4	51.9
Deposits in foreign currency to total deposits	43.4	42.2	41.2	45.6	53.2	49.9	49.1
Foreign currency loans to foreign currency deposits 2/	143.3	153.5	162.3	154.8	168.0	169.3	164.5
Net open FX position to regulatory capital (NBU definition) 5/	13.4	14.6	23.7	31.7	113.4	n.a.	n.a.
Net open FX position to regulatory capital (staff estimate) 5/	-18.3	-20.4	-20.9	-41.2	-97.2	n.a.	n.a.
Liquidity Risk							
Liquid assets to total assets	21.6	21.9	24.3	26.4	n.a.	n.a.	n.a.
Customer deposits to total loans to the economy	66.8	66.1	66.1	65.6	61.8	n.a.	n.a.
Earnings and Profitability							
Return on assets (after tax; end-of-period) 6/	-0.6	0.2	-1.1	-4.1	-22.3	-17.3	-12.4
Return on equity (after tax; end-of-period) 6/	-4.2	1.4	-7.9	-30.5	-285.9	-232.0	-168.1
Net interest margin to total assets	4.6	4.4	4.3	4.2	3.6	n.a.	n.a.
Interest rate spreads (percentage points; end-of-period)							
Between loans and deposits in domestic currency	7.4	4.5	6.2	6.9	10.8	8.4	8.1
Between loans and deposits in foreign currency	1.9	2.3	2.6	1.9	0.8	1.5	1.8
Between loans in domestic and foreign currency	11.4	8.4	7.5	8.4	16.2	15.0	14.0
Between deposits in domestic and foreign currency	5.9	6.2	3.8	3.3	6.1	8.0	7.7
Number of banks not complying with banking regulations							
Not meeting capital adequacy requirements for Tier I capital 7/	6	5	8	14	29	24	n.a.
Not meeting prudential regulations 7/	28	25	26	34	56	43	n.a.
Not meeting reserve requirements	37	27	33	34	29	26	n.a.

Sources: National Bank of Ukraine; and IMF staff estimates (for intra-quarter indicators where data available).

1/ Excludes banks under liquidation.

2/ Monetary statistics data.

3/ From December 2012, NBU changed loan classification, which resulted in the NPL series break.

4/ Includes 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.

5/ NBU definition did not take into account the effects of NBU Resolution 109, which

6/ Cumulative profits year-to-date, annualized.

7/ From 2015–2018, given the adverse exchange rate and losses in conflict areas, banks will be granted forbearance on meeting prudential requirements related to capital levels.

Table 7. Ukraine: Indicators of Fund Credit, 2014–25

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
	Projection											
Stock of existing and prospective Fund credit 1/ 2/												
In millions of SDRs	3,941	10,065	11,817	12,940	13,206	12,053	10,797	9,250	7,411	5,353	3,295	1,533
In percent of quota	287	734	861	943	963	878	787	674	540	390	240	112
In percent of GDP	4.4	15.8	17.8	17.7	16.4	13.9	11.5	9.2	6.9	4.7	2.7	1.2
In percent of exports of goods and services	8.3	26.5	29.0	29.8	28.5	24.5	20.7	16.6	12.4	8.3	4.8	2.1
In percent of gross reserves	75.8	77.5	75.1	64.6	53.8	45.5	41.1	34.3	28.7	22.8	15.9	8.6
Stock of existing Fund credit 1/ 2/												
In millions of SDRs	3,941	6,519	6,519	5,890	4,404	3,251	2,660	2,069	1,478	887	296	0
In percent of quota	287	475	475	429	321	237	194	151	108	65	22	0
In percent of GDP	4.4	10.2	9.8	8.0	5.5	3.7	2.8	2.1	1.4	0.8	0.2	0.0
In percent of exports of goods and services	8.3	17.1	16.0	13.6	9.5	6.6	5.1	3.7	2.5	1.4	0.4	0.0
In percent of gross reserves	75.8	50.2	41.4	29.4	18.0	12.3	10.1	7.7	5.7	3.8	1.4	0.0
Stock of prospective Fund credit 1/ 2/												
In millions of SDRs	0	3,546	5,298	7,050	8,802	8,802	8,138	7,182	5,934	4,467	3,000	1,533
In percent of quota	0	258	386	514	642	642	593	523	433	326	219	112
In percent of GDP	0	5.6	8.0	9.6	10.9	10.1	8.7	7.2	5.5	3.9	2.5	1.2
In percent of exports of goods and services	0	9.3	13.0	16.2	19.0	17.9	15.6	12.9	9.9	7.0	4.4	2.1
In percent of gross reserves	0	27.3	33.7	35.2	35.9	33.2	31.0	26.6	23.0	19.0	14.5	8.6
Obligations to the Fund from existing and prospective drawings 2/												
In millions of SDRs	0	652	246	928	1,863	1,543	1,602	1,840	2,067	2,208	2,127	1,791
In percent of quota	0	48	18	68	136	112	117	134	151	161	155	131
In percent of GDP	0	1.0	0.4	1.3	2.3	1.8	1.7	1.8	1.9	1.9	1.8	1.4
In percent of exports of goods and services	0	1.7	0.6	2.1	4.0	3.1	3.1	3.3	3.5	3.4	3.1	2.4
In percent of gross reserves	0	5.0	1.6	4.6	7.6	5.8	6.1	6.8	8.0	9.4	10.3	10.0
Obligations to the Fund from existing drawings 2/												
In millions of SDRs	0	619	118	744	1,575	1,198	623	617	611	605	599	297
In percent of quota	0	45	9	54	115	87	45	45	45	44	44	22
In percent of GDP	0	1.0	0.2	1.0	2.0	1.4	0.7	0.6	0.6	0.5	0.5	0.2
In percent of exports of goods and services	0	1.6	0.3	1.7	3.4	2.4	1.2	1.1	1.0	0.9	0.9	0.4
In percent of gross reserves	0	4.8	0.7	3.7	6.4	4.5	2.4	2.3	2.4	2.6	2.9	1.7
Obligations to the Fund from prospective drawings 2/												
In millions of SDRs	0	33	128	184	287	346	979	1,223	1,456	1,604	1,529	1,494
In percent of quota	0	2	9	13	21	25	71	89	106	117	111	109
In percent of GDP	0	0.1	0.2	0.3	0.4	0.4	1.0	1.2	1.4	1.4	1.3	1.2
In percent of exports of goods and services	0	0.1	0.3	0.4	0.6	0.7	1.9	2.2	2.4	2.5	2.2	2.0
In percent of gross reserves	0	0.3	0.8	0.9	1.2	1.3	3.7	4.5	5.6	6.8	7.4	8.4

Source: IMF staff estimates.

1/ End of period.

2/ Repayment schedule based on repurchase obligations and charges.

Table 8. Ukraine: Proposed Schedule of Purchases Under the Extended Arrangement

Date	Amount of purchase			Conditions
	Millions of SDRs	Millions of US\$ 1/	Percent of quota	
Mar 11, 2015	3,546.000	5,017.30	258.45	Board approval of extended arrangement
June 15, 2015	1,182.100	1,665.82	86.16	First review and end-March 2015 performance criteria
September 15, 2015	1,182.100	1,666.87	86.16	Second review and end-June 2015 performance criteria
December 15, 2015	1,182.100	1,668.60	86.16	Third review and end-September 2015 performance criteria
March 15, 2016	437.975	618.70	31.92	Fourth review and end-December 2015 performance criteria
June 15, 2016	437.975	619.07	31.92	Fifth review and end-March 2016 performance criteria
September 15, 2016	437.975	619.84	31.92	Sixth review and end-June 2016 performance criteria
December 15, 2016	437.975	621.03	31.92	Seventh review and end-September 2016 performance criteria
March 15, 2017	437.975	622.19	31.92	Eighth review and end-December 2016 performance criteria
June 15, 2017	437.975	623.18	31.92	Ninth review and end-March 2017 performance criteria
September 15, 2017	437.975	624.22	31.92	Tenth review and end-June 2017 performance criteria
December 15, 2017	437.975	625.30	31.92	Eleventh review and end-September 2017 performance criteria
March 15, 2018	437.975	626.31	31.92	Twelfth review and end-December 2017 performance criteria
June 15, 2018	437.975	627.30	31.92	Thirteenth review and end-March 2018 performance criteria
September 15, 2018	437.975	628.44	31.92	Fourteenth review and end-June 2018 performance criteria
December 15, 2018	437.975	629.73	31.92	Fifteenth review and end-September 2018 performance criteria
Total	12,348	17,504	900	

Source: IMF staff estimates.

1/ For 2015–18, the average USD/SDR rates used in this table are: 1.411, 1.415, 1.424, and 1.434, respectively.

Annex. Debt Sustainability Analysis

Under the policy and financing package supporting the extended arrangement under the EFF, including the expected outturn from the debt operation, Ukraine's public debt is assessed as sustainable with high probability. Such an assessment depends crucially on three main assumptions: (i) the full implementation of policies under the program; (ii) adequate and timely external financing from the official sector and, via a debt operation, the private sector; and (iii) the non-intensification of the conflict in the East. Given the revisions to the macroeconomic framework, public debt after the debt operation is projected to peak at 94 percent of GDP in 2015, above the 70 percent of GDP high-risk benchmark in the debt sustainability framework. Debt is projected to decline thereafter—reaching below 71 percent of GDP by 2020—driven by the successful completion of the envisaged debt operation, sustained fiscal adjustment, the elimination of quasi-fiscal losses in the energy sector, and growth recovery. The projected downward trajectory of Ukraine's public debt remains subject to considerable risks, particularly from growth and real exchange rate shocks, and larger-than-expected contingent liabilities emanating from the banking sector. The average gross financing needs during the program and post-program period are forecast to remain below 15 percent of GDP, somewhat mitigating the risks associated with the high-debt level. The shift in the composition of debt towards official debt with longer maturity and lower cost also lessens the risks. The external DSA continues pointing to significant solvency concerns as external debt would peak at about 148 percent of GDP in 2015, but the presence of significant corporate assets in foreign currencies provides a buffer for maintaining external debt service, while a sustained reduction in current account deficits and the ongoing process of voluntary private debt restructuring would put external debt on a downward path. Though external debt would remain on a downward trend, growth and export shocks would keep it more elevated than under the baseline.

1. **This appendix considers the analysis of sustainability of Ukraine's public and external debt.** Section A provides a brief summary of the revisions to the macroeconomic framework. Section B considers public debt sustainability, examining the debt trajectory under the program baseline, and under a variety of stress scenarios. Section C considers external debt sustainability. The analysis shows that the EFF-supported program would help place Ukraine's debt on a sustainable trajectory, but there are significant risks that its downward path may be interrupted by shocks.

A. Key Assumptions in the DSA

2. **The macroeconomic framework has been updated to reflect the most recent developments.** Such a revision projects a debt ratio before the debt operation of 79.2 percent of GDP by 2020.

- **Growth.** The baseline growth projection for 2015 have been revised down to -9 percent (compared to -5½ upon EFF approval), driven by the deterioration in industrial production due to the flare-up of the conflict in the East during January–February, expectations of a weaker agricultural season, and tighter credit. Growth projections for 2016–20 are broadly unchanged relative to the program.

- **Exchange rate.** The average exchange rate is projected at UAH 22/US\$1 in 2015, reflecting the recent stabilization in the FX market, and is expected to end the year at UAH 23.5/US\$1 compared to UAH 22/US\$1 projected at program approval.
 - **Inflation.** Inflation (measured by the GDP deflator) is projected to peak at 39 percent in 2015 compared to 28 percent at EFF approval. This is due to the largely one-off pass-through effects of the large exchange rate depreciation in February, and the increase in energy prices during Q2.
 - **Fiscal and Naftogaz deficits.** The combined general government and Naftogaz overall deficit remains unchanged relative to GDP. The near-term adjustment path keeps a primary surplus target of 1.1 percent of GDP in 2015 (an improvement of 2¼ percentage points of GDP over 2014), followed by a medium-term sustained fiscal effort to attain a primary surplus of about 1.6 percent (Figure 3). As noted at the time of EFF approval, this path is ambitious in the context of previous fiscal performance in Ukraine (an average primary deficit of 2.4 percent of GDP over 2004–13) and international comparisons (well above the 75th percentile of historical primary balance adjustments in countries with IMF-supported programs, Figure 2), though it is not unprecedented.
3. **Banking system support.** Fiscal needs to support bank restructuring in 2014–15 remain unchanged at 9.4 percent of GDP, preserving a buffer of nearly 4 percent of GDP in public funds to absorb additional bank recapitalization and resolution needs.
 4. **Debt operation.** The DSA is underpinned by the following program objectives that are currently guiding the negotiations with creditors: (i) generate about US\$15 billion in public sector financing during the program period; (ii) bring the public and publicly guaranteed debt/GDP ratio from a projected pre-operation 79.2 percent of GDP to under 71 percent of GDP by 2020; and (iii) keep the budget's gross financing needs at an average of 10 percent of GDP (maximum of 12 percent of GDP annually) in 2019–25. The debt operation is also expected to reduce notably gross financing needs during the program period (2015–18), from an average of 18 percent of GDP to 12 percent (see charts below). The authorities published the list of debt instruments subject to restructuring, including non-guaranteed debt owed by state-owned enterprises (see text table below, which reports debt and debt service of eligible instruments).
 5. **Official financing.** Multilateral and bilateral funding is provided at low borrowing costs (tied to Euribor/Libor and fixed annual rates below 2 percent, respectively), with loans amortizing in the range of 10–20 years (with multilaterals granting about five year grace period). IMF lending is calibrated to be on EFF terms.
 6. **Market access.** Evidence points to an early return to market access in past successful debt operations with time to re-access at about three years. Ukraine's time to re-access markets after its 1998 debt restructuring was also about three years. It is then assumed that by late-2017 Ukraine would be able to re-access international capital markets. Objective 3 of the debt operation, which aims at preserving a strong capacity to repay in the post-program period and avoiding a bunching of maturities, helps ensure the needed continuous market access.

**Ukraine: Debt and Debt Service of Instruments To Be Restructured 1/
(US\$ billion)**

	Debt service					Eligible Debt
	2015 2/	2016	2017	2018	Total	
Total	6.2	4.9	5.7	3.2	20.0	22.7
<i>of which: Principal</i>	5.5	3.6	4.6	2.6	16.2	
<i>of which: Interest</i>	0.7	1.3	1.1	0.6	3.8	
Sovereign Eurobonds 3/	4.9	3.5	4.1	0.5	13.0	16.8
Principal	4.4	2.6	3.3	0.0	10.3	
Interest	0.5	0.9	0.8	0.5	2.8	
Sovereign-guaranteed Eurobonds 4/	0.1	0.1	1.3	0.7	2.2	
Principal	0.0	0.0	1.1	0.7	1.8	1.8
Interest	0.1	0.1	0.1	0.0	0.4	
Sovereign-guaranteed commercial loans 5/	0.2	0.3	0.1	0.3	0.8	
Principal	0.2	0.2	0.1	0.3	0.7	0.7
Interest	0.0	0.0	0.0	0.0	0.1	
Non-guaranteed SOEs liabilities 6/	1.0	1.0	0.2	1.7	3.9	
Principal	0.9	0.8	0.1	1.6	3.4	3.4
Interest	0.1	0.2	0.1	0.1	0.5	

Sources: Ministry of Finance

1/ Eligible instruments to be restructured were announced in Cabinet Resolution No 318 on April 4.

2/ Excludes debt repayments before the expected opening of the debt operation.

3/ Includes Eurobonds issued by the city of Kyiv and excludes the Eurobond issued in 2014 with US guarantees.

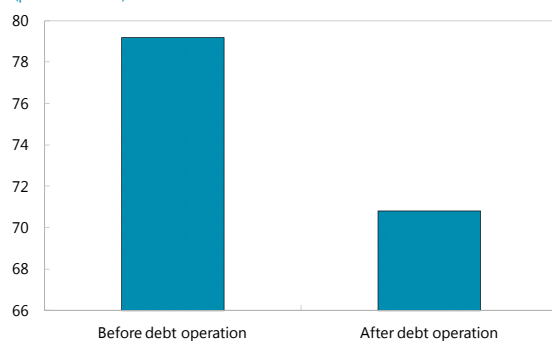
4/ Includes Eurobonds issued by the SOE "Financing of Infrastructural Projects" issued in 2010, 2011, and 2012.

5/ Includes external loans of SOEs: Ukravtodor, Yuzhnoye State Design Office, and Ukrmedpostatch.

6/ Includes Eurobonds and external loans of SOEs: Ukreximbank, Oschadbank, and Ukrzaliznytsya.

Public and Publicly Guaranteed Debt, 2020

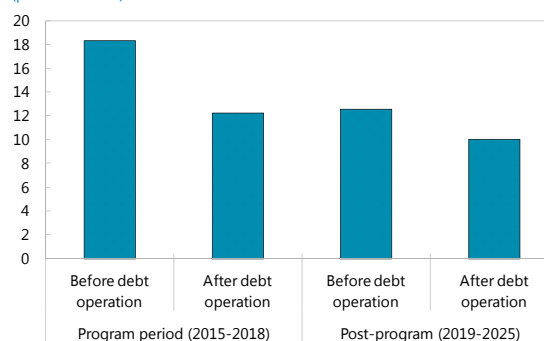
(percent of GDP)



Source: IMF staff estimation.

Gross Financing Needs

(percent of GDP)



Source: IMF staff estimation.

a. Public Sector DSA

7. **The coverage of public debt in this DSA includes** (i) central government direct debt (including domestic debt held by the NBU amounting to 20 percent of GDP at end-2014); (ii) domestic and external government guarantees on loans/bonds extended to state-owned enterprises; (iii) debt of local governments; and (iv) NBU's liabilities to the IMF.

Ukraine: Public and Publicly Guaranteed Debt, 2014

	UAH (Billion)	USD (Billion)	Percent of GDP	Percent of total
Public and publicly guaranteed debt	1116	70.8	71.2	100.0
Domestic debt	495	31.4	31.6	44.4
Direct debt in UAH	400	25.4	25.5	35.9
Direct debt in FX	67	4.3	4.3	6.0
Guaranteed debt	28	1.8	1.8	2.5
External debt	621	39.4	39.6	55.6
External direct debt	495	31.4	31.6	44.3
Multilateral 1/ of which: IMF budget support	171 86	10.8 5.4	10.9 5.5	15.3 7.7
Bilateral 2/ Sovereign Eurobonds	43 273	2.7 17.3	2.7 17.4	3.8 24.4
Local government Eurobonds 3/	9	0.6	0.6	0.8
External guaranteed debt	126	8.0	8.0	11.3
of which: IMF loans to NBU	34	2.2	2.2	3.1
of which: Eurobonds	29	1.8	1.8	2.6
of which: Commercial loans	52	3.3	3.3	4.6

Sources: Ministry of Finance

1/ Includes IMF, WB, EBRD, EIB.

2/ Includes EU.

3/ Issued by the city of Kyiv.

8. **Baseline projections indicate that the debt ratio would fall to below 71 percent of GDP in 2020 after the debt operation** (Figure 3). Debt reached 71 percent of GDP at end-2014, a jump of 30 percentage points from 2013, driven by the large exchange rate depreciation and notable external and domestic financing needs, mainly for Naftogaz. Similar factors at play in 2015 would lead public debt to peak at about 94 percent of GDP. Once the debt operation is completed, fiscal adjustment entrenched, and growth restored, the debt ratio is expected to gradually converge to below 71 percent of GDP, near the DSA high-risk benchmark.

9. **A heat map and fan charts indicate that Ukraine faces significant risks to debt sustainability** (Figure 1). Even with a successful program implementation and debt operation, significant uncertainty remains. However, risks stemming from the elevated debt level are mitigated by improved gross financing needs, projected to average 12 and 10 percent during and after the program period, respectively. The fan charts illustrate the possible evolution of the debt-to-GDP ratio over the medium term, based on both a symmetric and asymmetric distribution of risks. In the former, upside and downside risks to the main macro variables are treated as equally likely, while in the latter shocks to the primary balance and REER are restricted to be negative to reflect the ambitious fiscal adjustment plan and the possibility of continued depreciation. The asymmetric fan chart therefore shows that risks to the debt outlook are skewed upward if the envisaged fiscal consolidation and FX market stabilization fall short of expectations. Risks to the debt profile are mixed. High EMBIG spread reflects ongoing debt restructuring negotiations and the expectation of principal haircut. The share of public debt held by nonresidents is high, but the shift from private to official creditors is reducing the implied risks. On the other hand, short-term debt ratios are very

low, and the share of external debt is projected to decline in the coming years, mitigating rollover and exchange rate risks.

10. **Stress tests continue pointing to a number of sensitivities, with the balance of risk mostly tilted to the downside.** The projected decline in public debt remains fragile, vulnerable to lower growth, continued exchange rate depreciation, and contingent liabilities emanating from the banking system. Under a growth shock, entailing a cumulative growth decline of about 9 percentage points in 2016–17, the debt-to-GDP ratio reaches nearly 116 percent in 2017. A real exchange rate shock, not dissimilar to the one in 2014, would also keep the debt ratio above 100 percent of GDP throughout the projection period. The combined macro-fiscal shock, an aggregation of the shocks to real growth, interest rate, primary balance and exchange rate, produce unsustainable dynamics, sending debt above 200 percent of GDP in 2017. The contingent liabilities shock highlights the risk of a further deterioration of the banking sector and associated higher fiscal costs. Its impact is mitigated by the buffer embedded under the baseline for larger-than-expected bank restructuring costs. By imposing a large associated shock to growth (14 percentage points below the baseline in 2016–17) and given the resulting deterioration in the primary balance together with an increase in interest rates, under the contingent liabilities shock debt peaks at 113 percent of GDP in 2017.

11. **The baseline and shocks scenarios highlight the considerable risks related to potentially larger-than-expected financing needs of the banking sector and Naftogaz in the near term.** However, under the baseline, gross financing needs breach the high-risk benchmark of 15 percent of GDP only in 2015, as a result of the extensive support to the banking sector and Naftogaz. The average gross financing need for the remainder of the program period lies below 10 percent of GDP. Under stress tests, only the combined shock has a meaningful impact on gross financing needs, raising it to an average of more than 20 percent of GDP during the projection period.

a. External Sector DSA

12. **Baseline projections suggest that external debt could drop by about 40 percentage points of GDP by 2020, while remaining high.** Assuming a successful implementation of policies under the program, adequate and timely external financing from the official and private sectors, and non-intensification of the conflict in the East, the gross external debt-to-GDP ratio would peak at 148 percent of GDP in 2015 from 100 percent in 2014 before declining to 110 percent of GDP by end-2020. The medium-term sustainability of external debt is underpinned by the significant external adjustment, with the trade balance of goods and services moving from a deficit of close to 10 percent of GDP in 2013 to an average of below 2 percent in the medium term. Its downward path is also supported by the impact of the debt operation through the income balance in the current account. Moreover, private corporations maintain significant foreign currency assets—covering 84 percent of their foreign currency liabilities as of end-2014—which reduce their net exposure to external shocks and help them maintain external debt service. Finally, a number of large corporations have already engaged in voluntary debt restructuring/rollover operations.

13. **However, external debt dynamics are subject to downside risks due to macroeconomic shocks or a quick reversal of the recent external adjustment** (Figure 6). A slower-than-expected resumption of export growth, due to a protracted impact of the war-induced supply shocks or to delays in finding suitable markets for products previously targeted to CIS trading partners, could undo the adjustment of the current account deficit at the time when imports start to respond to growth recovery. If the current account deteriorates on average by 1 percent of GDP per year compared to the baseline, the external debt ratio would increase by about 8 percent of GDP by 2020. More importantly, the external debt dynamics are significantly affected by a growth shock. A half historical standard deviation shock from the growth path under the baseline, about 2½ percentage points lower growth on average per year, increases the external debt ratio by about 23 percentage points of GDP by 2020. Reduced FDI due to confidence effects from a prolongation or intensification of the conflict in the East would also significantly affect external debt dynamics, with a sizable upward shift in the debt adjustment path.

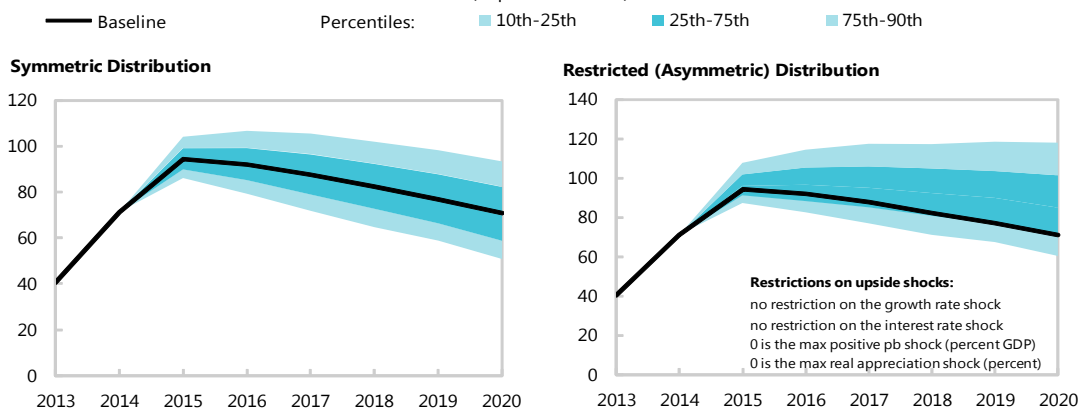
Ukraine Public DSA—Risk Assessment

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

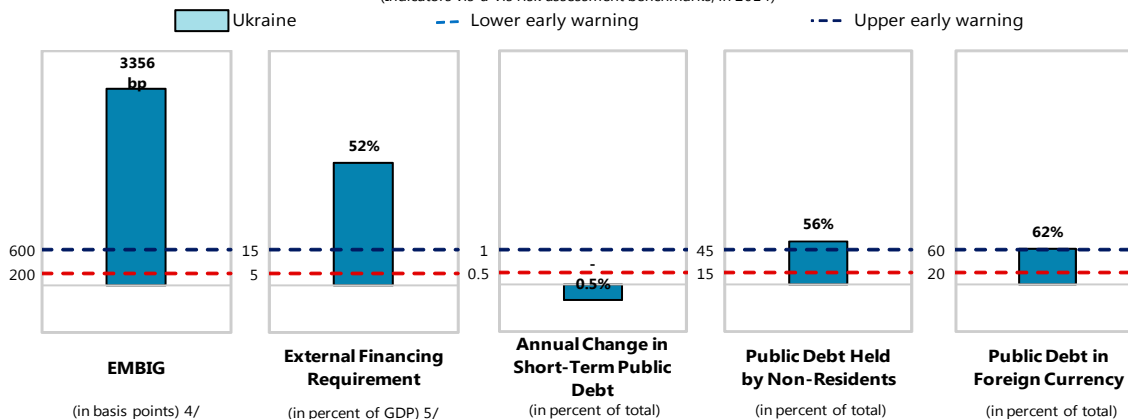
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2014)



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 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:

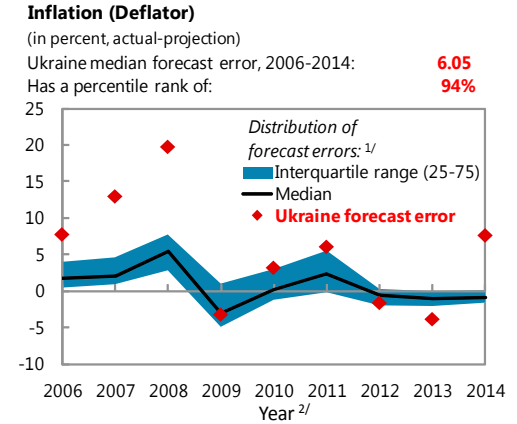
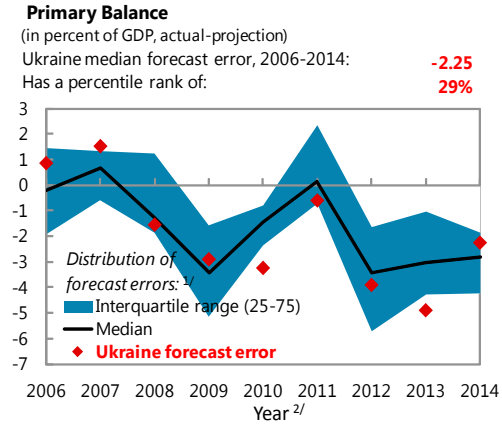
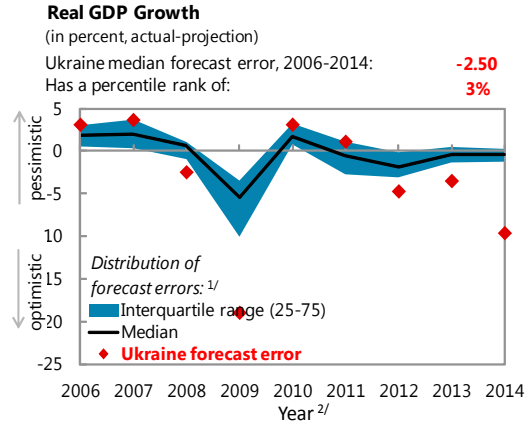
200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ EMBIG, an average over the last 3 months, 05-Mar-15 through 03-Jun-15.

5/ 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.

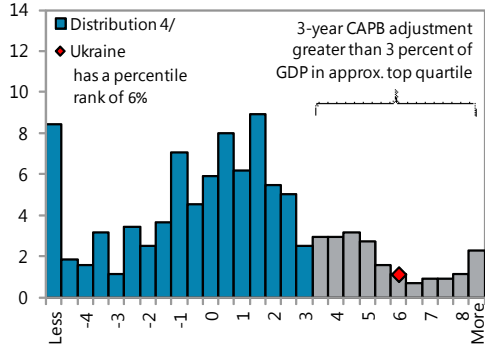
Ukraine Public DSA—Realism of Baseline Assumptions

Forecast Track Record, versus program countries

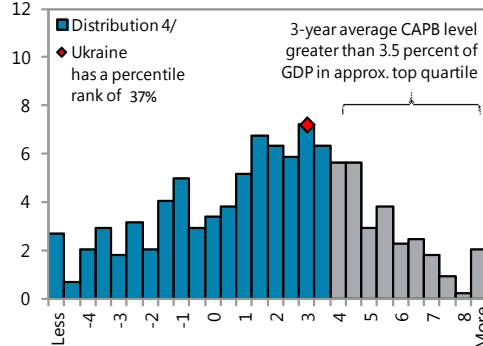


Assessing the Realism of Projected Fiscal Adjustment

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 DSA—Baseline Scenario

(in percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators ^{1/}

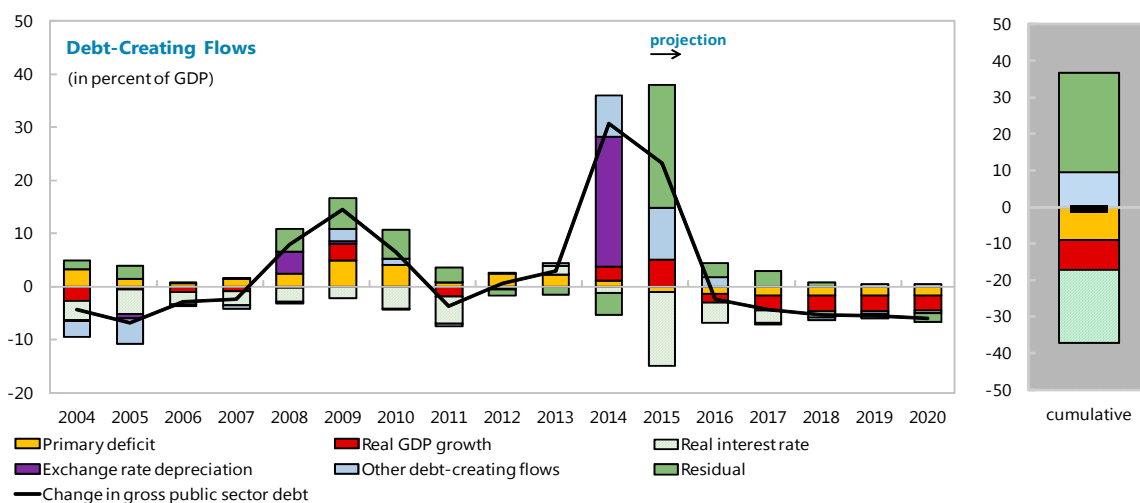
	Actual			Projections					
	2004-2012 ^{2/}	2013	2014	2015	2016	2017	2018	2019	2020
Nominal gross public debt	26.2	40.5	71.2	94.4	92.1	87.8	82.4	76.9	70.8
Of which: guarantees	6.2	7.1	9.8	18.9	20.9	21.7	21.0	19.0	16.5
Public gross financing needs	6.1	9.9	12.1	20.1	11.4	8.7	8.8	8.4	8.4
Real GDP growth (in percent)	2.6	0.0	-6.8	-9.0	2.0	3.5	4.0	4.0	4.0
Inflation (GDP deflator, in percent)	17.2	4.3	14.8	39.0	12.0	9.9	8.0	6.0	6.0
Nominal GDP growth (in percent)	20.4	4.3	6.9	26.4	14.2	13.7	12.3	10.2	10.3
Effective interest rate (in percent) ^{4/}	6.5	8.7	10.7	10.9	7.7	7.4	7.0	6.9	7.0

As of June 03, 2015

Sovereign Spreads		
EMBIG (bp) ^{3/}		2823
5Y CDS (bp)		3855
Ratings	Foreign	Local
Moody's	Ca	Ca
S&P's	CC	CCC
Fitch	CC	CCC

Contribution to Changes in Public Debt

	Actual			Projections						cumulative	debt-stabilizing primary balance ^{9/}
	2004-2012 ^{2/}	2013	2014	2015	2016	2017	2018	2019	2020		
Change in gross public sector debt	1.0	3.0	30.7	23.2	-2.3	-4.3	-5.4	-5.5	-6.0	-0.4	
Identified debt-creating flows	-1.4	4.4	34.8	0.0	-5.1	-7.2	-6.3	-4.6	-4.4	-27.6	
Primary deficit	2.4	2.3	1.2	-1.1	-1.4	-1.6	-1.6	-1.6	-1.6	-8.9	
Primary (noninterest) revenue and grants	41.3	43.3	40.8	40.8	39.7	40.0	40.0	40.0	39.9	240.5	
Primary (noninterest) expenditure	43.8	45.7	42.0	39.7	38.3	38.4	38.4	38.4	38.3	231.6	
Automatic debt dynamics ^{5/}	-3.1	1.6	25.9	-8.7	-5.4	-5.1	-4.2	-2.5	-2.3	-28.2	
Interest rate/growth differential ^{6/}	-3.5	1.6	1.4	-8.7	-5.4	-5.1	-4.2	-2.5	-2.3	-28.2	
Of which: real interest rate	-3.0	1.6	-1.1	-13.8	-3.7	-2.3	-1.1	0.5	0.5	-19.9	
Of which: real GDP growth	-0.5	0.0	2.6	5.1	-1.6	-2.8	-3.1	-3.0	-2.8	-8.3	
Exchange rate depreciation ^{7/}	0.4	0.0	24.4	...	...	...	...	...	...	...
Other identified debt-creating flows	-0.7	0.5	7.8	9.8	1.7	-0.5	-0.5	-0.5	-0.6	9.5	
Net Privatization Proceeds (negative)	-1.3	-0.1	-0.1	-0.4	-0.5	-0.5	-0.5	-0.5	-0.6	-2.9	
Bank and Naftogaz recapitalization	0.6	0.6	7.9	10.2	2.2	0.0	0.0	0.0	0.0	12.4	
Other adjustments	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/}	2.4	-1.4	-4.1	23.2	2.7	2.9	0.9	-0.9	-1.6	27.2	



Source: IMF staff.

1/ Public sector is defined as general government and includes public guarantees, defined as domestic and external guarantees. Projections assume new guarantees issuance of 1.5 percent of GDP in 2015, 0.9 percent in 2016-17, and 0.5 percent in 2018-2020.

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 $[(r - \pi(1+g) - g + ae(1+r))/(1+g+\pi+gr)]$ 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 (including IMF financing to NBU), and asset changes. For projections, includes exchange rate changes during the projection period.

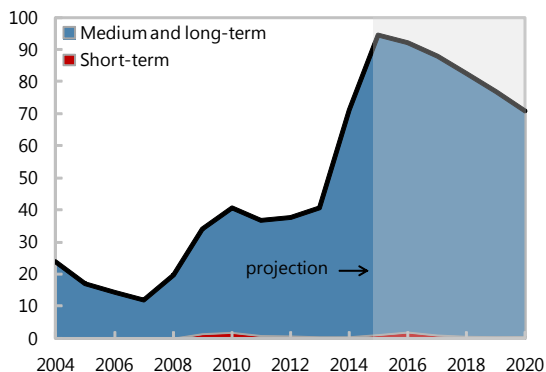
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Ukraine Public DSA—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

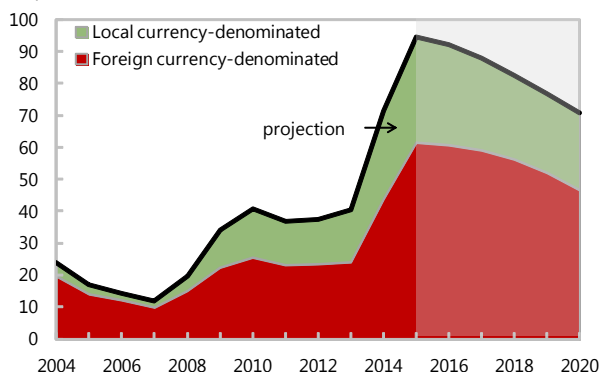
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)



Alternative Scenarios

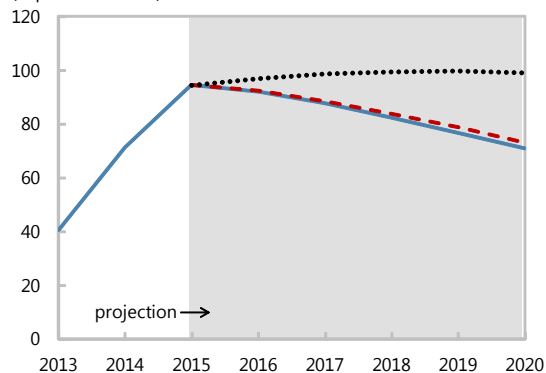
— Baseline

..... Historical

- - - Constant Primary Balance

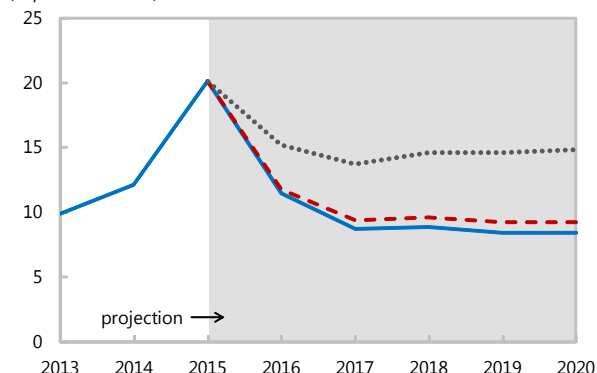
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

Baseline Scenario	2015	2016	2017	2018	2019	2020
Real GDP growth	-9.0	2.0	3.5	4.0	4.0	4.0
Inflation	39.0	12.0	9.9	8.0	6.0	6.0
Primary Balance	1.1	1.4	1.6	1.6	1.6	1.6
Effective interest rate	10.9	7.7	7.4	7.0	6.9	7.0

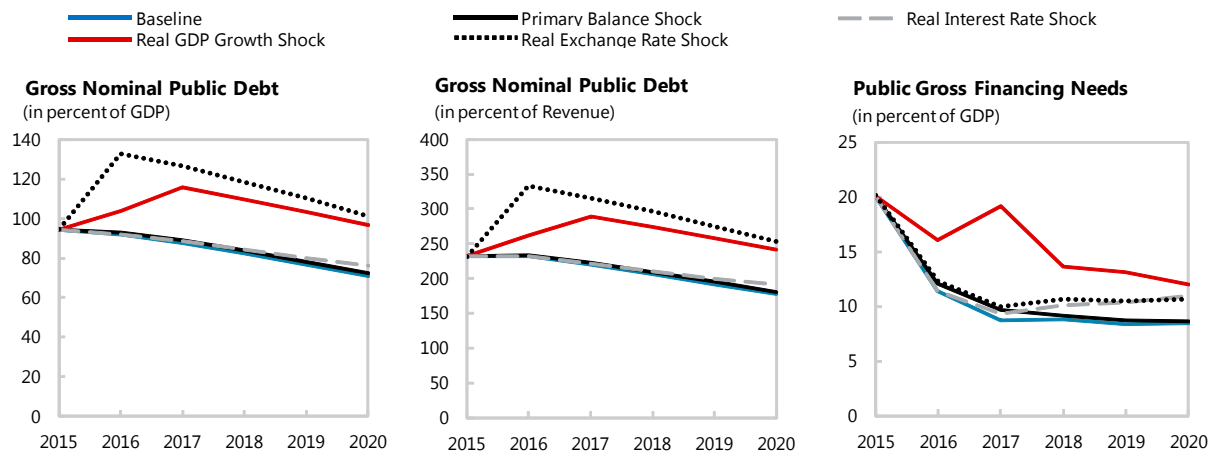
Constant Primary Balance Scenario	2015	2016	2017	2018	2019	2020
Real GDP growth	-9.0	2.0	3.5	4.0	4.0	4.0
Inflation	39.0	12.0	9.9	8.0	6.0	6.0
Primary Balance	1.1	1.1	1.1	1.1	1.1	1.1
Effective interest rate	10.9	7.7	7.4	7.0	6.9	7.0

Historical Scenario	2015	2016	2017	2018	2019	2020
Real GDP growth	-9.0	0.5	0.5	0.5	0.5	0.5
Inflation	39.0	12.0	9.9	8.0	6.0	6.0
Primary Balance	1.1	-2.2	-2.2	-2.2	-2.2	-2.2
Effective interest rate	10.9	7.7	7.0	6.2	5.9	5.7

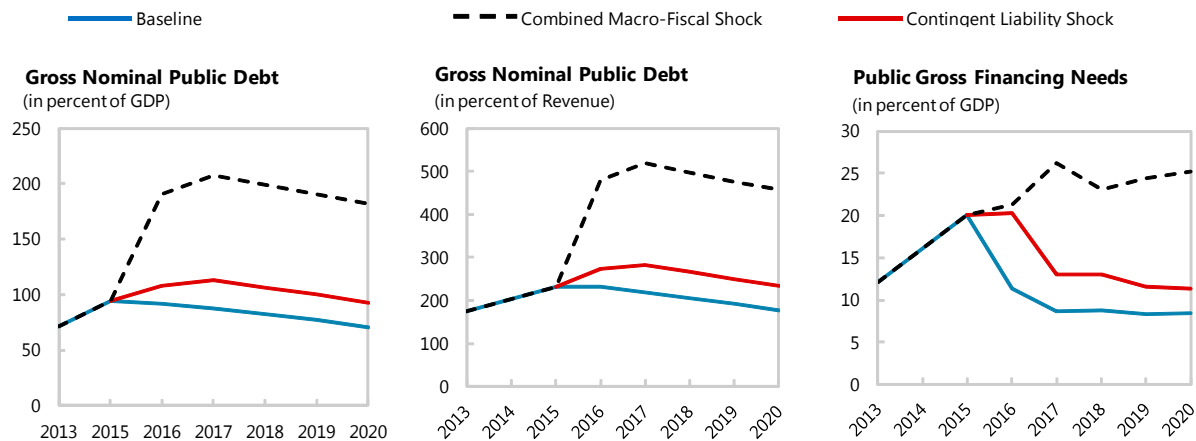
Source: IMF staff.

Ukraine Public DSA—Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



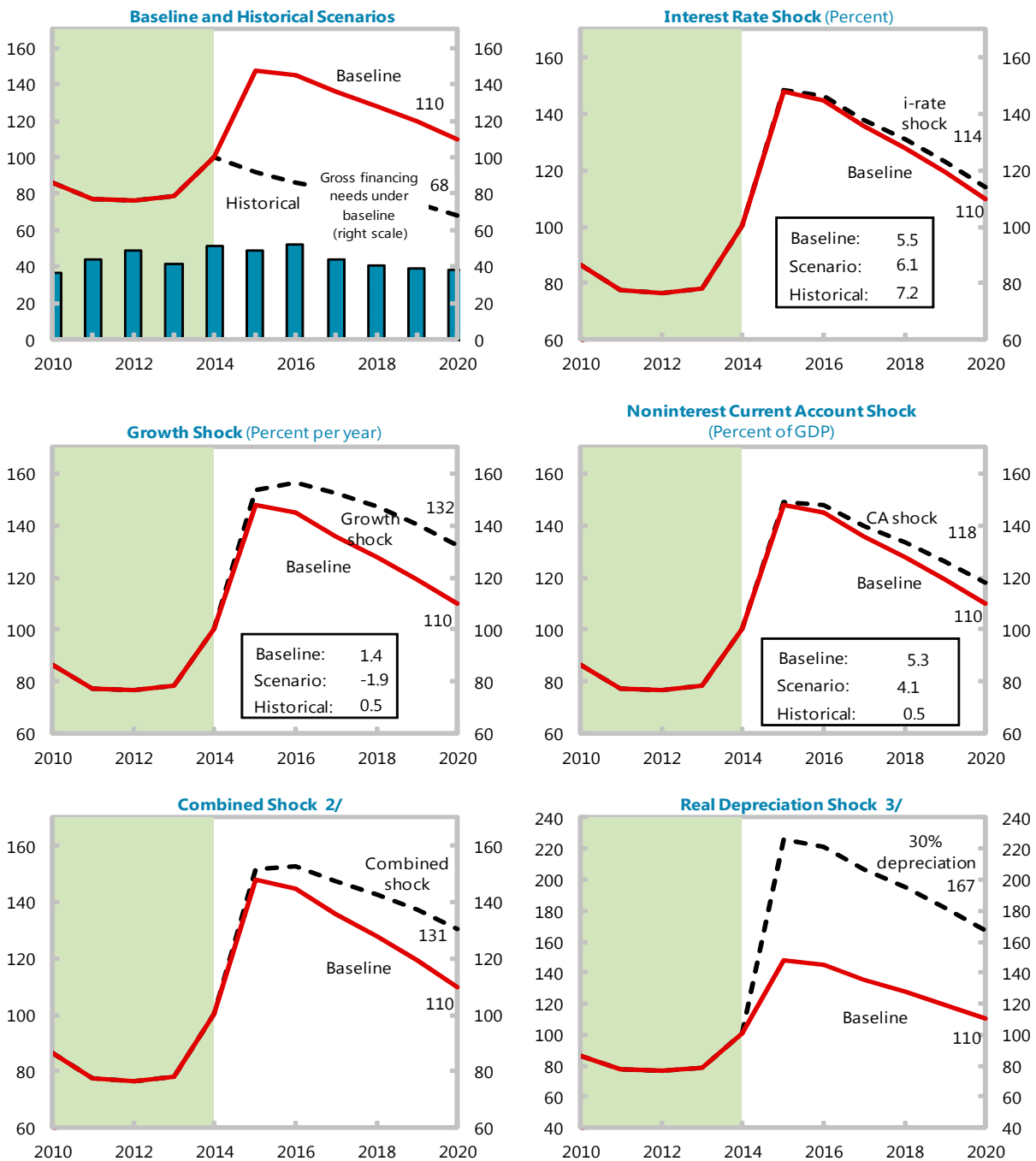
Underlying Assumptions (in percent)

	2015	2016	2017	2018	2019	2020
Primary Balance Shock						
Real GDP growth	-9.0	2.0	3.5	4.0	4.0	4.0
Inflation	39.0	12.0	9.9	8.0	6.0	6.0
Primary balance	1.1	0.7	0.9	1.6	1.6	1.6
Effective interest rate	10.9	7.7	7.4	7.0	6.9	7.0
Real Interest Rate Shock						
Real GDP growth	-9.0	2.0	3.5	4.0	4.0	4.0
Inflation	39.0	12.0	9.9	8.0	6.0	6.0
Primary balance	1.1	1.4	1.6	1.6	1.6	1.6
Effective interest rate	10.9	7.7	8.4	8.8	9.7	10.7
Combined Shock						
Real GDP growth	-9.0	-5.0	-3.5	4.0	4.0	4.0
Inflation	39.0	10.2	8.1	8.0	6.0	6.0
Primary balance	1.1	-2.1	-5.7	1.6	1.6	1.6
Effective interest rate	10.9	10.3	5.8	6.7	7.5	8.6
Real GDP Growth Shock						
Real GDP growth	-9.0	-5.0	-3.5	4.0	4.0	4.0
Inflation	39.0	10.2	8.1	8.0	6.0	6.0
Primary balance	1.1	-2.1	-5.7	1.6	1.6	1.6
Effective interest rate	10.9	7.7	7.5	7.5	7.3	7.3
Real Exchange Rate Shock						
Real GDP growth	-9.0	2.0	3.5	4.0	4.0	4.0
Inflation	39.0	44.4	9.9	8.0	6.0	6.0
Primary balance	1.1	1.4	1.6	1.6	1.6	1.6
Effective interest rate	10.9	10.3	5.7	5.6	5.7	6.0
Contingent Liability Shock						
Real GDP growth	-9.0	-5.0	-3.5	4.0	4.0	4.0
Inflation	39.0	10.2	8.1	8.0	6.0	6.0
Primary balance	1.1	-5.9	1.6	1.6	1.6	1.6
Effective interest rate	10.9	8.2	7.5	7.0	6.9	7.0

Source: IMF staff.

Ukraine 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 2015.

Ukraine: Program External Debt Sustainability Framework, 2012–20

(Percent of GDP, unless otherwise indicated)

	Actual			Projections					
	2012	2013	2014	2015	2016	2017	2018	2019	2020
Baseline: external debt	76.6	78.3	100.4	147.7	144.8	135.7	127.8	119.4	109.9
Change in external debt	-0.8	1.7	22.1	47.4	-2.9	-9.1	-7.9	-8.4	-9.5
Identified external debt-creating flows (4+8+9)	-4.4	0.9	35.1	12.4	-2.9	-6.2	-7.9	-6.6	-4.5
Current account deficit, excluding interest payments	2.4	3.2	-1.3	-5.7	-5.9	-5.9	-5.6	-4.7	-3.8
Deficit in balance of goods and services	8.2	8.7	4.0	1.3	1.3	1.0	0.7	0.9	1.3
Exports	51.2	47.6	52.4	59.5	61.4	59.3	57.6	56.6	55.4
Imports	59.4	56.3	56.5	60.8	62.6	60.3	58.3	57.5	56.7
Net non-debt creating capital inflows (negative) 1/	-7.0	-6.7	1.9	-3.2	-1.7	-3.1	-4.4	-3.7	-2.6
Automatic debt dynamics 2/	0.2	4.4	34.6	21.3	4.8	2.8	2.1	1.9	1.9
Contribution from nominal interest rate	5.7	6.0	5.4	7.7	7.6	7.4	7.0	6.6	6.3
Contribution from real GDP growth	-0.2	0.0	7.3	13.6	-2.8	-4.6	-4.9	-4.7	-4.4
Contribution from price and exchange rate changes 3/	-5.4	-1.7	21.9	...	...	...	...	...	...
Residual, including change in gross foreign assets (2-3) 4/	3.7	0.8	8.8	35.0	-0.1	-2.9	0.0	-1.8	-5.0
External debt-to-exports ratio (percent)	149.5	164.5	191.5	248.1	236.0	228.8	222.1	211.0	198.3
Gross external financing need (billions of U.S. dollars) 5/	85.4	73.7	66.0	44.0	48.7	45.0	46.3	48.2	52.2
Percent of GDP	48.6	41.0	50.5	50.4	53.5	44.5	41.4	39.5	39.1
Scenario with key variables at their historical averages 6/			100.4	91.5	85.7	82.3	79.7	74.8	67.8
Key macroeconomic assumptions underlying baseline									
Real GDP growth (percent)	0.2	0.0	-6.8	-9.0	2.0	3.5	4.0	4.0	4.0
GDP deflator in U.S. dollars (change in percent)	7.4	2.2	-21.9	-26.7	2.4	7.4	6.3	5.0	5.2
Nominal external interest rate (percent)	8.0	8.0	5.0	5.1	5.3	5.6	5.7	5.6	5.8
Growth of exports of goods and services (U.S. dollar terms, percent)	1.3	-5.1	-19.9	-21.6	7.3	7.4	7.4	7.3	7.2
Growth of imports of goods and services (U.S. dollar terms, percent)	5.4	-3.1	-27.0	-25.7	7.1	7.1	7.0	7.6	8.0
Current account balance, excluding interest payments	-2.4	-3.2	1.3	5.7	5.9	5.9	5.6	4.7	3.8
Net non-debt creating capital inflows	7.0	6.7	-1.9	3.2	1.7	3.1	4.4	3.7	2.6

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; r = change in domestic GDP deflator in U.S. dollar terms, 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: Letter of Intent

Kyiv, July 21, 2015

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

Dear Ms. Lagarde:

1. In the attached update to the Memorandum of Economic and Financial Policies (MEFP) from February 27, 2015, we confirm our commitment to the policies and objectives of the economic program supported by an IMF arrangement under the Extended Fund Facility (EFF). We also describe progress and further policy steps toward meeting these objectives.

2. Notwithstanding the exceptionally difficult situation in Ukraine—with the unresolved conflict in the East—we have made steadfast efforts to implement policies under the EFF-supported program reflecting our strong commitment to economic adjustment and reforms. Following the significant economic contraction in 2015:Q1, there are signs that economic stability is gradually taking hold. The foreign exchange market has remained broadly stable in the last few months. Our official reserves, although still very low, have increased considerably following disbursements from official creditors and the NBU's foreign currency purchases from the market. We have taken bold measures to advance much needed reforms, including in the energy sector, by adopting a new gas sector law and increased gas and central heating retail prices by 285 percent and 67 percent, respectively. These are important first steps toward reaching cost recovery based on international market prices and thus eliminating the large losses in the state-owned gas company Naftogaz, while at the same time increasing significant allocations for social assistance programs. Budget outturn for 2015:Q1 was stronger than expected owing mainly to large VAT revenue driven by the higher-than-expected exchange rate depreciation and inflation. Banks' local currency deposits are growing again, although the FX deposit outflows continue, which remains a key concern.

3. Our actions ensured that all performance criteria (PC) for end-March, the continuous PC, and most structural benchmarks due through June 2015 were met, albeit some with a delay. We have also met the end-June PCs (preliminary data is reported in Table 2, with final data to be provided before the date of the Board meeting). We passed the necessary legislation to strengthen collections of Naftogaz receivables prior to the completion of the review. We also passed important legislation that strengthens the NBU independence and governance arrangements.

4. Our efforts now focus on restoring macroeconomic stability and setting the stage for robust and inclusive growth so critical for the Ukrainian people. This includes actions to improve competitiveness and the business climate through far-reaching structural reforms, rehabilitate the banking system, and restore sustainable external and fiscal positions.

5. Despite our strong efforts, the debt restructuring process is advancing more slowly than expected. Constructive discussions with holders of the state-owned Ukreximbank's US\$1.5 billion Eurobonds led to the completion of a consensual reprofiling of those notes on July 8. Separately, state-owned Oschadbank launched on July 6 a consent solicitation for a reprofiling of its US\$1.2 billion Eurobonds with the backing of an ad hoc committee holding a majority of the notes. These reprofiling operations are fully in line with the debt operation targets under the EFF-supported program. We are also making steady progress on the broader sovereign debt restructuring with the objective of concluding an agreement as soon as possible (as noted in the joint statements with the Ad Hoc Creditor Committee on July 1 and 15). We remain determined to complete the debt operation in line with its stated program objectives.

6. On the basis of steps that we have already taken and commitments under the program, we request completion of the first review, and a disbursement in the amount of SDR 1,182.1 million.

7. We believe that the policies set forth in the attached MEFP are adequate to achieve the macroeconomic and financial objectives of the program, but we will take any additional measures that may be appropriate for this purpose. We will consult with the IMF on the adoption of these measures, and in advance of revisions to the policies contained in the MEFP, in accordance with the IMF's policies on such consultation. We will provide IMF staff with the data and information it requests for the purpose of monitoring program implementation. Reaffirming commitment to our policy of transparency, we consent to the IMF's publication of this letter, the MEFP, the Technical Memorandum of Understanding (TMU), and the accompanying Executive Board documents.

Yours sincerely,

/s/

Petro Poroshenko
President

/s/

Arseniy Yatsenyuk
Prime Minister

/s/

Natalie Jaresko
Minister of Finance

/s/

Valeria Gontareva
Governor, National Bank of Ukraine

Attachment I. Ukraine: Memorandum of Economic and Financial Policies

I. Recent Economic Developments and Outlook

1. **The decline in economic activity continued in early 2015.** As the conflict in the East intensified, industrial production, construction, and retail sales contracted sharply in January–March at a higher-than-expected pace. Accordingly, real GDP in the first quarter declined by 17.2 percent, about 1¼ percentage points worse than programmed.
2. **Inflation surprised on the upside, reflecting the sharp exchange rate depreciation in February.** After halving in value in February, the hryvnia recovered in March–May following the tightening of monetary policy and the administrative measures. In recent weeks, it has stabilized at around UAH 21–23/US\$1, broadly as projected under the program. Headline 12-month inflation accelerated to 61 percent y-o-y in April, reflecting a rapid pass-through of the large exchange rate depreciation and sharp increases in energy prices.¹ As the hryvnia recovered, however, prices of imported goods began declining while increases in prices of non-tradables remain moderate. This suggests that the sharp rise in inflation largely represents a one-time shift in the price level rather than acceleration of underlying inflation pressures, which are constrained by the weak economy. Indeed, inflation in June declined to 0.4 percent m-o-m (57½ percent y-o-y), broadly as expected.
3. **While the current account deficit is somewhat weaker than expected, the overall balance of payments remains in line with the program.** Lower domestic demand and tightening of import restrictions prior to approval of the program led to import compression. At the same time, exports also underperformed as the conflict flared up in January–February, directly impacting key export industries, terms of trade turned worse than expected, and the repatriation of export proceeds decreased. Nevertheless, the balance of payments remains in line with program and reserves reached US\$10.3 billion at end-June, following the first EFF purchase, disbursement of other official assistance, and NBU FX purchases.
4. **The macroeconomic framework has been updated to reflect the most recent developments.**
 - **Growth** for 2015 has been revised down to -9 percent (compared to -5½ percent upon EFF approval) driven by the deterioration in industrial production, tighter credit, and scaled-back exports as supply constraints caused by the conflict in the East proved tighter than expected. Projections for 2016–20 are unchanged relative to the program.

¹ Subsequently, the State Statistics Committee found out that the effect of the April gas price increase was overstated by some 4 percentage points and revised its CPI methodology accordingly as recommended by an IMF TA mission. This revision will affect the CPI in October–November, once the two-tier winter season gas price schedule returns.

- **Inflation** at end-2015 is projected at 46 percent compared to 27 percent at the EFF approval. This is due to the largely one-off pass-through effects of the large exchange rate depreciation in February 2015. Inflation is projected to recede in 2016 to around 12 percent as the one-off effects subside and economic stabilization takes hold.
- **Balance of payments:** The current account deficit is expected to widen to 1.7 percent of GDP, compared to 1.4 percent of GDP at program approval. Both export and import projections are more compressed than initially expected. This reflects mainly worse terms of trade than initially projected. The wider current account deficit is offset by a better-than-expected financial account, driven by significant private debt restructuring, lower than expected FX cash outflow from the banking system, and FDI pick-up in part related to bank recapitalization. Thus, the overall balance of payments remains unchanged.

II. Policies under the Program

5. **Against this backdrop and to keep the program on track, we have adapted program policies as needed to stabilize the economy and restore growth.** To this end, we will continue to maintain a flexible exchange rate regime and accumulate reserves as programmed. Until financial conditions have stabilized more firmly, capital controls and other FX restrictive measures will largely remain in place. At the same time, we have prepared a conditions-based roadmap for the unwinding of these restrictive measures as stability is restored and confidence returns. We will continue the implementation of the bank resolution strategy consistent with achieving adequate bank capitalization and the gradual unwinding of related loans. We also continue to implement reforms that entrench high-quality fiscal adjustment. We remain committed to a successful debt operation that is consistent with the program financing and debt sustainability objectives. Repairing Naftogaz finances through energy price adjustments to market levels and structural reforms in the energy sector remains a priority. Finally, we will reinvigorate our push to improve Ukraine's business environment and strengthen governance.

A. Monetary and Exchange Rate Policy

6. **We remain committed to reducing inflation and maintaining a flexible exchange rate, while building up NBU reserves.** In this regard, specific actions include:
- a. **Rebuilding reserves.** Efforts to rebuild a strong international reserve position in line with the program will continue. The NBU will continue to mop up the excess supply on the FX market, and limit FX sales to facilitate external payments by the central government and prevent disorderly market conditions. Naftogaz is now meeting its FX needs through borrowing and market purchases. The recent extension until 2018 of the swap line with the People's Bank of China for an amount up to the equivalent of US\$2.4 billion will help mitigate our foreign exchange needs and strengthen the balance of payments. To relieve pressures on reserves, the Ministry of Finance will seek to roll over the government's domestic FX debt liabilities at least at

the rate assumed under the program by offering suitable interest rate and maturity terms (TMU, Section 1.A).

b. **Preparing for the removal of administrative measures.** The temporary administrative measures have helped to contain BOP pressures. We expect that our policy program and the financial support of the international community will lead to steady improvement in the balance of payments, financial stability, and the return of depositors' and investors' confidence, which will set the stage for the safe removal of these administrative measures in due course. To this end, we have prepared a roadmap and will begin implementing it in a gradual and cautious manner once the following prerequisites are met:

- a successful completion of the debt operation in line with the objectives specified in paragraph 26 of the MEFP dated February 27, 2015;
- full implementation of bank recapitalization based on the results of the 2014 diagnostic studies;
- a target level of the NBU's net international reserves (NIR) as specified in the roadmap for the first stage of the liberalization; and
- full transition of Naftogaz to the interbank market for its FX purchases (i.e., no further reliance on NBU reserves).

7. **Monetary policy will aim to reduce inflation to single-digit levels.** For the time being, the current monetary policy stance remains appropriate given our near-term inflation projections and current inflation expectations (15–20 percent for the year to June 2016). Keeping the policy interest rate positive in real terms on a near-term forward-looking basis is essential to achieving our operational NIR/NDA targets through open market operations and anchoring inflation expectations. The NBU will monitor closely incoming data to ensure that inflation decelerates as projected and second-round effects from the exchange rate depreciation and energy price hikes remain contained. If inflation expectations are well anchored, inflation is under control, and foreign exchange market stability is entrenched, we will consider easing the monetary policy stance later in 2015 to support economic activity. Conversely, if despite our expectations inflation repeatedly surprises on the upside, or strong exchange rate depreciation pressures return, we will tighten policy as needed to address these adverse developments.

8. **To support the conduct of monetary policy, we remain committed to** (i) further improving the NBU's monetary policy and operational framework; (ii) strengthening the NBU's institutional independence and effectiveness, including safeguarding a strong balance sheet; and (iii) sharpening the NBU's accountability and communication with the market and general public to better guide their decisions and inflation expectations. In this regard:

- **To strengthen the NBU's institutional foundation and effectiveness, parliament has passed legislative amendments to the NBU Law.** The amendments transform the Board into an Executive Committee—composed of the governor and deputy governors—in charge of

formulating financial, monetary, and exchange rate policy. They also strengthen the oversight mandate of the NBU Council and the personal autonomy of the Council members. Given that the passage of these amendments was overdue (a missed structural benchmark for end-April), parliament passed these amendments (Laws 2742 and 2743) as a **prior action**.

B. Financial Sector Policies

9. **Our key near-term priority remains the restoration of stability and confidence in the financial sector.** To this end, we continue taking steps to (i) stabilize the banking system through prudent provision of collateralized liquidity by the NBU and close monitoring of banks' liquidity conditions; (ii) strengthen our regulatory and supervisory framework; and (iii) update and implement our bank resolution strategy. In particular, we have passed legal amendments (Law 218) to increase bank owners' liability for bank failure in case of wrongdoing and strengthen NBU's powers to require banks to identify and unwind excess risk concentrations from related party loans. We have effectively completed the first wave of bank recapitalization (covering the largest 35 banks) and continue to clean up the system by resolving insolvent and nonviable banks. More generally, we are working on five fronts to restore confidence in the financial sector by (i) taking decisive steps to monitor and substantially reduce related party lending; (ii) enhancing our banking recapitalization and resolution strategy; (iii) strengthening governance and financial performance in the DGF and state-owned banks; (iv) improving the existing framework for resolving bad loans; and (v) reforming securities markets.

Taking decisive steps to monitor and substantially reduce related party lending

10. **We have initiated the review of the banks' related party loans and are further enhancing our capacity to monitor such exposures.** By June 15, the top 10 private banks submitted their reports of related party exposure according to the new legal and regulatory framework. Moreover, independent accounting firms have begun reviewing these reports on the basis of terms of reference (TOR) provided by the NBU with IMF and World Bank (WB) staff assistance. To further support the review and monitoring process of related parties we will:
- a. **Create a committee to oversee the review process.** By end-July, the NBU will create a committee comprised of the first deputy governor, and the heads of the Special Monitoring Unit (SMU), On-site Supervision, Off-site Supervision and Licensing Departments. The committee will also have observers from the IMF and the WB. The resolution for the Committee will be agreed with the IMF and WB staff. The Committee shall consider and approve the outcomes of the comprehensive analysis of banks' related party transactions and advise the NBU Board to approve or not banks' related party exposure unwinding plans.
 - b. **Enhance the NBU's monitoring capacity.** By end-July, the NBU will assess its information needs and agree on MOUs with the authorities that maintain public registers as well as the other financial sector regulators to share key data on corporations, including the main shareholders, senior managers, and properties, which the SMU can use to identify related parties. Furthermore,

no later than end-July, the NBU will ensure sufficient budgetary allocation for the SMU to be fully operational by end-September.

11. The NBU is also working to improve its supervisory capacity as well as other aspects of market discipline. More specifically, we are:

- a. Seeking parliamentary approval of the amendments to the banking law to establish a credit registry at the NBU by end-September 2015. To this end, a draft bill agreed with Fund staff has been submitted to parliament. Among other things, the draft requires banks to report to the NBU detailed information of their borrowers, and also states that the DGF should ensure that banks under special administration and liquidation must continue reporting the payment status of borrowers so that their total credit exposure is not suddenly reduced in case of bank resolution.
- b. Instructing banks to adopt full IFRS for both financial reporting and the accounting of their daily operations no later than end-December 2015. We are also reinforcing our discretionary supervisory powers to request higher capitalization to banks when the implementation of accounting rules on loan provision fails to timely capture credit risk. To this end, by end-September 2015, with technical support of Fund staff, we will complete the review of the relevant regulations with the aim to ensure that our potential use of such powers is prudent, transparent, and in line with international best practices.

Enhancing banking recapitalization and resolution strategy

12. The NBU is monitoring closely the implementation of banks' recapitalization plans and will update assessments to identify new losses. Of the 18 largest banks identified by the 2014 diagnostic exercise as having capital needs, five were unable to present credible recapitalization plans and have been resolved by DGF, 12 have implemented their recapitalization plans as agreed with the NBU, and one large bank is set to raise the remaining UAH 2.5 billion by extending a subordinated loan that matures in September.² Given the extraordinary events since last year, on April 24 we initiated a new round of diagnostics (asset quality review and stress tests), on the basis of TOR agreed with the IMF and WB staff, to identify losses from the larger-than-expected exchange rate depreciation and the conflict in the East. Results for the top 10 banks and 10 subsequent banks will be available by end-August and end-October 2015, respectively, and the recapitalization plans for each bank will be ready within three months after the bank receives its final capital need estimate from the NBU. Any bank that finds itself with negative equity after the diagnostics will have to bring it to positive territory as part of their recapitalization plans within the same time frame (three months after the receipt of the final capital need estimate); meanwhile, such banks will be

² To ensure the credibility of the recapitalization process, this bank's shareholders have blocked in the bank funds of UAH 2.5 billion that will be immediately converted to subordinated debt by September 30 in case the envisaged extension of a subordinated loan that matures on this date does not materialize or if the extended loan does not meet the criteria for being counted as bank capital. This commitment of shareholders is final and irrevocable.

subject to enhanced supervisory constraints, including an *in situ* NBU supervisor. Furthermore, all banks will bring their post-diagnostics capital-asset ratios to at least 5 percent within six months after their recapitalization plans have been accepted by the NBU. We will allow viable but undercapitalized banks to temporarily continue operating with capital levels below 10 percent of risk weighted assets, with the 10 percent statutory CAR requirement being restored gradually by end-December 2018. Moreover, to support the bank restructuring efforts, we have:

- a. Established a Steering Committee (SC) to oversee the diagnostic results. The SC shall commence consideration of the reports for the largest 10 banks and 10 subsequent banks by mid-August and mid-September, respectively; and
- b. Identified a group of potentially problematic small banks based on quantitative criteria and supervisory intelligence as part of our efforts to identify emerging weaknesses in the banking system with the view to timely address them and prevent bank failure. We plan to continue strengthening our tools to anticipate problems, for which by end-August 2015 we plan to complete an assessment of our framework as regards to the soundness of metrics used to identify problems and effectiveness of our remedial measures.

13. **Our contingency planning is being enhanced to minimize fiscal costs associated with downside risks.** To this end, the NBU and MoF have agreed with IMF and WB staff on a set of strategic and operational principles that will guide the resolution of systemically important banks. These principles have established that:

- a. Triggers for resolution should be transparent and well grounded in the law.
- b. The NBU and MOF will take the lead in assessing tentative resolution options, taking into account viability criteria and including bail-in of non-deposit, unsecured creditors in line with international best practice;
- c. Key management may need to be replaced promptly with independent, experienced bankers;
- d. A sizeable amount of loans may need to be fully provisioned or removed to ensure bank viability, so there is a need to consider the transfer of such assets to a specialized unit (preferably inside the banks) to ensure prompt recovery;
- e. Public funds are injected on market terms in order to bring the bank's capital adequacy ratio to at least 10 percent or the average for the bank's peer group, whichever is lower. This will contain the risk that a systemic bank, recapitalized with public funds, may use its higher capitalization level to unfairly attract deposits from other banks; and
- f. The Financial Stability Council will need to develop a communication strategy to explain to the public how the actions protect depositors and help restore financial stability.

14. **We are ensuring that our legal framework is set to facilitate program implementation.** To this end, we will ensure that legislation is passed to:

- a. Ensure that the law provides that an appeal before the judicial branch by borrowers classified by the NBU as related parties to a bank does not halt the bank's unwinding of excess lending to insiders (**prior action**). The law that enhances NBU independence and institutional capacity (18) already includes amendments to this effect;
- b. Enhance further our capacity to monitor, restructure and resolve problem and insolvent banks. To this end, we already have:
 - i. Refined existing provisions in law to facilitate the resolution of systemic banks, including by giving the DGF the power to allow the bail-in of unsecured non-depositor creditors before public funds are used to recapitalize systemic banks and ensuring close coordination between the DGF, the MoF, and the NBU on resolution options;
 - ii. Enhanced DGF powers to speed resolution, accelerate repayment of depositors, prevent former bank owners from participating in the acquisition of other banks and consolidate management of assets from banks under liquidation into the DGF to improve asset recovery.

Strengthening governance and financial performance at the DGF and state-owned banks

15. **We will continue to implement measures to improve depositor payout, the least cost resolution process, and prospects for asset recovery from failed banks.** In this regard, we: (i) extended the timeframe to complete bank liquidation from three to five years; (ii) are creating a centralized unit to improve asset recovery; and (iii) have completed the terms of reference to conduct due diligence investigations (forensic audits) of failed banks and are pursuing funding to launch the bid process to select the auditing firms no later than end-August 2015. The DGF will develop an action plan to initiate immediate recovery of bank losses from shareholders found responsible for their banks' failures. For non-systemic banks, the DGF will start preparations for takeover, including early verification of banks' deposit records and prequalification of bidders, to improve the timeliness of depositor payouts. Also, banks meeting certain criteria will be automatically liquidated and the time period for temporary administration shortened to reduce the asset deterioration that occurs under the current lengthy administration process.

16. **The MoF will also establish a plan to improve the financial performance and monitoring of majority state-owned banks.** We are working on a strategic plan to strengthen governance and financial performance of the state-owned banks and have invited an expert supported by the IMF to assess the draft plan on the basis of international best practices. Based on the expert's recommendations, we will finalize the plan and publish it by end-September 2015 along with a schedule for its implementation.

Improving the existing framework for resolving bad loans

17. **We are working to strengthen the framework for resolving NPLs and corporate insolvency.** With the assistance from the March 2015 IMF technical assistance mission, we have

identified a set of reforms that are needed to strengthen our legal framework for corporate debt restructuring on the basis of international best practice and cross-country experience. Key areas of reform, as identified by the technical assistance mission, should include:

- a. Improvements to the corporate insolvency regime to (a) lower barriers to creditor access, (b) increase involvement and protection of secured creditors and decision-making power for creditors generally, (c) streamline the process to limit appeals and other delaying tactics, (d) protect post-petition finance, (e) develop procedures of sale to maximize value in liquidation, and (f) strengthen the “claw-back” and executory contract rules to better protect the insolvency estate;
- b. Removal of tax impediments to debt restructuring; and
- c. Strengthening the legal regime for enforcement of loan collection, including use of out-of-court enforcement mechanisms, limitations on appeals, and reduction of the need for multiple valuations.

To develop the necessary legislation, we will form by end-August an interagency committee with representatives of all agencies with competencies in these areas, a designated lead agency, and a secretariat. We will then prepare a first draft of the legislation by end-November, conduct a workshop with relevant stakeholders to seek their views on the draft legislation by end-December, and submit a final draft of the legislation to parliament by end-January. We will obtain parliamentary approval of the reforms of the bankruptcy law, the tax code, the mortgage law and the commercial and civil procedure codes to address all issues outlined in a), b) and c) above, consistent with Fund staff’s advice, by end-March 2016 (**structural benchmark**).

18. **Work on an alternative out-of-court mechanism for debt restructuring is also progressing.** With technical assistance from the EBRD and the WB, we have made significant progress in designing a coordinated out-of-court restructuring arrangement for corporate debt (the “Kyiv approach”), in line with international best practice including the INSOL principles, and the Istanbul approach. The necessary legislative framework will be introduced in parliament by end-September 2015 and adopted by end-October 2015.

19. **We are taking steps to facilitate the restructuring of foreign currency denominated mortgage loans through a voluntary negotiation process between borrowers and banks.** 11 banks have signed a Memorandum with the NBU on voluntary restructuring of mortgage loans and other banks with large portfolios are considering signing. Moreover, parliament passed amendments to the Tax Code in May 2015 that provide borrowers with tax relief from the proceeds arising from the partial debt forgiveness and tax deductibility of such losses to banks. By end-July 2015, the NBU, after consulting with Fund staff and stakeholders, will issue a Code of Conduct to guide the voluntary negotiations, debt restructuring, and appeals process.

Reforming the securities markets and other nonbanks

20. **We are committed to reforming our securities markets' regulation and supervision.** To function properly, Ukrainian securities markets require a significant overhaul and close supervision. However, a moratorium imposed in 2014 on conducting on-site inspections and investigations in regulated entities by most state agencies—including the National Securities and Stock Market Commission—may be undermining the Commission's ability to identify risk and misconduct. To correct this problem, by end-September 2015 we will lift the moratorium on inspections by the National Securities and Stock Market Commission. By end-August 2015, with technical assistance of international donors, we will define a clear action plan of measures to bring the functioning of our capital markets and the regulator's powers and independence to best international practices. Among other benefits, this could contain the evasion of capital controls by some corporates.

C. Fiscal Policy

21. **We are determined to reduce the fiscal deficit to the level necessary to secure a sustainable path for public debt in a balanced and socially fair manner.** Our adjustment strategy remains focused on expenditure-led consolidation that targets a smaller and more efficient government, while making the tax system growth-friendly, efficient, and equitable. We remain committed to reducing the *combined general government and Naftogaz deficit* from 10.1 percent of GDP in 2014 to 7.4 percent of GDP in 2015. Within this, we are committed to achieve a general government primary surplus of 1.1 percent of GDP in 2015 and 1.6 percent of GDP in the medium term. At the same time, bringing Naftogaz to financial health and eliminating government support to the company by 2017 is a priority. Starting with the 2017 budget, any government support to Naftogaz will be in line with ESA/GFSM accounting standards, where government support to state-owned enterprises is shown as a current subsidy. To complement our fiscal efforts and bring debt firmly on a sustainable path towards our target of below 71 percent of GDP by 2020, we are advancing discussions with creditors on a debt operation, which we aim to complete by late September 2015.

22. **The end-March general government deficit target was met with a significant margin.** The general government budget registered a surplus of UAH 3.2 billion in 2015:Q1. Strong revenue growth, mainly in VAT—owing to higher than projected inflation and exchange rate depreciation—and spending restraint caused by liquidity constraints early in the quarter account for this outcome.

23. **As revenue drivers are expected to wane in the remainder of the year, the 2015 budget deficit targets remain appropriate.** As the exchange rate has appreciated in Q2, the economy remains weak, and inflation is expected to decline, we expect revenue growth to slow down in the remainder of the year. We plan to channel the small projected revenue overperformance towards (i) national security needs; (ii) allocating sufficient funds for pensions and social assistance, including to support the internally displaced persons from the conflict in the East; (iii) clearing VAT refund arrears, which have picked up again; and (iv) supporting ongoing judicial and civil service reforms. Moreover, the Ministry of Finance will prepare a plan to clear outstanding arrears to suppliers of

community services stemming from maintaining tariffs below cost as mandated by the state. With support from our parliamentary majority, we are committed to preventing adoption of laws that are inconsistent with program policies and objectives, including recently submitted draft bills in the areas of pension reform, expenditure rationalization, and energy sector reform. Should any of these bills be passed, the Cabinet of Ministers will submit to the president proposals for a veto and the president will veto them. For any potential new draft laws, inconsistent with program policies and objectives, the Cabinet of Ministers will submit to the parliament its objection.

24. **We are preparing our 2016 budget in line with program targets.** To this end, we will take the necessary measures to achieve the program's deficit target of 3¾ percent of GDP in 2016, a reduction of ½ percentage point relative to 2014. To meet this target, provide extra funds for energy-related social assistance, and offset the impending large loss of revenue (about 2¼ percent of GDP) from the expiration of the temporary import surcharge and lower NBU profit transfer to the budget, we aim to undertake revenue-raising measures to the tune of 1½ percent of GDP (mainly in VAT and social security contributions) and expenditure cuts of about 1¾ percent of GDP. In our 2016 budget, we will aim to contain total general government expenditure to 43.4 percent of GDP. Specific measures will include:

- *Agriculture VAT.* We plan to submit to parliament by September, Tax Code amendments, which will introduce the general VAT regime in agriculture effective January 1, 2016. This measure will yield about 0.3 percent of GDP.
- *Social Security Contribution (SSC) reform.* We are reviewing the impact of amendments governing the calculations of SSC rates introduced in December 2014 and March 2015 on the reporting of actual wages. This analysis will inform options for reforming the SSC. The specific features of the reformed SSC will be developed in consultation with IMF staff. We aim to raise 0.5 percent of GDP in extra revenue through this reform in 2016.
- *Natural resource taxation.* Royalty rates introduced in July 2014 on gas and petroleum extracting companies are high by international standards and could be discouraging investments in the industry. With the assistance of IMF staff and in close consultations with the industry, we will develop amendments to the tax code with the aim to strike a balance between preserving revenue and encouraging investments into the industry. The amendments will become effective by October 1, 2015.
- *Revenue administration reform.* The revenue administration reform is a crucial element of our broader reform effort to strengthen governance and improve business environment. With input from IMF staff, we have developed and adopted a coherent revenue administration reform strategy and have started its implementation. The system of special VAT accounts has been piloted since February 2015 and seems to have contributed to the revenue overperformance. We have introduced this system in the whole country from July 1, 2015 after reviewing its design to ensure that it does not unduly block working capital of the VAT-paying companies. The process of moving large taxpayers to the large taxpayers' office and taxation of high-net-worth

individuals is also progressing well. These reforms together with our efforts to strengthen control at customs will raise revenue by at least 0.3 percent of GDP in 2016.

- Public Procurement.* With the assistance of the European Union, we have introduced an electronic procurement system on a pilot basis in various government agencies and state-owned enterprises. We are working on two procurement laws which will facilitate the full introduction of the new system. One—about simplification of procedures and regulations to streamline the public procurement process—was submitted to parliament and passed on first reading in June 2015. The second—about the full-fledged introduction of the electronic procurement system—will be submitted to parliament before end-2015. Following the adoption of these laws, the e-procurement system will be implemented over the course of 2016–17 in the entire public sector. When fully completed, this reform is expected to save about 20 percent of the total procurement budget, with about one-half coming from enhanced competition and the other half from transparency-induced cost-reduction effects.
- Pension reform.* Following the reform measures adopted in March that began to improve the sustainability and equity of the pension system, we will continue with broader parametric reforms to make the system financially viable in the medium term. To this end, with technical assistance from the IMF, we will review all parameters of our current pay-as-you-go system and design a reform that will begin to steadily reduce pension expenditure relative to GDP already in 2016. Among other things, the reform options will include termination of special pensions, which had unjustifiably created a privileged group of pensioners, and further tightening of occupational early retirement options. Once these measures, in combination with improvements in contribution compliance, create sufficiently large and permanent fiscal space to finance the cost of a mandatory, fully-funded pension pillar, we will consider the introduction of such a scheme. This sequencing of reforms will also allow us to develop and implement a plan to strengthen the institutional, technological, and capital market preconditions required for safe, efficient, and transparent operation of the funded schemes. To this end, by end-December 2015, parliament will pass pension reform legislation agreed with IMF staff that revises the parameters of the pay-as-you-go system to make it more sustainable, abolishes special pensions, and lays the conditions for the adoption of a funded system that would complement the pay-as-you-go system (**structural benchmark**).
- Health reforms.* Legislation allowing public procurement of medicines through UN-based organizations has been approved by parliament and the first procurements through the new system will take place within the next few months. Another legislation package changing the basis of public financing for healthcare will shortly be submitted to parliament.
- Education reforms.* Amendments of the legislative framework this summer will allow the consolidation of the secondary school network. Local governments are analyzing the existing network and deciding on its optimization. According to recent information, their plans will result in reducing the number of schools by 5 percent after the end of the 2015–16 academic year. Expected savings will be reinvested in the sector to upgrade the school and class infrastructure

and support student transportation. The process of optimization of high education and vocational training institutions is also ongoing.

- *Wage bill.* We are making progress on rightsizing the budget sector and our compensation and safety net programs have been enhanced to better serve the retrenched workers. We have already reduced staff employment by 26,000 positions in 2015:Q1 and are on track to complete the planned retrenchment of 3 percent of all budgetary positions by end-year.
- *Social assistance reform.* Increasing gas and heating prices to cost recovery requires an effective and fiscally affordable strategy for protecting vulnerable households. Under the current benefits system and projected price increases, the vast majority of households—including many with well above average income—would be eligible to receive significant social assistance next year. Reforms to the current system are needed to cope with the expected large increase in applicants and contain the fiscal costs while protecting vulnerable households. Specifically:
 - Effective July 1, 2015, we have introduced income testing into the category-based energy privileges program. Specifically, eligibility for privileges across most eligible categories (excluding people with disability, the military, military and police veterans, and Chernobyl survivors as specified in Law 76-VIII dated December 28, 2014) has been limited to households with gross monthly income per capita under the threshold for taxing social privileges (UAH 1710 in 2015). Moreover, we will make the necessary legislative and regulatory changes to ensure that from December 1, 2015 households that are subject to income testing according to Law 76-VIII/2014 can choose between being enrolled in either the privileges programs or the housing utility subsidy (HUS) one, but not both.
 - By July 31, 2015, on the basis of current technical capabilities we will set up a central monitoring system of the characteristics of households participating in the privileges and HUS programs (number of recipients, evaluation of family income, the amount of subsidies, etc.). At present, we can collect most of the necessary information and will start the system with the available indicators, with the view to add the rest by October 1, 2015. We will regularly analyze this information to monitor whether the two existing programs deliver assistance as intended. These analyses will inform the design of the 2016 reforms as noted below.
 - By May 31, 2016, we will reform utility-related social assistance by (i) reducing the scope of energy privilege programs to cover only households that remain exempt from income testing according to Law 76-VIII/2014; (ii) converging the associated benefits to the levels in the HUS program; and (iii) revising the benefit formula of the expanded HUS program in consultation with IMF staff to channel benefits to vulnerable households and provide incentives for energy efficiency. The overall fiscal envelope for all energy-related social assistance programs (privileges and HUS) will be set at UAH 43 billion. All these reform elements will be a **structural benchmark** for end-May 2016.

D. Energy Sector Policy

25. **We have made significant progress with the agreed energy sector reforms.**

- **Naftogaz deficit remains within program targets.** In 2015:Q1, the deficit reached UAH 14.3 billion (0.7 percent of annual GDP), below the program target. We remain committed to keeping Naftogaz's deficit below 3.1 percent of GDP for 2015.
- The independent audit of Naftogaz receivables (end-June SB) was completed on time by Price Waterhouse Coopers with external funding by the UK's DFID. As follow up actions, Price Waterhouse Coopers will work with Naftogaz to develop recommendations to improve debt recovery and to set collections targets.
- The gas market law was approved by parliament on April 8 (end-April SB). This law paves the way for the restructuring of Naftogaz by establishing a new model of the gas market in Ukraine. The law is expected to become effective on October 1, 2015. We are currently working on drafting necessary secondary legislation to operationalize the law.
- The Ministry of Social Policy has started an information campaign on assistance with the higher utility bills. In addition, an information campaign on energy savings has been rolled out.

26. **Despite this progress, we recognize that more needs to be done to keep Naftogaz on track to reach its programmed deficit targets.** We remain committed to improve Naftogaz's revenue collections. Although the end-March SB on parliamentary approval of legislative amendments to improve Naftogaz collections was missed, Law 2214 was passed on May 14. The law lifts the 2005 moratorium on collection enforcement proceedings against energy companies effective September 1, 2015 (and January 1, 2016 for Energoatom, our nuclear energy company). The law lifting the moratorium on enforcement proceedings for companies with at least 25 percent state ownership for companies that are debtors to Naftogaz and its daughter companies (Law 2956) was passed as a **prior action** for the approval of the review and will become effective upon publication, but no later than July 31, 2015. We are committed to not extending the deadlines for repeal of these two moratoria or reintroducing them once their cancelation becomes effective (including for Energoatom).

27. **We also intend to undertake additional measures to generate sufficient revenue flows for Naftogaz, strengthen transparency, and increase efficiency in the energy sector.** These include:

- By August 31, 2015, we will revise the formula for the distribution accounts collecting district heating bill payments to include an "adjustment coefficient" that allows Naftogaz to gradually collect payments for district heating company arrears that have accumulated since November 1, 2014.

- Also by August 31, 2015, we will adopt secondary legislation needed to facilitate the application of the new gas market law. This legislation will allow for below-international-parity gas pricing for a transition period until 2017 and the provision of subsidies to vulnerable consumers. In addition, we will take any necessary actions to change regulations in order for the distribution accounts in the gas market to continue being operational.
- By September 30, 2015, we will publish the independent audit on Naftogaz receivables to foster transparency and good governance. The study will also contain specific targets for Naftogaz debt collections and recommendations on needed collection methods and legislative improvements.
- We will improve Naftogaz collections by recommending to the energy regulator to revise by August 31, 2015 certain types of contracts for gas sales that delay the timing when Naftogaz can start collection procedures on payment arrears until the subsequent year.

E. Governance, Business Climate, and State-Owned Enterprise Reform

28. **Our reform strategy approved in December 2014 focuses on overhauling governance and fighting corruption, improving the business climate, and state-owned enterprise reform.**

We have undertaken a number of actions to implement it:

- We have ensured the establishment of the National Anti-corruption Bureau (NAB). The AML framework is being strengthened (end-June SB), and parliament adopted amendments in the legal framework related to asset disclosures to ensure that high-level officials disclose assets of which they are the ultimate owners or controllers and that the NAB can investigate cases of submission of fraudulent information.
- We supported the EBRD-led initiative to establish the Business Ombudsman. We are implementing the action plan to remove regulatory and legislative impediments to a growth-conducive business climate adopted in March. A deregulation law, the law on de-licensing, and the law on investor protection have recently been adopted by parliament.
- The State Regulatory Service, with assistance from the WB and external experts, is developing a methodology for regulatory impact assessment (RIA) of draft legislation, which will be used to prevent overregulation.
- A unit at the Ministry of Economy has been put in charge of SOE-related reform initiatives. The first statement of fiscal risks emanating from SOEs has been prepared. An annual report with financial indicators of the 100 largest SOEs has also been published. In addition, a draft law on corporate governance has been prepared and a new nomination procedure for appointment of CEOs in SOEs through an independent committee is being implemented. In May, the cabinet approved a list of about 350 state-owned assets that are subject to privatization in 2015. The new list includes SOEs previously on the non-privatization list.

29. **We remain determined to continue our efforts to strengthen transparency and improve governance.** Specifically:

- *Business climate.*
 - a. The Cabinet of Ministers will take all the necessary steps to ensure the full implementation of the deregulation action plan. Monthly implementation reports will be published on the State Regulatory Service and the Cabinet of Ministers websites, following submission to the cabinet.
 - b. We are preparing for a broad-scale revision of regulatory norms, which includes (i) codification of all norms that impact business; (ii) design of a list of criteria to assess these norms; and (iii) recommendations on whether the norm should be eliminated, revised or maintained. The government will adopt the reform and create a legal framework through a resolution of the Cabinet of Ministers.
 - c. Starting October 2015, we will ensure that all new and amended draft legislation includes a quantitative analysis of their regulatory impact, in line with the methodology on the RIA approved by the State Regulatory Service.
 - d. The Cabinet of Ministers will ensure that the recently adopted law on licensing of business activities is fully operational. Specifically, by end-July the licensing entities will submit to the Cabinet of Ministers proposed rules and conditions under which licenses in their competencies will be issued. Delays in submission or approval of these rules and conditions will not serve as a basis for denying a license or for prohibition of business activities.
- *Anti-corruption.* As the key legal and institutional reforms have been completed, we are resolutely turning to the implementation of the anti-corruption framework. Specifically, we will:
 - a. **Make the NAB operational.** We will ensure the establishment of a specialized anti-corruption prosecution function in charge of overseeing NAB's investigations, in accordance with the Law on the Prosecutor's office and enable NAB to timely access relevant information from other public institutions by end-September 2015 (**structural benchmark**). In particular, we will ensure:
 - Appointment of the head of the anti-corruption prosecutors and allocation of appropriate premises to the anti-corruption prosecutor's office. To ensure a timely, fair, and balanced appointment process, we will make the following amendments to the Law on Prosecutor Office:
 - At least five members of the Selection Committee for the head of the Anti-Corruption Prosecutor Office and his/her deputies will be nominated by a decision of parliament, in order to eliminate the risks of challenging the results of the selection. These persons will be of impeccable reputation, high professional and moral qualities, and authority in the society;

- As an interim measure, until the qualification commission for prosecutors is established, no more than five members of the above-mentioned Selection Committee will be nominated by the general prosecutor;
- The Selection Committee will be chaired by a widely recognized and well-respected expert with rich experience in the prosecution of corruption, elected by parliament as an additional member of the committee;
- The committee will submit one candidate for each of the three positions (head and two deputies) to the general prosecutor;
- There will be no amendments to the Law on Prosecutor Office concerning the selection procedure for the head of the Anti-Corruption Prosecutor Office and his/her deputies, other anti-corruption prosecutors, and non-prosecutorial staff, other than the ones specified above, unless otherwise agreed with the IMF.
- Agreement on technical details to ensure NAB's direct electronic access to administrative and law enforcement databases it deems relevant for its activities, particularly from the Ministries of Interior and Justice, and from the tax and customs administrations. An electronic mechanism will be agreed between the NAB and the financial intelligence unit (FIU) to enable the FIU to promptly respond to NAB's information requests. In cases when the FIU deems dissemination of information from its databases inappropriate, it will provide justification to the NAB.

We will also ensure that the NAB is fully operational by end-January 2016 (**structural benchmark**). In this regard, steps will be taken to ensure:

- Allocation of necessary infrastructure (e.g., hardware; software; access to administrative, law enforcement, and commercial databases; vehicles; special tools; investigative material), supported by the appropriate budgetary allocation if necessary.
 - Operation of a hotline, including back office to identify cases deserving pre-trial investigation.
- b. **Implement the AML framework.** The NBU will develop risk-based off-site and on-site AML supervisory tools, focusing on risks related to domestic politically exposed persons, by end-December 2015.
- c. **Implement asset disclosure requirements for high-level officials.** By end-December 2015, the Ministry of Justice will ensure that applicants and newly appointed officials to high-level positions under the NAB's jurisdiction file their asset disclosures electronically. The disclosures will be directly and freely available to the public on a single website shortly after submission. In line with legislation, all high-level officials will report their assets electronically by end-April 2016.

- d. **Other measures.** Going forward, and in line with the July 2014 diagnostic study and the Anti-Corruption Strategy for 2014–2017, the government will supplement the above measures by prioritizing the submission of a Bill on the Business Ombudsman to ensure adequate authority and access to information to perform his functions, preparing amendments to the legal framework for asset recovery including to establish an agency in charge of managing seized and confiscated assets, and ensuring that specialized judges receive training relevant to corruption cases. Finally, we will continue our efforts to establish a robust and effective institutional framework for prevention of corruption, including through the launch of a national corruption prevention agency.
- *Judicial reform.* Following up on the recommendations of the July 2014 diagnostic report, we will press for measures to enhance the efficiency and effectiveness of the legal enforcement process and the integrity of legal institutions. Specifically, our reform program will encompass the following areas: (i) judicial reform; (ii) financial efficiency; and (iii) effective enforcement of commercial claims. These reforms will be supported by a number of measures:
 - a. **Order of Payment Procedure and Garnishments.** By end-December 2015, a Law will be adopted which strengthens the provisions in the Code of Civil Procedure on Order for Payment for domestic transactions and on garnishment of bank accounts (**modified structural benchmark**). In particular, the Order of Payment provisions will be amended to expand substantially the range of claims covered, streamline the evidence required, and make use of standardized forms. Regarding garnishment, our goal is to remove bottlenecks that have been identified as hampering the effectiveness of the procedure in such areas as definitional issues, locating debtor bank accounts, service of process, adherence to strict timelines, and the liability of banks for noncompliance. We will complete an implementation plan for the new provisions by end-December 2015. The law will take effect according to a schedule allowing assessment of the results of its implementation and mitigating the risks of negative consequences.
 - b. **Private Enforcement Profession.** We will continue to work on a Law establishing a profession of private enforcement agents as outlined in the February 2015 MEFP, to be adopted by end-September 2015.
 - c. **High Council of Justice.** We will take steps to strengthen the management of the judiciary by taking the following steps by end-September 2015: appointing sufficient commissioners to the High Council of Justice to meet quorum requirements and allocating to the Council the necessary budget for salary payments.
30. **We are committed to a thorough implementation of the SOE-reform strategy.** This includes actions needed to (i) improve budgetary oversight, specifically by enhancing the fiscal-risk assessment; (ii) implement a comprehensive ownership policy and ensure a clear separation of ownership and regulatory functions; (iii) strengthen corporate governance, including by adoption of a new law on corporate governance; (iv) prioritize enterprises subject to restructuring; and

(v) implement transparent privatization of identified assets in the medium run. Specific near-term measures include:

- a. **SOE fiscal risk assessment.** We will establish an inter-ministerial working group which will be led by the Ministry of Finance with the participation of the Ministry of Economic Development and Trade. The main task of the working group will be to (i) improve the methodology for assessing risks and identify the largest 30 SOEs with the highest fiscal risks, and (ii) review the financial plans of these SOEs and inform the respective ministry about fiscal risk aspects. The working group will also inform the Minister of Finance on the adequacy of financial plans of the SOEs with the highest risks and recommend mitigation measures as an input to the budgetary process. An update of the first SOE fiscal-risk statement will be published on Ministry of Finance and Ministry of Economic Development and Trade websites by end-October 2015.
- b. **Stocktaking of arrears.** By end-August, we will extend the coverage of the SOEs reporting to include all arrears of the 50 largest companies, as defined in consultation with Fund staff and prepare information on the stock of these arrears as of end-2013, end-2014, March 2015 and June 2015.
- c. **Privatization/Restructuring.** We will start implementing our SOE Reform Strategy. Key near-term measures include:
 - Completion by end-September 2015 of a review of the existing portfolio of SOEs to identify non-operating companies for immediate liquidation. The review, prepared in consultation with Fund staff, will outline a timeline for the disposal of each company with the necessary intermediate steps, as well as preliminary estimates of budgetary and other costs stemming from liquidation, with the goal of initiating the first liquidations by end-2015.
 - Preparation, in agreement with the line ministries, of the priority privatization list of 10 SOEs by end-July 2015. Companies shall be selected based on cost-benefit analyses. Building on this list, we will establish a working group, including the State Property Fund (SPF) that will develop a privatization action plan. The plan will define, for each SOE, the key parameters and conditions of the process, including the timeline for divesting, method of privatization, and intermediate steps to be taken. The action plans for five of these companies will be approved by SPF decision by end-August 2015. Furthermore, we will seek adoption, by cabinet resolution, of the action plan for these five companies by end-September 2015 (**structural benchmark**).
 - Preparation of the list of 10 SOEs posing the biggest fiscal risks that will be subject to restructuring other than privatization by mid-September 2015. Detailed restructuring action plans for five of these companies will be agreed, in consultation with IMF staff, between the respective line ministry, Ministry of Economy and the Ministry of Finance by end-January 2016 (**structural benchmark**).

- d. We will prepare legislative amendments needed to facilitate these actions. In particular,
- In July, we adopted a government decree mandating external audits for at least the largest 100 SOEs (by assets or revenue).
 - By September 30, 2015, the Ministry of the Economy will adopt a regulation revising the methodology for developing the SOEs' financial plans to require the inclusion of a three-year action plan to increase operating efficiency.
 - We will review needed changes to the SOEs remuneration policy to better align shareholders and management's interests. In this context, we will also seek to strengthen the legal environment to improve transparency and governance, including by introducing supervisory boards in unitary enterprises.

III. Safeguards

31. **In line with the recommendations of the IMF safeguards assessment of the NBU, we are taking the necessary measures to improve NBU governance and autonomy as well as NBU internal controls.** We have adopted legislative amendments to the NBU Law to address the governance and autonomy issues (¶18) and remain committed to their implementation. This will include prompt re-establishment of an Audit Committee following constitution of a new Council of the NBU. With regards to internal controls, the NBU established a permanent senior-level credit committee in June 2015 to oversee NBU's lending to financial institutions. Further, a new loan origination and management process is being developed and will be implemented by October 2015. Concerning the servicing of future financial obligations to the IMF related to budget support, we have updated the relevant agreements on the respective roles and responsibilities between the MoF and the NBU. In addition, quarterly data audits are ongoing with the results timely conveyed to the IMF.

IV. Program Monitoring

32. **Implementation of the policies under the program will continue to be monitored through prior actions, quantitative performance criteria, indicative targets, continuous performance criteria, structural benchmarks, and quarterly reviews,** as envisaged in our Memorandum of Economic and Financial Policies dated February 27, 2015 along with this Memorandum. The attached Technical Memorandum of Understanding (TMU) defines the quantitative performance criteria and indicative targets under the program. The **prior actions** and **structural benchmarks** are set out in Table 1. The quantitative targets for target dates through end-December 2015, along with a continuous quantitative performance criterion are set out in Table 2.

Table 1. Ukraine: Prior Actions and Structural Benchmarks

Prior actions	Status	Completion date
Parliamentary passage of Law 2956, lifting the 2001 moratorium on enforcement proceedings for companies with at least 25 percent state ownership that are debtors to Naftogaz and its daughter companies (July MEFP ¶126).		
Parliamentary passage of Laws 2742 and 2743 to strengthen the governance and autonomy framework of the NBU as agreed with IMF staff and also ensure that the law provides that an appeal before the judicial branch by borrowers classified by the NBU as related parties to a bank does not halt the bank's unwinding of excess lending to insiders (July MEFP ¶¶18, 14).	Met	June 18, 2015
Proposed New Structural Benchmarks	Status	Completion date
Parliament will approve amendments to legislation as described in MEFP ¶17, consistent with IMF staff advice, to strengthen the corporate insolvency and credit enforcement regimes, and to remove tax impediments (July MEFP ¶17).		End-March 2016
Undertake measures to make the National Anti-Corruption Bureau operational, including with regard to its prosecutorial function (July MEFP ¶29).		End-January 2016
Establish a specialized anticorruption prosecution function in charge of overseeing NAB's investigations, in accordance with the Law on the Prosecutor's Office, and enable NAB timely access to relevant information from other public institutions (July MEFP ¶29).		End-September 2015
Adoption by a cabinet resolution of the privatization action plan for five large SOEs from the priority privatization list (July MEFP ¶30).		End-September 2015
Agreement on detailed restructuring action plans, prepared in consultation with IMF staff, for five SOEs with the largest fiscal risks, between the respective line ministry, Ministry of Economy and the Ministry of Finance (July MEFP ¶30).		End-January 2016
Parliamentary passage of pension reform legislation, as agreed with IMF staff that revises the parameters of the pay-as-you-go system to make it more sustainable, abolishes special pensions, and lays the conditions for the adoption of a funded system that would complement the pay-as-you-go system (July MEFP ¶24).		End-December 2015
Reform utility-related social assistance by (i) reducing the scope of energy privilege programs to cover only households that remain exempt from income-testing according to Law 76-VIII/2014; (ii) converging the associated benefits to the levels in the HUS program; and (iii) revising the benefit formula of the expanded HUS program in consultation with IMF staff to channel benefits to vulnerable households and provide incentives for energy efficiency. The overall fiscal envelope for all energy-related social assistance programs (privileges and HUS) will be set at UAH 43 billion (July MEFP ¶24).		End-May 2016

Previous Structural Benchmarks	Status	Completion date
NBU and Financial Sector		
Parliament will approve amendments to the NBU Law to strengthen the governance and autonomy framework of the NBU (February MEFP ¶19).	Converted and met as a prior action	End-April 2015
NBU will notify banks of any identified discrepancies in the related-party exposure reports based on steps (i) and (ii) as described in February MEFP ¶13.		End-July 2015
Judiciary/Enforcement		
Parliament will approve a law on a selective increase of court fees, aiming to double court fee revenue in real terms within 12 months (February MEFP ¶35).	Met	May 22, 2015
Parliament will approve a law which strengthens the provisions in the Code of Civil Procedure on Order for Payment for domestic transactions and on garnishment of bank accounts (February MEFP ¶35).		End-December 2015; reset from end-August 2015
Fiscal Policy		
Government will prepare a revenue administration reform plan in order to overhaul the state fiscal service. The plan will include measures to implement governance and institutional reforms that clarify the tax agency's reporting to the minister of finance; and remove large numbers of underperforming officials as described in February MEFP ¶25.	Met with a Delay June 26, 2015	End-April 2015
The State Fiscal Service will transfer all taxpayers meeting large taxpayer criteria to the LTO (February MEFP ¶22).		End-December 2015
The State Fiscal Service will implement its new arrangements as specified under the revenue administration reform plan (February MEFP ¶25).		End-December 2015
State-Owned Enterprises		
The Ministry of Economy in cooperation with the Ministry of Finance will prepare a statement of fiscal risks emanating from SOEs as described in February MEFP ¶36.	Met with a delay May 29, 2015	End-April 2015
The government will adopt a broad-based strategy (prepared in consultation with the IMF and the WB staff) to reform the SOE sector as described in February MEFP ¶36, including measures needed to improve budgetary oversight, develop a comprehensive ownership policy, strengthen corporate governance, prioritize which enterprises should be made subject to restructuring, and examine options for improving management of other state assets.	Met	May 27, 2015

Previous Structural Benchmarks	Status	Completion date
Governance		
Take necessary measures to establish the National Anti-corruption Bureau (February MEFP ¶132).	Met with a delay May 7, 2015	End-April 2015
Strengthen the implementation of the AML framework to prevent the misuse of the financial sector to launder the proceeds of corruption. This includes (i) regulatory amendments to ensure proper implementation of the legal requirements related to domestic politically exposed persons (PEPs); (ii) the FIU will develop guidance to assist financial institutions in identifying domestic PEPs; and (iii) proper arrangements will be put in place to facilitate cooperation between the NBU, FIU and NAB (February MEFP ¶132).	Met with a delay July 20, 2015	End-June 2015
Energy Sector		
Parliament will approve legislative amendments to improve Naftogaz collections. These amendments should include (i) lifting two long-lasting moratoria (Law 2711-IV/2005 and Law 2864-III/2001) that protect energy and other companies from enforcement proceedings; and (ii) disconnecting noncompliant customers from the gas supply grid (February MEFP ¶128).	Converted into a prior action	End-March 2015
Parliament will approve a new gas market law (February MEFP ¶128).	Met	April 9, 2015
Undertake an independent audit of all Naftogaz receivables (February MEFP ¶128).	Met	June 30, 2015

Table 2. Ukraine: Quantitative Program Targets and Projected Performance 1/

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

	2014		2015						2016		
	December	March			June			September	December	March	June
		PC	Adj. PC	Actual	PC	Est. Adj. PC	Est.	PC	PC	IT	IT
I. Quantitative performance criteria											
Ceiling on the cash deficit of the general government (- implies a surplus) 2/	-	20,400	13,357	-14,536	32,700	34,110	7,816	43,100	82,700	12,700	32,400
Ceiling on the cash deficit of the general government and Naftogaz (- implies a surplus) 2/	-	36,500	29,457	-243	62,000	59,079	31,329	97,100	144,600	5,700	37,100
Floor on cumulative change in net international reserves (in millions of U.S. dollars) 3/ 4/	1,827	-2,502	-2,639	-2,125	-1,448	-2,528	-1,492	-284	2,098	2,224	2,545
Ceiling on cumulative change in net domestic assets of the NBU 3/ 4/	304,385	57,704	62,490	32,303	76,176	103,878	20,709	84,571	57,720	54,520	69,445
Ceiling on publicly guaranteed debt 2/	-	30,000	30,000	0	30,000	30,000	0	30,000	30,000	20,000	20,000
II. Continuous performance criterion											
Non-accumulation of new external debt payments arrears by the general government 2/	0	0			0			0	0	0	0
III. Indicative Targets											
Ceiling on cumulative change in base money 2/	333,194	18,256	18,256	-1,203	53,350	53,350	-2,816	80,086	90,796	89,584	109,578
Ceiling on net accumulation of VAT refund arrears 2/	697	0		2,942	0		7,000	0	0	0	0
IV. Memorandum Items											
Naftogaz deficit	87,301	16,100	16,100	14,293	29,300	24,970	23,512	54,000	61,900	-7,000	4,700
External project financing 2/	-	4,523		441	11,064		1,485	13,000	14,937	6,995	15,107
NBU loans to DGF and operations with Government bonds issued for DGF financing or banks recapitalization 3/	-	25,000		7,950	44,000		24,750	53,000	55,000	55,000	55,000
Government bonds issued for banks recapitalization and DGF financing 2/	26,716	29,000		0	59,500		18,004	59,500	152,000	0	0
Programmed disbursements of international assistance except IMF (millions of U.S. dollars) 3/ 4/	-	476		172.7	3,233		1,476	3,504	5,475	6,204	6,204
<i>Percent of it applied to adjustment</i>		100		100	100		100	100	100	100	100
Conversion of a non-reserve currency under a central bank swap line into a reserve currency through an outright sale 4/	-	-			0		581				
Exceptional financing (millions of U.S. dollars) 3/ 4/	-	-			-			500	4,228	4,228	5,478
Purchases of foreign exchange from the NBU for the purposes of critical energy imports (incl. those of Naftogaz, millions of US dollars) 3/ 4/	-	1,486		1,319.9	1,686		1,590	1,686	1,686	1,686	1,686
NBU purchases of T-bonds Issued by Government for Naftogaz recapitalization 3/	-	17,200		17,200	26,100		26,100	28,300	28,300	28,300	28,300
Projected Payments of Interest on government bonds held by NBU 2/	-	7,100		8,500	17,400		17,400	30,300	41,800	10,600	21,800
<i>Program exchange rate, Hryvnia per U.S. dollar</i>	15.7686	15.7686		15.7686	15.7686		15.7686	15.7686	15.7686	15.7686	15.7686

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 January 1, 2015. Data for December 2014 are stocks as of end-December, 2014. For 2016, cumulative flows from January 1, 2016.

3/ Targets and projections are cumulative flows from January 1, 2015. Data for December 2014 are stocks as of end-December, 2014.

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

Attachment II. Ukraine: Technical Memorandum of Understanding

July 21, 2015

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 by the Extended Arrangement under the Extended Fund Facility, as described in the authorities' Letter of Intent (LOI) dated July 21, 2015 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.
2. Prior actions and structural benchmarks are listed in Table 1 of the MEFP, with corresponding definitions in Section I below. The quantitative performance criteria are shown in Table 2 of the MEFP. The definitions of these quantitative targets and the adjustment mechanisms are described 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 15.7686 set by the NBU as of December 31, 2014; and (ii) reference exchange rates of foreign currencies reported by the European Central Bank (ECB) on its web site as of December 31, 2014, which the NBU used to set official exchange rates of hryvnia to those currencies. In particular, the Swiss Franc is valued at 0.9904 per dollar, the Euro is valued at 1.2141 dollars, the Pound Sterling is valued at 1.5587 dollars, the Australian dollar is valued at 0.8187 U.S. dollars, the Canadian dollar is valued at 0.8633 dollars the Japanese yen is valued at 119.6195 per dollar, and the Norwegian Krone is valued at 0.1343 dollars. The accounting exchange rate for the SDR will be 0.690224 per dollar. Official gold holdings were valued at 1,206.00 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 of Ukraine. 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 2008 and excludes Crimea and Sevastopol.

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 denominated in convertible foreign currencies 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; 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
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
Settlement of foreign securities	2746, minus 4746
2. Short-term liabilities to nonresidents (in convertible currencies)	
Correspondent accounts of nonresident banks	3201
Short-term deposits of nonresident banks	3211
Operations with nonresident customers	3230, 3232, 3233
Use of IMF credit	IMF, Finance Department

Assumptions in line with the authorities' commitments

8. The NIR/NDA targets assume a rollover of general government's domestic foreign exchange debt liabilities in the amount of US\$100 million in June 2015 and US\$200 million in July 2015, and a rollover rate of at least 40 percent in 2016. The rollover will be achieved through an issuance of new general government foreign exchange bonds with a maturity of at least one year. Furthermore, the

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 December 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.

NIR/NDA targets assume that there will be no early repayment of domestic foreign exchange bonds, in line with the authorities' commitment.

Adjustment mechanism

- 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). Program disbursements are defined as external disbursements (excluding project-financing 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 deficit.
- NIR targets will be adjusted upward by the cumulative shortfall in purchases of foreign exchange from the NBU for the purposes of paying critical energy imports (including those of Naftogaz) relative to the baseline projection (Table C).
- NIR targets will be adjusted downward by the full amount of the cumulative excess in government purchases of foreign exchange from the NBU for the purpose and in the event of early repayment of the government-guaranteed part of a maturing external loan to Naftogaz (in case this loan is repaid ahead of schedule). The downward adjustment of the NIR targets will be capped at US\$500 million.
- In case the NBU converts Renminbi or any other non-reserve currency provided under a central bank swap agreement with the NBU into a reserve currency through an outright sale, a symmetric adjustor will be applied to NIR targets. NIR targets will be adjusted upward by the amount that will be converted into a reserve currency at the time of the conversion. NIR targets will be adjusted downward by the amount of a reserve currency (both the principal and interest due), when the NBU repays the non-reserve currency provided under a central bank swap agreement.
- In the event of higher exceptional financing than envisaged under the baseline (Table D), either due to the discontinuation of payments or due to changes to the terms resulting from the issuance of new debt upon completion of the debt operation on general government direct and guaranteed debt included in the perimeter of the debt operation as published in the Cabinet of Minister's Resolution No. 318-p on April 4, 2015, NIR targets will be adjusted upward by the full amount of the cumulative excess in exceptional financing in foreign exchange relative to the baseline.

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

(Cumulative flows from end-December 2014, millions of U.S. dollars at program exchange rate)

	Eurobond placement	World Bank	EU	Others (Canada, Germany, Japan)	Total
End-March 2015	0	0	304	173	4763
End-June 2015	1,000	500	1,032	701	3,233
End-September 2015	1,000	1,000	1,032	472	3,504
End-December 2015	2,000	1,000	1,760	715	5,475
End-March 2016	2,000	1,000	2,489	715	6,204
End-June 2016	2,000	1,000	2,489	715	6,204

Table C. Purchases of Foreign Exchange from NBU for the Purposes of Critical Energy Imports: Projections for NIR Adjustment

(Cumulative flows from end-December 2014, millions of U.S. dollars)

	Purchases of foreign exchange from the NBU for critical energy imports (incl. those of Naftogaz)
End-March 2015	1,486
End-June 2015	1,686
End-September 2015	1,686
End-December 2015	1,686
End-March 2016	1,686
End-June 2016	1,686

Table D. Exceptional Financing: Projections for NIR/NDA Adjustment

(Cumulative flows from end-December 2014, millions of U.S. dollars at program exchange rate)

	Exceptional Financing
End-September 2015	500
End-December 2015	4,228
End-March 2016	4,228
End-June 2016	5,478

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

Definition

9. Net domestic assets (NDA) of the NBU are defined as the difference between the monetary base (as defined below) and the NIR of the NBU (as defined above). For the purpose of computing the NDA target, the NIR is valued at the program exchange rates defined in paragraph 3 and expressed in hryvnia.

Adjustment mechanism

- Consistent with the NIR target adjustment mechanism (as defined above), NDA targets 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 rates.
- 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 relative to the baseline projection (Table E).
- Consistent with the NIR target adjustment mechanism (as defined above), NDA targets will be adjusted upward by the hryvnia equivalent of the full amount of the cumulative excess in government purchases of foreign exchange from the NBU for the purpose of repaying the government-guaranteed part of a maturing external loan to Naftogaz (in case this loan is repaid ahead of schedule). The upward adjustment of the NDA target will be capped to hryvnia equivalent of US\$500 million, calculated using the program exchange rate defined in paragraph 3.
- 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 for bank recapitalization, relative to the baseline projection, and evaluated at the program exchange rates if provided in foreign exchange (Table E).
- In case another central bank uses the hryvnia provided under a central bank swap agreement with the NBU, a symmetric adjustor will be applied to NDA targets. NDA targets will be adjusted upward by the amount of hryvnia placed in a commercial bank's account at the NBU, when the central bank uses the hryvnia. NDA targets will be adjusted downward by the amount of hryvnia (both the principal and interest due), when the other central bank repays the used hryvnia.
- In the event of higher exceptional financing than envisaged under the baseline (Table D), either due to the discontinuation of payments or due to changes to the terms resulting from the issuance of new debt upon completion of the debt operation on general government direct and guaranteed debt included in the perimeter of the debt operation as published in the Cabinet of Minister's Resolution No. 318-p on April 4, 2015, NDA targets will be adjusted downward by the full amount of the cumulative excess in exceptional financing in foreign exchange relative to the baseline and evaluated at the program exchange rates.

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

(Cumulative flows from end-December 2014, millions of hryvnia)

	NBU loans to DGF and purchases of government bonds issued for DGF Financing or Bank Recapitalization	NBU purchases of government bonds issued for Naftogaz recapitalization
End-March 2015	25,000	17,200
End-June 2015	44,000	26,100
End-September 2015	53,000	28,300
End-December 2015	55,000	28,300
End-March 2016	55,000	28,300
End-June 2016	55,000	28,300

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

Definition

10. The NBU's monetary base comprises domestic currency outside banks and banks' reserves, including cash in vault of commercial banks, and funds of customers at the NBU.⁴ 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 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 323,⁵ 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

⁴ 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.

⁵ Includes accounts of following sectors: 2 - other financial intermediaries and other financial organizations; 6 - regional and local authorities; 7 - government nonfinancial corporations; 8 - private and foreign-controlled nonfinancial corporations; 9 - noncommercial organizations serving households.

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, relative to the baseline projection (Table E), and evaluated at the program exchange rates if provided in foreign exchange.

- Consistent with the NDA target adjustment mechanism (as defined above), monetary base targets will be adjusted upward by the amount of hryvnia placed in a commercial bank's account at the NBU, when another central bank uses the hryvnia provided under a central banks swap agreement. Monetary base targets will be adjusted downward by the amount of hryvnia (both the principal and interest due), when the other central bank repays the used hryvnia.

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

Definition

11. The general government comprises the central (state) government, including the Road Fund (UkrAvtoDor), all local governments, and all extra budgetary funds, including the Pension Fund, Unemployment Fund, and the Fund for Social Insurance of Ukraine (formerly temporary disability insurance and 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 sales⁶ (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 Naftogaz⁷ and other SOEs; plus

⁶ From here on, treasury bills are defined as all treasury securities (including long-term instruments or treasury bonds).

⁷ These are included in the financing 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 and the net sale of nonfinancial assets); 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.

12. 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 adjustor 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 F). 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 F. External Financing of General Government Projects—Adjustment

Cumulative flows from January 1, 2015	In millions of hryvnia
External project financing (technical assumption for the adjustor purpose)	
End-March 2015	4,523
End-June 2015	11,064
End-September 2015	13,000
End-December 2015	14,937
End-March 2016 1/	6,995
End-June 2016 1/	15,107

1/ Cumulative flows from January 1, 2016.

- The ceilings on the cash deficit of the general government at end-September and end-December 2015 are subject to an automatic adjustor corresponding to the full amount of government bonds issued for the purposes of banks recapitalization and DGF-financing, up to a cumulative maximum of UAH 152 billion in 2015. (Table 2 of the MEFP).
- The ceiling on the cash deficit of the general government is subject to an automatic adjustor 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. This definition excludes unpaid pensions to individuals who resided or continue to reside on the territories that are temporarily outside the government control.
- The ceiling on the cash deficit of the general government at all 2015 test dates will be automatically adjusted downward by VAT refund arrears accumulated as defined in Section E from January 1, 2015.
- The ceilings on the cash deficit of the general government at end-September and end-December 2015 are subject to an upward adjustment for the full amount of government repaying government-guaranteed part of an external loan to Naftogaz, in case this loan is repaid ahead of schedule and the repayment is recorded as above-the-line transaction. The adjustment

will be equal to the actually repaid amount in US\$ terms capped at US\$500 million, and recalculated in hryvnia at the actual exchange rate at the time of repayment.

13. The ceilings on the cash deficit of the general government at end-September and end-December 2015 are subject to an automatic downward adjustor corresponding to the full savings on the budgetary interest bill resulting from any restructuring or reprofiling of existing government debt to NBU as of end-2014. Such savings will be determined as the difference between the actual and projected payments on government bonds held by the NBU. The projected payments are presented in Table G.

Table G. Projected Payments of Interest on Government Bonds held by NBU

Cumulative flows from January 1, 2015	In billions of hryvnia
End-March 2015	7.1
End-June 2015	17.4
End-September 2015	30.3
End-December 2015	41.8
End-March 2016 1/	10.6
End-June 2016 1/	21.8

1/ Cumulative flows from January 1, 2016.

E. Ceiling on VAT Refund Arrears (Indicative Target)

14. The ceiling on net accumulation of VAT refund arrears is set to UAH 0 billion. 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 Fiscal Service (SFS). In 2015, 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 March 31, 2015 was UAH 2.9 billion.

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

Definition

15. 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.

16. 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 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.

17. For the purposes of measuring the deficit of Naftogaz, all flows in foreign currency will be accounted in hryvnias at the official exchange rate as of the date of the transaction. When there are arrears outstanding as of the test date, the official exchange rate on the test date will apply to their valuation.

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 by the net amount of accumulated domestic arrears by Naftogaz to Ukgazvydobuvannya and Ukrtransgaz, measured on a cumulative basis from the beginning of each calendar year.

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

Definition

18. 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

19. The ceiling on publicly guaranteed debt will apply to the amount of guarantees issued in 2015 by the central (state) government. The official exchange rate will apply to all non-UAH denominated debt. New state guarantees in 2015 will amount to no more than UAH 30 billion. This ceiling excludes guarantees issued by the Ministry of Finance for NBU borrowings from IMF.

I. Other Continuous Performance Criteria

20. During the period of the Extended 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

21. The NBU will, on a daily basis, set the official rate calculated as a weighted average of the exchange rates of the interbank market deals on the same day. To calculate the official exchange rate, all deals concluded on the day will be considered regardless of the settlement date. Specifically, tod, tom and spot (T+2) deals will be included. NBU will make public its official exchange rate by no later than 18:00 of the day, preceding the one for which it is set.

III. Reporting Requirements

A. National Bank of Ukraine

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

23. The NBU will provide to the IMF, on a daily 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).

24. The NBU will provide the IMF on a daily basis with information on obligatory foreign exchange sales and approved foreign exchange demand in the interbank market, including Naftogaz foreign exchange purchases. The NBU will provide the IMF on a daily basis with information on official foreign exchange interventions and intervention quotations. In this context, it will also provide the results of any foreign exchange auctions.

25. 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."

26. 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 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.

27. The NBU will provide information on daily transactions (volumes and yields) on the secondary market treasury bills (including over the counter transactions).

28. The NBU will provide to the IMF, on a daily basis, the information on the claims on banks provided and liabilities in the format agreed with the IMF staff.

29. The NBU will provide to the IMF its financial statements (income and expenses) for the current and, if available, for the following year, as approved by the NBU's Council. The IMF is to be notified immediately of any update.

30. The NBU will continue to provide 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. It will also provide, on a weekly basis, bank-by-bank information on the outstanding amount and weighted-average interest rates of loans from the NBU, reported by type of lending. On a monthly basis, the NBU will provide information on the collateral that has been pledged to the NBU for loans (by bank and loan type as well as by collateral type, haircut and currency). The weekly reporting of NBU loans and collateral will separately identify which banks are under temporary administration or liquidation.

31. The NBU will provide to the IMF, on a monthly basis but not later than 30 days after the expiration of the reporting month, the report on the banking sector financial stability indicators (FSIs) in the format agreed with the IMF staff. The NBU will also provide core FSIs, as defined in the IMF Compilation Guide, for the individual banks in Group I and Group II on a monthly basis.

32. On a daily basis, 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.

33. 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.

34. 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 Treasury denominated in foreign currency (account 3513 A).

35. The NBU will provide to the IMF, on a monthly basis, projections for external payments falling due in the next 12 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.

36. 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.

37. The NBU will provide to the IMF, on a daily basis, data on foreign exchange export proceeds and obligatory foreign exchange sales; data on import transactions for goods and services; data on amounts of foreign exchange transferred from abroad to the benefit of physical persons—residents and nonresidents—to be paid in cash without opening an account; data on foreign exchange wires from Ukraine abroad for current foreign exchange nontrade transactions on the basis of the orders of physical persons; data on sales and purchases of foreign exchange cash by individuals (incl. through banks, exchange offices, and Ukrposta); data summarizing the implementation of T+3 verification system, namely, the total number and volume of transactions screened and the total number and volume of transactions blocked, with separate information on imports. The NBU will provide to the IMF weekly data on the volumes of noncash foreign exchange purchases on behalf of banks' clients and banks broken down by reasons (form N 538).

38. The NBU will provide to the IMF, on a daily basis, data on foreign assets and liabilities of the overall banking system (excl. the NBU); data on banks' open foreign exchange positions by main groups of banks; data on deposits on the aggregated basis for the overall banking system (excl. the NBU) broken down by households and legal entities, maturity, as well as by national and foreign currency; data on loans on the aggregated basis for the overall banking system (excl. the NBU) broken down by households and legal entities as well as by national and foreign currency. In addition, the NBU will provide to the IMF, on a daily basis, data on deposits and credits on the aggregated basis for the overall banking system (excl. the NBU) without deposits and credits of banks in liquidation starting from the beginning of 2014 and broken down by households and legal entities, as well as by national and foreign currency. On a weekly basis, the NBU will provide the IMF

data on foreign (external) assets and foreign liabilities (broken down by domestic and foreign currency) for the individual banks in Group I and Group II. On a monthly basis, Foreign assets will be broken down by type (i.e., cash and deposits, government securities, nongovernment securities, loans, other) and foreign liabilities by type, holder (i.e., banks, other financial institutions, nonfinancial corporate, and individuals) and remaining maturity (less than one month, one to three months, three to 12 months and over 12 months). For foreign credit lines from banks and for securities, the rollover rates will also be provided.

39. The NBU will provide, on a daily basis, bank-by-bank data for the largest 35 banks and aggregate data for the Group III and IV banks separately on the liquidity ratio and amounts of cash and cash equivalents, available funds in NBU accounts (excl. reserve requirements), correspondent accounts with well-known international banks (excl. encumbered accounts), and deposits from customers; total assets and liabilities; loans and claims (by households, legal entities, and banks); and foreign exchange net open position. The data will be reported by domestic and foreign currency. The deposits data will be reported by households and legal entities and by maturity (current accounts, saving accounts, and time deposits). In addition, for the aggregate of the banking sector as well as Group III and IV banks, the NBU will provide data excluding those banks in liquidation since 2014.

40. 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.

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

42. 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, maturity (average weighted), interest rate as well as transactions to absorb liquidity from the banking system.

43. The NBU will provide the IMF, on a weekly basis, bank-by-bank for Group I and Group II banks the average interest rate on deposits to customers (by domestic and foreign currency, and legal entities and households); and the average interest rate on interbank borrowings (by domestic and foreign currency).

44. The NBU will provide the IMF, on a two weekly basis, in an agreed format, data for the entire banking sector—aggregate for Group III and IV and on a bank-by-bank basis for Group I and Group II banks—risk weighted assets and other risk exposures (for ratio H2 calculation), including for the excess of long-term asset to funding and foreign exchange open position; total regulatory (Tier 1 and Tier 2) and core (Tier 1) capital; capital adequacy ratio for total regulatory (H2) capital; loans and claims by maturity buckets for households, legal entities, and banks in domestic and foreign currencies; deposits by maturity buckets for households, legal entities, and banks in domestic and foreign currencies; and foreign exchange net open position, split between total foreign exchange assets (long position) and foreign exchange liabilities (short position), and between on- and off-balance sheet.

45. The NBU will provide the IMF, on a monthly basis, in an agreed format, data for the entire banking sector (and aggregates for Group III and IV) as well as on a bank-by-bank basis for Group I and Group II banks the amount of loans and claims (by households in domestic and foreign currency, legal entities in domestic and foreign currency, banks in domestic and foreign currency, maturity, and by loan classification categories I, II, III, IV, and V); collateral for loans and claims (by type of collateral, legal entities in domestic and foreign currency, households in domestic and foreign currency, banks in domestic and foreign currency, and by loan classification categories I, II, III, IV, and V); provisions on loans and claims (by households in domestic and foreign currency, legal entities in domestic and foreign currency, banks in domestic and foreign currency, and by loan classification categories I, II, III, IV, and V); large exposures (loans equal to or greater than 10 percent of equity), refinanced loans, and restructured loans (by households, legal entities, and banks); the average interest rate on the outstanding stock of loans to customers (by legal entities and households; accrued interest on loans (by domestic and foreign currency); securities held for trading and available for sale, with government securities reported separately (by domestic and foreign currency); securities held to maturity and as investment, with government securities reported separately (by domestic and foreign currency).

46. The NBU will provide the IMF, on a monthly basis, in an agreed format, bank-by-bank for the Group I and Group II banks the amount of deposits of related parties (by domestic and foreign currencies, and households and legal entities); deposits of related parties pledged as (cash cover) collateral (by domestic and foreign currencies, and households and legal entities); other liabilities to related parties (by domestic and foreign currencies); related party loans (by households, legal entities, and banks); counterparty names and amounts of the largest 20 loans to related parties; collateral for loans and claims on related parties (by type of collateral, legal entities, households, and banks in domestic and foreign currencies, as well as by loan classification categories I, II, III, IV, and

V); provisions on loans and claims on related parties (by households, legal entities, and banks in domestic and foreign currencies, as well as by loan classification categories I, II, III, IV, and V).

47. The NBU will provide to the IMF, on a monthly basis, data bank-by-bank and by region loans and provisions (by households and legal entities, domestic and foreign currencies, and by loan classification categories I, II, III, IV, and V); deposits (by households and legal entities, and domestic and foreign currencies); due from banks (by domestic and foreign currencies).

48. The NBU will report to the IMF, on a monthly basis, data for the entire banking sector (and aggregates for Group III and IV) as well as on a bank-by-bank basis for Group I and Group II banks on cumulative income statements, including total revenues; interest revenues (from loans to households, loans to legal entities, interbank loans, placements with the NBU, securities); revenues from fees and commissions; total expenses; interest expenses (on deposits to legal entities, deposits to households, interbank borrowing, borrowing from NBU, securities issued); fees and commissions paid; salaries and other staff compensation; other operational expenses; net earnings before loan loss provisions; loan loss provisions; net earnings after loan loss provisions; taxes paid; net earnings.

49. The NBU will provide to the IMF the two-week projections of cash flows for the Group I and II banks.

50. The NBU will report to the IMF on a bi-weekly basis and bank-by-bank the amount by which the Group I and II banks' regulatory capital has been increased. The report will disclose the instrument or transactions by which the regulatory capital has been increased (e.g., capital injection, conversion of subordinated debt to equity etc.).

51. The NBU will, once a month, inform the IMF any regulatory and supervisory measures against banks violating the NBU regulations on capital adequacy, liquidity ration, large exposures, and connected lending, as well as about decisions on declaring a bank as problem or insolvent.

52. 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 (III, IV, and V category).

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

54. 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.

55. The NBU will inform IMF staff if the Treasury does not pay interest or principal on domestic government bonds 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.
56. The NBU will inform IMF staff of any changes to reserve requirements for deposit money banks.
57. 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.
58. 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.
59. 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.
60. The NBU will provide the Fund with data relative to the interest income received from January 1, 2015 on the portfolio of government bonds on a quarterly basis but no later than 15 days from the end of the reporting period.

B. Deposit Guarantee Fund

61. The DGF will provide, on a monthly basis, data on the total number and volume of household deposits broken down in groups by deposit size. The data will be reported bank-by-bank for the largest 35 banks and on aggregate for the remaining banks.
62. The DGF will report to the IMF on a monthly basis and bank-by-bank for all banks in the banking system the amount of insured deposits and total household deposits. The data will be reported according to an agreed format, by domestic and foreign currency.
63. The DGF will report to the IMF on a monthly basis and bank-by-bank the total insured deposits and remaining insured deposits to be paid by the DGF for the banks under liquidation and

under provisional administration. The data will be reported according to an agreed format, by domestic and foreign currency.

64. The DGF will report to the IMF on a monthly basis the financial position of the DGF, including information about the cash balance, bond holdings, credit lines, and loans. The data will be reported according to an agreed format.

65. The DGF will report to the IMF on a monthly basis the financing arrangements of the DGF, including information about contracted financing from MoF. The data will be reported according to an agreed format.

66. The DGF will report to the IMF on a monthly basis a one-year forecast of the amount and type of financial resources that the DGF expects to receive from MoF, NBU and other entities, the amount that DGF expects to pay out to insured depositors in banks in liquidation, and the amount of asset recoveries expected by DGF. The data will be reported according to an agreed format.

C. Ministry of Finance

67. 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.

68. 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 the execution of the state, local, and consolidated budgets on the revenue side and data on revenues from the social security contributions, monthly data on funds, deposited with the Single Treasury Account, on the registration accounts of the entities which are not included in the state sector, information on balance of funds as of the 1st day of the month on the account #3712 "accounts of other clients of the Treasury of Ukraine," on inflow to the State budget from placing Treasury or any other liabilities to households in foreign and domestic currency and their redemption.

69. The Ministry of Finance 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 Ministry of Finance 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.

70. The Ministry of Finance will report monthly data on the public wage bill (excluding SOEs) 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 information on municipal borrowing and amortization of debt in format agreed with IMF staff.

71. 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.

72. The Ministry of Finance will provide data on the stock of all budgetary arrears on a monthly basis, no later than on the 1st day of the second subsequent 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 classification of expenditures). The Pension Fund will provide monthly reports on net unpaid pensions to the individuals who resided or continue to reside in the territories that are temporarily outside the government control.

73. 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.

74. 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.

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

76. 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.

77. 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), the Fund for Social Insurance, Employment Fund (detailed data on the breakdown of revenues and expenditure by main categories are expected for this 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.

78. 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.

79. 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, including the respective changes as a result of supplementary budgets.

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

81. SFS 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	Deferrals 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										

82. The SFS 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.

83. The SFS 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 SFS more than 74 days before the end of period).

84. The SFS 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.

85. The SFS will provide on a quarterly basis but no later than 25 days after the end of each quarter information on the number of tax appeals and the associated disputed amounts received by the SFS in each reporting period, the number of internally resolved appeals indicating the number of appeals resolved in favor of the controlling body, in favor of taxpayer and partial satisfaction.

D. Ministry of Economy, Ministry of Energy and Coal Industry, Ministry of Housing and Municipal Economy of Ukraine, and National Commission in Charge of State Regulation in Energy and Utilities (NCSREU)

86. 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 NCSREU will provide the methodology underlying the tariff calculations for full cost recovery, including heating and gas.

87. 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, SFS/SCS, MoF, NCSREU, 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.

88. 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.

89. 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 domestic gas used by Naftogaz for sales to households, heating utilities, budget institutions, and industries, including gas produced by SC "Ukrigasvydobuvannya," and OJSC "Ukrnafta."

90. 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.

91. The National Commission for State Energy and Public Utilities Regulation will provide information with a breakdown by its licensees regarding the levels of tariffs for heat energy for the

households, centralized heating services and centralized hot water supply to the households in the event of their changes with the definition of average tariff levels (net of VAT and VAT included).

92. The National Commission for State Energy and Public Utilities Regulation will inform in advance (10 days before the day of the meeting at which it is planned to adopt such a decision) about any amendments that can be made to the Commission's decisions regulating the distribution accounts for companies in the natural gas sector. The National Commission for State Energy and Public Utilities Regulation on the day following the adoption of the Resolution on the approval of Register of norms for the transfer of funds received as payment for provided heat and / or utilities including centralized heating, centralized hot water supply to all categories of consumers and as a payment of heat supplying enterprises for heat produced by heat generating enterprises for respective month and on the changes to the Register of norms, will inform about them in the electronic format.

93. The Ministry of Energy and Coal Industry (based on information by Naftogaz) will report on a weekly basis data on Naftogaz daily market purchases of foreign exchange.

94. The Ministry of Economy will provide on a quarterly basis, but no later than 80 days after the end of each quarter consolidated information from the financial statements of 50 largest SOEs (excluding Naftogaz). Specifically, the information will include data on (a) gross profit/losses; (b) net financial results; (c) subsidies received from the budget; (d) guarantees granted from the budget; (e) stock of debt, broken down by domestic and foreign; (f) taxes and dividends paid; (g) wage arrears; and (h) other payment arrears. The report will also include information on the number of all SOE (a) making profits, (b) making loss or (c) balanced with aggregated financial results for each of these groups.

E. State Statistics Service

95. 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.

F. Ministry of Social Policy

96. The Ministry of Social Policy will collect and submit to IMF and World Bank staff on a monthly basis data on HUS and privileges for energy consumption. The data, which will be presented in an agreed excel format, will show for each program (a) the number of households

which applied for HUS; (b) number of approvals extended to such HUS applications; (c) number of households-recipients of HUS and privileges in the reporting month; (d) total value of transfers; (e) number of refusals extended to such applications; (f) income per capita of participants, both for HUS and privileges; (g) number of household members; and (h) main reasons for refusal for HUS application (e.g., lack of residency information) and are to be presented by overall, by region and for rural/urban areas.



UKRAINE

FIRST REVIEW UNDER THE EXTENDED ARRANGEMENT—SUPPLEMENTARY INFORMATION

July 29, 2015

Approved By
**Thanos Arvanitis and
Mark Flanagan**

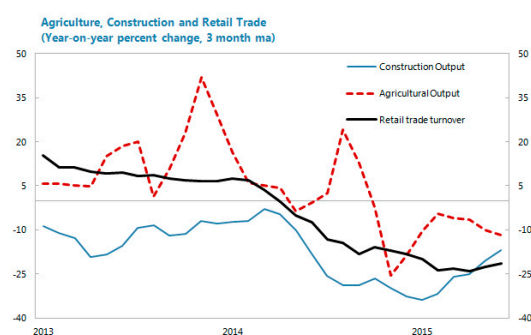
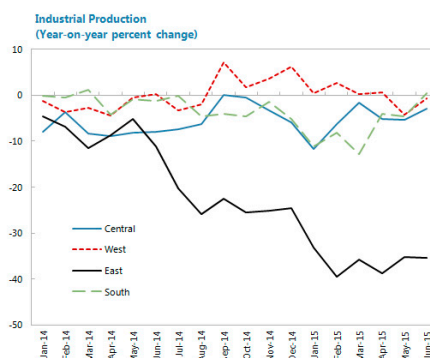
Prepared By the European Department

1. This supplement provides information that has become available since the Staff Report (EBS/15/84) was circulated to the Executive Board on July 22, 2015.

This information does not alter the thrust of the staff appraisal.

2. All prior actions have been completed and all end-June PCs have been met. On July 25, Law 2956 became effective after its official publication. The Law lifted the 2001 moratorium on enforcement proceedings for companies with at least 25 percent state ownership that are debtors to Naftogaz and its subsidiary companies. Final data for end-June performance criteria (PCs) also show that all PCs have been met (Table 1).

3. High frequency data through June suggest that that economic activity may have troughed. Following the severe contraction in Q1, indicators of activity through June point to a stabilization of economic activity, albeit at a low level. Supported by some revival in manufacturing and mining activity, industrial production experienced mild growth m-o-m (seasonally adjusted) in both May and June. Construction and retail trade picked up as well. On the other hand, agricultural output remained weak, largely owing to a weather-related shifting in the timing of the harvest. Underpinning these developments, both consumer and investor confidence bounced back significantly in Q2.



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

4. The NBU recently modified its operational framework for absorbing liquidity. The NBU amended its operational framework by aligning interest rates on certificates of deposits (CDs, the NBU's liquidity absorbing instrument) with their effective maturity and by introducing quantitative tenders for CDs at longer maturities (30 and 89 days) where the NBU acts as a price taker. In line with Fund TA recommendations, this new liquidity management framework is expected to help the NBU manage its net domestic assets in line with program targets. To ensure sufficient demand across the yield curve, the NBU also reduced the effective fixed interest rates on shorter-maturity CDs by 200–400 basis points to 18–20 percent and successfully conducted quantitative long-term CD tenders at 22–23 percent. As inflation expectations have fallen rapidly, the CD rates remain positive in real terms on forward-looking basis. The NBU's discount rate and all rates on liquidity-providing instruments remained unchanged at 30–33 percent. Staff and the authorities will continue to monitor the effectiveness of this framework in mopping up excess liquidity and the authorities stand ready to adjust it as needed to continue to advance the disinflation process.

5. The first disbursement under the EC's Macro-Financial Assistance (MFA) operation took place on July 23. The disbursement, in the amount of €600 million, is the first installment under the third MFA plan, which totals €1.8 billion.

Table 1. Ukraine: Quantitative Program Targets and Projected Performance ^{1/}

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

	2014		2015						2016		
	December	March			June			September	December	March	June
		PC	Adj. PC	Actual	PC	Adj. PC	Actual	PC	PC	IT	IT
I. Quantitative performance criteria											
Ceiling on the cash deficit of the general government (- implies a surplus) 2/	-	20,400	13,357	-14,536	32,700	35,530	10,133	43,100	82,700	12,700	32,400
Ceiling on the cash deficit of the general government and Naftogaz (- implies a surplus) 2/	-	36,500	29,457	-243	62,000	59,192	31,422	97,100	144,600	5,700	37,100
Floor on cumulative change in net international reserves (in millions of U.S. dollars) 3/ 4/	1,827	-2,502	-2,639	-2,125	-1,448	-2,528	-1,492	-284	2,098	2,224	2,545
Ceiling on cumulative change in net domestic assets of the NBU 3/ 4/	304,385	57,704	62,490	32,303	76,176	103,878	20,713	84,571	57,720	54,520	69,445
Ceiling on publicly guaranteed debt 2/	-	30,000	30,000	0	30,000	30,000	0	30,000	30,000	20,000	20,000
II. Continuous performance criterion											
Non-accumulation of new external debt payments arrears by the general government 2/	0	0		0	0		0	0	0	0	0
III. Indicative Targets											
Ceiling on cumulative change in base money 2/	333,194	18,256	18,256	-1,203	53,350	53,350	-2,815	80,086	90,796	89,584	109,578
Ceiling on net accumulation of VAT refund arrears 2/	697	0		2,942	0		7,075	0	0	0	0
IV. Memorandum Items											
Naftogaz deficit	87,301	16,100	16,100	14,293	29,300	23,662	21,289	54,000	61,900	-7,000	4,700
External project financing 2/	-	4,523		441	11,064		2,992	13,000	14,937	6,995	15,107
NBU loans to DGF and operations with Government bonds issued for DGF financing or banks recapitalization 3/	-	25,000		7,950	44,000		24,750	53,000	55,000	55,000	55,000
Government bonds issued for banks recapitalization and DGF financing 2/	26,716	29,000		0	59,500		18,004	59,500	152,000	0	0
Programmed disbursements of international assistance except IMF (millions of U.S. dollars) 3/ 4/ <i>Percent of it applied to adjustment</i>	-	476		173	3,233		1,476	3,504	5,475	6,204	6,204
Conversion of a non-reserve currency under a central bank swap line into a reserve currency through an outright sale 4/	-	-		0			581				
Exceptional financing (millions of U.S. dollars) 3/ 4/	-	-		-				500	4,228	4,228	5,478
Purchases of foreign exchange from the NBU for the purposes of critical energy imports (incl. those of Naftogaz, millions of US dollars) 3/ 4/	-	1,486		1,320	1,686		1,590	1,686	1,686	1,686	1,686
NBU purchases of T-bonds Issued by Government for Naftogaz recapitalization 3/	-	17,200		17,200	26,100		26,100	28,300	28,300	28,300	28,300
Projected Payments of Interest on government bonds held by NBU 2/	-	7,100		7,100	17,400		17,400	30,300	41,800	10,600	21,800
<i>Program exchange rate, Hryvnia per U.S. dollar</i>	15.7686	15.7686		15.7686	15.7686		15.7686	15.7686	15.7686	15.7686	15.7686

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 January 1, 2015. Data for December 2014 are stocks as of end-December, 2014. For 2016, cumulative flows from January 1, 2016.

3/ Targets and projections are cumulative flows from January 1, 2015. Data for December 2014 are stocks as of end-December, 2014.

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

**Statement by Menno Snel, Executive Director for Ukraine
and Oleksandr Petryk, Alternate Executive Director
July 31, 2015**

With the unresolved conflict in the East, the situation in Ukraine remains extremely difficult. Due to the uncertainty surrounding this conflict, the economy substantially contracted in the first quarter of 2015 and the Hryvnia sharply depreciated. Nevertheless, despite these challenges, the authorities did everything in their power to implement the program reforms aimed at restoring stability, strengthening the fundamentals of the economy and bringing back sustainable growth. The policies focus on ensuring price and financial stability under the flexible exchange rate, a sound and prudent banking system, sustainable public finance and deep and comprehensive structural reforms, including anti-corruption measures. Due to the steadfast implementation of the program, signs of stabilization are emerging.

All performance criteria (PC) for end-March were met, as well as the PC and structural benchmarks for end-June 2015. The prior actions were fulfilled. The remaining prior actions that will trigger the disbursement of the two Development Policy Loans (DPLs) from the World Bank were adopted as well. The authorities are strongly committed to continue with program implementation. They regret the unfortunate misunderstanding that led to a misreporting on the prior action regarding retail heating prices, and want to reassure the Board that mistakes like this will not be repeated.

The authorities worked very hard to make progress with the debt operation. Despite their strong efforts, the process is advancing slower than expected. In joint statements with the Ad Hoc Creditor Committee, the authorities confirm their objective to reach an agreement on the broader sovereign debt restructuring as soon as possible and in line with the agreed program objectives. That said, a consensual reprofiling of the notes of the state-owned Ukreximbank's US\$1.5 billion Eurobonds was completed on July 8 and the state-owned Oschadbank launched a consent solicitation for a reprofiling of its US\$1.2 billion Eurobonds.

Macroeconomic outlook

The authorities broadly share staff's analysis of the macroeconomic outlook. GDP contracted faster than expected in the first quarter of 2015 and is now estimated to be around -9 percent for 2015, mainly due to high uncertainty and reduced demand as a result of the conflict. The Hryvnia sharply depreciated in January and February which led to a significant increase in headline inflation in March and April due to high pass-through effects and increases in regulated energy prices. However, after the EFF was put in place, the Hryvnia started to stabilize and inflation is coming down.

The depreciation of the Hryvnia in the first months of 2015, in combination with the introduction of additional import duties and weak domestic demand, led to current account improvements turning into surplus in March 2015 (US\$0.3 billion, 1.3 percent of GDP).

However, export performance remains weak because of the conflict, low commodity prices and the trade restrictions imposed by Russia. The financial account in the balance of payments remains in deficit (US\$1.8 billion, 7.5 percent of estimated GDP over January–April) as the recovery of foreign investment and capital inflows were hindered by high risks and uncertainty. The overall balance of payments remains in line with the program.

Gross reserves increased to US\$10.3 billion at the end of June 2015, compared to US\$5.6 billion before the start of the EFF end-February 2015. This was mainly because of the disbursement of the first tranche under the EFF and support from other official creditors, as well as foreign currency purchases by the NBU from the market (US\$726 million in the first quarter and US\$556 million in the second quarter). Moreover, the agreed swap line is very helpful to increase reserves and confidence. The authorities are thankful to the People's Bank of China and welcome the ongoing talks with some other central banks. Reserves are expected to further increase to over US\$18 billion by year-end or 3.7 months of future imports.

Fiscal policy

The end-March general government deficit target was met with a large margin, resulting in a budget surplus of UAH 3.1 billion or 0.8 percent of GDP in the first quarter. Because of higher-than-projected inflation and exchange rate depreciation, but also due to a widening of the tax base and changes in the tax legislation, revenues overperformed. Spending was lower than planned because of liquidity constraints early in the year. The additional space will be used to finance national security needs, allocate funds for pensions and social assistance for displaced persons, clearing VAT refund arrears and support ongoing judicial and civil service reforms.

The authorities are determined to further reduce the fiscal deficit to ensure debt sustainability. The adjustment will be an expenditure-led consolidation with a smaller and more efficient government. The tax system will be reformed to make it more growth-friendly, efficient, and fair. A restructuring of Naftogaz will make it financially sustainable and independent from government support by 2017.

The government is working on structural reforms of the fiscal framework. The revenue administration is undergoing a major overhaul which will increase tax revenues by at least 0.3 percent of GDP in 2016. The authorities have presented amendments to the tax code to Parliament, aiming to reduce the tax rates on royalties for gas and petroleum extracting companies and increase taxes on profits, which should preserve revenues while encouraging investments in the industry. Coming September, the government will submit amendments to the tax code to Parliament which will introduce a general VAT regime for the agriculture sector. Reforms to the pension, health and education systems will also contribute to the fiscal adjustment path.

Monetary and exchange rate policy and financial stability

In early June 2015, the NBU took initial steps to liberalize the monetary and currency markets. Some administrative restrictions were eased and the control over individual transactions of residents was simplified. The authorities, together with the Fund, developed a road map for further gradual and controlled removal of the administrative measures. This process will start as soon as the debt operation is completed, the bank recapitalization is fully implemented, net international reserves reach the established target and the transition of Naftogaz to the interbank market has been finalized.

Parliament adopted the amendments to the NBU law in June 2015. These amendments will substantially increase the effectiveness of the NBU by strengthening its institutional and financial independence. The law envisages that the NBU no longer transfers advanced profits to the state budget. Furthermore, the role of the NBU's Executive Board is strengthened and its autonomy enhanced. The NBU now has the right to base monetary policy on its own macroeconomic forecast. There is a clear division of responsibilities of the NBU Council and the Executive Board. Moreover, the accountability of the NBU is enhanced by making the NBU Council responsible for the audit.

A key objective of the program is a well supervised, sound, and solid banking system. As the liquidity in the banking sector was high in the first half of 2015, the NBU eased its liquidity support to banks. The NBU's supervision has strengthened with the help of Fund technical assistance. A comprehensive bank recapitalization and resolution plan was launched. Since early 2014, already around 54 out of the 180 banks were transferred to the Deposit Guarantee Fund (DGF) as a result of consistent efforts to make the banking sector more resilient. Capital requirements were increased and the closing of "pocket banks" was accelerated. Measures are being taken to combat related party lending as well as to ensure a transparent ownership structure of the banking sector.

Structural reforms and anti-corruption program

Although reforms in the energy sector are only in an initial stage, the impact on the economy is already noticeable. All contracts now exclude intermediaries. The gas market was liberalized and aligned with the European Third Energy Package. Over 60 percent of gas imports are now coming from European reverse flow contracts. This is a significant change from the earlier exclusive reliance on a single supplier. The reduction in subsidies and the more than tripling of the gas prices, with well-targeted compensation for vulnerable families, is unprecedented in Ukraine's history. As a result, the Naftogaz deficit is reduced from US\$10 billion to less than US\$2 billion. It is expected that by end-2017, the deficit will be completely eliminated.

A key element of the reform program is to eradicate corruption. In order to implement the late 2014 package of anti-corruption legislation, the government approved in April 2015 a national anti-corruption program for 2015–17. Among other elements, it introduces an

electronic declaration system for public officials, monitoring of the transactions of state employees and related persons, measures to prevent conflict of interest and protection of whistleblowers of corruption. The management of the independent National Anti-Corruption Bureau was appointed in April 2015 using open procedures. Many public services and institutions underwent a thorough clean-up. The road patrol service in Kiev was eliminated and replaced by an entirely new traffic police service.

The authorities have launched an ambitious deregulation program containing more than 70 initiatives. The Ministry of Economic Affairs estimated US\$2.5–3 billion in savings for the business community. Moreover, it could lead to a further improvement in Ukraine's ranking in the World Bank's Doing Business indicators. Ukraine already advanced by 56 positions since 2012.

Final remarks

Despite the challenging environment, including a divided political landscape, the authorities have proven to be able to deliver on the so crucial reforms. They are fully aware that this is the only way forward and are strongly committed to continue on this decisive path. The authorities are grateful for the continued support from the Fund, other IFIs and the international community in this very difficult period.